United States Government Accountability Office

GAO

Report to Congressional Committees

March 2009

TROUBLED ASSET RELIEF PROGRAM

March 2009 Status of Efforts to Address Transparency and Accountability Issues

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GAO-09-504

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Highlights

Highlights of GAO-09-504, a report to congressional committees

March 2009

TROUBLED ASSET RELIEF PROGRAM

March 2009 Status of Efforts to Address Transparency and Accountability Issues

Why GAO Did This Study

GAO's third report on the Troubled Asset Relief Program (TARP) follows up on recommendations from the January 28, 2009, report (GAO-09-296). It also reviews (1) the nature and purpose of activities that had been initiated under TARP as of March 27, 2009; (2) the Department of Treasury's Office of Financial Stability's (OFS) hiring efforts, use of contractors, and progress in developing an internal control system; and (3) TARP performance indicators. For this work, GAO reviewed signed agreements and other relevant documentation and met with officials from OFS, contractors, and federal agencies.

What GAO Recommends

This report has six new recommendations to Treasury, including to continue developing an integrated communication strategy; require AIG to seek appropriate concessions from employees and derivatives counterparties, among others; update documentation of certain internal control procedures and the public guidance on determining warrant exercise prices; publicly report monies, such as dividends received from TARP participants; and finish reviewing existing conflict mitigation plans, renegotiate them as appropriate, and improve associated conflicts documentation.

In written comments, Treasury described steps it had taken in the last 60 days to address the extraordinary economic challenges.

To view the full product, including the scope and methodology, click on GAO-09-504. For more information, contact Thomas McCool at (202) 512-2642 or mccoolt@gao.gov. To view the e-supplement online, click on GAO-09-522SP.

What GAO Found

As of March 27, 2009, Treasury had disbursed $303.4 billion of the $700 billion in TARP funds (see table). Most of the funds (almost $199 billion) went to purchase preferred shares of 532 financial institutions under the Capital Purchase Program (CPP), Treasury's primary vehicle under TARP for stabilizing financial markets. Treasury has continued to improve the integrity, accountability and transparency of TARP. For example, it recently expanded monthly surveys of the largest institutions' lending activity to cover all CPP participants, as GAO recommended. These surveys should provide additional important information about how the capital investments are impacting participants' lending activities and capital levels.

Status of TARP Funds as of March 27, 2009 (dollars in billions)

Program	Maximum announced program funding level[a]	Projected use of funds	Disbursed
Capital Purchase Program	$250.0	$218.0	$198.8
Systemically Significant Failing Institutions	70.0	70.0	40.0
Targeted Investment Program	40.0	40.0	40.0
Automotive Industry Financing Program	24.9	24.9	24.5
Citigroup Asset Guarantee	5.0	5.0	0.0
Bank of America Asset Guarantee	7.5	7.5	0.0
Homeowner Affordability & Stability Plan	50.0	50.0	0.0
Term Asset-Backed Securities Loan Facility (TALF)[b]	100.0	55.0	0.1
Unlocking Credit for Small Business	15.0	15.0	0.0
Auto Supplier Support Program	5.0	5.0	0.0
Public Private Investment Program	100.0	100.0	0.0
Capital Assistance Program	TBD[c]	TBD	0.0
Total	**$667.4**	**$590.4**	**$303.4**

Source: Treasury OFS, unaudited.

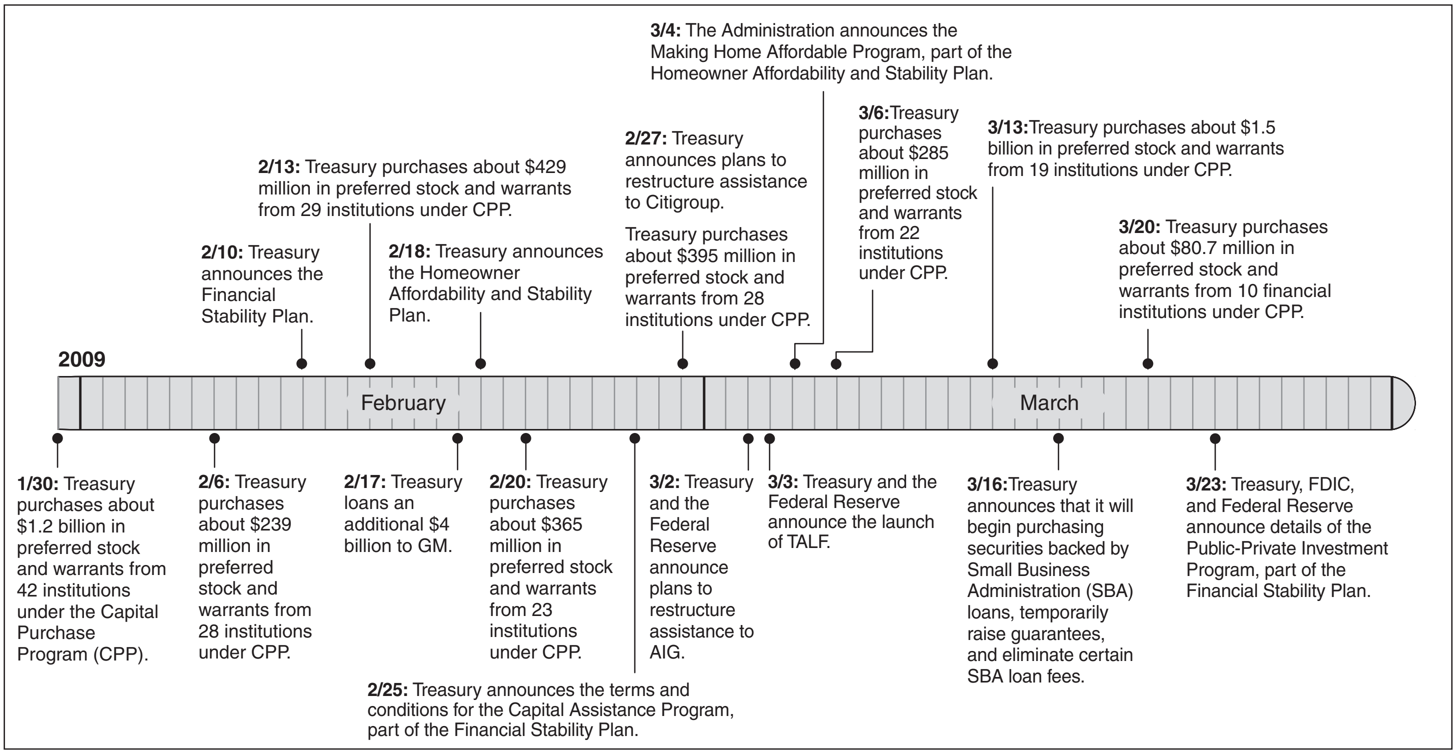
[a]Some of Treasury's announced transactions are not yet legal obligations and actual amounts will depend on participation.

[b]Treasury considers this program part of its Consumer & Business Lending initiative.

[c]Treasury has announced the Capital Assistance Program, but has not yet announced the funding level for that program.

Treasury also continues to develop a process to monitor compliance with the terms of the agreements but has not yet hired asset managers. Treasury officials told GAO that these managers will have a role in helping ensure that institutions were honoring dividend and stock repurchase requirements. In February 2009, Treasury announced its broad strategy for using the remaining TARP funds and in the following weeks provided details for its major components. While articulating its plan was an important step, Treasury continues to struggle with developing an effective overall communication strategy that is integrated into TARP operations. Without such a strategy, Treasury may face challenges should it need additional funding for the program. Finally, as Treasury finalizes the terms of the agreement with American International Group, Inc. (AIG) for $30 billion in additional assistance, it should require that AIG seek additional concessions from employees and existing derivatives counterparties, as appropriate.

Timeline of Programs and Selected Actions under TARP, January 30, 2009, to March 23, 2009



Source: GAO.

GAO's January 2009 report also included recommendations about OFS's management infrastructure, including hiring, contract oversight, and internal controls. Treasury has continued to take steps to address GAO's recommendations. First, it has continued to hire additional permanent staff to address OFS's long-term organizational needs. Second, Treasury has enhanced its capacity to manage vendors by using trained oversight personnel and looking for opportunities to use fixed-price arrangements. Further actions are needed to complete its review of existing vendor conflict-of-interest mitigation plans and to improve documentation of decisions relating to potential conflicts. Third, OFS continued to refine, develop, and document its internal control framework over financial reporting and compliance, including its risk assessment activities. However, GAO noted that certain internal control procedures and the guidance pertaining to determining warrant exercise prices had not been updated to be consistent with actual practice. GAO also noted that Treasury had not publicly reported that through March 20, 2009, it had received dividends totaling almost $2.9 billion from TARP participants. Further steps in these areas are needed to improve the program's transparency and integrity.

GAO again notes the difficulty of measuring the effect of TARP's activities. Developments in the credit markets have generally been mixed since the January 2009 report. Some indicators revealed that the cost of credit has increased in interbank and corporate bond markets and decreased in mortgage markets, while perceptions of risk (as measured by premiums over Treasury securities) have declined in interbank and mortgage markets and risen in corporate debt markets. In addition, although Federal Reserve survey data suggest that lending standards remained tight, the largest CPP recipients extended roughly $245 billion in new loans to consumers and businesses in both December 2008 and January 2009, according to the Treasury's new loan survey. However, attributing any of these changes directly to TARP continues to be problematic because of the range of actions that have been and are being taken to address the current crisis. While these indicators may be suggestive of TARP's ongoing impact, no single indicator or set of indicators can provide a definitive determination of the program's impact.

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Abbreviations

ABS	asset-backed security
AGP	Asset Guarantee Program
AIG	American International Group Inc.
CAP	Capital Assistance Program
CBOE	Chicago Board Options Exchange
CDFI	Community Development Financial Institutions Fund
CMBS	commercial mortgage-backed security
COP	Congressional Oversight Panel
COTR	Contracting Officer's Technical Representative
CPP	Capital Purchase Program
FDIC	Federal Deposit Insurance Corporation
FHA	Federal Housing Administration
FHFA	Federal Housing Finance Agency
FinSOB	Financial Stability Oversight Board
GM	General Motors Corporation
GSE	government-sponsored enterprise
HAMP	Home Affordable Modification Program
HUD	Department of Housing and Urban Development
LIBOR	London Interbank Offered Rate
MBS	mortgage-backed security
OCC	Office of the Comptroller of the Currency
OFS	Office of Financial Stability
OGE	Office of Government Ethics
OMB	Office of Management and Budget
OTS	Office of Thrift Supervision
SBA	Small Business Administration
SES	Senior Executive Service
SIGTARP	Special Inspector General for TARP
SSFI	Systemically Significant Failing Institutions Program
TALF	Term Asset-Backed Securities Loan Facility
TARP	Troubled Asset Relief Program
TIP	Targeted Investment Program

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United States Government Accountability Office
Washington, DC 20548

March 31, 2009

Congressional Committees

On October 3, 2008, the Emergency Economic Stabilization Act of 2008 (the act) was signed into law. The act established the Office of Financial Stability (OFS) within the Department of the Treasury (Treasury) and authorized the Troubled Asset Relief Program (TARP).[1] Among other things, the act provides Treasury with broad, flexible authorities to buy or guarantee up to $700 billion in "troubled assets," which include mortgages and mortgage-related instruments, and any other financial instrument whose purchase Treasury determines is needed to stabilize the financial markets.[2]

The act also created oversight mechanisms for the implementation and operations of TARP. Among other things, the U.S. Comptroller General is required to report at least every 60 days on findings resulting from GAO's oversight of TARP's performance in meeting the purposes of the act; the financial condition and internal controls of TARP, its representatives, and agents; the characteristics of both asset purchases and the disposition of assets acquired, including any related commitments that are entered into; TARP's efficiency in using the funds appropriated for the program's operation; TARP's compliance with applicable laws and regulations; efforts to prevent, identify, and minimize conflicts of interest among those involved in TARP's operations; and the efficacy of contracting procedures.[3]

This report follows up on the status of recommendations from our December 2008 and January 2009 reports and addresses (1) the nature and purpose of activities that have been initiated under TARP from January 30, 2009, through March 27, 2009, unless otherwise noted; (2) OFS's progress

[1]Pub. L. No. 110-343, 122 Stat. 3765 (2008), codified at 12 U.S.C. §§ 5201 et seq.

[2]Section 102 of the act, 12 U.S.C. § 5212, authorizes Treasury to guarantee troubled assets originated or issued prior to March 14, 2008, including mortgage-backed securities.

[3]Section 116 of the act, 12 U.S.C. § 5226.

in hiring, use of contractors, and developing a system of internal control; and (3) outcomes measured by indicators of TARP's performance.[4]

Scope and Methodology

To determine the nature and purpose of TARP activities from January 30, 2009, through March 27, 2009, unless noted, and the status of actions taken in response to our recommendations from our prior reports, we reviewed documents from OFS that described the amounts, types, and terms of Treasury's purchases of preferred stocks and warrants under the Capital Purchase Program (CPP), the Systemically Significant Failing Institutions Program (SSFI), the Automotive Industry Financing Program (AIFP), the Targeted Investment Program (TIP), the Capital Assistance Program (CAP), and the Term Asset-Backed Securities Loan Facility (TALF).[5] We also reviewed documentation and interviewed officials from OFS responsible for selecting financial institutions to participate in CPP. Additionally, we contacted officials from the four federal banking regulators—the Federal Deposit Insurance Corporation (FDIC), the Office of the Comptroller of the Currency (OCC), the Board of Governors of the Federal Reserve System (Federal Reserve), and the Office of Thrift Supervision (OTS)—to obtain information on their process for reviewing CPP applications, the status of pending applications, and their examination process for reviewing uses of CPP funds and compliance with TARP requirements. Also, we have developed an approach to determine the extent to which the review and approval process for CPP applications has been consistently applied across financial institutions. Specifically, we have collected documentation supporting all funding decisions for the period covering October 28, 2008, through January 31, 2009, and are in the process of reviewing these decisions. For SSFI and TALF, we reviewed program revisions and agreements, as appropriate, and contacted officials from OFS.

To describe Treasury's efforts to preserve homeownership, we reviewed announcements, fact sheets, and program guidelines issued by Treasury and held meetings to discuss these documents with OFS. To describe how Treasury estimated the cost of the loan modification program and the number of borrowers it expected to reach, we reviewed written

[4] GAO, *Troubled Asset Relief Program: Additional Actions Needed to Better Ensure Integrity, Accountability, and Transparency*, GAO-09-161 (Washington, D.C.: Dec. 2, 2008) and *Troubled Asset Relief Program: Status of Efforts to Address Transparency and Accountability Issues*, GAO-09-296 (Washington, D.C.: Jan. 30, 2009).

[5] A warrant is an option to buy shares of common stock or preferred stock at a predetermined price on or before a specified date.

explanations of OFS's projections. To discuss the cross-agency effort to design and plan the implementation of the loan modification program, we reviewed Financial Agent Agreements that Treasury executed with Fannie Mae and Freddie Mac, and met with representatives of Fannie Mae, Freddie Mac, and the Federal Housing Finance Agency (FHFA), Federal Housing Administration (FHA), OCC, and OTS.

To assess the progress of OFS's hiring efforts, we reviewed OFS's workforce planning documents, updated organizational chart, and OFS job announcements posted on USAJOBS. To assess its performance, we reviewed our prior work on human capital flexibilities, organizational transformation, and strategic workforce planning. In addition, we met with a variety of Treasury and OFS officials to discuss their approach to staffing the office in the near and long terms and their strategies for recruiting qualified individuals. We also discussed Treasury's efforts to coordinate its recruitment and hiring efforts, including its use of human capital flexibilities, with officials from the Office of Personnel Management (OPM).

To assess OFS's use of contractors and financial agents to support TARP administration and operation for the period of January 21 through March 13, 2009, we reviewed information from Treasury for new (1) contracts and financial agency agreements and (2) task orders, modifications, and amendments involving ongoing contracts and financial agency agreements. We also identified any small and/or disadvantaged business contractors or subcontractors providing TARP services and supplies. To obtain information concerning (1) the progress of ongoing actions taken by OFS and Treasury in response to our recommendation to improve oversight of TARP contractors and financial agents and (2) OFS's reliance on contractors and financial agents to perform a range of professional and financial services in support of key TARP programs, we reviewed applicable documents and interviewed officials from Treasury and two TARP contractors and one financial agent. To assess OFS's progress responding to our recommendation for addressing potential conflicts of interest for new contractors and financial agents, we reviewed solicitation and contract documentation describing organizational and personal conflicts-of-interest issues and mitigation plans to address those issues. We interviewed officials and senior managers from Treasury and the TARP contractors and financial agent to obtain information on OFS's and contractor's policies and processes to ensure compliance with TARP conflicts of interest requirements.

To assess the status of internal controls related to TARP activities and the status of TARP's consideration of accounting and reporting topics, we reviewed documents provided by OFS and conducted interviews and made inquiries with officials from OFS, including the Chief Financial Officer, Deputy Chief Financial Officer, Cash Management Officer, Director of Internal Controls, and their representatives. Additionally, we made inquiries with contractor personnel, including PricewaterhouseCoopers. To evaluate selected internal control activities related to the CPP and SSFI programs, we designed tests using the OFS's process flows, narratives, risk matrices, and high-level operational procedures. For CPP, we made a statistical selection of 45 unique transactions for the 4 months ending January 31, 2009, using a monetary unit sampling (probability proportionate to size) methodology. For this sample, we tested selected CPP control activities related to asset purchases and dividend receipts. For SSFI, we tested the only SSFI transaction completed as of March 27, 2009, including selected control activities related to dividends.

In our initial report under the mandate, we identified a preliminary set of indicators on the state of credit and financial markets that might be suggestive of the performance and effectiveness of TARP. We consulted Treasury officials and other experts and analyzed available data sources and the academic literature. We selected a set of preliminary indicators that offered perspectives on different facets of credit and financial markets, including perceptions of risk, cost of credit, and flows of credit to businesses and consumers.[6] We assessed the reliability of the data upon which the indicators are based and found that, despite certain limitations, they were sufficiently reliable for our purposes. To update the indicators in this report, we primarily used data from the Federal Reserve. As these data are widely used, including by GAO and the Federal Reserve, and are considered to be a reliable and often definitive source for banking sector data, we conducted only a limited review of the data but ensured that the trends we found were consistent with other research. We also relied on data from the Chicago Board Options Exchange (CBOE), *Inside Mortgage Finance*, Treasury, and Global Insight. We have relied on CBOE and Global Insight data for past reports, and we determined that, considered together, these auxiliary data were sufficiently reliable for the purpose of presenting and analyzing trends in financial markets. The data from Treasury's survey of lending at the top 20 CPP recipients (as of December 31, 2008) are based on internal reporting from participating institutions, and the definitions of loan categories may vary across banks. Because the

[6]No indicator on its own provides a definitive perspective on the state of markets; collectively, the indicators should provide a broad sense of stability and liquidity in the financial system and could be suggestive of the program's impact. However, it is difficult to draw conclusions about causality.

data are unique, we are not able to benchmark the origination levels against historical lending or seasonal patterns at these institutions. Based on discussions with Treasury and our review of the data, we found that the data are sufficiently reliable for the purpose of documenting trends in lending. The survey data will prove valuable for more thorough analyses of lending activity in future reports.

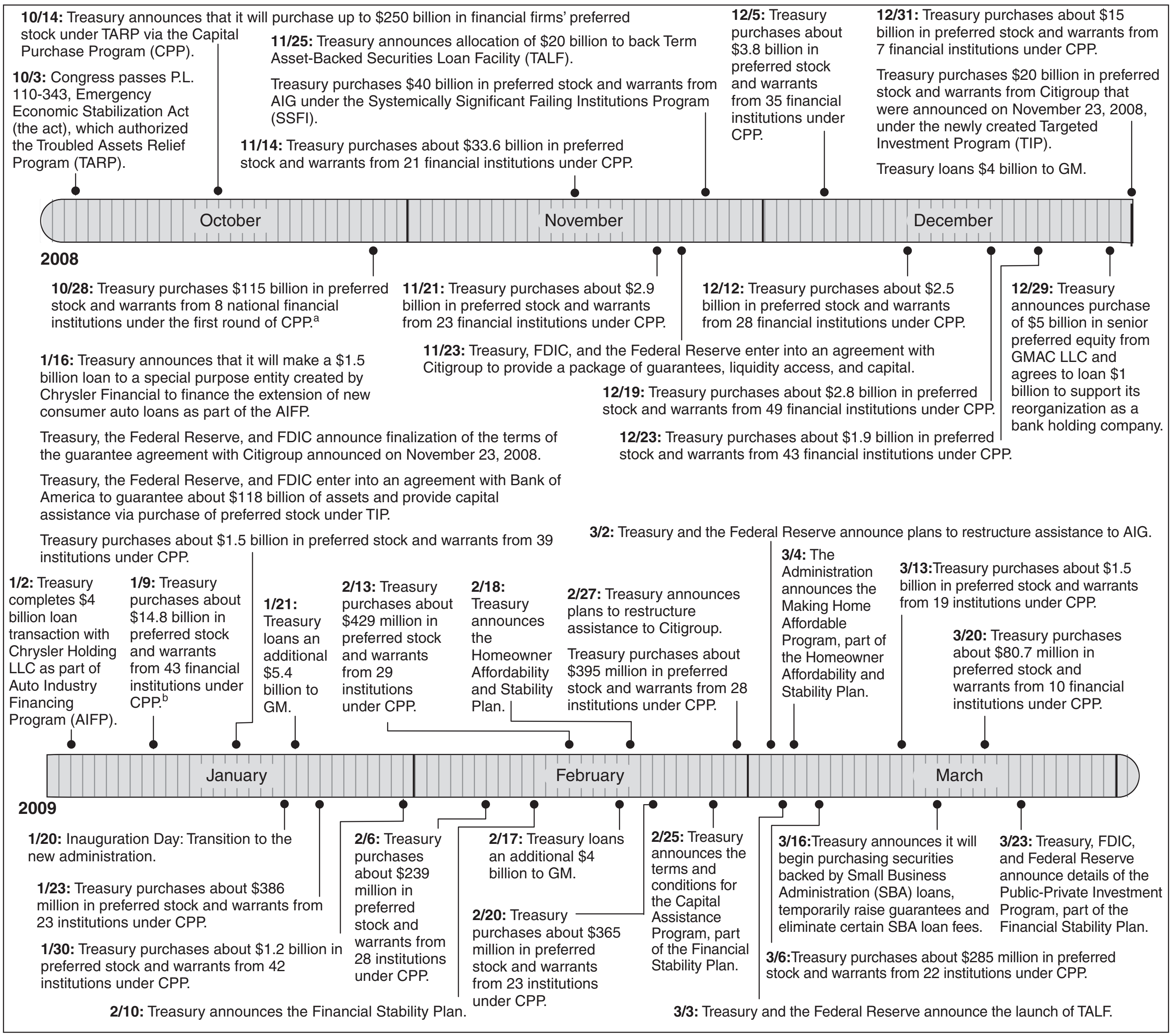
We plan to continue to monitor the issues highlighted in our prior reports, as well as future and ongoing capital purchases, other more recent transactions undertaken as part of TARP, and the status of other aspects of TARP. Together with the Special Inspector General for TARP, we also plan to review the payment of taxes by the recipients of TARP funds.

We conducted this performance audit between February 2009 and March 2009 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Background

Treasury has engaged in a variety of activities to address instability in the financial markets (see fig. 1). Leading up to the transition to the new administration, Treasury made additional equity purchases in financial institutions under CPP and invested in and announced future plans to support the automotive industry under AIFP. Following the transition to the new administration on January 20, 2009, Treasury continued to make additional equity investments in financial institutions under CPP, announced plans to restructure the assistance previously provided to Citigroup Inc. (Citigroup) and American International Group, Inc. (AIG), and launched TALF, a consumer lending facility established by the Federal Reserve Bank of New York for which Treasury originally pledged support in November 2008. In addition, the new administration announced its plan to pursue new initiatives under the authority of the act.

Figure 1: Timeline of Program Activities for TARP, October 2008-March 2009



Source: GAO.

[a]The participation of a ninth institution was deferred to allow for completion of its merger with another institution.

[b]This includes purchases of preferred stock and warrants from the institution whose receipt of CPP funds was deferred pending the completion of a merger (see October 28, 2009 CPP transaction). The merger was completed on January 1, 2009.

As we described in our January 2009 report, the act created other oversight entities in addition to our oversight responsibilities, including the Congressional Oversight Panel (COP), the Special Inspector General for TARP (SIGTARP), and the Financial Stability Oversight Board (FinSOB).[7] We are coordinating our work with COP, SIGTARP, and FinSOB, and are meeting with officials from these entities to share information and effectively make use of our combined resources. These meetings help to ensure that we collaborate appropriately and eliminate unnecessary duplication of effort.

After we issued our January 2009 report on TARP, COP issued reports in February and March 2009.[8] COP's February 2009 report focused on the methods Treasury used to make equity investments in financial institutions under the CPP and concluded that Treasury paid substantially more for the assets it purchased under TARP than their then-current market value. COP's March 2009 report reviewed Treasury's plans to mitigate foreclosures, in particular Treasury's Homeowner Affordability and Stability Plan. While the report acknowledges Treasury's progress in providing increased refinancing and loan modification opportunities to homeowners, it also raised questions about, for example, legal protection for loan servicers involved with voluntary loan modifications, the role of second mortgages in the foreclosure process, and the federal regulators' enforcement of new industrywide standards for financial institutions receiving TARP funds.

In addition, SIGTARP issued its first report to Congress in February 2009.[9] The report covers TARP activities through January 23, 2009, and describes how financial institutions used TARP funds during that period. SIGTARP recommended that TARP managers take action to increase transparency and oversight through various means, such as acknowledging SIGTARP's oversight authority in TARP agreements, developing and communicating

[7]GAO-09-296.

[8]Congressional Oversight Panel, *Valuing Treasury's Acquisitions* (Washington, D.C., Feb. 6, 2009) and *The Foreclosure Crisis: Working Towards a Solution* (Washington, D.C., Mar. 6, 2009).

[9]Special Inspector General for Troubled Asset Relief Program, *Initial Report to the Congress* (Washington, D.C., Feb. 6, 2009).

methods used to value program investments, and taking steps to prevent fraud, waste, and abuse of funds provided.

FinSOB issued its first quarterly report on December 31, 2008, on Treasury's policies to implement TARP.[10] We summarized FinSOB's report in our January 2009 report. FinSOB plans to issue its next quarterly report in spring 2009.

Treasury's Strategy for Deploying TARP Funds Continues to Evolve, Though CPP Remains the Key Effort to Stabilize the Financial Markets

As of March 27, 2009, Treasury had announced several programs under TARP with a maximum announced total funding of $667.4 billion of its $700 billion. As shown in table 1, as of that date Treasury's projected use of funds was $590.4 billion and it had disbursed about $303.4 billion in TARP funds, approximately $198.8 billion of it for CPP. Included in this amount was $24.5 billion for General Motors Corporation (GM), Chrysler Holdings LLC (Chrysler), GMAC LLC, and Chrysler Financial Services Americas LLC. We have initiated a separate effort to, among other things, discuss the impact of federal financial assistance on the viability of GM and Chrysler. Treasury has recently announced the Financial Stability Plan, which outlines a set of measures to address the financial crisis and hopefully restore confidence in the U.S. financial and housing markets and a Homeowner Affordability and Stability Plan to mitigate foreclosures and preserve homeownership. A key component of the Financial Stability Plan is CAP, for which Treasury recently announced standardized terms.

[10]Financial Stability Oversight Board, *First Quarterly Report to Congress Pursuant to Section 104(g) of the Emergency Economic Stabilization Act of 2008* (Washington, D.C., Dec. 31, 2008).

Table 1: Status of TARP Funds as of March 27, 2009

Dollars in billions

Program	Maximum announced program funding level[a]	Projected use of funds	Apportioned	Asset purchase price[b]	Disbursed
Capital Purchase Program	$250.0	$218.0	$230.0	$198.8	$198.8
Systemically Significant Failing Institutions	70.0	70.0	70.0	40.0	40.0
Targeted Investment Program	40.0	40.0	40.0	40.0	40.0
Automotive Industry Financing Program	24.9	24.9	24.9	24.8	24.5
Citigroup Asset Guarantee	5.0	5.0	5.0	5.0	0.0
Bank of America Asset Guarantee	7.5	7.5	0.0	0.0	0.0
Homeowner Affordability & Stability Plan	50.0	50.0	32.5	0.0	0.0
Term Asset-Backed Securities Loan Facility (TALF)[c]	100.0	55.0	20.0	20.0	0.1
Unlocking Credit for Small Business	15.0	15.0	0.0	0.0	0.0
Auto Supplier Support Program	5.0	5.0	0.0	0.0	0.0
Public-Private Investment Program	100.0	100.0	0.0	0.0	0.0
Capital Assistance Program	TBD[d]	TBD	0.0	0.0	0.0
Total	**$667.4**	**$590.4**	**$422.4**	**$328.6**	**$303.4**

Source: Treasury OFS, unaudited.

[a]Some of Treasury's announced transactions are not yet legal obligations and actual amounts will depend on participation.

[b]The Asset Purchase Price reflects the aggregate purchase price amount of outstanding troubled assets purchased by Treasury that are subject to the $700 billion purchase limit in section 115 of the act. It also includes the aggregate amount of outstanding guaranteed obligations subject to the limit, but before subtracting the balance in the Troubled Assets Insurance Financing Fund required by section 102.

[c]Treasury considers this program part of its Consumer & Business Lending Initiative.

[d]Treasury has announced CAP but has not yet announced its funding level.

Officers and employees of Treasury may not obligate or expend appropriated funds in excess of the amount apportioned by the Office of Management and Budget (OMB) on behalf of the President. Of the funding levels announced for TARP, Treasury stated that OMB had apportioned about $422.4 billion as of March 27, 2009. Based on this information, it appears that Treasury has not exceeded the troubled asset purchase limit or obligated funds in excess of those OMB has apportioned. We are continuing to obtain additional information from Treasury and to review the controls that Treasury has in place to help ensure compliance with these restrictions. We will discuss these issues in subsequent reports.

CPP Continued to Be a Primary Vehicle for Stabilizing the Financial Markets

Treasury has continued to use CPP as a primary vehicle under TARP as it attempts to stabilize financial markets. As of March 27, 2009, Treasury had disbursed about 80 percent of the $250 billion it had allocated for CPP to purchase almost $198.8 billion in preferred shares of 532 qualified financial institutions.[11] These purchases ranged from about $300,000 to $25 billion per institution. About $4.6 billion in preferred stock shares of 215 financial institutions has been purchased since our January 2009 report.

Table 2: Capital Investments Made through the Capital Purchase Program, as of March 27, 2009

Closing date of transaction	Amount of CPP capital investment	Cumulative percentage of allocated fund used for CPP capital investment	Number of qualified financial institutions receiving CPP capital
10/28/2008	$115,000,000,000	46.0	8
11/14/2008	33,561,409,000	59.4	21
11/21/2008	2,909,754,000	60.6	23
12/05/2008	3,835,635,000	62.1	35
12/12/2008	2,450,054,000	63.1	28
12/19/2008	2,791,950,000	64.2	49
12/23/2008	1,911,751,000	65.0	43
12/31/2008	15,078,947,000	71.0	7
1/09/2009	14,771,598,000	76.9	43
1/16/2009	1,479,938,000	77.5	39
1/23/2009	385,965,000	77.7	23
1/30/2009	1,151,218,000	78.1	42
2/06/2009	238,555,000	78.2	28
2/13/2009	429,069,000	78.4	29
2/20/2009	365,397,000	78.5	23
2/27/2009	394,906,000	78.7	28
3/06/2009	284,675,000	78.8	22
3/13/2009	1,455,160,000	79.4	19
3/20/2009	80,748,000	79.4	10
3/27/2009	192,958,000	79.5	14
Total	**$198,769,687,000**	**79.5%**	**532**[a]

Source: Treasury and GAO.

[11]For purposes of CPP, financial institutions generally include qualifying U.S.-controlled banks, savings associations, and both bank and savings and loan holding companies.

[a]The total number of financial institutions was reduced by two because SunTrust Banks, Inc. (SunTrust) and Bank of America Corporation (Bank of America) each received two capital investments under CPP. SunTrust received a partial capital investment of $3.5 billion on November 14, 2008, and another of $1.35 billion on December 31, 2008. Bank of America received $15 billion on October 28, 2008, and, after merging with Merrill Lynch & Co., Inc., an additional $10 billion on January 9, 2009.

As of March 27, 2009, the types of institutions that had received CPP capital included 272 publicly held institutions, 248 privately held institutions, and 12 community development financial institutions (CDFI).[12] These purchases represented investments in state-chartered and national banks and bank holding companies located in 48 states, the District of Columbia, and Puerto Rico. For a detailed listing of banks that received CPP funds as of March 20, 2009, see the e-supplement to GAO-09-504, available electronically at GAO-09-522SP.[13]

According to OFS and the bank regulators, over a thousand applications for funding are under review. As of March 27, 2009, Treasury was in the process of reviewing approval recommendations from bank regulators for 1,190 qualified financial institutions. Treasury also reported that the bank regulators were reviewing applications from more than 750 institutions that had not yet been forwarded to Treasury. Qualified financial institutions generally have 30 calendar days after Treasury notifies them of preliminary approval for CPP funding to submit investment agreements and related documentation. OFS officials stated that over 250 financial institutions that received preliminary approval had withdrawn their CPP applications as of March 27, 2009. Further, Treasury officials stated that some of these institutions had indicated that they were uncomfortable with the uncertainty surrounding future program requirements. As of March 27, 2009, Treasury had yet to deny an application.

We are continuing to examine the process for accepting and approving CPP applications. Specifically, we have developed a methodology for reviewing CPP applications that had been funded from October 2008

[12]A CDFI is a specialized financial institution that works in market niches that are underserved by traditional financial institutions. CDFIs provide a range of financial products and services, such as mortgage financing for low-income and first-time homebuyers and not-for-profit developers; flexible underwriting and risk capital for needed community facilities; and technical assistance, commercial loans, and investments to small start-up or expanding businesses in low-income areas.

[13]GAO, *Troubled Asset Relief Program: Capital Purchase Program Transactions for the Period of October 28, 2008, through March 20, 2009, and Information on Financial Agency Agreement, Contract, and Blanket Purchase Agreements Awarded as of March 13, 2009*, GAO-09-522SP (Washington, D.C.: Mar. 31, 2009).

through January 2009 to determine the extent to which the regulators and OFS were consistently applying established criteria and adequately documenting the regulators' recommendations and OFS's final decisions. As part of this review, we have collected relevant case decision memos and other supporting documentation from Treasury and the regulators. We will also continue to coordinate and leverage the work of other agencies and offices involved in the oversight of CPP, including the COP, the Offices of the Inspector General of FDIC, Federal Reserve, Treasury, and SIGTARP, all of which have work under way on their review of CPP's implementation at their respective agencies. In coordination with the other oversight agencies and offices, we plan to focus our initial review on the final phases of the CPP application process—from the point at which the regulators transmit their recommendations to Treasury to the final approval by OFS's Interim Assistant Secretary.

OFS Has Started Monitoring All Participants' Use of CPP Funds but Has Not Yet Hired Asset Managers to Help Ensure Compliance with Purchase Agreements

Treasury has taken a number of important steps toward better reporting and monitoring of CPP. These steps are consistent with our prior recommendations that Treasury bolster its ability to determine whether all institutions are using CPP proceeds in ways that are consistent with the act's purposes. Treasury has completed the first 2 monthly surveys of the 20 largest institutions to monitor their lending and issued its first report in February 2009.[14] In our January 2009 report, we recommended that Treasury expand these surveys to include all CPP participants. In response, Treasury expanded the monthly survey to all CPP participants as of March 2009. In addition, it plans to release its analysis of quarterly monitoring data (call reports) for all reporting institutions by June 30, 2009.[15] Treasury is also requiring that, starting in April 2009, the monthly surveys of the large CPP recipients collect information on lending to small businesses. Taken together, these monthly surveys are a step toward greater transparency and accountability for institutions of all sizes. Survey results will allow Treasury's newly created team of analysts to understand how institutions are using CPP funds and will help in measuring the program's effectiveness. We will continue to monitor Treasury's oversight efforts, including implementation of its new survey of smaller institutions.

[14]See *Treasury Department Monthly Lending and Intermediation Snapshot: Summary Analysis for October-December 2008*, http://www.ustreas.gov/press/releases/tg30.htm.

[15]Call reports are quarterly reports that collect basic financial data of commercial banks in the form of a balance sheet and income statement (formally known as Report of Condition and Income).

Also consistent with our prior recommendations, Treasury has continued to take steps to increase its oversight of compliance with terms of the CPP agreements, including limitations on executive compensation, dividends, and stock repurchases. Participating institutions are required to comply with the terms of these agreements, and we recommended that Treasury develop a process to monitor and enforce them. Treasury has named an Interim Chief Compliance Officer and uses information sources such as Bloomberg, SEC filings, press releases, and other information sources to monitor dividend payments and stock repurchases. Treasury officials told us that they still plan to hire asset managers, whose primary role will be to provide market advice about the portfolio, but also will help monitor dividends and stock purchase limitations. They noted that asset managers will have a limited role in the area of executive compensation. To date, they had not yet hired any asset managers. Without a more structured mechanism in place, and with a growing number of institutions participating in the program, ensuring compliance with these important aspects of the program will become increasingly challenging. While the institutions are obligated to comply with the terms of the agreement, Treasury has not developed a process to help ensure this compliance and to verify that any required certifications are accurate.

On February 4, 2009, Treasury issued a press release announcing a new set of guidelines on executive pay for financial institutions that receive government assistance. However, the Emergency Economic Stabilization Act, as amended by the American Recovery and Reinvestment Act of 2009, imposed additional standards. Specifically, it generally prohibits (1) bonus and incentive compensation payments to certain employees, depending on the amount of TARP assistance received, (2) certain golden parachutes, and (3) compensation that encourages risk-taking that would threaten the value of the institution. The new law also requires (1) reimbursement (clawback) of certain bonus or incentive compensation based on materially inaccurate criteria, (2) compensation tax deduction limits, (3) compliance certification, (4) establishment of a policy on excessive or luxury expenditures, (5) creation of a board compensation committee, and (6) permission to conduct a nonbinding shareholder vote on pay. According to Treasury, it is planning to implement its guidelines and the new law. We will be monitoring these efforts.

Treasury Agrees to Participate in Citigroup's Proposed Exchange Offering If Certain Conditions Are Met

On February 27, 2009, Treasury announced that Citigroup had asked it to participate in an exchange of preferred shares for common stock so that the institution could strengthen its capital structure by increasing tangible common equity. According to Citigroup, this would help remove uncertainty and help restore confidence in the company. But the conversion potentially increases risks to the government and taxpayers, because common stockholders are lower in the ownership structure than preferred shareholders.[16] Terms of the transaction were also announced, but the exchange offering had not occurred as of March 27, 2009. Treasury noted that it was willing to participate in Citigroup's exchange offering on the following conditions:

- Treasury would convert its preferred shares only in an amount equal to the amount of preferred stock converted by other preferred shareholders and would only participate if at least $11.5 billion in privately held preferred stock was converted.
- Up to $25 billion of Treasury's CPP senior preferred shares would be converted to common stock in the exchange offering.
- The $20 billion in Treasury's preferred shares issued under TIP and the $4 billion in preferred shares issued under the Asset Guarantee Program (AGP) to Treasury would be converted into a trust preferred security of greater seniority that would have the same 8 percent dividend rate as the existing preferred stock.[17]
- Treasury would receive the most favorable terms and price offered through the exchange offering.

[16]Tangible common equity equals shareholder's equity minus preferred shares minus intangible assets.

[17]FDIC will also receive $3 billion in preferred stock, for a total of $7 billion.

Treasury's Recently Announced Assistance to AIG Provides an Opportunity to Encourage AIG to Renegotiate Contracts as Appropriate

On March 2, 2009, the Federal Reserve and Treasury announced plans to restructure and expand AIG's assistance.[18] Under the announced plans, Treasury is to receive noncumulative preferred stock equal to the sum of the $40 billion in cumulative preferred stock previously issued to Treasury on November 25, 2008, plus any accrued and unpaid dividends related to those shares.[19] According to OFS officials, this conversion will not increase the amount of money the government has invested in AIG but will help AIG maintain its credit rating, because credit rating agencies generally weight noncumulative preferred stock as 75 percent equity when calculating capital, compared with 25 percent for cumulative preferred stock.[20] This change will result in a more favorable treatment of Treasury's investment in AIG by the credit rating agencies. In addition, the restructuring plan creates an equity capital facility that will enable AIG to issue to Treasury up to $30 billion in new preferred shares that generally will have the same terms as the planned $40 billion preferred stock restructuring. The equity capital facility had not been funded as of March 27, 2009, and negotiations are ongoing.

In reviewing government assistance to the private sector in the past, we found that it was essential to establish mechanisms, structures, and protections to help ensure prudent use of taxpayer resources and to manage the government's risk, consistent with the congressional goals and objectives of any federal financial assistance program such as SSFI.[21] Further, because assistance programs pose significant financial risk to the federal government, consistent with Treasury's announced executive compensation guidelines, appropriate mechanisms are needed to help protect the government and taxpayers from excessive or unnecessary risks.

[18] See GAO, *Federal Financial Assistance: Preliminary Observations on Assistance Provided to AIG*, GAO-09-490T (Washington, D.C.: Mar. 18, 2009) for discussion on the Federal Reserve's restructuring of AIG's debt.

[19] Dividends do not accumulate on noncumulative preferred stock.

[20] This statement reflects the market's view that cumulative preferred stock is generally viewed as more akin to debt than equity.

[21] GAO, *Troubled Financial Institutions: Solutions to the Thrift Industry Problem* (GAO/GGD-89-47, Feb. 21, 1989), *Resolving the Savings and Loan Crisis* (GAO/T-GGD-89-3, Jan. 26, 1989), *Guidelines for Rescuing Large Failing Firms and Municipalities* (GAO/GGD-84-34, Mar. 29, 1984), and *Commercial Aviation: A Framework for Considering Federal Financial Assistance* (GAO-01-1163T, Sept. 20, 2001).

There are a number of actions that have been taken in the past that could be considered as Treasury completes its negotiations with AIG and any future SSFI recipients. But one in particular—obtaining concessions from others with an interest in the outcome—seems most relevant in light of AIG's recent payment of $165 million in retention bonuses to employees of its Financial Products division. In past crises, and when asked in December 2008 about providing assistance to the automakers as part of the government's response to the current crisis, we have stated that the government should require concessions from those with a stake in the outcome. In AIG's case, those with such a stake would include management, employees, derivatives counterparties, and creditors. For example, concessions could include requiring AIG to seek to renegotiate existing employee bonus contracts and derivatives contracts, as appropriate. Consistent with this view, the Treasury Secretary also noted the need for "strong conditions to protect the taxpayers" when providing exceptional assistance when he announced the Financial Stability Plan. As we have stated in the past, the concessions are not meant to extract penalties for past actions, but to ensure cooperation and flexibility in securing a successful future outcome. Treasury has an opportunity to negotiate additional requirements into its latest agreement, including that AIG seek additional concessions from others for the up to $30 billion in additional federal assistance. While the purchase of preferred shares in AIG differs from previous cases of federal assistance, which were usually loans or loan guarantees, the fundamentals are the same in terms of the need to protect the government's interests. If such concessions are not considered to be in the government's interest, the reasons should be clearly articulated and explained.

Treasury Has Taken Steps to More Clearly Articulate Its Strategy for Stabilizing Financial Markets and Continued to Finalize the Details

In our January 2009 report, we recommended that Treasury articulate a clear strategy for TARP. In response to such calls for greater transparency and a clear strategy, Treasury announced the Financial Stability Plan in February that outlined a comprehensive set of measures to help address the financial crisis and restore confidence in our financial markets. Treasury described the plan as a comprehensive approach designed to resolve the credit crisis by restarting the flow of credit to consumers and businesses, strengthening financial institutions, and providing aid to homeowners and small businesses. The plan established six components: Capital Assistance Program; Public-Private Investment Fund; Consumer and Business Lending Initiative; Small Business and Community Lending Initiative; Affordable Housing Support and Foreclosure Prevention Plan (Housing Affordability and Modification Plan); and Transparency and Accountability Agenda.

The Capital Assistance Program Has Been Launched

CAP is designed to help ensure that qualified financial institutions have sufficient capital to withstand severe economic challenges. These institutions must meet eligibility requirements, which will be substantially similar to those used for CPP. A key component of CAP is a forward-looking supervisory assessment (“stress test”) of the 19 largest institutions (those with risk-weighted assets of $100 billion or more).[22] Bank regulators will use the results of this stress test, along with their specific knowledge of the institutions’ portfolios and management strategies, to assess whether they have the capital necessary to continue lending and to absorb the potential losses that could result from a more severe decline in the economy than currently projected by professional economic forecasters. Currently, the 19 largest institutions are undergoing comprehensive stress tests that are expected to be completed by the end of April 2009. Regulators will use the stress test results to determine whether the institutions have enough capital to absorb losses from a severe economic downturn and continue lending. Institutions that do not will have 6 months to raise private capital or to access capital through CAP. Institutions with less than $100 billion in risk-weighted assets do not have to complete a stress test but are also eligible to obtain capital under CAP. In a process similar to the one used for CPP, institutions interested in CAP must submit their CAP applications to their primary banking regulators by May 25, 2009. The regulators are to submit recommendations to Treasury regarding an applicant’s viability. CAP is currently available only to publicly traded institutions, but Treasury is developing terms for privately held institutions, subchapter S-corporations, and mutuals.[23]

All approved institutions will have 6 months to raise capital from the private sector, or Treasury will purchase convertible preferred shares to help the institution absorb losses and raise private capital.[24] Any capital investments made by Treasury under CAP will be managed by a separate entity—the Financial Stability Trust. Under CAP, an institution can receive an investment of 1 to 2 percent of its risk-weighted assets. These institutions can also receive additional capital to redeem senior preferred

[22]Risk-weighted assets are the total assets and off balance sheet items held by an institution that are weighted for risk according to regulation by the Federal Reserve.

[23]An S corporation makes a valid election to be taxed under Subchapter S of Chapter 1 of the Internal Revenue Code and, thus, does not pay any income taxes. Instead, the corporation’s income or losses are divided among and passed through to its shareholders. A mutual organization is a company that is owned by its customers, rather than by a separate group of stockholders. Many thrifts and insurance companies (for example, Metropolitan and Prudential) are mutuals.

[24]These preferred shares will be convertible to common shares.

shares issued under CPP, enabling them to replace the existing preferred shares with convertible preferred shares.[25] If applicable, the proceeds from the sale of the convertible preferred also may be used to redeem the preferred stock sold to Treasury under TIP. Issuance of the convertible preferred stock to Treasury under CAP is considered Tier 1 regulatory capital for holding companies and a "qualified equity offering" for CPP purposes.[26] In addition, the issuance of convertible preferred stock in excess of 1 to 2 percent of the institution's risk-weighted assets may be available on a case-by-case basis and will constitute "exceptional assistance" requiring additional terms and conditions. CAP convertible preferred stock shares will carry a 9 percent dividend yield that may increase to 20 percent if the necessary shareholder approvals are not received by the 6-month anniversary after issuance. Subject to the approval of the primary bank regulator, such shares can be redeemed at their face value, plus any accrued and unpaid dividends prior to 2 years.[27] These shares are convertible into common stock at a price equal to 90 percent of the average closing price for the 20 trading-day period ending February 9, 2009.[28] The convertible preferred stock mandatorily converts to common equity after 7 years, and after the mandatory conversion date, Treasury must make reasonable efforts to sell, on an annual basis, an amount of common stock equal to at least 20 percent of the amount of stock owned on the mandatory conversion date.

Under CAP, Treasury will also receive warrants to purchase a number of shares of common stock of the financial institution equaling 20 percent of the convertible preferred stock amount on the date of the investment.[29] If

[25]While the CAP term sheet and application includes TIP participants, according to Treasury officials, CAP will be limited to CPP participants.

[26]Tier 1 capital is the core measure of a bank's financial strength from a regulator's point of view. It is considered the most stable and readily available capital for supporting a bank's operations. A "qualified equity offering" under CPP is the sale and issuance of Tier 1 qualifying perpetual preferred stock, common stock, or a combination of such stock for cash. CPP senior preferred may be redeemed prior to 3 years from the date of investment only if the proceeds of "qualified equity offerings" results in aggregate gross proceeds to the financial institutions of not less than 25 percent of the issue price of the senior preferred.

[27]Such shares are redeemable with the proceeds of a cash sale of common stock, provided that the gross proceeds from the stock sale are at least 25 percent of the CAP convertible preferred issuance price or additions to retained earnings.

[28]This date is one day before the Treasury announced its Financial Stability Plan.

[29]The date of the investment is the date that Treasury provides capital assistance to a financial institution.

any necessary shareholder approvals are not received, the exercise price will be reduced by 15 percent of the original exercise price on each 6-month anniversary of the issue date of the warrants,[30] subject to a maximum reduction of 45 percent of the original exercise price. Treasury requires that participants be subject to restrictions on executive compensation, payment of common stock dividends, repurchase of shares, and cash acquisitions. Institutions also must comply with Treasury rules, regulations, and guidance regarding executive compensation, transparency, accountability, and monitoring, as published and in effect at the time of the investment closing. In addition, as part of the application process institutions must submit a plan showing how they intend to use this capital to support their lending activities and how lending will increase over what would have been possible without government assistance. Collecting this information from CAP applicants addresses concerns we raised in our January report about the need to ensure an appropriate level of accountability and transparency for those institutions receiving TARP funds. Participating institutions under CAP will be required to submit to Treasury monthly reports—similar to those for CPP—on their lending activities.

Public-Private Partnership Investment Fund Programs Have Been Established

On March 23, 2009, the Federal Reserve, FDIC, and Treasury released the details of the Public-Private Investment Plan. The plan is designed to help reduce the liquidity discounts currently observed in the prices of legacy assets—troubled assets on banks' books—and protect taxpayers by ensuring that the government is not paying more for assets than their long-run value, as determined by private investors. The plan consists of two key elements: the Legacy Loans Program and the Legacy Securities Program. TARP funds will be used to invest alongside private capital on similar terms, reducing the likelihood taxpayers will be overpaying for assets.

Through an auction process, the Legacy Loans Program will purchase troubled and illiquid loans and other assets in "substantially sized" pools from insured banks and thrifts. FDIC and Treasury launched this program to attract private capital to purchase eligible legacy loans from participating banks through the provision of FDIC debt guarantees and Treasury equity co-investment. The funds will have asset managers for asset management and servicing within parameters established by FDIC and Treasury and are designed to facilitate buy-and-hold strategies. FDIC

[30]If the institution does not have sufficient available authorized shares of common stock to reserve for the conversion of the convertible preferred and the exercise of the warrants and stockholder approval is required for issuance, the institution is to call a meeting of its stockholders to increase the number of authorized shares of common stock.

will oversee the formation, funding, and operation of the new funds that will purchase the debt, and private sector investors and Treasury will provide equity to the funds. The funds will finance their purchases with FDIC-guaranteed debt. FDIC, in conjunction with participating banks, Treasury, private investors, and contractors, will administer the auctions of the asset pools. With input from a third-party valuation firm, FDIC will establish financing terms and leverage ratios for each fund and disclose these terms to potential investors as part of the auction process. Banks that sell the pools get cash and FDIC-guaranteed debt issued by the funds. Treasury and the private sector investors will share profits and losses in proportion to their investment; FDIC's guarantee of the public-private investment funds' debt will be secured by the eligible assets purchased by the funds. FDIC and Treasury will establish governance procedures.

Eligible private investors must be prequalified by FDIC and are expected to include, but are not limited to, financial institutions, individuals, publicly managed investment funds, and pension funds. According to an OFS official, participating banks will initially include the 19 banks that are undergoing the stress test under CAP. Interested banks are to work with their primary regulators to identify and evaluate eligible asset pools to be sold and the corresponding impact on the bank from the sale. Once potential pools are identified, the banks and regulators are to contact FDIC. The banks must demonstrate to the satisfaction of Treasury and FDIC that the contemplated loan pools qualify, based upon Treasury and FDIC agreed-upon minimum requirements. The goal is to restore maximum confidence for depositors, creditors, investors, and other counterparties. OFS officials noted that the program is anticipated to expand to include other insured institutions not participating in the stress test.

The Legacy Securities Program consists of two related parts designed to draw private capital into these markets: first, by providing debt financing from the Federal Reserve under TALF; second, through Treasury's partnering side-by-side with private investors in legacy securities investment funds. The goal of the Legacy Securities Program is to restart the market for legacy securities, allowing banks and other financial institutions to free up capital and stimulate the extension of new credit. Treasury and FDIC encourage small, veteran-, minority- and women-owned private managers to partner with others that meet minimum bidding criteria.

Through TALF, nonrecourse loans will be made available to investors to fund purchases of legacy securitization assets. Eligible assets are expected to include certain nonagency residential mortgage-backed securities that were originally rated Aaa, outstanding commercial mortgage-backed securities (CMBS), and asset-backed securities (ABS) that are rated Aaa. Borrowers must meet eligibility criteria. Haircuts—a percentage reduction of collateral valuation—minimum loan sizes, loan durations, and interest rates have not been determined for eligible assets.

In the new program that will have Treasury partnering with private fund managers to support the market for legacy securities, public-private investment funds raise equity capital from private investors and receive matching equity funds and leverage from Treasury. The investment objective of the funds will be to generate attractive returns for both the Treasury and the private investors, predominantly by following a long-term buy-and-hold strategy, but Treasury will consider other strategies involving limited trading.

Treasury has published criteria for potential fund managers and is accepting applications until April 10, 2009. The criteria include a demonstrable historical track record in the targeted asset classes, a minimum amount of assets under management in the targeted asset classes, and detailed structural proposals for the proposed legacy securities public-private investment fund. Treasury currently expects to approve approximately five fund managers, although more may be added, depending on the quality of applications received. Approved fund managers for the public-private investment funds will raise the private equity capital and make control decisions, including asset selection, pricing, liquidation, trading, and disposition. Applicants will have a limited period of time from preliminary approval to raise at least $500 million in private capital and demonstrate committed capital before receiving final approval from Treasury.

Treasury equity capital will be invested on a fully side-by-side basis with private investors in each public-private investment fund. Moreover, subject to certain restrictions, fund managers will have the option to obtain secured nonrecourse loans from Treasury (up to 50 percent of a fund's total equity capital), an amount that could rise to 100 percent, subject to additional restrictions. Treasury debt financing will be secured by the eligible assets held by the applicable fund. Loans made by Treasury to any public-private investment fund will accrue interest at an annual rate to be determined by Treasury and will be payable in full on the date of termination. As required by the act, Treasury will take warrants, whose terms and amounts will be determined, in part, on the amount of Treasury debt financing taken. Additionally, fund managers may charge private investor fees at their discretion, and Treasury will accept proposals for fixed management fees, to apply as a percentage of equity capital contributions for invested equity capital.

Federal Reserve and Treasury Launch Consumer and Business Lending Initiative

This initiative builds on previous efforts of the Federal Reserve and Treasury to establish TALF, which was announced in November 2008. TALF is intended to increase the availability of credit for consumers and businesses. Originally, TALF was set up as a $200 billion program to support consumer finance securitization markets—specifically, credit cards, auto loans, student loans, and small business loans—and would be partially supported by $20 billion in TARP funds. In February 2009, as part of the Financial Stability Plan, the Federal Reserve and Treasury announced an expansion of TALF to include increasing the funding size up to $1 trillion, with Treasury providing up to $100 billion in TARP funds. On March 19, 2009, the Federal Reserve extended the range of eligible collateral to include ABS backed by mortgage servicing advances, business equipment loans or leases, floorplan loans, and leases of business fleets. The Federal Reserve noted that the objective in expanding TALF would be to provide additional assistance to financial markets and institutions to meet the credit needs of households and businesses and thus, to support overall economic growth in the current period of severe financial strains.

Under TALF, the Federal Reserve will make nonrecourse loans to certain holders of Aaa-rated ABS secured by newly and recently originated consumer and small business loans. These will be 3-year loans, secured by eligible collateral. Haircuts will be determined based on the level of risk for each type of eligible collateral and the maturity of the pledged collateral.

On March 3, 2009, Treasury and Federal Reserve launched TALF. Funding requests were accepted on March 19, 2009, and on March 25, 2009, the new securitizations were funded by the program. Since our January 2009 report, the Federal Reserve has released revised terms and conditions for the facility and revised sets of frequently asked questions. The revisions include (1) a reduction in the interest rate and collateral haircuts for loans secured by the Small Business Administration (SBA) or backed by government-guaranteed student loans; (2) a statement that executive compensation restrictions will not apply to TALF sponsors, underwriters, and borrowers as a result of their participation; and (3) a requirement that participating sponsors certify that the ABS are eligible under TALF and include an attestation by an independent accounting firm of the securities' eligibility. TALF fundings will be held monthly and will cease at the end of 2009, unless the Federal Reserve extends the program. As described previously, on March 23, 2009, Treasury and the Federal Reserve announced that TALF would be broadened to include certain legacy securities.

Small Business and Community Lending Facility Was Rolled Into TALF

Treasury announced that, working together with the Federal Reserve, it would establish a lending facility to increase lending in the secondary markets, reduce borrowing costs, and unfreeze the credit markets to get credit flowing again to small businesses and consumers. Originally, this lending facility was to be structured like TALF—Treasury providing capital and the Federal Reserve providing financing—but, instead, it was rolled into TALF. Treasury also announced that it would commit up to $15 billion to purchase securities backed by the guaranteed portion of loans made under SBA's 7(a) and the first-lien mortgages of the 504 Community Development Loan Program.[31] In addition to these activities under TARP, SBA will take several steps to make it easier for small businesses to obtain credit from community and large banks, including increasing the federally guaranteed portion of loans, eliminating or reducing fees for SBA loans, and expediting approval of loans.

A Mortgage Modification Program Has Been Announced, but Significant Program Components and Controls Are under Development

On March 4, 2009, Treasury unveiled the structure and key components of its Making Home Affordable program. One of its components—the Home Affordable Modification Program (HAMP)—will use $50 billion in TARP funds to modify mortgages. According to OFS officials, Fannie Mae and Freddie Mac will provide an additional $25 billion, for a total of $75 billion, to help up to 3 million to 4 million homeowners avoid potential foreclosure.[32] The goal of modifying these mortgages is to reduce participants' monthly mortgage payments to affordable levels (a mortgage debt-to-income ratio of 31 percent).[33] Treasury will share the cost of restructuring the mortgages with lenders (if financial institutions hold the

[31]SBA's 7(a) program guarantees loans made by commercial lenders—mostly banks—to small businesses for working capital and other general purposes. The guarantee assures the lender that if a borrower defaults on a loan, the lender will receive an agreed-upon portion (generally between 50 percent and 85 percent) of the outstanding balance. The 504 program provides long-term, fixed-rate financing for major fixed assets, such as land and buildings, through a loan backed by an SBA-guaranteed debenture from a community development company. These purchases will include securities packaged on or after July 1, 2008.

[32]According to Treasury officials, TARP funds will be used to modify mortgages that financial institutions own and hold in their portfolios (whole loans) and private-label securitized loans (loans not insured or guaranteed by Fannie Mae, Freddie Mac, HUD's FHA, the Department of Veterans Affairs, and rural housing loans).

[33]Treasury's HAMP guidelines, issued on March 4, 2009, specify the use of a ratio of principal, interest, taxes, insurance, and any association fees to monthly gross income for the debt-to-income calculation.

whole loans) or investors (if the loans have been securitized). The lender or investor must first reduce the borrower's monthly mortgage payment down to 38 percent of income. For these mortgages, Treasury will then match further reductions on a dollar-for-dollar basis down to the target of 31 percent. For eligible loans where the borrower's monthly mortgage payment is already below 38 percent, Treasury matches reductions in mortgage payments from the borrower's current monthly payment. According to Treasury, loan servicers could begin modifying mortgages consistent with HAMP guidelines as of March 4, 2009. However, Treasury will not make payments under HAMP until it has executed contracts, which are currently in draft form, with the servicers. Treasury has announced a series of financial incentives for loan servicers, mortgage holders/investors, and borrowers that are intended to encourage servicers to modify loans, borrowers to continue paying on time under the modified loans, and servicers and mortgage holders/investors to modify at-risk loans before borrowers miss payments. Within OFS, the Office of Homeownership Preservation is responsible for administering HAMP and is led by a new interim chief. The structure and initial hiring for this office are in progress, and its efforts are supported by other personnel within OFS and Treasury. The Making Home Affordable program also includes a non-TARP funded initiative to help up to 4 million to 5 million homeowners refinance loans owned or guaranteed by Freddie Mac and Fannie Mae at current market rates. According to Treasury, this initiative could help homeowners save thousands of dollars in annual mortgage payments.

Treasury worked with other agencies to estimate the cost and number of borrowers who would be eligible for loan modifications under HAMP and to design program parameters. Treasury stated that it used data from commercial vendors, Fannie Mae, and Freddie Mac to estimate the potential universe of homeowners who were in default or likely to be in imminent danger of default from April 2009 to March 2012 and the number of homeowners eligible and likely to participate in HAMP during the program's 3-year application period. Treasury then estimated the cost of the key parameters of HAMP, including the monthly payment subsidy, incentive payments, and other payments—for example, payments to homeowners for signing over deeds instead of going through foreclosure proceedings, and payments to lenders for eliminating second liens for HAMP participants. According to Treasury officials, HAMP parameters were designed to provide incentives to servicers, investors, and borrowers to modify mortgage payments quickly and efficiently without using government funds to pay for modifications that servicers would already complete without government assistance. Treasury officials told us that the principal goal of HAMP was to get mortgage payments to an affordable level and avoid foreclosures. Treasury officials said that they recognized that, for some borrowers, an affordable mortgage payment was not the only concern and that negative equity was also an issue.[34] Treasury's HAMP guidelines allow servicers to reduce the amount of mortgage principal, in addition to reducing interest rates to reach an affordable payment. To reach borrowers, Treasury launched its Making Home Affordable Web site on March 19, 2009, that, among other things, provides program, eligibility, and housing counseling information.[35]

As we have previously stated, some of the challenges that loan modification programs face include making transparent to investors the analysis supporting the value of modification over foreclosure, designing the program to limit the likelihood of redefault, and ensuring that the program does not encourage borrowers who otherwise would not default to fall behind on their mortgage payments. Treasury pointed to a number of HAMP features designed to address these challenges. According to Treasury, requiring the use of a standardized net present value test will provide greater transparency to investors about the value of modification over foreclosure. Treasury officials stated that HAMP contained features designed to limit the likelihood of redefault, including a 90-day trial modification period, the reduced monthly payment, and incentives to keep borrowers current on their modified loan payments. Treasury stated that the likelihood that performing borrowers would intentionally default on their mortgages to access HAMP (e.g., moral hazard) was limited. For instance, servicers are required to obtain information on borrowers' current income to verify that the debt-to-income ratio without loan modification is greater than 31 percent, and borrowers must also represent and warrant that they do not have sufficient liquid assets to make their monthly mortgage payments. To reduce adverse selection (the risk that servicers would selectively choose loans for HAMP), Treasury requires that servicers consider all the loans that they service for participation in its loan modification program, unless prohibited by the rules of the applicable servicing agreements. Treasury has begun developing a data reporting system that will be used, among other things, to monitor servicers' compliance with HAMP requirements, as well as the performance of loans that have been modified.

[34]Having negative equity or being "under water" means that the current market value of the home is less than the outstanding mortgage balance.

[35]See http://makinghomeaffordable.gov/.

While the basic structure of HAMP has been announced, Treasury has not specified several critical components—including a system of internal control over TARP funds used for loan modification—as of March 23, 2009.[36] Treasury officials said that they plan to have a system of internal control in place when the first payments are due to servicers. As we noted in our first TARP report, the absence of appropriate internal control heightens the risk that the interests of the government and taxpayers may not be adequately protected and that the program objectives may not be achieved in an efficient and effective manner.[37] Treasury's loan modification proposal calls for payments to be made to offset probable losses from home price declines in the event of failed modifications. However, Treasury officials told us that the specifics of how this HAMP feature would work were still being developed as of March 20, 2009. Additionally, incentive payments to servicers and mortgage holders/investors to offer alternatives to foreclosure to homeowners who fail to qualify for or default under HAMP had not been specified as of March 20, 2009. Treasury has selected Fannie Mae to administer, maintain records for, and serve as the paying agent for its homeowner assistance programs, including HAMP, and Freddie Mac as the compliance agent to oversee servicers' modifications. Fannie Mae's responsibilities include developing and implementing a marketing plan, call center for borrowers, standard agreements with servicers, standardized modification documentation, modification reporting systems, processes for servicer data reporting and collection of data, and fraud monitoring and detection. Freddie Mac's compliance responsibilities include conducting examinations, reviewing servicer compliance with HAMP's published rules, and reporting the results of the examinations to Treasury. According to representatives of Fannie Mae and Freddie Mac, the government-sponsored enterprises (GSE) are establishing separate internal organizations and firewalls, as well as appropriate procedures and controls—all of which must be approved by Treasury—to avoid conflicts of interest in carrying out their compliance responsibilities. We will continue to monitor the design and implementation of this program, with a particular focus on the empirical basis for HAMP and the structure and effectiveness of its internal control system.

[36]Internal control is an integral component of an organization's management that provides reasonable assurance that the following objectives are being achieved: effectiveness and efficiency of operations, reliability of financial reporting, and compliance with applicable laws and regulations. Internal control comprises the plans, methods, and procedures used to meet missions, goals, and objectives. See GAO, *Standards for Internal Control in the Federal Government*, GAO/AIMD-00.21.3.1 (Washington, D.C.: November 1999).

[37]GAO-09-161.

New Framework of Corporate Governance, Oversight, and Transparency

In response to concerns raised by Congress, GAO, and, subsequently, COP and the SIGTARP about oversight, the Financial Stability Plan also calls for a new transparency and accountability agenda that is to consist of a framework of corporate governance and oversight to help ensure that banks receiving government funds are held responsible for the appropriate use of those funds through stronger requirements on acquisitions, dividend payments, executive compensation, and enhanced public reporting including reporting on lending activity. The new standards apply to future participants and are not retroactive.

TARP Has Received Approximately $2.9 Billion in Dividend Payments, Representing About 80 Percent of Possible Dividends

TARP had received approximately $2.9 billion in dividend payments through March 20, 2009. But dividends were not declared and not paid to Treasury for $733 million of cumulative dividends from AIG under the SSFI program and about $150,000 of noncumulative dividends from eight institutions under CPP. The undeclared dividends, approximately 20 percent of possible dividends during the period, were identified by TARP through a process that it implemented to identify possible dividends and determine whether they were declared and received when due.

The approximately $2.9 billion TARP received in dividends related to shares of preferred stock were acquired through CPP, TIP, AIFP, and AGP. Treasury's agreements under these programs entitled it to receive dividend payments on varying terms and at varying rates.[38] Table 3 summarizes the dividends received and those not declared and not paid under each program.

[38]For example, according to the CPP terms for publicly held institutions, participating institutions pay quarterly dividends at a rate of 5 percent per year for the first 5 years on the initial preferred shares acquired by Treasury. After the first 5 years, the preferred shares pay dividends quarterly at a rate of 9 percent per year. Any preferred shares acquired through Treasury's exercise of warrants pay quarterly dividends at a rate of 9 percent per year.

Table 3: TARP Dividends through March 20, 2009

Dollars in thousands

Program	Dividend payments received	Cumulative dividends not declared and not paid	Noncumulative dividends not declared and not paid
Capital Purchase Program	$2,473,019	-	$150
Targeted Investment Program	328,889	-	-
Automotive Industry Financing Program	53,986	-	-
Asset Guarantee Program	26,893	-	-
Systemically Significant Failing Institutions Program	-	$733,333[a]	-
Total	**$2,882,787**	**$733,333**	**$150**

Source: Treasury OFS, unaudited.

[a]The AIG Board of Directors did not declare a dividend for the February 1, 2009, dividend payment date. However, the dividends are cumulative, and Treasury has announced plans to restructure and expand AIG's assistance. Under the announced plans, Treasury is to receive noncumulative preferred stock equal to the sum of the $40 billion in cumulative preferred stock previously issued to Treasury on November 25, 2008, plus any accrued and unpaid dividends related to those shares.

For the above-listed programs, the dividend payments to Treasury are contingent on each institution declaring dividends. Generally, in the event that an institution does not declare a dividend for cumulative preferred stock during the dividend period, the unpaid dividends accumulate, and the institution must pay the cumulative accrued dividends before making dividend payments to other classes of shareholders. But if the institution does not declare a dividend for noncumulative preferred stock during the dividend period, the noncumulative preferred shareholders generally have no right to receive any dividend for the period, and the issuer has no obligation to pay a dividend for the period, whether or not dividends are declared for any subsequent dividend period.

Treasury did not receive all possible dividend payments under two programs. First, the sole participant in SSFI—AIG—notified Treasury that the board of directors did not declare a dividend of approximately $733 million for the February 1, 2009, dividend payment date. The agreement detailing the terms of Treasury's November 25, 2008, $40 billion investment in AIG's senior preferred stock states that dividends will be payable at an annual rate of 10 percent when and if declared by the AIG Board of Directors. Under this agreement, accrued but unpaid dividends compound quarterly. The agreement further states that if dividends on the senior preferred stock are not paid in full for four dividend periods, whether or not consecutive, the senior preferred stockholders have the right to appoint at least two directors to the board. As discussed earlier in our report, on March 2, 2009, the Federal Reserve and Treasury announced plans to restructure and expand AIG's assistance. Under the announced plans, Treasury is to receive noncumulative preferred stock equal to the sum of the $40 billion in cumulative preferred stock previously issued to Treasury on November 25, 2008, plus any accrued and unpaid dividends related to those shares.

Second, Treasury did not receive approximately $150,000 in possible noncumulative dividends related to eight CPP participants. According to Treasury officials, these eight banks informed Treasury that they lacked the necessary regulatory or shareholder approvals to declare dividends on their preferred stock. Federal banking laws and regulations include minimum capital requirements and limitations on the use of capital to pay dividends.[39] In addition, some state laws impose similar limitations and require shareholder approval for certain reductions of capital.[40]

OFS officials told us they consulted with Treasury's Office of the General Counsel to address these CPP dividends that were not declared. Since the $150,000 in undeclared dividends are noncumulative and were not declared during the dividend period, these institutions are not obligated to pay, and Treasury has no right to receive the dividends for the period. According to the standard terms of CPP, after six nonpayments by a CPP institution (whether or not consecutive), Treasury and other holders of preferred securities equivalent to Treasury's can exercise their right to appoint two members to the board of directors for that institution at the institution's first annual meeting of stockholders subsequent to the sixth nonpayment. Although OFS indicated that they were aware of the dividend restrictions for certain banks, Treasury officials told us that Treasury had not directly suggested to any institution that it seek the approvals necessary to declare dividends. These officials said that they had contacted all eight banks regarding the undeclared dividends. Six of the eight banks that did not declare dividends have formally communicated to Treasury their intentions to seek necessary approvals for future dividend payments.

[39]For example, see 12 U.S.C. §§ 59 (national banks) and 1831*o* (FDIC insured banks) and 12 C.F.R. § 208.5(d).

[40]For example, see the State of California's Financial Code, Section 644.

As part of our audit work, we noted that Treasury has not report to the Congress and the public the amount of dividends received or other receipts from TARP participants. Disclosing amounts received by Treasury from these participants would improve the overall transparency of TARP. By not sharing this information, Treasury is missing an opportunity to provide information about the return it is receiving on its investments. Treasury officials acknowledged the benefits of such disclosures and have agreed to consider establishing a mechanism for publicly reporting monies received under TARP, such as dividends.

OFS Has Yet to Develop an Integrated Communication Strategy for TARP

Treasury has taken a number of steps to address the ongoing crisis, creating new programs, and expanding existing initiatives. However, Treasury continues to be hampered with questions about TARP and what it is doing, which raises questions about the effectiveness of its existing communication strategy. The Financial Stability Plan represents an important step in clarifying Treasury's strategy for addressing the financial and housing crisis using its authorities under TARP, consistent with our January 2009 recommendation. But Treasury's strategy has otherwise largely been one of posting information to its Web site, issuing press releases, speeches, testimonies, and engaging in ad hoc outreach to Congress, and it continues to face ongoing communication challenges. The complexity of the issues involved and the heightened public scrutiny make an effective communication strategy critical going forward. Treasury has yet to develop a communication strategy for regularly and routinely communicating its activities to relevant congressional committees, members, the public, and other critical stakeholders. An effective communication strategy may consist of any number of elements, such as building understanding and support for the program (regular and routine outreach, including confidential member briefings), integrating communications and operations (making communication integral to the program), and increasing the impact of communication tools (print and video). Without a mechanism for regular and ongoing dialogue about plans for the program and its progress, TARP continues to be poorly understood by Congress and the public. If a communication strategy that includes regular and routine communication with Congress is not established, any request for additional funding, as contemplated in the President's budget, could be severely hampered.

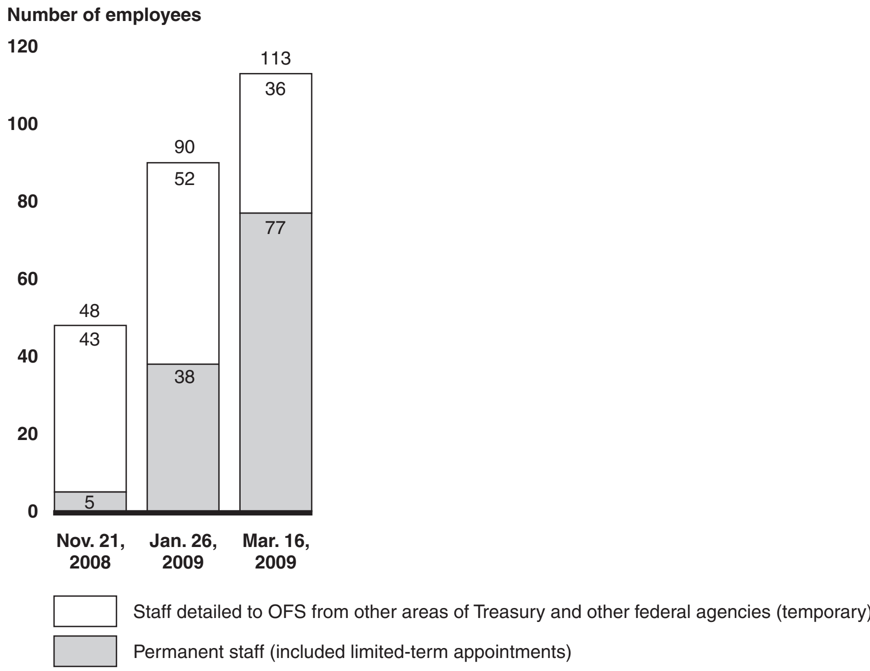
Treasury Continues to Make Progress in Establishing OFS

Since our January 2009 report, Treasury has made progress in its hiring efforts and now has a more stable workforce. Previously, we recommended that Treasury expedite hiring to ensure that OFS had the personnel it needed to administer TARP.[41] Since our last report, Treasury has continued to use a variety of hiring mechanisms to bring staff on board to carry out and oversee TARP, including direct-hire authority, merit promotion appointments, limited-term Senior Executive Service (SES) appointments, and reassignments.[42] As of March 20, 2009, OFS had 113 total staff, with the number of permanent staff increasing substantially—from 38 to 77—since our last report and the number of detailees decreasing from 52 to 36 (see fig. 2). Treasury anticipates that OFS will need 196 full-time employees to operate at full capacity, an increase of 65 from its January 2009 estimate of 131.

[41]GAO-09-161.

[42]Under authorization by OPM, agencies may make appointments for positions that are not of a confidential or policy-determining character, not in the SES, and not practical to examine. These are referred to as Schedule A appointments and are exempt from the examination requirements typically required for competitive service positions. Although Treasury has not used Schedule A authority since our last report, it anticipates doing so in the future. See 5 C.F.R. §§ 213.3101-3102.

Figure 2: Number of Permanent Staff and Detailees, November 2008 through March 2009



Source: GAO analysis of Treasury data.

Of the permanent staff currently working in OFS, 50 have come from other parts of Treasury and the federal government and 27 from the private sector. In addition, detailees from several Treasury and non-Treasury offices, bureaus, and agencies currently support OFS (see table 4). As discussed later in this report, OFS also obtains services from financial agents and contractors to provide a variety of services in support of TARP programs.

Table 4: Agencies Detailing Federal Employees to the Office of Financial Stability

Treasury Departmental Offices and Bureaus	Number of employees
Alcohol and Tobacco Tax and Trade Bureau	1
Bureau of Public Debt	2
Community Development Financial Institution Fund	1
Internal Revenue Service	4
Office of the Comptroller of the Currency	1
Office of Thrift Supervision	3
Treasury Departmental Offices	4
Total Treasury	**16**
Non-Treasury Departments and Agencies	
Department of Housing and Urban Development	3
Department of State	1
Export-Import Bank	1
Federal Deposit Insurance Corporation	2
Board of Governors of the Federal Reserve System	10
Securities and Exchange Commission	3
Total Non-Treasury	**20**

Source: Treasury data, as of March 12, 2009.

In prior work, we stated that it was important for agencies developing a workforce planning strategy to implement all of the appropriate administrative authorities to build and maintain the workforce needed for the future.[43] According to Treasury, as of March 20, 2009, 12 detailees had been converted to permanent staff. Treasury expects that permanent staff will be largely tasked with long-term responsibilities, but as the TARP strategy continues to develop, detailees will continue to play a critical role in supporting the flexibility of OFS operations. Having a mix of detailees, permanent staff, and financial agents and contractors on board helps ensure that OFS can fulfill its short- and long-term organizational needs. Treasury may use detailees to perform long-term tasks when no permanent staff are available or when Treasury expects the work to wind down. For example, Treasury arranged for detailees to review financial institution applications for CPP and CAP.

[43]GAO, *Human Capital: Key Principles for Effective Strategic Workforce Planning*, GAO-04-39 (Washington, D.C.: Dec. 2, 2003).

Recent changes to OFS's organizational structure have affected Treasury's efforts to identify its short- and long-term organizational needs and, therefore, engage in more formal workforce planning efforts. Following the transition to the new administration and pursuant to the introduction of new initiatives under its Financial Stability Plan, Treasury consolidated OFS's chief risk and chief compliance offices into a single functional area, the Office of the Chief Risk and Compliance Officer. Treasury said that it consolidated these functions in order to reduce unnecessary duplication, as the offices shared some responsibilities and performed some of the same tasks.

Treasury said that it planned to start formal workforce planning efforts soon, given that the organizational structure had been more clearly defined and the new administration had articulated further details of its Financial Stability Plan. In preparation, OFS has updated descriptions of its various functional areas (e.g., Office of the Chief Financial Officer and Office of the Chief Risk and Compliance Officer) to better assess the skills and abilities needed by the organization. Treasury also has prepared a draft workforce planning document and anticipates conducting bimonthly reviews of OFS's workforce operations, during which the Office of the Chief Operating Officer will consider, among other things, organizational hierarchies and position classifications; short-, medium- and long-range business requirements; and skills gaps within OFS.

While Treasury has not documented information on qualified candidates' reasons for declining offers of employment at OFS, Treasury said that, as mentioned in our last report, compensation and conflict-of-interest issues continued to affect their ability to recruit individuals with the appropriate backgrounds, experience, and skills to administer TARP.[44] In our ongoing monitoring, we plan to review more detailed information on Treasury's efforts to (1) fill gaps in critical skills and abilities within the organization and (2) address conflicts of interest that may be relevant to current OFS employees and any steps taken to mitigate such conflicts. We will discuss the findings resulting from this analysis and Treasury's progress in OFS workforce planning in future reports.

[44] GAO-09-296.

Treasury Has Made Additional Progress In Managing Contractor Support and Addressing Conflicts Of Interest

Since our January 2009 report, Treasury has awarded seven new contracts and two new financial agency agreements, bringing to 25 the total number of TARP financial agency agreements, contracts, and blanket purchase agreements as of March 13, 2009. Four new contracts are for a variety of legal services; others are for management consulting, document production, and program support services; and the two new financial agency agreements are to support the new homeownership preservation program.[45] Of these new contracts, one is with a woman-owned small business. In addition, Treasury issued a new task order, valued at approximately $5 million, to the internal control services contractor for expanded OFS support.[46] For detailed status information on new, ongoing, and completed Treasury contracts and financial agency agreements, as of March 13, see our e-Supplement at http://www.gao.gov/cgi-bin/getrpt?GAO-09-522SP.[47]

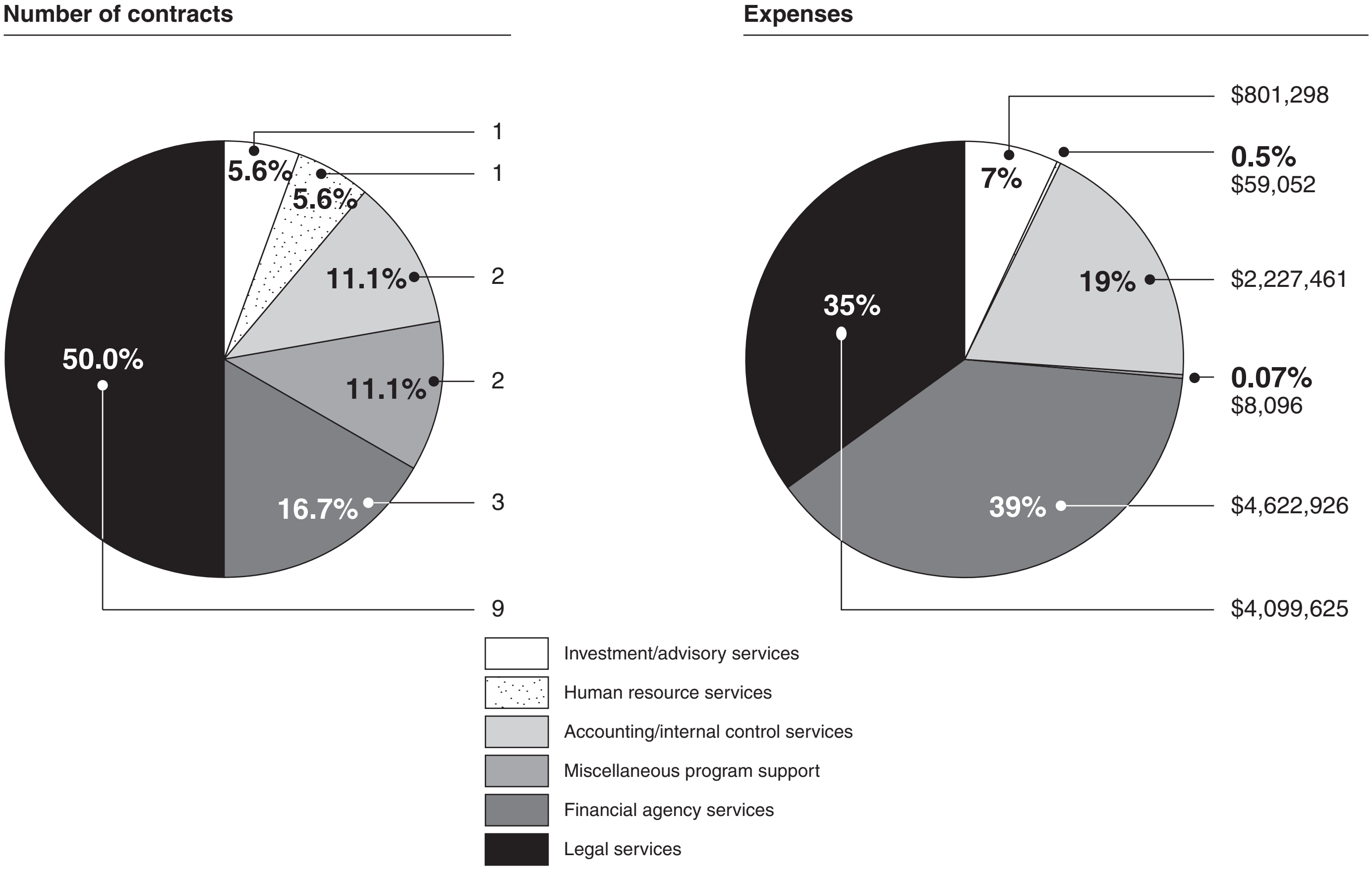
As of March 13, 2009, legal services contractors and financial agents accounted for two-thirds of the 18 service providers directly supporting OFS's administration of TARP, as shown in figure 3. As of the same date, Treasury had expended about $12 million for actions related to contracts- and financial agency agreements. The largest share of the total (39 percent) was for financial services with one financial agent (Bank of New York Mellon) while the second largest share (35 percent) was for legal services divided among four law firms (fig. 3).

[45] In addition, Treasury issued a delivery order to a small business for office equipment. Treasury awarded another financial agency agreement on March 16, 2009, designating EARNEST Partners as the asset manager for the small business assistance program. EARNEST is a minority-owned firm. We will provide additional details on this agreement in our next report.

[46] Treasury also modified several other existing task orders to obligate more funds and extend the performance periods.

[47] GAO-09-522SP.

Figure 3: Number of and Expenses for OFS Financial Agency Agreements, Contracts, and Blanket Purchase Agreements, as of March 13, 2009



Source: GAO analysis of Treasury data.

Note: This figure reflects 18 contracts and financial agency agreements that directly support OFS's administration of TARP; it does not reflect one contract for management consulting services. It also does not reflect contracts for, among other things, property leases, a human resources advertisement, and the purchase of office equipment.

Budget officials in OFS's Office of the Chief Financial Officer told us that they anticipated modest increases in the volume and cost of TARP contract and financial agency agreement activity for the remainder of fiscal year 2009. Overall, Treasury has budgeted about $175 million to cover anticipated OFS costs in fiscal year 2009 for the use of contractors and financial agents, as well as for OFS interagency agreement obligations to pay, among other things, personnel costs of employees detailed from other agencies.

OFS Relies on Contractors and Financial Agents to Help Implement TARP

As discussed in the previous section on OFS's hiring status, a key factor in Treasury's ongoing efforts to quickly establish the new organization to operate and administer TARP was the use of a mix of private contractors and financial agents to fill short- and long-term needs. OFS relies on this private sector workforce to help implement TARP. According to OFS preliminary data, about 30 percent of the employees of TARP contractors and financial agents are on site at Treasury working with OFS employees in various program offices, primarily to perform accounting services and support human resources, and temporary documentation activities. The remaining 70 percent work off site at their respective offices.

OFS officials responsible for several aspects of TARP, including asset management and legal services support of CPP and AIFP, noted that TARP contractors and financial agents play important roles in the administration and operations of these programs. In discussing the roles of contractors and financial agents in TARP operations and administration, OFS program managers we spoke with generally characterized contractors' involvement as providing technical and operational input into program execution. Table 5 provides a summary of the types of services provided, based on our analysis of selected TARP contracts and a financial agency agreement.

Table 5: Services and Support Tasks Provided by Selected TARP Contractors and a Financial Agent

TARP contractor or financial agent	Types of services provided
Ennis Knupp and Associates	This investment advisory firm assists OFS program offices with the evaluation of potential CPP asset manager proposals by: • designing asset manager compensation plans and investment policies for the request for proposals, • developing evaluation criteria, • providing a structured analysis of proposal submissions, • supporting follow-up interviews, and • evaluating potential asset manager conflicts of interest.

TARP contractor or financial agent	Types of services provided
Bank of New York Mellon	As custodian for the TARP program, this financial agent conducts the necessary tasks to complete weekly closings of CPP deals negotiated by the OFS program office, including: • taking possession of certificates, • monitoring CPP assets, • tracking receipt of dividends, • maintaining storage of all CPP documentation, and • generating reports to track CPP closings and dividend payments. Bank of New York Mellon also provides expert advice to OFS program offices regarding the feasibility and structure of new TARP programs, for example, preparing various analyses on the potential performance of asset-backed securities for TALF.
Cadwalader, Wickhersham & Taft LLP	This firm provides a range of legal advisory and support services to OFS's chief counsel and program offices on the AIFP by: • producing memos and discussing legal options, and • providing advice and expertise on bankruptcies and restructurings.

Source: GAO analysis of Treasury information.

OFS officials told us that the use of contractors and financial agents for the above professional services was critically important given the technical nature of the tasks, the need for expertise, and the speed with which OFS must act regarding TARP. OFS officials believe they retain control over the direction of TARP and have sufficient management oversight of the advice and assistance provided by TARP contractors and financial agents.[48] For example, an OFS program manager noted that the advice provided by the Bank of New York Mellon did not equate to a policy decision but rather supported OFS officials' development and execution of policy decisions.

[48]We have previously reported that contractor services that include expert advice, opinions, and other types of consulting require an enhanced degree of management oversight to ensure that agency officials retain control over and remain accountable for policy decisions that may be based, in part, on a contractor's performance and work products. See GAO, *Department of Homeland Security: Improved Assessment and Oversight Needed to Manage Risk of Contracting for Selected Services*, GAO-07-990 (Washington, D.C.: Sept. 17, 2007).

OFS Has Made Progress in Strengthening Oversight of Contractors and Financial Agents

In response to the recommendation in our January 2009 report that Treasury improve its oversight of contractors, Treasury has taken steps to help ensure that sufficient personnel are assigned to facilitate effective management and oversight of TARP contracts and financial agency agreements. As shown in table 6, except for one key position that is to be filled as Treasury enters into financial agency agreements for asset managers, key contract staffing positions were filled through new hiring and reassignment actions.

Table 6: Key Positions for TARP Oversight of Contracts and Financial Agency Agreements, as of March 2009

Position	Office	How Filled	Oversight role
Contract Administration Manager	Chief Operating Officer, OFS	New Hire	Oversees long-range requirements planning; improves management practices; provides leadership and guidance to OFS staff overseeing contractors and financial agents
Director for Financial Agents	Chief Investment Officer, OFS	Reassignment	Supervises Custodian/Infrastructure Program Manager and Manager of Asset Managers
Custodian/Infrastructure Program Manager	Chief Investment Officer, OFS	Reassignment	Supervises Vendor Managers
Manager of Asset Managers	Chief Investment Officer, OFS	Pending[a]	Supervises Vendor Managers
Vendor Manager	Chief Investment Officer, OFS	New Hire	Manages Financial Agents
Chief, Programs Branch	Procurement Services Division, Treasury	New Hire	Provides full-time procurement support to OFS
TARP Team Lead	Procurement Services Division, Treasury	New Hire	Provides full-time procurement support to OFS

Source: GAO analysis of Treasury information.

[a]This role is currently being filled by the Custodian/Infrastructure Program Manager.

OFS also made progress responding to our recommendation to help ensure that staff were appropriately trained to oversee contractors' technical performance. In particular, it made progress on certifications and formal training for OFS's roster of Contracting Officers' Technical Representatives (COTR). OFS has now replaced all the executive-level COTRs who earlier had been assigned COTR responsibilities without receiving requisite formal training and certifications in their acquisition-related responsibilities. Consistent with Treasury's internal guidance and our prior recommendation, OFS ensured that the replacement COTRs received the appropriate formal training and certification.

Given the constantly evolving and financially complex TARP program requirements, we reviewed OFS's technical oversight of contractors' performance. We found that OFS exercises oversight consistent with good practices we have identified when using contractors for more complex professional services.[49] Specifically, information discussed with COTRs, OFS program officials, and senior contractor officials responsible for three key TARP areas demonstrated that an interactive working environment exists between OFS and its TARP contractors and financial agents. For example, OFS officials, as well as Bank of New York Mellon managers, told us that they talk daily, and often many times a day, regarding the execution of the end-of-week closings on capital investments through CPP—a complex undertaking that involves many transactions that can total in the billions of dollars.[50] According to Treasury officials, this level of interaction provides frequent opportunities for oversight and helps them to ensure that their needs are met.

Since January 2009, the Office of the Chief Operating Officer has hired an executive-level contract administration manager, another action responsive to and consistent with our prior recommendation.[51] His job, in part, is to apply contract management best practices to TARP contracts and financial agency agreements, and provide leadership and guidance to COTRs and financial agent managers. Based on information we reviewed from the contract administration manager, as well as COTRs and financial agent managers in three program offices, these efforts should better

[49]GAO-07-990 and GAO, *Highlights of a GAO Forum: Federal Acquisition Challenges and Opportunities in the 21st Century*, GAO-07-45SP (Washington, D.C.: Oct. 6, 2006).

[50]Other examples concern OFS's investment advisory contractor and a legal services contractor. According to the Office of the Chief Investment Officer's COTR and Ennis Knupp's Chief Executive Officer, communications is primarily by phone two to three times per week and sometimes several times per day. These frequent phone conferences are to discuss upcoming contract support tasks to follow up questions on completed assignments, or to review and resolve matters concerning emerging organizational or personal conflicts of interest. On Cadwalader, Wickersham, and Taft's legal services contract to support OFS, the Chief Counsel's COTR and the law firm's leading partner for the contract interact frequently with each other through document sharing, e-mail exchange, teleconferences, and in-person meetings in order to submit the contracted legal advice concerning the structure of the TARP automotive industry program.

[51]A mid-March update to OFS's organization chart indicates additional staffing to support the contract administration manager position, including government positions for procurement, program, and reports analysts and an acquisition program manager.

position OFS to strengthen contract management.[52] Other OFS actions to facilitate the oversight of TARP contractor and financial agent performance are listed in table 7.

Table 7: OFS Actions Since January 2009 to Enhance Oversight of TARP Contractors' and Financial Agents' Performance

Action	Purpose	Status
Contracting Agreement Review Board	Treasury and OFS executive-level group meets monthly and as needed to review TARP contractors' and financial agents' performance and to examine issues with planned TARP acquisitions.	Implemented
COTR online filing system	Standardizes and centralizes in a data repository key COTR recordkeeping requirements, including contractors' and financial agents' invoices; correspondence with contractors; and documentation of TARP contractors' and financial agents' conflict-of-interest issues. This system is intended to enhance collaboration across OFS offices and assist in the transfer of records between COTR appointment transitions.	In development
COTR roundtable	Weekly discussions with all TARP COTRs led by OFS and Treasury contract and procurement services managers. The roundtable provides an opportunity for COTRs to discuss oversight issues they experience across all TARP contracts and financial agency agreements.	Implemented
Supplemental COTR training	Annual refresher training program intended to supplement the formal training and certification required prior to COTR appointment. OFS Office of the Chief Operating Officer plans to initiate this annual training to further enhance skills development for COTRs assigned to TARP contracts and financial agency agreements.	Planned
Outside expert speaker series	OFS's Contract Administration Manager plans to bring in outside, executive-level experts from government, the private sector, and academia to discuss lessons learned working in high-profile environments with COTRs and other OFS staff responsible for TARP programs.	Planned

Source: GAO analysis of Treasury information.

Finally, in response to and consistent with our recommendation, Treasury has made further progress in using fixed-price contracting arrangements when the parties possess sufficient knowledge of the requirements. Although Treasury has awarded new time-and-materials contracts since January, it also converted work under two time-and-materials task orders for legal services to fixed-price arrangements after determining that there were clearly defined requirements (i.e., transactional legal services for which the parties could estimate accurately the level of performance

[52]These latest actions build on earlier practices put in place as of January, such as the bi-weekly Contract Management Reporting Forms submitted by COTRs to track cost, schedule, and performance of contracts and financial agency agreements awarded under TARP.

required).[53] In addition, in response to GAO's recommendation, Treasury negotiated a firm fixed price for two workstreams making up about 20 percent of the new $5 million task order for internal control services performed by a contractor. Treasury and OFS officials have worked closely to analyze the use of time-and-materials arrangements for follow-on requirements to ensure such arrangements are only used when other contract types are not suitable. Treasury officials said that their reviews indicate that, given the nature of the services OFS is procuring, opportunities may be limited for the foreseeable future to use fixed-price mechanisms when placing orders for follow-on work or awarding future contracts.[54] According to these officials, fixed-price arrangements may not be appropriate for many TARP contracts. Considering the still-evolving nature of TARP's requirements, the ability of the parties to accurately anticipate the performance requirements and estimate costs, as required for fixed-price arrangements, is limited. This limitation places Treasury at risk of paying a higher fixed price for the services than it might otherwise pay under a time-and-materials contract. Treasury is gathering cost data from existing time-and-materials and labor-hour contracts to identify costs of recurring transactions to support the future negotiation of reasonable fixed pricing for follow-on work where appropriate. In our view, Treasury's actions since January in response to our recommendation generally indicate it is placing a high priority on making individualized assessments of the nature of each requirement in order to identify those requirements that may effectively utilize a fixed-price contract.

[53]This type of fixed price arrangement is called a firm fixed-price, level of effort term contract. These contracts require the contractor to provide a certain level of effort, over a stated period of time, on work that can be stated only in general terms. Under these contract types, the government pays the contractor a fixed dollar amount. 48 C.F.R. § 16.207-1.

[54]According to TARP contract managers, other services being procured through time-and-materials contracts that are unlikely to be suitable for conversion to fixed pricing are the contracts with law firms and accounting firms. According to these officials, it is standard practice for such firms to bill commercial and government customers on an hourly basis for each attorney and accountant involved in the work, consistent with their time-and-materials pricing arrangements for TARP.

OFS Has Made Further Progress Implementing a Compliance System for Potential Conflicts of Interest Among Contractors and Financial Agents

Since issuing an interim conflicts-of-interest rule in January 2009, and consistent with our prior recommendation, OFS continued to make progress implementing a system of compliance for conflicts of interest that may arise with vendors seeking or performing work under TARP. [55] Consistent with the framework the interim rule provides, OFS is formalizing its process for reviewing and addressing potential or actual organizational and personal conflicts of interest disclosed by contractors and financial agents.[56] Specifically, OFS is making progress (1) developing and applying its compliance system under the interim rule, and (2) reviewing existing contracts that predate the interim rule to determine what changes may be needed.

Regarding OFS's progress in further developing and applying its conflicts-of-interest compliance system, discussions with OFS program and compliance officials, two TARP contractors, and a financial agent's senior contracts manager indicate that a mutual environment for sustained attention and control is taking root. Specifically, our discussions with OFS and TARP contractor officials indicate that all parties have a range of formal and informal processes in place, under which TARP contractors are expected to detect potential conflicts of interest. Once detected, the interim rule requires that potential conflicts be disclosed to Treasury within 5 business days. A disclosure can trigger a formal review by the OFS compliance officer, who is responsible for making a final determination.[57] The processes include an ongoing dialogue among OFS officials and officials from TARP contractors and financial agents about new potential conflicts and, as needed, discussions about changes to

[55]74 Fed. Reg. 3431-3436 (Jan. 21, 2009). Public comments on the TARP conflicts-of-interest interim rule were due March 23, 2009.

[56]Under the interim rule, for some administrative service providers (e.g. temporary services for document production), OFS has decided that those contractors are unlikely to have conflicts of interest and do not warrant the burden imposed by the requirements.

[57]Under the interim rule, in making the required determination there are three possibilities—i.e., OFS must conclude that (1) no conflict exists; (2) no conflict exists that has not been adequately mitigated; or (3) if a conflict exists that cannot be adequately mitigated, OFS has expressly waived it.

contractors' mitigation plans to increase their effectiveness and conform with the interim rule.[58]

We note, however, that OFS does not have fully developed procedures for capturing its decisions on potential conflicts of interest. For example, concerning the regular discussions of new potential conflicts that may arise and require OFS's compliance review, it is not clear that all discussions are documented, or that all information is captured, such as information supporting OFS's determination that a conflict does not exist or has been satisfactorily mitigated. TARP contractors told us that they did not routinely retain records from their discussions with OFS officials about potential conflict disclosures and mitigations. These discussions frequently entail phone conferences but do not always result in formal correspondence addressing the matter. In the absence of documentation, there is no record of how issues were addressed and resolved, should the need to revisit those issues arise in the future. OFS compliance officials acknowledged that they needed to enhance the procedures for documenting conflicts discussions in order to better demonstrate compliance with the interim rule. OFS officials stated they were drafting new policy and procedure instructions to do so. As conflict disclosures and proposed mitigations involving TARP contractors and financial agents continue to emerge, we will need to revisit OFS procedures to ensure that it maintains appropriate documentation.

OFS has made progress since January, in response to our recommendation that it review its existing contracts to determine whether changes are needed in light of the interim rule.[59] Specifically, OFS has reviewed six contracts that predate the interim rule. As of March 13, 2009, this process has resulted in the renegotiation of two contractors' mitigation plans. OFS compliance officials expect to finish reviewing the remaining four mitigation plans within the next several months. We plan to continue

[58]For example, consistent with the interim rule's personal conflicts-of-interest disclosure procedures, one TARP contractor told us about recently disclosing to the TARP program manager a potential personal conflict of interest involving a new employee. Rather than disqualifying this person from being hired, the contractor discussed the matter with OFS officials who were satisfied that the contractor's mitigation measures (which involved establishing an ethical screen to prevent the employee from speaking with staff engaged on the TARP work or accessing related files) had neutralized the conflict.

[59]According to Treasury and OFS procurement and compliance officials, three existing legal services contracts that predate the TARP conflicts-of-interest rule are not in need of mitigation plan reviews and renegotiation to conform, because their performance periods are to end in April 2009.

monitoring OFS's progress to ensure that it fully implements our prior recommendation.

Although the above efforts indicate that progress is being made related to potential conflicts of interest, there may be an opportunity, going forward, for streamlining OFS oversight in this area. For example, the portion of the interim rule focusing on personal conflicts of interest requires that certain contractors obtain financial disclosures in writing from management officials and key individuals working on TARP that are no less extensive than those that are required of new high-level federal government officials.[60] Specifically, the interim rule requires that before working on a TARP matter, management officials and key individuals at firms involved with the acquisition, valuation, management, or disposition of troubled assets must disclose information, in writing, on their and their family's personal, business, and financial relationships.[61] We recognize the importance of collecting such information to detect and deter conflicts of interest. However, the selected use of a more streamlined approach, in appropriate circumstances, could reduce the burden of providing this information and promote compliance.[62] Treasury officials acknowledged that an alternative financial disclosure process could offer a less burdensome way for TARP contractors to obtain required written disclosures from employees but said that any consideration of an alternative would occur only in the context of evaluating public comments on the interim conflicts rule. In finalizing the TARP conflicts-of-interest rule, OFS officials told us that they would be reviewing various options to the current requirement in the interest of striking a balance between

[60] Section 31.212(b) requires that the information to be obtained in writing be no less extensive than that required under Office of Government Ethics (OGE) Form 278, *Executive Branch Personnel Public Financial Disclosure Report.* Among the very high-level federal officials required to annually file this report are the President, vice president, presidential nominees to positions requiring Senate confirmation, military general and flag officers, and senior executives.

[61] According to OGE Form 278, the basic premise of the financial disclosure requirement is that those having responsibility for review of the reports must be given sufficient information by reporting individuals concerning the nature of any outside interests and activities so that an informed judgment can be made with respect to compliance with applicable conflicts-of-interest requirements.

[62] For example, there is an alternative financial disclosure report currently required of certain other federal employees: OGE Form 450, *Confidential Financial Disclosure Report (Executive Branch).* Unlike the longer Form 278 required of very high-level officials, the Form 450 does not require a detailed breakout of the valuation of listed assets and sources of investment or other income by dollar amount and type.

Treasury's need to protect the government's interests and the burden the requirement placed on TARP contractors and financial agents.

OFS Is in the Process of Building TARP's Financial Reporting Structure

Treasury must annually prepare and submit to Congress and the public audited fiscal year financial statements for TARP that are prepared in accordance with generally accepted accounting principles.[63] Moreover, the act requires Treasury to establish and maintain an effective system of internal control over TARP that includes providing reasonable assurance of the reliability of its financial reporting[64] and compliance with applicable laws and regulations.[65] It further, requires Treasury to annually report on its assessment of the effectiveness of internal control over financial reporting. The act also requires GAO to audit TARP's financial statements annually in accordance with generally accepted auditing standards.[66]

The fiscal year ending September 30, 2009, will be the first year for which Treasury prepares financial statements for TARP. OFS has begun to build a financial reporting structure for preparing the financial statements. OFS officials told us that they were continuing to address key accounting and reporting topics, such as defining the reporting entity; determining the types of revenues and expenses to be included in TARP; determining the appropriate valuation methods for assets and liabilities; determining the accounting for administrative expenses, dividends, and interest; and defining the form and content of TARP's financial statements. In addition, OFS continues to refine, develop, and document its internal control

[63]Section 116(b) of the act, 12 U.S.C. §5226(b).

[64]Section 116(c) of the act, 12 U.S.C. § 5226(c). An entity's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and disposition of the assets of the entity; (2) provide reasonable assurance that transactions are recorded, as necessary, to permit preparation of financial statements in accordance with generally accepted accounting principles and that receipts and expenditures of the entity are being made only in accordance with authorizations of management and those charged with governance; and (3) provide reasonable assurance regarding prevention or timely detection and correction of unauthorized acquisition, use, or disposition of the entity's assets that could have a material effect on the financial statements.

[65]Internal controls over compliance with laws and regulations should provide reasonable assurance that transactions are executed in accordance with laws governing the use of budget authority and with other laws and regulations that could have a direct and material effect on the financial statements, and, as applicable, other laws and regulations identified in OMB's audit guidance.

[66]Section 116(b) of the act, 12 U.S.C. § 5226(b).

framework over financial reporting and compliance, including its risk assessment activities. The implementation of a well-defined internal control framework and the decisions involving key accounting and reporting issues are critical to enabling OFS to prepare its fiscal year-end financial statements and to OFS's reporting on its assessment of the effectiveness of TARP's system of internal control.

As part of GAO's responsibilities under the act, we have begun our audit of TARP's financial statements and the related internal controls. Our objectives will be to render opinions on (1) the financial statements as of and for the period ending September 30, 2009, and (2) internal control over financial reporting and compliance with applicable laws and regulations as of September 30, 2009. We will also be reporting on the results of our test of TARP's compliance with selected provisions of laws and regulations related to financial reporting.

Documentation of Certain Internal Control Procedures and Guidance Is Not Consistent With Actual Practice

We noted two areas in which OFS's documentation of certain internal control procedures and guidance pertaining to determining warrant exercise prices were not updated to be consistent with actual practice. While these issues do not significantly affect OFS's financial reporting, they, nevertheless, merit the attention of OFS management to decrease the risk that the transactions will not be recorded completely, properly, or consistently and that guidance available to the public on determining warrant exercise prices will create confusion about the actual terms and conditions executed by Treasury for its investments.

Documentation of Certain Internal Control Processes Is Not Consistent with the Controls Applied

As part of its internal control framework, OFS plans to develop formal written policies and procedures governing OFS's operations and expects to have these policies and procedures finalized by September 30, 2009. In the interim, OFS has developed and documented process flows and narratives describing internal control processes for TARP transactions. Our audit of selected control activities for CPP and SSFI transactions found that OFS had applied adequate financial reporting controls over the transactions we tested. However, we found that the actual control processes and procedures performed for some of the transactions we tested were inconsistent with the documented flows and descriptions. Inconsistencies in the application of a control procedure complicate the review of the transactions and increase the risk that the transactions will not be recorded completely, properly, or consistently. According to Treasury officials, these inconsistencies arose from the removal of certain control activities that were no longer relevant and the implementation of more effective controls without the simultaneous updating of the documented process flows or narratives to reflect these changes. The officials told us that TARP control processes were continually evolving as management gained more experience with processing TARP transactions.

Guidance for Determining CPP Warrant Exercise Prices Is Not Consistent with the Procedures Applied

Under CPP, Treasury receives warrants to purchase shares of stock of qualified financial institutions. The date selected as the basis for determining the warrant exercise price impacts the exercise price and the number of shares included in the warrants. Treasury consistently applied its preliminary approval date as the basis for determining the warrant exercise prices. However, Treasury has not established guidance, consistent with its procedures, regarding the date to be used as a basis for determining the warrant exercise prices. We found four Treasury documents that each had a different description of the date to use as the basis for determining the warrant exercise prices. For example, the announced CPP terms and conditions specify, among other things, the use of the investment date as the basis for determining the warrant exercise price, but the term "investment date" is not specifically defined. The CPP program description on Treasury's Web site, the CPP Application Guidelines, and the Security Purchase Agreement each provide different guidance on which date to use as a basis for determining the warrant exercise prices. Inconsistencies in guidance available to the public for warrant exercise price determinations may create confusion about the actual terms and conditions executed by Treasury for its investments.

The eight institutions comprising the first group of CPP transactions, amounting to $115 billion, signed Participation Commitment documents stating that the financial institutions are to issue preferred shares to the Treasury under the terms and conditions announced for CPP.[67] Treasury used October 13, 2008, the date the institutions signed the Participation Commitment documents, as the basis for determining the warrant exercise prices. OFS officials told us they considered the date the institutions signed the Participation Commitment documents to be Treasury's preliminary approval date.

According to OFS, for the second and subsequent group of CPP transactions, Treasury's preliminary approval date is the date the Investment Committee recommends that the Assistant Secretary for

[67]In addition to the eight institutions funded in the first group, Merrill Lynch & Co., Inc. (Merrill Lynch) signed a participation commitment on October 13, 2008. Following Merrill Lynch's merger with Bank of America, on January 9, 2009, Bank of America received the $10 billion specified in Merrill Lynch's Participation Commitment with Treasury.

Financial Stability approve the application.[68] Our tests of selected CPP transactions beyond the first group showed that Treasury consistently utilized the Investment Committee's recommendation date as the basis for determining the warrant exercise prices. In addition, the executed agreements between the financial institutions and Treasury detail, for each warrant, the number of shares of stock Treasury may purchase at the specific exercise price. As such, these parties are aware of and consent to the specific terms of the warrants.

Indicators Suggest Mixed Recent Developments in Credit Markets, but Isolating the Impact of TARP Continues to Present Challenges

Although indicators of the cost of credit and perceptions of risk in credit markets suggest mixed developments since our last report, TARP's activities could improve market confidence in participating banks and have other beneficial effects on credit markets. However, several factors will complicate efforts to measure any impact, including contemporaneous changes in monetary and fiscal policy; other programs introduced by Treasury, the Federal Reserve, FDIC, and FHFA, and general market forces. As a result, any changes in credit markets cannot be attributed solely to TARP. Similarly, slow recovery does not necessarily reflect its failure. However, if TARP is having its intended effect, a number of developments might be observed in credit and other markets over time, such as reduced risk spreads, declining borrowing costs, and more lending activity than there would have been in the absence of TARP. Credit market indicators we have been monitoring suggest the cost of nonmortgage credit has risen, and perceptions of risk (as measured by premiums over Treasury securities) have declined in mortgage and interbank markets, while rising in corporate debt markets. While lending standards remained tight, according to Federal Reserve data, the largest CPP recipients continued to extend loans to consumers and businesses of at least $200 billion a month since October, based on our analysis of Treasury's new loan survey. As TARP has evolved, we have also initiated tracking of foreclosure data and consumer credit measures, such as auto loan and credit card rates, to provide indicators relevant to the new programs.

[68]As part of the process of determining eligibility in CPP, Treasury established an investment committee to evaluate each financial institution's application. The investment committee either recommends that the Assistant Secretary for Financial Stability approve the application or requests additional analysis or information. According to Treasury, the investment committee was created after October 13, 2008.

TARP Programs Could Have a Number of Effects on Credit Markets and the Economy

TARP's activities could improve market confidence in participating banks and have other beneficial effects on credit markets, but several factors will complicate efforts to measure any impact. In our previous reports we focused on CPP, detailing the expected effects, as well as the tension between promoting lending and improving the capital position of banks. As indicated above, CAP, as proposed by the new administration, aims to eliminate uncertainty about the solvency of financial institutions through stress tests and by infusing capital into the financial system to the point where participating banks can absorb losses even worse than expected scenarios. The intent is to improve confidence in financial institutions, allowing the banks to borrow on more favorable terms, attract private capital and continue lending to creditworthy businesses and households. Like CPP, if CAP is effective we should also see improvement in credit market conditions, including declining risk premiums (the difference between risky and risk-free interest rates, such as rates on U.S. Treasury securities) for interbank lending and bank debt and lower borrowing costs for business and consumers. Improved market conditions may permit some borrowers to avoid foreclosures by enhancing the capacity and willingness of banks to refinance loans or modify others. HAMP is intended to reduce foreclosures by directly modifying and refinancing mortgages and, therefore, may also indirectly improve the balance sheets of banks by restoring value to mortgage-related securities. However, as we discussed in our December 2008 and January 2009 reports, to the extent that credit quality in the economy is deteriorating, confidence remains low and the economy continues to experience a downturn, during which lending and borrowing levels normally drop. Low interest rates and lower premiums may not translate into increased lending immediately. Nevertheless, lending may still be higher than it would have been if the equity injections had not taken place. Similarly, market forces may continue to force a correction in housing prices and result in additional foreclosures, albeit fewer than would have occurred in the absence of TARP.

Similarly, TARP activities could improve credit market conditions by supporting securitization markets through the expansion of TALF. As indicated above, TALF will provide funding to certain holders of Aaa-rated ABS backed by newly and recently originated small business, student, automobile, and credit card loans. By increasing demand and prices for these securities, TALF should reduce the rates faced by borrowers in the associated loan categories and increase the availability of new credit to consumers and businesses.[69] Moreover, by providing support to securitization markets, TALF may encourage private investors to return to asset-backed securities, thereby increasing liquidity and improving general market conditions. However, as we discussed in our previous reports, other important policies and interventions by government agencies (some collaborative efforts) that are undertaken to restore financial stability, as well as general market forces, will complicate a determination of TARP's specific effectiveness. TALF, as a joint program with the bulk of the funding provided by the Federal Reserve, highlights the difficulty of attributing changes in credit market conditions exclusively to TARP.

Changes in Select Indicators Suggest Mixed Recent Development in Credit Markets, although These Changes Are Not Necessarily Attributable to TARP

While it is difficult to isolate one program's effects, given the numerous actions being undertaken, we considered a number of indicators that, although imperfect, may be suggestive of TARP's impact on credit and other markets. Improvements in these measures would indicate improving conditions, even though those changes cannot be exclusively linked to any one program. Table 8 lists the indicators we have reported on in previous reports, as well as the changes since the last report and the changes since the announcement of CPP, the first TARP program. In general, the indicators illustrate that the cost of nonmortgage credit has risen and that perceptions of risk have declined in mortgage and interbank markets, while rising in corporate debt markets since January 2009. For example, while the cost of interbank credit (LIBOR) has risen slightly since our January 2009 report, the TED spread, which captures the risk perceived in interbank markets, has declined. Since the announcement of CPP, the TED spread has fallen 350 basis points.[70] Since the announcement of CPP, corporate bond spreads are up, and there have been increases of 38 and 27 basis points for high quality (Aaa) and moderate quality (Baa) corporate spreads, respectively, since our January 2009 report, indicating heightened risk perceptions. Like the LIBOR, Aaa and Baa bond rates have increased, indicating an increase in the cost of credit for businesses. However, the improvement in the mortgage market is consistent across rates and spreads. Mortgage rates were down 9 basis points, and the mortgage

[69]The Federal Reserve Bank of New York will initially provide $200 billion in funding for TALF, while Treasury's initial $20 billion will fund, in part, a special purpose vehicle that will manage the collateral taken by the Federal Reserve Bank of New York if a borrower defaults. TALF is similar in many ways to the Federal Reserve program to buy Fannie Mae and Freddie Mac mortgage-backed securities (MBS).

[70]A basis point is a common measure used in quoting yield on bills, notes, and bonds and represents 1/100 of a percent of yield. An increase from 4.35 percent to 4.45 would be an increase of 10 basis points.

spread is down 45 basis points. (See our December and January reports for a more detailed description and motivation for the indicators.) As discussed above, changes in credit market conditions may not provide conclusive evidence of TARP's effectiveness, as other important policies, interventions, and changes in underlying economic conditions can influence these markets. Recently, the Federal Reserve announced—in addition to further interventions in the GSE mortgage-backed security and debt market—that it intended to improve conditions in private credit markets by purchasing up to $300 billion of longer-term Treasury securities over the next 6 months. This activity could result in lower costs for borrowing activities whose rates tend to move with the Treasury yield.[71]

Table 8: Changes in Selected Credit Market Indicators, January 22, 2008, and March 25, 2009

Credit market rates and spreads			
Indicator	**Description**	**Change since January report**	**Change since October 13, 2008**
LIBOR	3-month London interbank offered rate (an average of interest rates offered dollar-denominated loans)	Up 6 basis points	Down 353 basis points
TED Spread	Spread between 3-month LIBOR and 3-month Treasury yield	Down 6 basis points	Down 350 basis points
Aaa bond rate	Rate on highest quality corporate bonds	Up 38 basis points	Down 84 basis points
Aaa bond spread	Spread between Aaa bond rate and 10-year Treasury yield	Up 35 basis points	Up 40 basis points
Baa bond rate	Rate on corporate bonds subject to moderate credit risk	Up 27 basis points	Down 24 basis points
Baa bond spread	Spread between Baa bond rate and 10-year Treasury yield	Up 24 basis points	Up 100 basis points
Mortgage rates	30-year conforming loans rate	Down 9 basis points	Down 143 basis points
Mortgage spread	Spread between 30-year conforming loans rate and 10-year Treasury yield	Down 45 basis points	Down 33 basis points

[71]As we noted in our last report, mortgage rates fell by 90 basis points shortly after the Federal Reserve announced it would intervene in the GSE MBS and debt markets.

Credit market rates and spreads			
Indicator	Description	Change since January report	Change since October 13, 2008
Quarterly mortgage volume and defaults			
Indicator	**Description**	**Change since January report**	**Change from September 30, to December 31, 2008**
Foreclosure rate	Percentage of homes in foreclosure	-	Up 0.33 percentage points to 3.3%
Mortgage originations	New mortgage loans	-	Down $50 billion to $250 billion

Source: GAO analysis of data from Global Insight, Federal Reserve Bank of St. Louis, and *Inside Mortgage Finance.* (Daily and weekly data will be updated 4-5 days before the release of March report.)

Note: Rates and yields are daily except mortgage rates, which are weekly. Higher spreads (measured as premiums over Treasury securities of comparable maturity) represent higher perceived risk in lending to certain borrowers. Higher rates represent increases in the cost of borrowing for relevant borrowers. As a result, "down" suggests improvement in market conditions for credit market rates and spreads. Foreclosure rate and mortgage origination data are quarterly. See previous TARP reports for a more detailed discussion.

Other indicators that may become better measures of TARP's effectiveness over time are mortgage originations and foreclosures. While the volume of new mortgage lending may reflect changes in credit risk or the demand for credit, it may also indicate the availability of credit as well.[72] As table 9 indicates, mortgage originations fell from $300 billion in the third quarter to $250 billion in the fourth quarter of 2008. To the extent that credit and economic conditions improve over time, we would expect mortgage originations to stop declining and eventually rise, although it is not clear that this measure would or should return to the level seen in the period leading up to the credit market turmoil. Similarly, foreclosure data should provide an indication of the effectiveness of the recently implemented HAMP program going forward. The percentage of loans in foreclosure had reached an unprecedented high of 3.3 percent at the end of the fourth quarter of 2008, up from 2.97 percent the previous quarter. As stated above, general market forces, including falling housing prices, rising unemployment, and other programs outside of TARP that are being undertaken to address the rising foreclosure rate will complicate efforts to determine the effectiveness of HAMP.

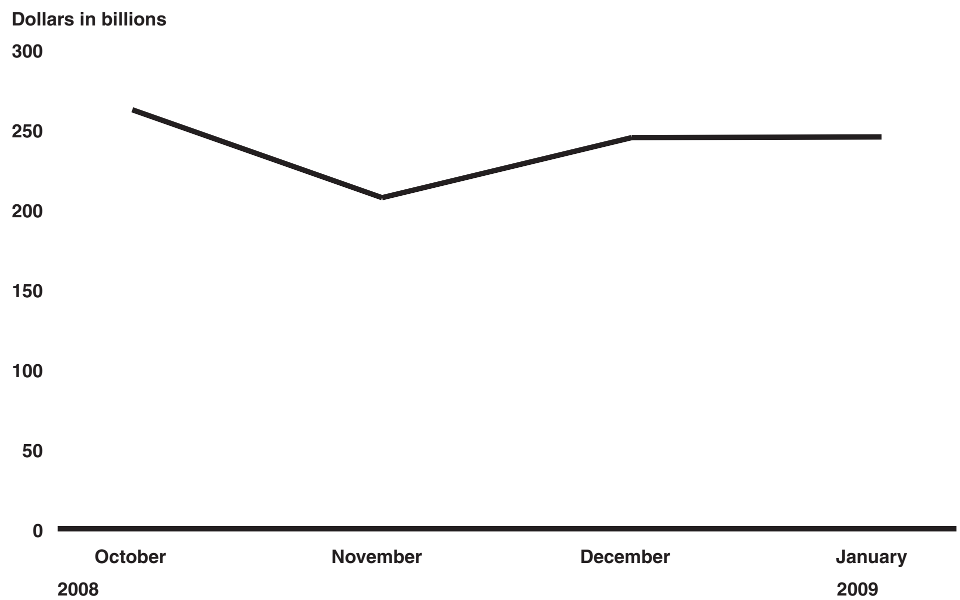
New Lending at the 20 Largest Participants in CPP

The largest CPP recipients continued to extend loans to consumers and businesses, over $200 billion a month since October, based on our analysis

[72]Like other bank interest rates, mortgage rates may reflect the customers to whom banks choose to lend, rather than the cost of credit for all potential customers.

of Treasury's new loan survey. Because these data are unique, we were not able to benchmark the origination levels against historical lending or seasonal patterns at these institutions. As illustrated in figure 4, while total mortgage originations fell in the fourth quarter of 2008, these data suggest that new lending at the 20 largest institutions participating in CPP (as of December 31, 2008), after dropping by about 21 percent from October to November, rose roughly 18 percent from November to December.[73]

Figure 4: New Lending at 20 Largest Recipients of CPP, between October 1, 2008, and January 31, 2009



Source: GAO analysis of Treasury loan survey data.

Although lending normally drops during a recession, according to our analysis of the survey, aggregate new lending by these institutions in December amounted to roughly $245 billion (table 9). Total new lending in January increased slightly. The reporting institutions generally received CPP funds on October 28, 2008, or November 14, 2008, with a few institutions receiving funds on December 31, 2008. In figure 4, we present new lending by month. Although we recognize the limitations inherent in

[73]New lending includes new mortgage, home equity lines of credit, credit card and other consumer originations, and new or renewed commercial and industrial, and commercial real estate loans.

these data, the survey data will prove valuable for more thorough analyses of lending activity in future reports.

Table 9: New Lending at 20 Largest Recipients of CPP, between October 1, 2008, and January 31, 2009

Dollars in millions

			New Lending			
Institution	**Date of CPP**	**Size of CPP**	**October**	**November**	**December**	**January**
Citigroup	10/28/2008	$25,000	$19,373	$17,854	$22,864	$18,814
JP Morgan Chase & Co.	10/28/2008	25,000	61,192	51,178	52,376	46,785
Wells Fargo Bank	10/28/2008	25,000	35,073	26,709	31,063	50,560
Bank of America	10/28/2008	15,000	70,569	48,864	61,427	60,624
Goldman Sachs & Co.	10/28/2008	10,000	1,490	1,666	2,551	6,487
Morgan Stanley	10/28/2008	10,000	1,787	6,302	3,170	3,551
Bank of New York Mellon Corp	10/28/2008	3,000	879	800	849	730
State Street	10/28/2008	2,000	1,404	749	1,403	289
U.S. Bancorp	11/14/2008	6,599	13,371	11,244	17,262	13,866
Capital One Financial Corporation	11/14/2008	3,555	3,477	2,825	3,024	2,531
SunTrust Banks, Inc.	11/14/2008	3,500	7,612	4,827	6,514	6,511
Regions	11/14/2008	3,500	5,994	4,664	5,832	4,983
BB&T Corp.	11/14/2008	3,134	5,929	4,901	6,197	5,976
KeyCorp	11/14/2008	2,500	3,238	2,671	4,518	3,065
Comerica Inc.	11/14/2008	2,250	3,830	2,300	3,242	1,425
Marshall & Ilsley	11/14/2008	1,715	1,331	1,181	1,206	960
Northern Trust	11/14/2008	1,576	1,985	1,364	1,810	1,270
PNC Financial Services Group Inc.	12/31/2008	7,579	11,273	6,313	8,076	8,170
Fifth Third Bancorp	12/31/2008	3,408	7,025	6,414	7,119	5,070
CIT Group Inc.	12/31/2008	2,330	5,317	4,232	4,182	3,429
Total		**$156, 646**	**$262,149**	**$207,059**	**$244,686**	**$245,095**

Source: GAO analysis of Treasury loan survey data.

Note: The table features the 20 largest recipients of CPP funds who had received funds, as of December 31, 2008, and does not include American Express, which received CPP funds in January. New lending includes new mortgage, home equity lines of credit, credit card and other consumer originations, new or renewed commercial and industrial loans, and commercial real estate loans. However, new lending does not include other important activities that these institutions may undertake to facilitate credit intermediation, including underwriting and purchasing MBS and ABS. Date and size of CPP refers to the initial infusion of CPP funds. Citigroup and Bank of America have received additional TARP funds.

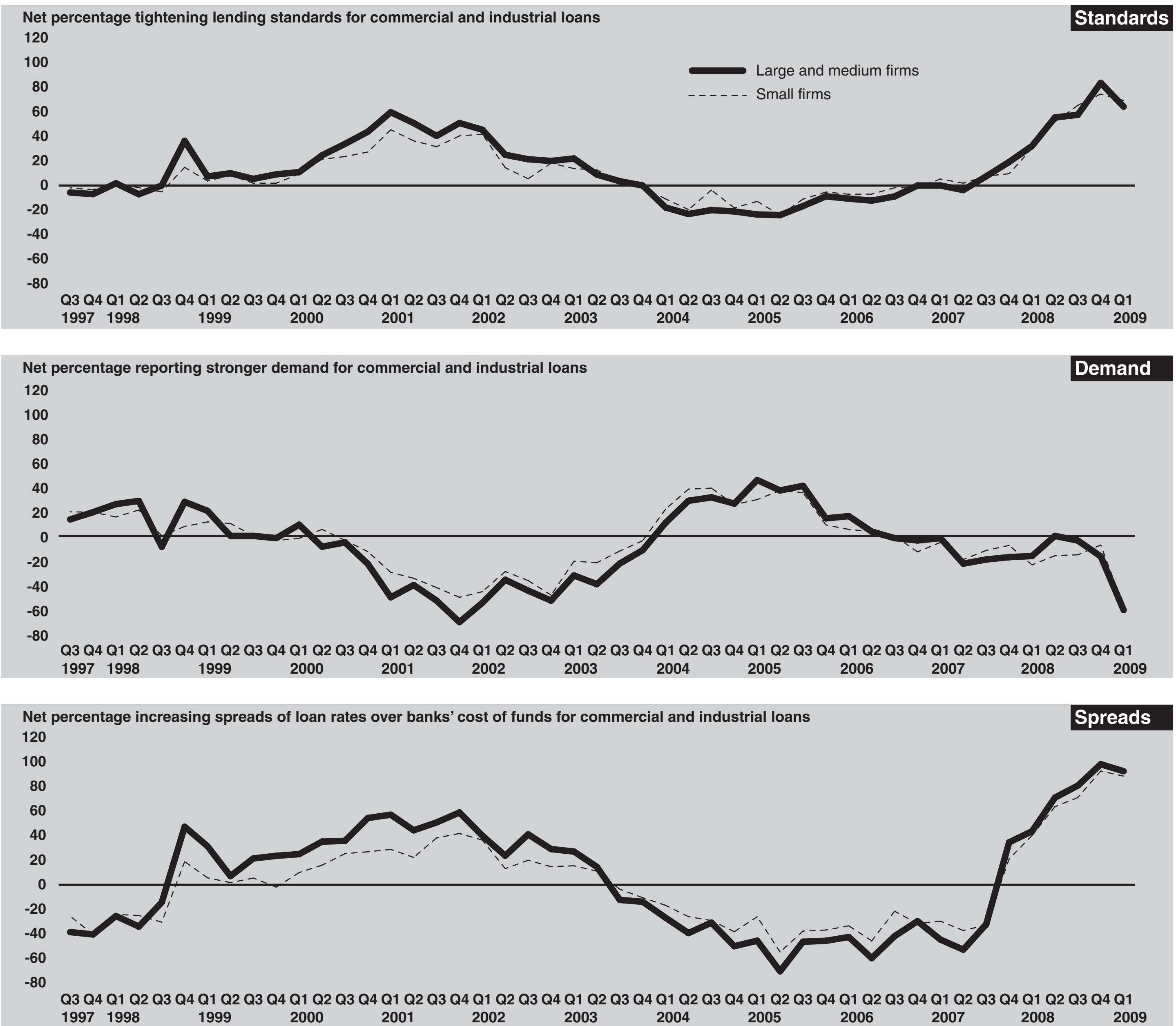
Federal Reserve Senior Loan Officer Opinion Survey

The Federal Reserve Loan Officer survey asks senior loan officers at U.S. banks about changes in lending standards, lending terms, and the state of business and household demand for loans.[74] The most recent survey suggests that although the percentage of banks tightening credit remains above previous peaks, fewer banks have tightened credit standards in approving applications for loans since the October 2008 survey.[75] For example, the net percentage of banks tightening credit standards for commercial and industrial loans fell from roughly 84 percent in October 2008 to approximately 64 percent in January 2009 for large firms, although the drop for small firms was somewhat less significant, 75 percent and 70 percent, respectively (fig. 5). Although not reported here, similar patterns emerged for subprime and prime residential mortgage loans and other consumer loans. However, lending standards in January remained as tight as they were in October for credit card lending. As figure 5 shows, the results of the survey also suggest weaker demand for commercial and industrial loans by both smaller and larger firms and a slight decrease in the percentage of banks indicating increased spreads (loan rate charged firms over the cost of funds), although spreads remain well above previous highs. However, the percentage of banks reporting stronger demand for both prime and subprime loans has increased significantly since the October survey, while the demand for other consumer loans has remained roughly the same.

[74]The results are based on a survey of approximately 60 banks, accounting for more than 75 percent of the real estate loans originated by banks in the U.S. The sample is selected from among the largest banks in each Federal Reserve District. See http://www.federalreserve.gov/boarddocs/snloansurvey/.

[75]Respondent banks received the January survey on or after December 30, 2008, and their responses were due January 13, 2009. Banks received the October survey on or after October 2, and their responses were due on October 16.

Figure 5: Net Percentages of Banks Tightening Lending Standards, Increasing Spreads, and Reporting Stronger Demand for Loans, by firm size, between October 1997 and March 2009



Source: GAO analysis of Federal Reserve data.

Note: Negative percentage implies, for example, that the percentage of firms loosening standards exceeds the percentage tightening standards. Large and medium-size firms are those with annual sales of $50 million or more.

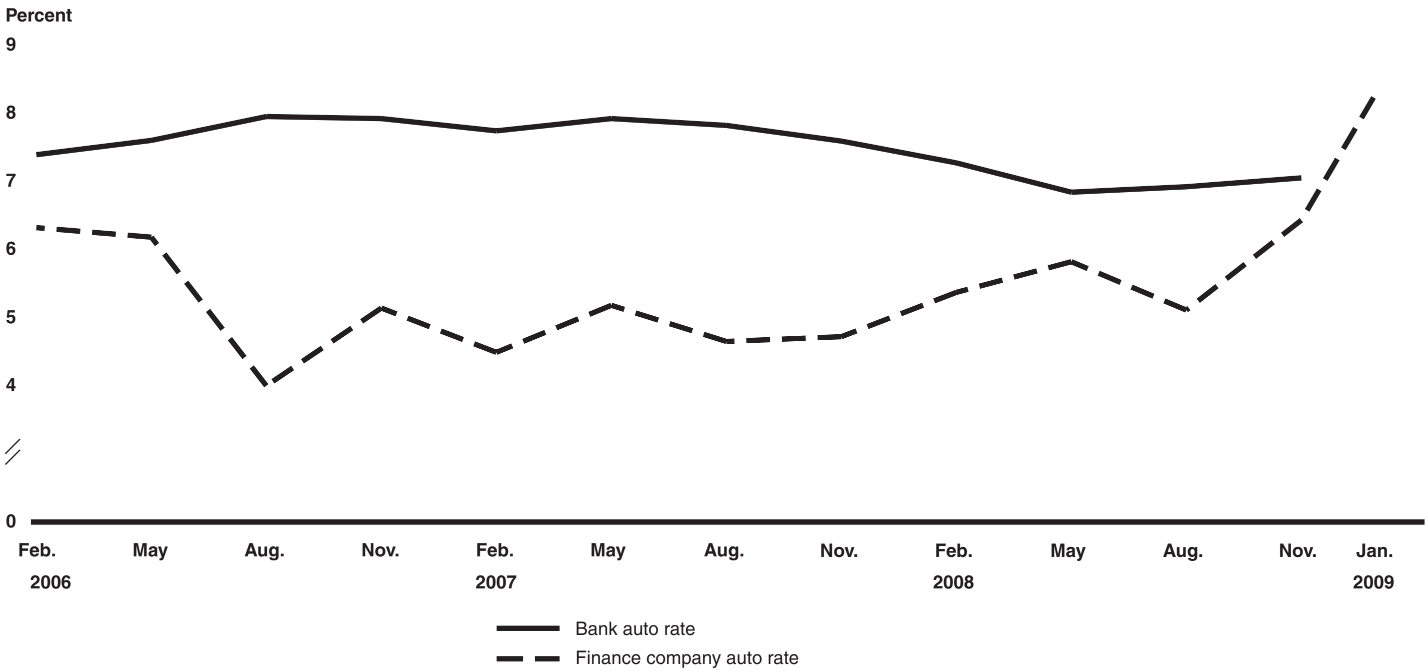
Automobile Lending and Credit Card Rates

In addition to the indicators previously identified, we continue to evaluate the potential usefulness of other indicators and expect to add new indicators and modify or drop others. Among these are measures of lending activity in consumer loan markets that may become more appropriate indicators as time progresses, given the initiation of TALF. As stated above, TALF support to securitization markets should result in lower rates and increased availability of credit for the businesses and households that receive the underlying loans. The primary consumer-ABS markets include ABS backed by auto loans, credit card receivables and student loans. Although the TALF program was initiated only recently, figure 6 establishes the historical context for continued monitoring of auto loan rates. As the figure shows, until recently, average finance company auto rates were consistently below commercial bank auto rates. However, from August to November of 2008, finance company rates increased significantly (132 basis points), while bank rates increased just slightly (13 basis points). Finance company rates increased another 180 basis points from November 2008 to January 2009.[76] Because stand-alone auto finance companies are more heavily reliant on securitization than commercial banks, the difference in these trends (or the spread between the two rates) could partially reflect the issues in securitization markets that TALF is intended to address.[77] We continue to monitor this spread, as well as other measures of consumer loan activity.

[76]January and February data were unavailable for commercial bank auto rates for inclusion in this report.

[77]However, differences in these trends could also reflect the success of CPP (or CAP) in lowering, or preventing a rise, in bank auto rates.

Figure 6: Average Finance Rate for New Cars at Auto Finance Companies and Banks, February 2006 and January 2009



Source: GAO analysis of Federal Reserve data.

Conclusions

Treasury has continued to take significant steps to address all the recommendations from our December 2008 and January 2009 reports. In particular, Treasury has recently expanded the scope of the monthly CPP surveys of the 20 largest institutions to include all institutions participating in the program. This change should provide Treasury with the information necessary to begin to track the effectiveness of the program and effectively implement our recommendation. Treasury also has expedited efforts to ensure that trained and certified personnel oversee the performance of all contracts and moved toward fixed-price arrangements, when appropriate. These actions were consistent with our recommendations for improved contractor oversight in these areas. Moreover, Treasury continued to make progress in several other areas, including ensuring that future agreements entered into under its new programs better enable it to determine what institutions plan to do with any capital infusions and to track the resulting lending activity of participating institutions on a regular basis. Appendix II provides our assessment of Treasury's implementation of our open recommendations from our January 2009 report, and appendix III provides a high-level summary, prepared by Treasury, of the progress it has made on each recommendation since our last report and some planned next steps.

During this period, Treasury has also continued to improve its monitoring of compliance with the terms of its existing agreements. Treasury officials told us that asset managers are to play a role in monitoring the participating institutions' compliance with the agreements. In the interim, Treasury has taken some steps to help ensure that institutions are complying with dividend, stock repurchase, and executive compensation restrictions. Treasury relies on participants' representations and warranties in the agreements, and if it finds reason to believe that these representations can not be relied upon, it can pursue the available remedies for any false representations. At this point, Treasury has not taken steps to verify the information or require the institutions to provide any additional documentation. As recommended in our December 2008 report, we continue to believe that Treasury should develop a formal system to help ensure compliance with the agreements. For example, leverage the oversight activities of the bank regulators by having them include compliance with the agreements as part of their ongoing examinations. This type of compliance activity is generally consistent with ensuring the safety and soundness of institutions. The regulators previously told us that they were taking steps to build such oversight into their examination procedures. However, without a consistent oversight approach, Treasury runs the risk of receiving inconsistent or incomplete information from the regulators.

Treasury has also continued to take steps to articulate a more clearly defined vision for TARP, and in February 2009, provided its strategy for using its remaining funds. This strategy defined the existing problems and how the various programs would begin to address them. While the initial plan provided a broad vision and strategy, in the subsequent weeks, Treasury provided additional details for the various components of the program. In particular, it announced its plans to participate in the purchase of troubled assets through public-private partnerships and launched a homeownership protection program, activities that are consistent with the original plans for TARP. Given that only 60 days have passed since our last report, we acknowledge the significance of these accomplishments. Yet, Treasury continues to be hampered by questions about its overall strategy and OFS's activities, raising questions about the effectiveness of its existing communication strategy. Treasury's strategy has largely been one of posting information to its Web site; issuing press releases, speeches, and testimonies; and reaching out to Congress on an ad hoc basis; and it continues to face ongoing communication challenges.

Given the complexity of the issues involved and the heightened public scrutiny, an effective communication strategy continues to be critical, but Treasury has yet to develop a means of regularly and routinely communicating its activities to relevant congressional committees and members, the public, and other critical stakeholders. For example, TARP had received approximately $2.9 billion in dividend payments through March 20, 2009, but this information has not been reported to the Congress and the public. To improve transparency, Treasury should publicly announce the amounts, such as dividends, it has received from TARP participants. By not sharing this information, Treasury is missing an important opportunity to provide information about the returns it is receiving on its investments. An effective communication strategy should, among other things, build understanding and support for the program through regular and routine outreach, including confidential member briefings; integrate communications and operations by making communication integral to the program; and increase the impact of communication tools such as electronic and print media and video. Given that the President's proposed budget contemplates additional funding, an effective communication strategy is critical for ensuring the support necessary to obtain such funding.

Treasury has taken appropriate actions to bolster the conditions or requirements for assistance that is deemed exceptional, but certain assistance may require that it go farther to repair damage caused to the program. Controversies about the actions of some TARP participants continue to surround the program, in general, and AIG, in particular. While Treasury announced $70 billion dollars in assistance to AIG—more assistance than has been provided to any other single institution to date—it has yet to disperse the up to $30 billion of additional assistance announced on March 2, 2009, or finalize the agreement. Therefore, Treasury has an opportunity to further improve the integrity and accountability associated with this additional assistance. Based on our previous work on government assistance to the private sector, as well as the Treasury Secretary's position, as articulated in the Financial Stability Plan that government support must come with strong conditions, Treasury has an opportunity to take additional steps to strengthen its agreement with AIG by requiring AIG seek to negotiate concessions from management, employees, and counterparties, as appropriate, before the agreement is finalized. For example, Treasury could require that AIG seek to renegotiate contracts with its employees, such as existing contracts similar to the contract for retention bonuses with AIG Financial Products' employees, and with existing counterparties that would face substantial losses were AIG to have its credit downgraded or fail. While we understand that Treasury is making an investment in AIG, Treasury's failure to act in this instance could cause additional harm to its reputation and impair its ability to seek additional funding for TARP that might be needed in the future.

Next, Treasury has also made progress in establishing its management infrastructure and has responded to our five open recommendations that are related to hiring, contracting, and establishing its internal controls.

- In the hiring area, Treasury has continued to make progress in establishing its management infrastructure, including hiring more staff. In accordance with our prior recommendation that it expeditiously hire personnel to OFS, Treasury continued to use direct-hire and various other appointments to bring a number of career staff on board quickly. Since our January 2009 report, Treasury has increased the total number of OFS staff overall and the balance has shifted from mostly detailees to more permanent staff, indicating that the workforce has become more stable over time. In our last report, we recognized that the changing nature of OFS had made it difficult for officials to determine its long-term organizational needs but that such considerations continued to be vital to retaining institutional knowledge within the organization as programs evolved. Treasury has taken further steps to align OFS's human capital program with its current and emerging mission and programmatic goals. For example, as outlined in its draft workforce plan, Treasury has taken steps to identify the critical skills and competencies needed to operate OFS and plans to develop strategies to address gaps in these areas. These actions will be critical to OFS's ability to monitor its progress in building and developing the OFS workforce.

- Treasury has continued to build a network of contractors and financial agents to support TARP administration and operations. At the same time, Treasury has continued to build its capacity to manage these vendors by putting into place the people and processes necessary to enhance its oversight of contractor and financial agent performance. Given the still-evolving nature of TARP requirements, we recognize that opportunities for using fixed-price arrangements may be limited. Nonetheless, Treasury has a process that should help it determine where those opportunities exist. In developing this process, Treasury has addressed our prior recommendation in this area, and we will monitor continued progress. In addition, Treasury could enhance its efforts to safeguard the TARP program from conflicts of interest involving its contractors and financial agents by completing its review of mitigation plans to ensure conformity with the new conflicts-of-interest rule and by requiring that decisions on potential conflicts be documented.

- OFS has begun to build a financial reporting structure, including addressing the key accounting and financial reporting issues necessary to enable it to prepare financial statements and to assess the effectiveness of TARP's system of internal control. Consistent with our previous recommendations, OFS is continuing to develop a comprehensive system of internal control and has established plans for finalizing formal policies and procedures to govern TARP activities and assess its risks. In the interim, OFS has developed and documented process flows and narratives describing internal control procedures for TARP transactions. While OFS applied adequate control procedures over selected CPP and SSFI transactions we tested, it has not taken steps to provide consistency between the documented descriptions and the actual procedures for certain controls that were applied to the transactions. Inconsistencies in the application of a control procedure complicate review of the transactions and increase the risk that the transactions may not be recorded completely, properly, or consistently. Similarly, OFS needs to address inconsistencies in guidance pertaining to determining warrant exercise prices. Inconsistencies in guidance available to the public for these price determinations may create confusion about the actual terms and conditions executed by Treasury for its investments.

Finally, we again note that while isolating the effect of TARP's activities continues to be difficult, developments in the credit markets have generally been mixed since our January 2009 report. Some indicators demonstrate that the cost of credit has increased in interbank and corporate bond markets and decreased in mortgage markets, while perceptions of risk (as measured by premiums over Treasury securities) have declined in interbank and mortgage markets and risen in corporate debt markets. In addition, although Federal Reserve survey data suggest that lending standards remained tight, the largest CPP recipients extended over $240 billion in new loans to consumers and business in both December 2008 and January 2009, according to the Treasury's new loan survey. Attributing any of these changes directly to TARP continues to be problematic because of the range of actions that have been and are being taken to address the current crisis. While these indicators may be suggestive of TARP's ongoing impact, no single indicator or set of indicators will provide a definitive determination of the program's impact.

Recommendations for Executive Action

While Treasury continues to take action to address our recommendations and has begun to make progress in many areas, we identified new areas that warrant ongoing attention and focus. Therefore, we recommend that Treasury take the following actions as it continues to improve the integrity, accountability, and transparency of the program.

We recommend that Treasury take the following six actions:

- Develop a communication strategy that includes building an understanding and support for the various components of the program. 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 counsel of advisors, and leveraging available technology.

- Require that AIG seek concessions from stakeholders, such as management, employees, and counterparties, including seeking to renegotiate existing contracts, as appropriate, as it finalizes the agreement for additional assistance.

- 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.

- Improve transparency pertaining to TARP program activities by reporting publicly the monies, such as dividends, paid to Treasury by TARP participants.

- Complete the review of, and as necessary renegotiate, the four existing vendor conflicts-of-interest mitigation plans to enhance specificity and conformity with the new interim conflicts-of-interest rule.

- Issue guidance requiring that key communications and decisions concerning potential or actual vendor-related conflicts of interest be documented.

Agency Comments and Our Analysis

We provided a draft of this report to Treasury for review and comment. We received written comments from Treasury that are reprinted in Appendix I. We also received technical comments from Treasury, that we incorporated, as appropriate. In its comments, Treasury described steps it had taken in the last 60 days to address extraordinary economic challenges and noted that recommendations in our latest report presented a thoughtful way forward.

We are sending copies of this report to the Special Inspector General for TARP and interested congressional committees and members, Treasury, the federal banking regulators, and others. The report also is available at no charge on the GAO Web site at http://www.gao.gov.

If you or your staff have any questions about this report, please contact Richard J. Hillman at (202) 512-8678 or hillmanr@gao.gov, Thomas J. McCool at (202) 512-2642 or mccoolt@gao.gov, or Orice M. Williams at (202) 512-8678 or williamso@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who made major contributions to this report are listed in appendix IV.

Gene L. Dodaro
Acting Comptroller General
of the United States

List of Congressional Committees

The Honorable Daniel K. Inouye
Chairman
The Honorable Thad Cochran
Vice Chairman
Committee on Appropriations
United States Senate

The Honorable Christopher J. Dodd
Chairman
The Honorable Richard C. Shelby
Ranking Member
Committee on Banking, Housing, and Urban Affairs
United States Senate

The Honorable Kent Conrad
Chairman
The Honorable Judd Gregg
Ranking Member
Committee on the Budget
United States Senate

The Honorable Max Baucus
Chairman
The Honorable Charles E. Grassley
Ranking Member
Committee on Finance
United States Senate

The Honorable David R. Obey
Chairman
The Honorable Jerry Lewis
Ranking Member
Committee on Appropriations
House of Representatives

The Honorable John M. Spratt, Jr.
Chairman
The Honorable Paul Ryan
Ranking Member
Committee on the Budget
House of Representatives

The Honorable Barney Frank
Chairman
The Honorable Spencer Bachus
Ranking Member
Committee on Financial Services
House of Representatives

The Honorable Charles B. Rangel
Chairman
The Honorable Dave Camp
Ranking Member
Committee on Ways and Means
House of Representatives

Appendix I: Comments from the Department of the Treasury

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

ASSISTANT SECRETARY

March 27, 2009

Thomas J. McCool
Director, Center for Economics
Applied Research and Methods
U.S. Government Accountability Office
441 G Street, N.W.
Washington, D.C. 20548

Dear Mr. McCool:

The Treasury Department (Treasury) appreciates the opportunity to review GAO's latest report on Treasury's Troubled Assets Relief Program, entitled *March 2009 Status of Efforts to Address Transparency and Accountability Issues.* Treasury welcomes the recognition by the GAO that "Treasury has continued to improve the integrity, accountability and transparency of the program" and that "Treasury has continued to take significant steps to address all the recommendations from GAO's December 2008 and January 2009 reports."

In the past two months, Treasury has taken important steps to stabilize financial institutions, launch new programs, monitor existing agreements, and build an operational infrastructure. There is important work ahead, and GAO's recommendations are a thoughtful step forward.

Treasury has made significant progress in the last sixty days to address extraordinary economic challenges. In February, Treasury announced the new Financial Stability Plan, a comprehensive approach to stabilizing the financial system and enabling credit to flow to our communities. This plan includes the following components: 1) the Homeowner Affordability and Stability Plan, designed to help millions of homeowners stay in their homes by reducing their monthly mortgage payments to an affordable level; 2) the Consumer and Business Lending Initiative, which will increase the availability of credit to consumers and businesses; 3) the Capital Assistance Program that will ensure banks have an adequate capital buffer to be able to continue lending during severe downturns; and 4) the Public-Private Investment Program, which will combine public and private financing to help clear banks' balance sheets of legacy assets so they can support new lending. In addition to launching these new programs, Treasury continued to make weekly investments in viable institutions through the Capital Purchase Program.

While taking these aforementioned actions to stabilize the financial system and restore the flow of credit, Treasury remained focused on addressing GAO's recommendations in the last report. Treasury made significant progress in implementing every GAO recommendation, including the following important measures: Treasury hired more staff, strengthened its internal controls framework, improved procedures to oversee contractor performance, and published and expanded its survey on the lending and intermediation activities of banks. Treasury also continued to make progress on the GAO recommendation to improve its communication with the public. Notably, Treasury is finalizing the launch of a new web site, FinancialStability.gov, with a wealth of additional and more user-friendly information designed to more clearly communicate our policies and programs to taxpayers, Congress and various stakeholders. In addition, together with the Department of Housing and Urban Development, Treasury launched a second new web site for homeowners seeking help with their mortgage payments. This web site, MakingHomeAffordable.gov, has had over 3 million visitors since March 19, 2009.

The recommendations in GAO's latest report present a thoughtful way forward, and track several initiatives that Treasury is already undertaking. Treasury agrees that, when intervening to stabilize an institution, the government should maximize protection for taxpayers while ensuring financial stability. Accordingly, on March 26, Treasury proposed important regulatory reforms focused on systemic risk, including a stronger resolution authority to protect against the failure of complex institutions. This would include broad powers, including to renegotiate or repudiate the institution's contracts (including with its employees), and to deal with a derivatives book.

Once again, Treasury appreciates the opportunity to review this report and GAO's thoughtful recommendations. We look forward to demonstrating further progress in your next report.

Sincerely,

Neel Kashkari
Interim Assistant Secretary for
Financial Stability

Appendix II: Status of GAO Recommendations (January 2009 Report)

GAO Recommendation	Status
Expand the scope of planned monthly CPP surveys to include collecting at least some information from all institutions participating in the program.	Implemented
Ensure that future CPP agreements include a mechanism that will better enable Treasury to track the use of the capital infusions and seek to obtain similar information from existing CPP participants.	Partially Implemented
Establish a process to ensure compliance with all CPP requirements, including those associated with limitations on dividends and stock repurchase restrictions.	Partially implemented
Communicate a clearly articulated vision for TARP and how all individual programs are intended to work in concert to achieve that vision. This vision should incorporate actions to preserve homeownership. Once this vision is clearly articulated, Treasury should document needed skills and competencies.	Partially implemented
Continue to expeditiously hire personnel needed to carry out and oversee TARP.	Partially implemented
Expedite efforts to ensure that sufficient personnel are assigned and properly trained to oversee the performance of all contractors, especially for contracts priced on a time-and-materials basis, and move toward fixed-price arrangements whenever possible as program requirements are better defined over time.	Implemented
Develop a comprehensive system of internal control over TARP activities, including policies, procedures, and guidance that are robust enough to ensure that the program's objectives and requirements are met.	Partially implemented
Develop and implement a well-defined and disciplined risk-assessment process, as such a process is essential to monitoring program status and identifying any risks of potential inadequate funding of announced programs.	Partially implemented
Review and renegotiate existing conflicts-of-interest mitigation plans, as necessary, to enhance specificity and conformity with the new interim conflicts-of-interest regulation, and take continued steps to manage and monitor conflicts of interest and enforce mitigation plans.	Partially implemented

Source: GAO.

Appendix III: Treasury's Actions in Response to Our January 2009 Report Recommendations

The U.S. Treasury Department
Summary Response to Recommendations in the January 2009 GAO Report

March 18, 2009

Introduction:
The Treasury Department (Treasury) welcomes the recommendations made by the GAO on the Troubled Assets Relief Program (TARP) in all of its reports, including the 9 most recent recommendations set forth in the GAO's January 2009 report. Treasury has actively kept the GAO apprised of all of its progress on all the GAO recommendations to date, as well as on developments with current and proposed programs and policies under the EESA. The Office of Financial Stability (OFS) continues to make tremendous progress on building the organization and related frameworks and procedures, while simultaneously developing and implementing Treasury's policies to respond to the financial crisis.

This document is Treasury's second Summary Response to the GAO's recommendations, with a specific focus on the recommendations in the January 2009 report. This Summary Reponse provides a written, high level summary of Treasury's progress on the January GAO recommendations and identifies the next steps that Treasury plans to take in these areas.

The March report is structured as follows:

- Identification of the January GAO recommendation
- Summary of Treasury's status on that recommendation at the time of the January GAO Report
- High level illustration of Treasury's progress on the issue to-date
- Identification of Treasury's next steps

GAO Recommendation 1 and Treasury Progress

GAO January Recommendation 1:
Treasury should expand the scope of planned monthly CPP surveys to include collecting at least some information from all institutions participating in the program.

Status at January GAO Report:
In January, Treasury launched a monthly bank lending survey, requesting data on lending and intermediation activities from the 20 largest CPP recipients. Treasury's Office of Financial Stability (OFS) was also working with the federal bank to develop a quarterly process for analyzing the CPP program that would include specific metrics, as well as more in-depth qualitative analysis on topical issues.

High Level Summary of Progress since January GAO Report:

- Treasury expanded the Monthly Intermediation Snapshot surveys to the 21 largest CPP recipients because another large CPP investment was made.
- Treasury published two Monthly Intermediation Snapshot surveys of the largest CPP participants, on February 17 and March 15, 2009. The February Snapshot assesses the lending and intermediation activities of 20 institutions over the fourth quarter of 2008 (October 2008 to December 2008), essentially the period following the launch of the CPP. The March 2009 Snapshot covers the month of January for the 21 largest participants. Going forward the results of the survey will be published on the 15th of each month and cover the activities for the prior month.
- Treasury has worked closely with the federal banking agencies and finalized a data collection template for all CPP recipients beyond the top 21. Treasury is finalizing the process of obtaining clearance from the Office of Management and Budget (OMB) for this survey and expects to send out the data request to the CPP participants this week.
- In the expanded survey, Treasury will require all CPP participants to report on their loans outstanding by total amount and by key categories. As with the Monthly Intermediation Snapshot, these surveys will published monthly at the institution level. The first request will cover data for the months of February and March. The data will be due to Treasury by April 30 and will be published by mid-May.
- Treasury's Quarterly Analysis Project, which it leads in coordination with the 4 federal banking agencies, has advanced into the design stage The project consists of two work streams:

    1. Research that focuses on identifying the specific metrics that will be calculated and tracked for the Quarterly Analysis report. This work stream will leverage work that the banking regulators have already conducted on lending and intermediation activities during past recessions and incorporate that analysis and metrics into the Report.

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2. In-depth qualitative analysis on TARP-related issues, including both exam and research focused. Going forward, this group will coordinate topics of interest to the entire group, ensure that information is shared and conduct research accordingly.

- The quarterly analysis project is holding regular meetings. The first Quarterly Analysis report is scheduled for release on June 30, 2009, and will cover the fourth quarter of 2008 and the first quarter of 2009.

Treasury's Next Steps:

- Small business lending will be added to the Monthly Intermediation Snapshot for the largest CPP recipients beginning with the April 2009 submission, which will be due to Treasury on May 31, 2009.

GAO Recommendation 2 and Treasury Progress

GAO January Recommendation 2:
Treasury should ensure that future CPP agreements include a mechanism that will better enable Treasury to track the use of the capital infusions and seek to obtain similar information from existing CPP participants.

Status at January GAO Report:
The CPP agreements through which Treasury purchases preferred stock in financial institutions do not contain provisions requiring these institutions to report information on their intermediation activities.

High Level Summary of Progress since January GAO Report:

- In January 2009, as noted in the response to Recommendation 1, Treasury initiated a survey of the largest CPP participants regarding their lending and intermediation activities and published 2 Snapshots with results.
- In February 2009, Treasury established the Capital Access Program (CAP). Under the terms of this program, Treasury will require all participating financial institutions to submit a plan outlining their intended use of the capital received through the CAP. If the institution does not meet the goals outlined in its plans, the institution will be required to submit to Treasury a detailed explanation.
- In addition, Treasury will gather data on each institution's lending activity against a pre-established baseline lending level that would have occurred without the capital injection under the CAP. For programs under the Financial Stability Plan, participating financial institutions will submit a monthly report to Treasury outlining the amount of their loans outstanding, both in total and by key category. This amount will be compared to the firms' baseline level. Treasury has met with banking regulators to discuss possible measures and is in the process of finalizing the baseline calculation.
- Treasury will not amend past CPP agreements, but will ask all CPP participants to report lending data to Treasury. See recommendation 1.

Treasury's Next Steps:

- Each month, Treasury will publish the results of its survey of the lending levels of each institution participating in the CAP, along with a comparison against their reported baselines. Institutions that fall short of their baseline will be required to comment on the factors that caused the shortfall.

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GAO Recommendation 3 and Treasury Progress

GAO January Recommendation 3:
Treasury should establish a process to ensure compliance with all CPP requirements, including those associated with limitations on dividends and stock repurchase restrictions.

Status at January GAO Report:
In response to a similar recommendation in GAO's December report, Treasury highlighted its progress in increasing the number of OFS staff and also regulating executive compensation through a second interim rule.

High Level Summary of Progress after the January GAO Report:

- *Compliance*: Since GAO's January report, Treasury made significant progress toward institutionalizing a compliance process for CPP requirements. Notably:

    1. Dividend payments are being monitored, and the process flow for these payments is being documented.
    2. All other requirements have been catalogued, and detailed monitoring procedures for dividend and stock purchase restrictions are being developed and documented.
    3. Treasury is developing requirements for a software application to assist in tracking and reporting on compliance.

- *Executive Compensation*: Significant policy developments have occurred since GAO's second report in the area of executive compensation that have affected executive compensation policies and procedures for TARP. On February 4, the Obama Administration announced strict new restrictions for executive compensation, and, on February 17, President Obama signed into law the American Recovery and Reinvestment Act (ARRA) of 2009. This law amended the executive compensation provisions that apply to recipients of financial assistance under the TARP and imposes significant new limitations. In light of the ARRA:

    1. The executive compensation regulation that Treasury posted just prior to GAO's January report did not take effect
    2. Treasury is preparing a new interim rule to implement the requirements of the ARRA.
    3. Treasury has initiated a process to engage outside vendors to help Treasury implement the executive compensation compliance requirements under ARRA.

- The Office of the Chief Compliance Officer continues to make progress in building its staff.

Treasury's Next Steps:

- Treasury will continue to develop and implement a rigorous compliance program for the CPP, complete the interim rule and finalize the procurement of vendors to help implement our oversight of the compliance requirements.

- The Office of the Chief Compliance Officer will continue to build up its staff

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GAO Recommendation 4 and Treasury Progress

GAO January Recommendation 4:
Treasury should communicate a clearly articulated vision for TARP and how all individual programs are intended to work in concert to achieve that vision. This vision should incorporate actions to preserve homeownership. Once this vision is clearly articulated, Treasury should document needed skills and competencies.

Status at January GAO reports:
Treasury had used reports to Congress, Congressional testimony, and speeches and interviews by senior Treasury officials as a means to keep all stakeholders informed of the program's status and strategy.

Treasury met all of its reporting requirements on time, and posted all reports, speeches and testimony on the EESA website: http://www.treas.gov/initiatives/eesa/. Treasury expanded its outreach to ensure that all stakeholders are informed of TARP program developments as they occur.

- As of January 30, Treasury had published:
    1. 8 transaction reports: http://www.treas.gov/initiatives/eesa/transactions.shtml
    2. 2 tranche reports: http://www.treas.gov/initiatives/eesa/tranche-reports.shtml
    3. 2 section 105 reports: http://www.treas.gov/initiatives/eesa/congressionalreports.shtml
    4. 1 section 102 report: http://www.treas.gov/initiatives/eesa/congressionalreports102.shtml
    5. 1 response to questions from the Congressional Oversight Panel: http://www.treas.gov/press/releases/hp1336.htm
- Treasury officials also participated in Congressional hearings regarding the TARP on December 4 and December 10:
    1. http://www.treas.gov/press/releases/hp1312.htm
    2. http://www.treas.gov/press/releases/hp1322.htm
- Treasury officials also made public remarks on the program's status on 6 occasions:
    1. http://www.treas.gov/press/releases/hp1301.htm
    2. http://www.treas.gov/press/releases/hp1314.htm
    3. http://www.treas.gov/press/releases/hp1321.htm

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4. http://www.treas.gov/press/releases/hp1332.htm
5. http://www.treas.gov/press/releases/hp1347.htm
6. http://www.treas.gov/press/releases/hp1349.htm

High Level Summary of Progress since January GAO Report:

- On February 10, Secretary Geithner publically outlined Treasury's Financial Stability (FSP) Plan, a new, comprehensive strategy to restore stability to the nation's financial system. In his speech, he also addressed Treasury's plan to address home ownership preservation. The Secretary outlined the following goals of the FSP: to restore confidence in the strength of U.S. financial institutions; restart markets critical to financing American households and businesses; and address housing market problems and the foreclosure crisis. As Secretary Geithner outlined, these programs are built upon all of Treasury's actions to stabilize the financial system under the EESA.

- Treasury has launched a reinvigorated public communications initiative designed to more clearly and effectively explain our comprehensive policies to stabilize the financial system and restore the flow of credit to consumer and businesses. One key to this enhanced public outreach effort Treasury's new, revamped website- www.financialstability.gov which will become a one-stop destination for comprehensive information all programs under the EESA and the FSP. The website will provider more user-friendly information on each program and also works to explain how Treasury's programs work in concert to stabilize the system.

- Treasury has also clearly articulated its plans and policies to preserve home ownership. On March 4, Treasury released information and guidelines on the Homeowner Affordability and Stability Plan which will offer assistance to as many as 7 to 9 million homeowners making a good-faith effort to stay current on their mortgage payments, while attempting to prevent the destructive impact of foreclosures on families and communities. The plan will support low mortgage rates through strengthening confidence in Fannie Mae and Freddie Mac, providing up to 4 to 5 million homeowners with new access to refinancing. Additionally, the Homeowner Stability Initiative will provide a comprehensive approach in order to offer reduced monthly payments for up to 3 to 4 million at-risk homeowners.

- Treasury new programs and comprehensive vision for restoring financial stability have been outlined extensively by Secretary Geithner in a number of public forums, including:

    1. Launch of the Financial Stability Plan on February 10
    2. Testimony to the Senate Banking Committee on February 10
    3. Testimony to the Senate Budget Committee on February 11
    4. Statement following the G-7 meeting on February 14

5. Announcement of the Homeownership Affordability and Stability Plan on February 18
6. Testimony to the House Ways and Means Committee on March 3
7. Testimony to the Senate Finance Committee on March 4
8. Testimony to the House Budget Committee on March 5
9. Statements made prior to and during the G-20 Finance Ministers and Central Bank Governors Meeting on March 11
10. March 14 statement following the G20
11. Testimony to the Senate Budget Committee on March12

- Treasury continued to utilize reports to Congress, Congressional testimony, and speeches and interviews by senior Treasury officials as a means to keep all stakeholders informed of the program's status and strategy.
- As of March 13, 2009, Treasury has issued the following reports:
  1. 21 transaction reports: http://www.treas.gov/initiatives/eesa/transactions.shtml
  2. 5 tranche reports: http://www.treas.gov/initiatives/eesa/tranche-reports.shtml
  3. 4 section 105 reports: http://www.treas.gov/initiatives/eesa/congressionalreports.shtml
  4. 1 section 102 report: http://www.treas.gov/initiatives/eesa/congressionalreports102.shtml
- As of March 13, 2009, Treasury officials have participated in Congressional hearings regarding the TARP on:
  1. December 4: http://www.treas.gov/press/releases/hp1312.htm
  2. December 10: http://www.treas.gov/press/releases/hp1322.htm
  3. February 10: http://www.treas.gov/press/releases/tg02102009.htm
  4. February 11: http://www.treas.gov/press/releases/tg02112009.htm
  5. March 3: http://www.treas.gov/press/releases/tg47.htm
  6. March 4: http://www.treas.gov/press/releases/tg50.htm
  7. March 5: http://www.treas.gov/press/releases/tg51.htm

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8. March 11: http://www.treas.gov/press/releases/tg52.htm
9. March 12: http://www.treas.gov/press/releases/tg55.htm

- As of March 13, 2009, Treasury officials also made public remarks on the program's status on 6 occasions:

  1. December 1: http://www.treas.gov/press/releases/hp1301.htm
  2. December 5: http://www.treas.gov/press/releases/hp1314.htm
  3. December 8: http://www.treas.gov/press/releases/hp1321.htm
  4. December 19: http://www.treas.gov/press/releases/hp1332.htm
  5. January 8: http://www.treas.gov/press/releases/hp1347.htm
  6. January 13: http://www.treas.gov/press/releases/hp1349.htm
  7. February 8: http://www.treas.gov/press/releases/tg16.htm
  8. February 10: http://www.treas.gov/press/releases/tg18.htm
  9. February 14: http://www.treas.gov/press/releases/tg27.htm
  10. February 17: http://www.treas.gov/press/releases/tg31.htm
  11. March 11: http://www.treas.gov/press/releases/tg53.htm

- OFS staff works closely with Treasury public affair's office, which has numerous staff specifically dedicated to TARP, FSP, related domestic finance issues and the new website.

- With respect to identifying needed skills and competencies, the OFS is charged with executing the Administration's vision and policies for FSP and TARP within Treasury's Department of Domestic Finance. The OFS has staffed according (see section 5 below).

Treasury's Next Steps:

- Treasury will continue to develop, and launch, the new website www.financialstability.gov, posting detailed information about new and existing programs under the EESA.

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GAO Recommendation 5 and Treasury Progress

GAO January Recommendation 5:
Treasury should continue to expeditiously hire personnel needed to carry out and oversee TARP.

Status at January GAO Report:
The OFS filled or selected candidates for key leadership positions. As of January 15, 2009, OFS had a staff of 88 employees, including 28 long-term staff and 60 detailees. OFS continued to benefit from broad support across the Department of the Treasury and from individuals detailed to the OFS from within Treasury or other federal organizations.

High Level Summary of Progress since January GAO Report:

- As of March 16, 2009, Treasury had increased the number of OFS staff to 113 employees, including 77 long-term staff and 36 detailees. OFS also continues to benefit from the support of an additional 40 to 50 employees from throughout Treasury. Over the past two months, OFS has:

    1. Increased its overall staffing level by 30 percent;
    2. Increased long-term OFS staff by 175 percent; and
    3. Decreased detailee staff by 39 percent.

- The OFS expects to increase overall staffing levels to approximately 195 full-time employees.
- These staffing changes reflect the success of the OFS in shifting from reliance on Treasury staff (outside of OFS) and detailees to a reliance on long-term OFS staff. In the last month alone, OFS has added 23 long-term hires.
- The OFS is developing a formal Workforce Plan that balances the need for high performing, long-term personnel with that of the potential temporary nature of the OFS.
- The OFS has attracted excellent private and public sector candidates; OFS has received thousands of resumes through the OFS website and each job posting through USAJOBS.com generates a high level of interest.
- The OFS has established effective processes for refinement of staffing requirements, development of appropriate vacancy announcements, recruitment strategies and reviewing applications. There is broad involvement of the OFS staff in the recruitment and interviewing process and OFS is actively interviewing candidates for management and staff positions.
- The OFS developed a flexible Workforce Plan and created a bimonthly review process to address competencies, staffing needs, gaps, and changes in program direction

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Treasury's Next Steps:

- The OFS will continue to actively interview and hire candidates for management and staff positions.

GAO Recommendation 6 and Treasury Progress

GAO January Recommendation 6:
Treasury should expedite efforts to ensure that sufficient personnel are assigned and properly trained to oversee the performance of all contractors, especially for contracts priced on a time-and-materials basis, and move toward fixed-price arrangements whenever possible as program requirements are better defined over time.

Status at January GAO Report:
Executives in the OFS and Treasury's Office of the General Counsel managed contract performance. The OFS added additional personnel for procurement management, procurement services, and financial agent management to manage TARP contracts and financial agents. The OFS also continued to design the organizational infrastructure to oversee TARP's contracts and agreements. In addition, contracting officers and OFS staff identified opportunities to transition from labor-hour contracts to firm pricing arrangements where feasible. The Treasury instituted a twice per month contract performance report requirement for OFS procurements, monthly meetings with the financial agent's senior management, and "procurement summit" meetings with broad representation from employees across the Treasury to facilitate requirements planning and contract management. Procurement Services Division (PSD) provided training, support, and recommendations to the OFS with respect to OFS contracts. The OFS committed to complete hiring actions to transition to permanent and more experienced COTRs.

High Level Summary of Progress since January GAO Report:

- Treasury hired an executive Contract Administration Manager who reports to the OFS Chief Operating Officer. His responsibilities include: overseeing the planning of long range requirements, implementing contract management best practices, and providing leadership and guidance to OFS Contracting Officer Technical Representatives (COTRs) and Financial Agent management personnel.

- The OFS transitioned from a model of executive administration for OFS contracts and agreements to the executive oversight of professional COTRs. Trained, certified COTRs are now in place for all OFS contracts. The Contract Administration Manager has instituted weekly roundtable meetings with COTRs to identify significant issues and actions on particular contracts and agreements, facilitate cross-training and professional development of COTRs, and continuously improve the administration and oversight of OFS contracts and agreements.

- The OFS has created a Contract and Agreement Review Board comprised of program and procurement executives; the Board is chartered to monitor contracts and financial agency agreements and ensure sufficient and effective planning, administration, and management.

- Where appropriate, Treasury has begun to shift from time-and-materials based contracts toward fixed-price arrangements. Fixed price arrangements have been negotiated where OFS can accurately estimate the extent or duration of the work associated with a particular, repeatable transaction type. The programs created under the EESA often involve the creation of new financial structures, forms, and transaction sets. These requirements generally are not estimable at the time of contract due to the underlying complexity of the structures and the amount of information available about affected entities during their formulation. Once these structures are operational, Treasury collects data on the level of effort required to execute discrete transactions. The performance data enables Treasury to anticipate costs with a reasonable degree of confidence, allowing for fixed pricing in some circumstances.

- The OFS is designing an on-line Contracting Officer's Technical Representative (COTR) document management structure for contract and agreement administration to ensure consistent and complete documentation of COTR files, standardize processes, and facilitate personnel transition through access to information and shared practices.

Treasury's Next Steps:

- The OFS will continue to build its contract administration staff and infrastructure to ensure effective oversight of the performance of all contracts and agreements.

- The OFS will continue to select the appropriate contract type considering the complexity and the forseeability of the need, as well as capabilities in the commercial marketplace.

GAO Recommendation 7 and Treasury Progress

GAO January Recommendation 7:
Continue to develop a comprehensive system of internal control over TARP, including policies, procedures, and guidance for program activities that are robust enough to ensure that program's objectives and requirements are being met.

Status at January GAO Report:
Treasury had established a framework for internal controls and was initiating planning for its OMB Circular A-123 compliance program, including risk assessments, but had not fully established the governance bodies. Continued progress had been made on documenting the detailed elements of transactions that had occurred to date, particularly in the CPP program. Inputs and assumptions for subsidy cost models were generally documented.

High Level Summary of Progress Since January Report:

- Treasury has made considerable progress in the area of governance. Treasury has formed two governance committees that are actively discussing and prioritizing internal control objectives and providing oversight of the internal control program.

  1. The first is the Executive Committee (EC) chaired by the Assistant Secretary for Financial Stability. The EC serves as the primary management vehicle for OFS and also provides a link between the Treasury and OFS policy makers and the operational execution capabilities within OFS.

  2. The second committee is the Senior Assessment Team (SAT) chaired by the Deputy Chief Financial Officer (CFO). This committee oversees the execution by the OFS of the OMB Circular A-123 program and guides the office's efforts to meet the statutory and regulatory requirements surrounding a sound system of internal controls.

- In addition to the two governance committees, OFS formed a New Program Implementation Team (NPIT) to support the implementation of new programs and to help facilitate communication and ensure the right mix of internal controls is put in place by management. The purpose of this team is to strengthen the ability of the OFS to effectively implement new loan, insurance, asset purchase, and investment programs as they are developed. This cross functional team will serve as a bridge between the governance committee structure of the Executive Committee / Senior Assessment Team and the business and support functions that perform the control activities on a daily basis.

- Similarly, on the area of internal controls, the OFS has taken measurable steps as it continues to build a comprehensive system of internal controls to cover its core program and support functions in tandem with the growth and development of its business model. Initial efforts focused on the various equity and debt purchase transactions, but has since been expanded to include connection points with other Departmental Offices and third party service providers.

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- In compliance with Treasury departmental requirements, the OFS is conducting its own internal OMB Circular A-123 assessment for Fiscal Year (FY) 2009 and will report the results to Treasury through an Annual Assurance Statement signed by the Assistant Secretary for Financial Stability. OFS's Internal Control Program Office (ICPO) will lead the assessment from within the Office of the CFO. The ICPO will drive the development of policies and procedures, document business processes, conduct internal control assessments, evaluate assessment results, monitor and track corrective action plans (CAPs), and report CAP progress to the Senior Assessment Team. A detailed plan for complying with the requirements of OMB Circular A-123 has been created and will form the basis for defining the scope and timing of these efforts.

- In addition to the governance and internal control framework activities outlined above, the OFS continues to build on its efforts related to control activities, information and communication, and ongoing monitoring. Some examples of these efforts include the following.

    1. Within the office of the CFO, the internal control program office actively monitors transactions involving the disbursement of funds from Treasury, including documenting process flows, narratives, and risk and control matrices for key business and support functions.

    2. Staff gather data supporting the execution of controls on a near real-time basis, providing management with confirmation that the transaction controls are being executed as designed.

    3. The internal control program office is currently scoping and planning the assessment of Information Technology (IT) controls related to the important business and support processes across OFS including working with the Bank of New York Mellon to define the requirements for a TARP-specific SAS 70 examination and the timing of the delivery of a Type II report.

- The OFS has prioritized the documentation of policies and procedures for core program and support functions and is finalizing a plan to complete that documentation by June 30, 2009. The OFS recently completed initial policies and procedures for the following areas: 1) Budget Control and Reporting for Program Funds; 2) Credit Reform Modeling; 3) Accruals for Contracts, Inter/Intra-Agency Agreements and Financial Agent Agreements; and 4) Financial Agent Agreements.

- Treasury continues to utilize the outside expertise of PricewaterhouseCoopers in support of the development and execution of its internal controls framework

Treasury's Next Steps:

- As Treasury continues to rapidly establish new programs to stabilize the financial system, the OFS, still a new Department, will continue to monitor and document the operational processes and associated controls for these "start-up" program transactions on a real-time basis. At the same time, the OFS will continue its implementation of a comprehensive

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internal control program, including risk identification, key controls documentation, and effective processes to ensure control objectives are met. The OFS is committed to meeting Treasury and other federal requirements for a sustainable and effective system of internal control.

GAO Recommendation 8 and Treasury Progress

GAO January Recommendation 8:
Treasury should develop and implement a well-defined and disciplined risk-assessment process, as such a process is essential to monitoring program status and identifying any risks of potential inadequate funding of announced programs.

Status at January GAO Report:
Treasury was developing a risk assessment process, but it was informal and not fully documented.

High Level Summary of Progress since January GAO Report:

- The OFS has begun implementation of a well-defined risk assessment process. The process includes a number of steps, including the following:

    1. setting internal operational objectives;
    2. setting risk and other objectives;
    3. identifying major risks and assigning responsibilities;
    4. designing and implementing risk mitigation actions;
    5. monitoring and reporting on risks;
    6. testing risk mitigation actions.

- An Executive Committee and Senior Assessment Team have been established to implement this risk-assessment process. In addition to its other management duties, the Executive Committee has responsibility over setting objectives (e.g., internal, operational, risk, and establishing risk priorities. The Senior Assessment Team, together with the OFS operational units, identifies major risks, designs and implements risk mitigation activities, monitors and reports on risks, and works with the CFO's staff to test risk mitigation actions.

- OFS is undertaking a robust risk identification and assessment process, which is a combination of top-down and bottom-up processes.

    1. *Top Down Process*: Each area within OFS has identified first cut high level risks. This will be refined further over the coming weeks to ensure that all current Joint Chiefs and their Deputies have a chance to provide input on any potential risks to the program..
    2. *Bottom- Up Process*: This process builds on the OMB Circular A-123 control process. OFS is using the GAO checklist process as a way of identifying more granular risks from a variety of sources. The interview process will be

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substantially completed by March 13, 2009. The risk office will synthesize this data to develop a picture of potential risks.

Next Steps:

- Once this initial assessment is complete, the Executive Committee will prioritize the risks and assign responsibility for addressing them. The operating areas, in conjunction with the Risk Office, will develop action plans to quickly put the necessary mitigating actions into place.
- This will be an ongoing process, with formal Executive Committee risk oversight meetings occurring monthly.

GAO Recommendation 9 and Treasury Progress

GAO January Recommendation 9:
Treasury should review and renegotiate existing conflict-of-interest mitigation plans, as necessary, to enhance specificity and conformity with the new interim conflicts of interest regulation, and take continued steps to manage and monitor conflicts of interest and enforce mitigation plans.

Status at January GAO Report:
When GAO issued its last report, Treasury had just published its interim final regulations on conflicts of interest. These regulations describe formal steps for identifying, monitoring, and mitigating conflicts of interest during the procurement process and over the contract's term. Prior to these regulations, Treasury controlled conflicts by implementing conflicts guidelines and the Federal Acquisition Regulation.

High Level Summary of Progress after the January GAO Report:

- The compliance office has reviewed all existing contracts and financial agency agreements for conformity with the interim rule on conflicts of interest. Treasury executed nine contracts that contained conflicts mitigation plans before the interim rule took effect. Treasury reviewed all nine, renegotiated the conflicts provisions on two of them, and continues negotiations on four others. Treasury is not renegotiating the terms of the three remaining contracts because they are scheduled to expire shortly. These contracts, however, conform to the conflicts guidelines that were in place prior to the interim rule.

- Treasury has procedures in place to monitor conflicts of interest with contractors and financial agents. The compliance office currently devotes over two full-time employees to conflicts issues that arise with new and existing contracts and financial agency agreements; additional contracting personnel at Treasury also work on these issues.

- In addition to discussions on particular issues, Treasury meets bi-weekly by telephone or in person with our contractors and financial agents to discuss any conflicts issues on the horizon. When a potential conflict does arise in an existing contract, the compliance office takes a standard approach to evaluating the potential conflict and feasibility of mitigation measures.

Treasury's Next Steps:

- Treasury will analyze the interim final conflicts rule and any comments received with respect to the rule and will work to finalize the rule as soon as possible.

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Appendix IV: GAO Contact and Staff Acknowledgments

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