



Financial Services Regulatory Practice

Regulatory Practice Letter

ADVISORY

RPL Number 09-17

First Quarterly Report to Congress released by the Special Inspector General for the Troubled Asset Relief Program - SIGTARP

Executive Summary

The Special Inspector General for the Troubled Asset Relief Program ("SIGTARP") publicly released its first *Quarterly Report to Congress* ("Report") on April 21. The Report documents the progress of the Troubled Asset Relief Program ("TARP"), as well as SIGTARP's execution of its oversight responsibilities, through March 31, 2009. It also provides a number of recommendations to the Department of the Treasury ("Treasury") regarding administration of the TARP, including several related to concerns over the risk of fraud from the Treasury's Term Asset-Backed Securities Lending Facility ("TALF"), the Public/Private Investment Fund ("PPIF") and the Making Home Affordable mortgage modification program. Further, the Report includes an update on SIGTARP's request of TARP fund recipients to provide an explanation of their use of the TARP funds, and also the application of the executive compensation requirements to TARP fund recipients.

Background

SIGTARP was created by the *Emergency Economic Stabilization Act of 2008* ("EESA") to conduct, supervise and coordinate audits and investigations of any program established by the Treasury under EESA, which includes the TARP. Further, EESA mandates SIGTARP to provide periodic reports to Congress, which are to include detailed progress reports and program data.

SIGTARP released its *Initial Report to Congress* on February 6 with information current through January 23, 2009. SIGTARP's first *Quarterly Report to Congress* provides updates on the TARP programs that had been announced as of the Initial Report, SIGTARP's previous recommendations to Treasury, and also presents a new set of recommendations for TARP Programs.

EESA authorized the Treasury to spend \$700 billion through TARP. (Please refer to *RPL 09-05, Financial Institution Accountability for Use of TARP Funds*, and *RPL 09-11, SIGTARP Initial Report to Congress*, for additional information.).

Subject:
First Quarterly Report to the Congress

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Description

SIGTARP's Report includes: (1) explanations of the various TARP programs and details of the Treasury's use of those programs through March 31, 2009; (2) a description of SIGTARP's activities since its Initial Report, and; (3) a series of recommendations for the operation of TARP.

TARP Programs

Thus far, Treasury has allocated \$590.4 billion of the \$700 billion in TARP funding authorized by EESA through 11 separate programs. These programs include the:

(Authorized prior to January 23, 2009)

- Capital Purchase Program ("CPP");
- Targeted Investment Program;
- Systemically Significant Failing Institution Program;
- Asset Guarantee Program
- Automotive Industry Financing Program,

(Authorized after January 23, 2009)

- Term Asset-Backed Securities Lending Facility;
- Auto Supplier Support Program;
- Unlocking Credit for Small Businesses Program;
- Making Home Affordable Program;
- Public-Private Investment Program; and
- Capital Assistance Program ("CAP").

The most significant investment of TARP funds, \$218 billion, has been made in the CPP, though the funding for the CAP, which is directly related to the recently completed "stress tests" but may also be applied for by institutions not subject to the stress tests, has yet to be determined. Nearly \$110 billion remains available for this and other new programs or to increase funding to existing programs.

TARP Reporting

Beginning February 5, 2009 SIGTARP surveyed the 364 TARP fund recipients that existed on January 30, 2009 regarding their use of the TARP funds. As of March 23, 2009 all 364 recipients had provided responses. In general, the responses indicated the funds:

- Were used in a variety of ways including strengthening capital, retiring debt, purchasing mortgage-backed securities ("MBS"), increasing credit lines and making loans; and
- Had had an impact on lending to the extent the funds permitted institutions to either increase their lending or enhanced their capital levels enough to maintain their level of lending,

The Report also noted that Treasury has indicated it will not adopt SIGTARP's earlier recommendation to require all TARP recipients to account for their use of TARP funds and provide a report to Treasury. SIGTARP, however, continues to list this as a recommendation.

SIGTARP notes that some survey responses also indicated a level of frustration with the changing requirements for compliance with the executive compensation restrictions. SIGTARP recommends that Treasury expedite its release of implementing regulations for these requirements.

A preliminary report summarizing the responses is expected to be released in June 2009 with a complete report due to Congress by September 1, 2009.

SIGTARP Activities

SIGTARP has both investigative and audit functions. With regard to

investigations, SIGTARP has initiated nearly 20 criminal investigations based on tips received through its Hotline. Further, SIGTARP has created a multi-agency task force to deter, detect, and investigate any instances of fraud or abuse to prevent any efforts to profit criminally from the TALF. Member organizations participate in regular briefings to collectively identify areas of fraud vulnerability, engage in the training of agents and analysts with respect to the issues surrounding the program, and serve as points of contact for leads. (Please refer to RPL 09-14 for more information on the TALF.)

With regard to audits, SIGTARP is in the process of conducting six audit examinations that consider:

- Based upon the February survey, how TARP fund recipients as of January 30, 2009 have used their TARP funds.
- Based upon the February survey, how TARP fund recipients as of January 30, 2009 are implementing controls with respect to applicable executive compensation restrictions.
- An examination of Treasury's decision making regarding the first nine institutions to receive TARP funding, as well as an evaluation of the review and approval processes associated with TARP assistance provided to one of those institutions under three different TARP programs.
- Whether, or to what extent, external parties may have sought to influence decision making by Treasury or bank regulators in considering and deciding on applications for funding from individual banks seeking TARP funds.

- Federal oversight of executive compensation requirements, with a particular focus on one TARP fund recipient's recent payouts of large bonus payments.
- One TARP fund recipient's counterparty payments made to financial institutions, including foreign institutions and other TARP recipients, at full face value.

New Authorities

On April 24, the President signed S.383, the *Special Inspector General for the Troubled Asset Relief Program Act of 2009*, into law. The bill amends EESA to give SIGTARP new authorities and responsibilities. Among other things, the bill provides that:

- SIGTARP has the authority to conduct, supervise and coordinate audits and investigations of any activity established under EESA;
- The Treasury is required to address deficiencies identified by SIGTARP or certify to Congress that no action is needed; and
- SIGTARP must provide a report to Congress on how TARP recipients have used their funds by September 1, 2009.

Recommendations

In the Report, SIGTARP details instances in which Treasury has addressed recommendations made since the Initial Report, and makes a series of new recommendations including:

- **Use of Funds:** Require all TARP recipients participating in all TARP Programs to report on their actual use of TARP funds.
- **Expansion of TALF:** Diminish the risk of fraud from the expansion of TALF-eligible collateral to include certain residential mortgage-backed

securities ("RMBS") by: requiring a security-by-security screening for legacy RMBS; rejecting collateral if the loans backing particular RMBS do not meet certain baseline underwriting criteria or are in categories that have been proven to be fraudulent; and, requiring significantly higher haircuts for all MBS, with particularly high haircuts for legacy RMBS.

- **PIIP Fraud Vulnerabilities:** Diminish the risks of fraud, waste and abuse by: imposing strict conflict-of-interest rules upon Public-Private Investment Fund ("PIIP") fund managers; mandating transparency with respect to the participation and management of PIIPs (including disclosure of the beneficial owners of the private equity stakes in the PIIPs and of all transactions undertaken in them); and, establishing investor-screening procedures for all PIIP fund managers, including comprehensive "Know Your Customer" requirements at least as rigorous as that of a commercial bank or retail brokerage operation.
- **Interaction between PIIP and TALF:** Diminish the risk of diluting the private investors' personal stake in Legacy Securities PIIPs by prohibiting their ability to invest in the TALF unless significant mitigating measures are included to address the dilution, such as prohibiting the use of leverage for PIIPs investing through the TALF or proportionately increasing haircuts for PIIPs that do so.
- **Mortgage Modification Program:** Prevent fraud in the Making Home Affordable Program by building certain fraud protections into the mechanics of the program and

educating homeowners about the nature of the program,

KPMG Commentary

Institutions that have received TARP funding are under intense reputational scrutiny in a variety of activities such as finance, compensation, discretionary spending, loan origination and loss mitigation. The first quarter of 2009 saw many institutions express the desire to repay TARP money in an effort to avoid the public attention, though in order to do so, they must apply to the Treasury and receive permission from their bank supervisor.

TARP recipients are beginning to be examined by the banking regulators for their TARP reporting and control framework.

As TARP-recipients have begun to report their activities on an ongoing basis to Treasury, many institutions are realizing the complexities involved due to:

- Governance demands with Board and shareholders needs;
- Multiple party coordination, including Legal, Finance, Compliance, Consumer/Mortgage Lending, Treasury, Internal Audit, External Communications, Human Resources and Regulatory Relations;
- Reporting controls, including varying definitional terms, multiple data sources and systems, lack of clear policies and procedures and reconciliation to other public and internal data reporting;
- Regulatory relations, including coordination with TARP regulatory expectations and other ongoing and ad hoc regulatory requests;

- Testing/Audit, including the need to test TARP processes and accuracy in program governance, reporting and certification controls;
- The fungible nature of capital and ability to create separate fund accounts with TARP funds; and
- The application of executive compensation restrictions, including the associated governance and controls.

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