Audit Report

OIG-12-061

Treasury's Financial Agent Selection Process for the Agency Mortgage Backed Securities Purchase Program Was Not Fully Documented

July 31, 2012

Office of Inspector General

DEPARTMENT OF THE TREASURY

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Abbreviations

CFR	Code of Federal Regulations
FAA	financial agency agreement
FHFA	Federal Housing Finance Agency
Fannie Mae	Federal National Mortgage Association
Freddie Mac	Federal Home Loan Mortgage Corporation
GSE	government-sponsored enterprise
HERA	Housing and Economic Recovery Act of 2008
HFA	Housing Finance Agency
JAMES	Joint Audit Management Enterprise System
MBS	mortgage backed securities
NDA	non-disclosure agreement
NIBP	New Issue Bond Program
TCLP	Temporary Credit and Liquidity Program
U.S.C.	United States Code

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July 31, 2012

Mary John Miller
Under Secretary for Domestic Finance

Section 1117 of the Housing and Economic Recovery Act of 2008 (HERA)[1] authorized the Secretary of the Treasury to purchase obligations and securities issued by the Federal National Mortgage Association (Fannie Mae), the Federal Home Loan Mortgage Corporation (Freddie Mac), and the Federal Home Loan Banks.[2] Treasury's authority to make these purchases ended December 31, 2009. Section 1117 also authorized Treasury to sell or otherwise exercise any rights received in connection with these purchases, at any time.

The Agency Mortgage Backed Securities (MBS) Purchase Program is one of several programs that Treasury established under its HERA authorities.[3] Under this program, in its response to the financial crisis, Treasury purchased and sold through financial agents, MBS guaranteed by Fannie Mae and Freddie Mac (these securities are commonly referred to as "agency MBS"). In total, before its purchase authority expired, Treasury acquired $225 billion of agency MBS. In light of improved market conditions, Treasury started to sell its agency MBS in March 2011. On March 19, 2012, Treasury announced the

[1] Pub.L. 110-289
[2] Fannie Mae, Freddie Mac, and the Federal Home Loan Banks are government-sponsored enterprises (GSE). The GSEs are corporations chartered by Congress. As originally conceived, the GSEs were chartered to: provide stability in the secondary market for residential mortgages; respond appropriately to the private capital market; provide ongoing assistance to the secondary mortgage market by increasing the liquidity of mortgage investments and improving the distribution of investment capital available; promote access to mortgage credit throughout the nation; and manage and liquidate federally-owned mortgage portfolios in an orderly manner.
[3] In addition to the Agency MBS Purchase Program, Treasury established the Housing Finance Agency (HFA) Initiative and entered into Senior Preferred Stock Purchase Agreements with the GSEs. These programs are detailed in appendix 2.

completion of its sale of remaining agency MBS and reported that overall, cash returns of $250 billion were received from the agency MBS portfolio through sales, principal, and interest.

This report presents the results of our audit of Treasury's selection of financial agents for the Agency MBS Purchase Program. As part of the audit, we assessed Treasury's process for (1) determining the services to be carried out by financial agents and (2) selecting and awarding contracts to financial agents. To accomplish our objectives, we obtained and reviewed Treasury's documentation of the financial agent selection process and interviewed officials involved with the selections. We also reviewed laws and regulations on the use of financial agents. Appendix 1 details our objectives, scope and methodology; appendix 2 provides the background information for the audit; and appendix 3 presents a chronology of significant events pertaining to Treasury's use of its HERA authorities as it relates to the Agency MBS Purchase Program.

In brief, we found that Treasury lacked written policies and procedures for selecting financial agents, and did not fully document its decision-making process. Even so, we found that the approach used for selecting financial agents for the Agency MBS Purchase Program, as described by Treasury officials, was reasonable. In addition, according to Treasury officials, in the midst of the rapidly developing economic crisis at the time, a deliberate management decision was made to apply resources to other financial stability programs rather than to produce documentation for the financial agent selection process. While we understand the pressures facing the very small group of people involved in the selection process, we believe that a basic tenet of government accountability is maintaining complete and appropriate documentation and doing so is in the best long-term interest of the Department, should, at a later date, it want to repeat its actions or they be called into question. In this regard, appropriate documentation can be as simple as contemporaneous notes that provide a record of why decisions were made, the way they were made, and how the government satisfied itself as to whether it obtained the necessary services at a reasonable cost.

Accordingly, we recommend that Treasury develop written policies and procedures for selecting financial agents that will, among other things, require timely documentation of the selection process.

In a written response, Treasury management generally agreed with the recommendation and stated that they are moving to develop written policies and procedures. The management response is included as appendix 4 of this report.

Results of Audit

Treasury's Financial Agent Selection Process Was Not Fully Documented

Treasury's use of financial agents does not constitute a procurement contract under the purview of the Federal Acquisition Regulation. In this regard, the Secretary of the Treasury has broad authority in selecting financial agents.[4] 31 CFR part 202, *Depositaries and Financial Agents of the Federal Government*, provides that financial agents of the Federal government be insured depositaries that can perform specific services on behalf of the U.S. Treasury. The types of services that a financial agent may perform are described in appendix 2 of this report.

In August 2008, Treasury officials began the financial agent selection process with a list provided by Morgan Stanley of the 20 largest fixed-income asset-managing companies in the U.S.[5] After conducting their own research, in less than a week Treasury officials developed a smaller list of 10 fixed-income

[4] Financial agent designation authority is provided in 12 U.S.C. § 90, *Depositaries of public moneys and financial agents of Government*, and 12 U.S.C. § 265, *Insured banks as depositaries of public money; duties; security; discrimination between banks prohibited; repeal of inconsistent laws*. 12 U.S.C. § 90 provides that the Secretary of the Treasury may select financial agents in accordance with any process the Secretary deems appropriate.

[5] Morgan Stanley was hired by Treasury to advise senior Treasury officials on the condition of the GSEs and the housing finance markets. It provided Treasury a list of the largest fixed-income asset managing companies to aid in the financial agent selection process.

managers with particular expertise in MBS portfolios, and requested that all 10 companies sign a non-disclosure agreement (NDA). Once the NDAs were signed and returned, the 10 asset-managing companies received a program description with a request for a written proposal. Treasury received detailed proposals from 7 of the 10 companies it contacted. Treasury officials reviewed the proposals and then held telephone and face-to-face interviews with representatives from 5 of the companies of the 7 companies that submitted proposals (the other 2 companies had been eliminated by Treasury because they did not meet eligibility criteria). After the interviews, Treasury officials eliminated another company after that company's representation and warranty responses demonstrated that it did not meet the program criteria for deposit insurance. Treasury selected 2 of the remaining 4 companies—State Street Bank and Trust Company (State Street) and the New York Branch of Barclays Bank P.L.C. (Barclays)—as the financial agents for asset management services for the MBS Purchase program.[6]

Treasury officials explained that it was prudent to have more than one asset manager so that (1) no single financial agent would be aware of Treasury's full market involvement and (2) Treasury could obtain more market information. Treasury offered a fee structure to the 2 companies that were selected that was lower than what any of the 7 companies had proposed. Both State Street and Barclays agreed to accept the lower fee rate structure and signed FAAs with Treasury on September 15 and September 18, 2008, respectively.

Treasury also hired JPMorgan Chase Bank N.A. (JPMorgan Chase) as the custodian. JPMorgan Chase was selected on a sole source basis because of its prior custodial experience and familiarity with Treasury operations. JPMorgan Chase signed a FAA for custodial and accounting services on September 18, 2008. As of the quarter ended December 31, 2011, the three financial agents have been paid approximately $69.6 million, for

[6] Section 13 of the financial agency agreements (FAAs) for asset management services allowed both State Street and Barclays to use its affiliates, State Street Global Advisors and Barclays Global Investors, to perform services under the FAA.

services under the Agency MBS Purchase Program and for Treasury's HFA Initiative.[7]

Treasury evaluated policy options for supporting the MBS market, decided to implement a purchase program, created a competitive bidding process, selected financial agents, and stood up the Agency MBS Purchase Program in a very short period of time—less than a month. The policy deliberations and selection process began in late August 2008; the program was announced by the Treasury Secretary on September 7, 2008, concurrent with the public announcement by FHFA that Fannie Mae and Freddie Mac had been placed into conservatorship, and; by September 18, 2008, the selection of financial agents was complete. Treasury did this without having policies and procedures in place to document its selection decisions. While the efforts to accomplish the tasks in such a short period of time are noteworthy, we found that Treasury officials did not document their decision making process. Specifically, Treasury officials did not document how they evaluated the asset-managing companies initially identified by Morgan Stanley or the written proposals that were eventually reviewed. The officials did not document the method they used to move from the initial list of 20 asset-managing companies down to the 10 that were asked to sign a NDA, and ultimately down to the 2 that were selected. Even when Treasury received written proposals and other presentation materials from the bidders, the Treasury officials involved in the selection process did not annotate why they preferred one bidder over another. When asked how they made the final selections, the Treasury officials told us that both State Street and Barclays made presentations that best addressed the program's objectives. However, they did not describe in writing how the companies better addressed the program's objectives over the others.

[7] The amounts paid to the individual financial agents, as of December 31, 2011, are as follows: (a) State Street - $46.7 million, (b) Barclays - $9.8 million, and (c) JPMorgan Chase - $13.1 million. Treasury's FAA with Barclays was terminated in December 2009 at the expiration of Treasury's authority to purchase Agency MBS. At that time, the remainder of the Barclays portfolio was transferred to State Street. The FAAs with State Street and JPMorgan Chase were amended in 2009 to include services for Treasury's HFA Initiative (see appendix 2 for further information on the HFA Initiative). Barclays did not provide any services for Treasury's HFA Initiative.

Treasury officials we interviewed told us that the selection process had to be completed in a very short period of time. During that time, they had to contact the potential bidders, request and evaluate their proposals, make selections, and develop the FAAs. We were told that only two people handled the majority of the work, and based on management decisions to use staff on other financial stability programs during the fast-moving events at the time, they (consciously) did not take the time to document their reasons for selection decisions. Treasury officials also stated that due to the sensitivity of the program operation, in that premature disclosure could have had global market consequences, they were instructed by the then Secretary of the Treasury to limit the number of staff involved in the financial agent selection process.

Internal control standards in the federal government provide that internal control and all transactions and other significant events need to be clearly documented, and the documentation should be readily available for examination. The requirement for documentation should appear in management directives, administrative policies, or operating manuals and may be in paper or electronic form. All documentation and records should be properly managed and maintained.[8]

Treasury's documentation requirements are prescribed in Treasury Directive Publication 80-05, *Records and Information Management Program*, which states that all program officials shall create and maintain adequate and proper documentation of the program for which they are responsible. This means a record of the conduct of government business that is complete and accurate to the extent required to document the organization, functions, policies, decisions, procedures, and essential transactions of their office and to protect the legal and financial interest of the government and of persons directly affected by the activities of their office.

[8] U.S. Government Accountability Office, *Standards for Internal Control in the Federal Government*, November 1999.

Treasury officials told us that they considered these internal control criteria as more applicable for normal program operations and that the problems they faced in September 2008, during the time of this program's inception, were extraordinary. Treasury officials added that taking time to satisfy procedures that normally apply to administrative management would be counter-productive in meeting the Department's far more important responsibilities at the height of the crisis. While we understand the difficult and exigent decisions made during the extraordinary situation, we do not believe documentation would have taken that much time or resources, especially if the notion of documentation were a common program management practice.

In conclusion, Treasury officials described a selection process for the financial agents that provided a competitive selection process at a lower cost than the potential asset managers proposed and were thus successfully able to launch the Agency MBS Purchase Program in a very short period of time. However, Treasury did not fully document the selection process due to management decisions on what it believed to be the best use of personnel at the time. As a result we could not fully substantiate the appropriateness of the selections. As mentioned above, acceptable documentation can be as simple as contemporaneous notes that provide a record of why decisions were made, the way they were made, and how the government satisfied itself as to whether it obtained the necessary services at a reasonable cost.

Recommendation

We recommend that the Under Secretary for Domestic Finance ensure that written policies and procedures are developed for selecting financial agents. These policies and procedures should, among other things, require documentation supporting all key events and decisions.

Management Response

Treasury management generally agreed with the recommendation and stated that they are moving to develop written policies and procedures. Management noted that the policies and procedures will provide flexibility for times of exigent circumstances, such as periods of economic and financial distress.

OIG Comment

Management's response meets the intent of our recommendation. However, the response did not specify the target date for completing the planned action. The Office of Domestic Finance will need to establish a target date in the Joint Audit Management Enterprise System (JAMES).[9] While we acknowledge management's position regarding exigent circumstances, we do want to emphasize the importance of documenting key events and decisions as they occur, even in such circumstances.

* * * * *

We appreciate the courtesies and cooperation provided to our staff during the audit. If you wish to discuss the report, you may contact me at (202) 927-6516 or Michael Maloney, Audit Director, at (202) 927-6512. Major contributors to this report are listed in appendix 5.

/s/
Marla A. Freedman
Assistant Inspector General for Audit

[9] JAMES is the Department of the Treasury's audit recommendation tracking system.

The objective of this audit was to evaluate Treasury's decision to use the financial agents' services to purchase agency mortgage backed securities. Specifically, we assessed the process for (1) determining the services to be carried out by financial agents, and (2) selecting and awarding contracts to financial agents.

To accomplish the objective, we

- reviewed pertinent laws, regulations and federal guidelines, including those related to Treasury's authorities to use financial agents;

- obtained and reviewed documents provided by Treasury Office of Domestic Finance officials related to the financial agent selection process, including written proposals, non-disclosure agreements, financial agent agreements, presentation materials, and various correspondence between Treasury and the bidders;

- interviewed Treasury Office of Domestic Finance officials involved in the financial agent selection process and senior management and staff of the financial agents.

We conducted our fieldwork from May 2011 through January 2012 at the Department of the Treasury in Washington, D.C.

We conducted this performance audit 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 objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

Treasury Housing and Economic Recovery Act Programs

In the midst of a rapidly deteriorating mortgage market that threatened the soundness of Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac), Congress passed the Housing and Economic Recovery Act (HERA) in July 2008. HERA was a first step to address immediate and long-term concerns in the housing market. Among many things, HERA created the Federal Housing Finance Agency (FHFA), with enhanced regulatory authority over the government-sponsored enterprises (GSEs), and provided the Secretary of the Treasury with certain purchase authority for GSE obligations to provide stability to the financial markets, prevent disruptions in the availability of mortgage finance, and protect the taxpayer. After determining that Fannie Mae and Freddie Mac could not continue to operate safely and soundly and fulfill their critical public mission, the FHFA Director placed the two GSEs into conservatorship on September 7, 2008.[10]

Pursuant to the authorities provided to the Secretary of the Treasury under HERA, Treasury established programs and initiatives for the purposes of stabilizing the housing market and ensuring the continued availability of mortgage credit.

<u>Senior Preferred Stock Purchase Agreements</u>

Treasury entered into Senior Preferred Stock Purchase Agreements with Fannie Mae and Freddie Mac to provide capital support to the GSEs, as necessary, thereby minimizing potential systemic financial risks associated with their deteriorating financial condition. These agreements require that Treasury provide funding to the GSEs if at the end of any calendar quarter their total liabilities exceed total assets (deficiency amounts). The requests for funds must be made in writing by the FHFA in its role as the conservator. The maximum amount available to each GSE under the agreements are currently based on a formulaic cap which adjusts upwards for quarterly

[10] A conservatorship is a legal process in which a person or entity is appointed to establish control and oversight of a company to put it in a sound and solvent condition. In a conservatorship, the powers of the company's directors, officers, and shareholders are transferred to the designated conservator. In the instances of Fannie Mae and Freddie Mac, FHFA was appointed by its Director to be the conservator.

deficiencies through December 31, 2012, and will be decreased by any surplus realized in the last quarter. At that time, the cap will set at no less than $200 billion for each GSE. The GSEs may continue to draw funds until the maximum available amount set at December 31, 2012, is depleted. As of March 31, 2012, Treasury has funded the GSEs a total of $187 billion covering deficiency amounts through December 31, 2011.

Agency Mortgage Backed Securities (MBS) Purchase Program

The Agency MBS Purchase Program allowed Treasury, through two financial agents, to purchase agency MBS in the open market. The financial agents were also authorized to enter into other trade/sell transactions. By purchasing these credit-guaranteed securities, Treasury sought to broaden access to mortgage funding for current and prospective homeowners and to promote stability in the mortgage market. The size and timing of the MBS purchases were subject to the discretion of Treasury up to the sunset of the Treasury's purchase authority. From the inception of the program in September 2008 through the expiration of the purchase authority in December 2009, Treasury purchased MBS worth approximately $225 billion. Disposal of the MBS portfolio began in March 2011, and Treasury announced on March 19, 2012, that it had completed the disposition of its agency MBS portfolio. Treasury reported that overall, cash returns of $250 billion were received from the agency MBS portfolio through sales, principal, and interest, which was $25 billion more than the initial investment.

Housing Finance Agency (HFA) Initiative

On February 18, 2009, the President announced the Homeowner Affordability and Stability Plan. One component of this plan was to work with Fannie Mae and Freddie Mac to support state HFAs, which, due to market conditions, were experiencing a number of challenges in providing homebuyers with affordable mortgage options. The HFAs' challenges included lack of liquidity, credit and cash flow concerns, and a lack of investors to purchase new mortgage revenue bonds. The HFA Initiative is comprised of two programs, the Temporary Credit and Liquidity Program (TCLP) and the New Issue Bond Program (NIBP), which are supported by Treasury's purchase of obligations and securities issued by Fannie Mae and Freddie Mac. Together, these programs are intended to bring market stability and support the HFAs in providing single and multifamily mortgages. Through the NIBP, Treasury purchased $15.3 billion of securities issued by the GSEs that are backed by new mortgage revenue bonds issued by participating state and local HFAs. The purpose of NIBP is to allow state and local HFAs to continue issuing bonds creating new mortgage funding. Through the TCLP, Treasury committed $8.2 billion for a participation interest in the credit facilities established by the GSEs to support the existing variable rate demand obligations market. As of December 31, 2011, there had been no draw requests or disbursements from the TCLP.

One of the goals of the HFA Initiative is to transition HFAs back to the private market for capital. The fees for HFAs to use the TCLP increase over time to encourage the HFAs to make the transition as quickly as possible. Treasury's authority to enter additional purchase commitments under the NIBP and TCLP expired on December 31, 2009, and the programs were set to expire on December 31, 2010, and December 31, 2012, respectively. However, given the slower than expected recovery of the housing market and current market conditions, the NIBP program was extended twice and is set to expire on December 31, 2012. The TCLP was extended through December 31, 2015.

Financial Agent Selection

The National Bank Acts of 1863 and 1864 granted Treasury the authority to retain financial agents to provide services on its behalf.[11] Financial agents have the fiduciary obligation to protect the interests of the U.S. In addition to the financial agents used under the HERA initiatives, Treasury has 13 active Financial Agency Agreements (FAAs) worth approximately $722.5 million in total compensation related to its Emergency Economic Stabilization

[11] As discussed in footnote 4, financial agent designation authority is provided in 12 U.S.C. § 90 and 12 U.S.C. § 265.

Act of 2008 authorities and is seeking financial agents for asset management services for its Small Business Lending Fund.

Treasury's use of financial agents does not constitute a procurement contract under the purview of the Federal Acquisition Regulation. 31 CFR part 202 provides financial agent eligibility criteria. The criteria require that financial institutions are insured by the Federal Deposit Insurance Corporation and that credit unions are insured by the National Credit Union Administration. The criteria also outlines specific services that a financial agent must be able to perform, including accepting deposits covered by the appropriate Federal or state insurer, maintaining official accounts with balances above applicable insurance coverage, maintaining accounts in the name of the U.S. Treasury, and accepting deposits for credit to the U.S. Treasury. A financial agent must also be able to pledge collateral security as required by Treasury.

Treasury officials selected two financial agents for asset management services and one financial agent for custodian and accounting services for its Agency MBS Purchase Program. The agreements with the two of the three financial agents were also amended to include the services for the HFA Initiative. The following is a breakdown of the selected financial agents and services to be provided.

**State Street Bank and Trust Company (State Street),
State Street Global Advisors (corporate affiliate)**

State Street entered into an agreement with Treasury on September 15, 2008, to provide asset management services, to include acquisition, management, servicing, and accounting, for a portfolio of agency MBS. The agreement provided for an annual compensation rate of 3 basis points on the first $5 billion of assets under management, 2 basis points on the next $5 billion, and 1 basis point on assets under management above $10 billion. State Street was also paid 0.5 basis points for management of the agency MBS portfolio transferred from Barclays at the termination of Barclay's agreement with Treasury effective December 31, 2009. State Street remained the sole manager of the agency MBS portfolio through the completion of the portfolio's disposition in

March 2012. State Street also provided asset management services for Fannie Mae and Freddie Mac securities under the HFA Initiative, and was compensated under a similar 3-2-1 basis point fee structure for the first $10 billion under management, the next $10 billion, and above $20 billion under management. As of December 31, 2011, State Street had received total compensation of $46.7 million for its asset management services for the Agency MBS Purchase Program and HFA Initiative.

**New York Branch of Barclays Bank PLC (Barclays),
Barclays Global Investors NA (corporate affiliate)**

Barclays entered into an agreement with Treasury on September 18, 2008, to provide asset management services, to include acquisition, management, servicing, and accounting, for a portfolio of agency MBS. The agreement provided for an annual compensation rate of 3 basis points on the first $5 billion of assets under management, 2 basis points on the next $5 billion, and 1 basis point on assets under management above $10 billion. Barclays served as a financial agent during the agency MBS purchase period but was not used for services under the HFA Initiative. Treasury terminated its agreement with Barclays on December 31, 2009, and Barclays' agency MBS portfolio was transferred to State Street. Barclays received total compensation of $9.8 million for its asset management services.

**JPMorgan Chase Bank NA (JPMorgan Chase),
JPMorgan Investor Services Co. (corporate affiliate)**

JPMorgan Chase entered into an agreement with Treasury on September 18, 2008, to provide custodian and accounting services, including confirming all settled transactions and maintaining records of all trades executed, for the Agency MBS Purchase Program. The agreement provided for a compensation structure of 0.25 basis points for custody of assets, a $2 per transaction fee, and a $30,000 quarterly accounting fee. JPMorgan Chase also provided custodian and accounting services for the HFA Initiative and was paid under the same compensation structure. As of December 31, 2011, JPMorgan Chase had received total compensation of $13.1 million for its custodian and accounting services for the Agency MBS Purchase Program and HFA Initiative.

The following chronology describes the significant events that followed the enactment of the Housing and Economic Recovery Act of 2008 (HERA), which includes Treasury's process for selecting financial agents as asset managers for its HERA programs.

7/30/2008	HERA is enacted as Public Law 110-289.
8/26/2008	Morgan Stanley provided Treasury a list of the 20 largest fixed-income asset managers.
8/29/2008-9/3/2008	Treasury narrowed the list of potential asset managers to 10. All 10 asset managers signed a non-disclosure agreement and subsequently received a program description with a request for proposal.
9/4/2008	Treasury received written proposals from 7 of the 10 potential asset managers.
9/7/2008	The government-sponsored enterprises (GSEs)–Federal National Mortgage Association (Fannie Mae) and Federal Home Loan Mortgage Corporation (Freddie Mac) were placed under Federal Housing Finance Agency's conservatorship.
9/7/2008	Treasury announced the start of the Agency Mortgage Backed Securities (MBS) Purchase Program.
9/8/2008-9/17/2008	Treasury narrowed the list of potential asset managers to 5 and conducted phone and face-to-face interviews with them.
9/15/2008	Treasury and State Street Bank and Trust Company (State Street) entered into a Financial Agency Agreement (FAA) for asset management services.
9/18/2008	Treasury and the New York Branch of Barclays Bank PLC (Barclays Bank) entered into a FAA for asset management services.
9/18/2008	Treasury and JPMorgan Chase Bank NA entered into a FAA for custodian and accounting services.

9/23/2008	Treasury's financial agents began purchasing agency MBS.
10/23/2009	Treasury amended its FAA with State Street to include services in support of the Housing Finance Agency (HFA) Initiative.
11/10/2009	Treasury notified Barclays Bank that its FAA will be terminated effective December 31, 2009.
12/8/2009	Treasury amended its FAA with JPMorgan Chase Bank NA to include services in support of the HFA Initiative.
12/31/2009	Treasury's authority to purchase agency MBS expired.
11/1/2010	Treasury amended its FAA with State Street to extend the expiration date from December 31, 2010, to December 31, 2011.
11/24/2010	Treasury amended its FAA with JPMorgan Chase Bank NA to extend the expiration date from December 31, 2010, to December 31, 2011.
3/21/2011	Treasury announced the disposition of its MBS portfolio and began winding down the portfolio.
6/30/2011	Treasury amended its FAA with State Street to extend the expiration date from December 31, 2011, to June 30, 2012.
12/9/2011	Treasury amended its FAA with JPMorgan Chase Bank NA to extend the expiration date from December 31, 2011, to December 31, 2012.
3/19/2012	Treasury announced the completion of the sale of its agency MBS portfolio and reported a positive return of $25 billion for taxpayers.

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

UNDER SECRETARY

July 19, 2012

Marla A. Freedman
Assistant Inspector General for Audit
Office of the Inspector General
Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20036

Dear Ms. Freedman:

I write in response to your June 20, 2012 letter with which you provided a draft of your Audit Report, *Treasury's Financial Agent Selection Process for the Agency MBS Purchase Program Was Not Fully Documented* (Report). The Office of Domestic Finance appreciates the important work of the Office of Inspector General (OIG) and your review of the programs that the Department of the Treasury (Treasury) established and implemented under the authority that Congress provided to Treasury in the Housing and Economic Recovery Act of 2008 (HERA), including the Treasury program to purchase mortgage-backed securities (MBS) guaranteed by Fannie Mae and Freddie Mac (Agency MBS Purchase Program). This letter provides our official response to the draft Report. We separately provided technical comments to the OIG staff.

We appreciate that the draft Report states that "Treasury evaluated options for supporting the MBS market, decided to implement a purchase program, created a competitive bidding process, selected financial agents, and established the program in a short period of time—less than a month." As we explained to the OIG staff, the process for selecting financial agents to carry out Treasury's Agency MBS Purchase Program was designed, established, and implemented during the intense, emergency conditions at the onset of the financial crisis in September 2008. As we also explained, the scope of services that Treasury was seeking from bidders was highly market-sensitive, and Treasury officials were instructed to limit the staff involved in the selection process. The process resulted in a selection of financial agents that Treasury compensated at a lower cost to the taxpayers than the bidders had proposed. I would note that the MBS portfolio was liquidated at a profit to taxpayers over a one year period ending in March 2012.

The draft Report makes one recommendation with two elements: that the Under Secretary for Domestic Finance ensure that written policies and procedures are developed for selecting financial agents, and that these policies and procedures should, among other things, require documentation supporting all key events and decisions. We generally agree with this recommendation, and we are moving to develop written policies and procedures. We note, however, that our policies and procedures will provide flexibility for times of exigent circumstances, such as periods of economic and financial distress.

Thank you for the opportunity to review the draft Report. We value the role of strong oversight, and we look forward to continuing to work with your office in the future.

Sincerely,

Mary John Miller

Mary John Miller

Michael J. Maloney, Director, Fiscal Service Audits
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Office of the Deputy Chief Financial Officer, Risk and Control Group
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