



OFFICE OF THE SPECIAL INSPECTOR GENERAL

FOR THE TROUBLED ASSET RELIEF PROGRAM

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WASHINGTON, D.C. 20220

JUL 8 2010

Mr. Herbert M. Allison, Jr.
Assistant Secretary
Office of Financial Stability
U.S. Department of the Treasury
Main Treasury Building
1500 Pennsylvania Avenue, N.W.
Washington, D.C. 20220

Re: Treasury's Compliance and Internal Controls Program for PPIP

Dear Mr. Allison:

As you know, the Office of the Special Inspector General for the Troubled Asset Relief Program ("SIGTARP") began a review of Treasury's Public-Private Investment Program ("PPIP") compliance and internal controls program in October 2009, shortly after the first Public-Private Investment Fund ("PPIF") manager signed its Limited Partnership Agreement ("LPA"). We met with the Office of Financial Stability ("OFS") Compliance officials on numerous occasions and discussed their compliance and oversight efforts.

SIGTARP also consulted with officials at the New York Stock Exchange's Market Surveillance Team ("NYSE") and the Securities and Exchange Commission's Office of Compliance, Inspections and Examinations ("SEC") regarding best compliance practices for a program such as PPIP. We believe Treasury's compliance and internal controls program would greatly benefit by incorporating the following suggestions.¹

Treasury's PPIP Policies and Procedures

In its Quarterly Report to Congress issued July 21, 2009 (the "Quarterly Report"), SIGTARP recommended that metrics be defined and an evaluation system be put in place to monitor the effectiveness of the PPIF managers, ensure that they are fulfilling the terms of their agreements, and to measure their performance. The Quarterly Report noted that, without standardized policies and procedures, including written guidance as to how they would evaluate and test the PPIF managers' compliance with program rules, it is unclear how Treasury can consistently and properly identify and act on any potential risks to the program.

¹ These suggestions supplement and are not intended to replace any recommendations found in SIGTARP's Quarterly Reports.

Although Treasury reported that it would adopt this recommendation and was developing appropriate metrics and internal controls, nearly one year later, nothing has yet been issued. The Quarterly Report cautioned that expecting the PPIF managers, without detailed guidance, to design policies and procedures that meet Treasury's and the public's expectations is not appropriate in light of the risk of conflicts of interests inherent in the design of PPIF.

On February 17, 2010, Treasury informed SIGTARP that it had contracted with PricewaterhouseCoopers ("PwC") to develop PPIF compliance policies and procedures within six weeks. On June 18, 2010, however, Treasury stated that a recently completed draft of its PPIF compliance policies and procedures was going through a final approval process. SIGTARP has yet to see the draft and therefore cannot comment on specifics, but we suggest the policies and procedures include key provisions, such as:

- Guidelines to evaluate and test: (1) whether a PPIF manager has an overriding personal conflict of interest such as investment of his own money in other funds; and (2) whether other funds in a PPIF manager's portfolio could be benefiting at the expense of the PPIF fund.
- Plans to review PPIF managers' compliance with other provisions of the LPA not covered in the analysis performed by PwC, and actions it will take on instances of non-compliance (for example, how the PPIF manager keeps complete, accurate and appropriate books and records, or maintains compliance with the various trade and fee restrictions in Section 1.8 of the LPA).
- A framework addressing how Treasury will detect and report potential fraud or other potential securities laws violations by the PPIF managers. Treasury may want to incorporate step-by-step procedures that delineate, at a minimum: (1) whether and how Treasury will test for securities violations; (2) how potential securities violations will be treated; and (3) who supervises the process to ensure all steps are followed.

PPIF Manager Compliance and Internal Controls Review

Treasury stated that, as part of the due diligence during the asset manager selection process, the PPIF manager internal controls were reviewed. Although Treasury is assessing the need for a formal compliance review, Treasury has yet to initiate a formal review of those internal controls.

SIGTARP suggests that such a review is imperative. Review of the PPIF managers will provide Treasury the opportunity to analyze and determine whether each PPIF manager documents and complies with its internal controls requirements and provide a mechanism to monitor the program's risks and determine whether the PPIF managers are operating in accordance with the guidelines and rules in the LPA.

Currently, Treasury relies solely on the PPIF managers' Quarterly Certification. Although self-certifications are important to a compliance program, they alone are not sufficient

to ensure compliance with the LPA. Further, Treasury may want to consider incorporating processes where The Bank of New York Mellon, as administrator, custodian and valuation agent, could validate the integrity of the data provided by the PPIF managers.

Treasury's reviews, which should be done periodically, should focus on at least the following areas:

1. Compliance Program: review the PPIF managers' policies and procedures for effectiveness
2. Portfolio Management: evaluate how the PPIF managers select securities and engage in risk management such as evaluating ratings of securities and trade allocation analysis
3. Valuation: assess reasonableness and accuracy of valuation process
4. Reporting: evaluate whether monthly reporting requirements are met and review accuracy of the reports
5. Conflicts: assess potential misappropriation of government funds, insider trading, and other conflicts of interest
6. Asset Verification: verify the existence of securities by reviewing settlement of trades and how errors are accounted for both in PPIF and non-PPIF accounts.²

Monitoring of Trade Data

Finally, Treasury, through PwC, analyzes the PPIF managers' trade data for compliance with certain elements of the LPA on a monthly basis.³ SIGTARP has learned that the PPIF manager's weekly trade data is made available to Treasury on the FTP secured website. Both the SEC⁴ and NYSE informed SIGTARP that a comprehensive surveillance program requires real-time monitoring along with a monthly review of trading.

The NYSE and SEC told SIGTARP that both real-time monitoring for trade aberrations such as significant price movements and monthly trade surveillance for fraud schemes based on trends over time are necessary. Each serves a unique purpose and together they provide a

² Treasury may want to consider instituting an asset verification process on an annual basis. This annual analysis would allow Treasury to review the entire universe of each PPIF manager's trade data to validate whether all eligible asset positions and trades have been captured in the current monthly reports. This would require a complete download of all purchases and sales in every PPIF and non-PPIF account, including eligible and non-eligible assets. The trade data download would come directly from the PPIF managers' trade order management system.

³ Treasury told SIGTARP that it also performs other analyses like looking at trade settlement dates, outside of the monthly trade analysis.

⁴ The opinions expressed by individuals at the Securities and Exchange Commission are the opinions of those individuals, and the Commissioners, the agency or any other employee of the Securities and Exchange Commission, as a matter of policy, disclaim responsibility for any private publication or statement by any of its employees.

A/S Herbert Allison

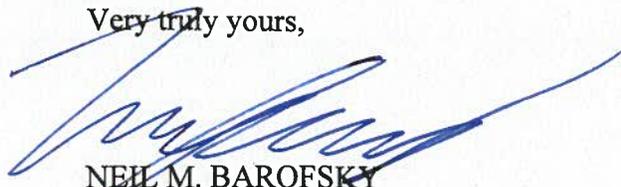
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comprehensive surveillance program. We recognize that real-time monitoring may be difficult, but at least a weekly analysis would be possible and might assist Treasury in identifying irregular trends or market movement.

SIGTARP encourages Treasury to adopt these suggestions in its PPIP compliance and internal controls program. These suggestions will strengthen Treasury's oversight of the program and further protect the taxpayers' investments from fraud, waste and abuse. As always, we are available to meet with you to discuss these issues.

Very truly yours,

A handwritten signature in blue ink, appearing to read "Neil M. Barofsky", is written over the typed name and title.

NEIL M. BAROFSKY

Special Inspector General