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S. HRG. 111–901

TREASURY'S USE OF CONTRACTING AUTHORITY UNDER TARP

HEARING

BEFORE THE

CONGRESSIONAL OVERSIGHT PANEL

ONE HUNDRED ELEVENTH CONGRESS

SECOND SESSION

SEPTEMBER 22, 2010

Printed for the use of the Congressional Oversight Panel

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CONGRESSIONAL OVERSIGHT PANEL

PANEL MEMBERS

DAMON SILVERS, *Deputy Chair*

RICHARD H. NEIMAN

J. MARK MCWATTERS

KENNETH R. TROSKE

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TREASURY'S USE OF CONTRACTING AUTHORITY UNDER THE TARP

WEDNESDAY, SEPTEMBER 22, 2010

U.S. CONGRESS,
CONGRESSIONAL OVERSIGHT PANEL,
Washington, DC.

The Panel met, pursuant to notice, at 10:05 a.m. in room SR–428A, Russell Senate Office Building, Washington, DC, Damon Silvers, presiding.

Present: Mr. Damon Silvers (presiding), Mr. J. Mark McWatters, and Dr. Kenneth R. Troske.

OPENING STATEMENT OF DAMON SILVERS, DEPUTY CHAIR, CONGRESSIONAL OVERSIGHT PANEL

Mr. SILVERS. Good morning. This hearing of the Congressional Oversight Panel will now come to order. My name is Damon Silvers and I am the Deputy Chair of the Congressional Oversight Panel for the Troubled Asset Relief Program.

I want to begin by noting the absence of our former Chair, Professor Elizabeth Warren, who recently resigned from the Panel to take on the difficult and important task of establishing a new Consumer Financial Protection Bureau.

The Panel's work is a joint endeavor and its accomplishments are shared by all of its members and its very dedicated staff. Even so, our work would be impossible without the—would have been impossible without the fierce, uncompromising leadership of Professor Warren. Her insistence that the TARP was created to help every American, not just those on Wall Street, remains the guiding principle of our work. We owe her a deep debt of gratitude.

On a personal note, let me say that I was often asked in the context of my service on the Panel with Elizabeth what Elizabeth was like to work with. And I always answered that she is exactly as you see her when she chairs these hearings: straightforward, public-spirited, generous, and yet exacting.

We will miss her deeply at the Oversight Panel, but our loss is President Obama's and our nation's gain.

We are here today to examine Treasury's use of private contractors under the TARP. In the minds of most Americans, the TARP is a government program designed by Congress and paid for by taxpayers to promote a public purpose, the stability of our economy. But in many ways the TARP today no longer looks like a government program. Many of its most critical functions are managed by private companies operating under 83 different contracts and agreements worth about $445 million.

Congress authorized the TARP program to contract out certain types of work that would otherwise have been required to be done by the government itself. To give just one example, Treasury hired Freddie Mac to serve as the compliance officer for its foreclosure mitigation programs. To do the job, Freddie Mac plans to hire 200 people. By comparison, TARP has only 220 staffers working on all TARP programs combined. Put another way, the vast majority of people working on the TARP today receive their paychecks from private companies and not the Federal Government.

Private contractors do not take an oath of office, they do not stand for an election, nor are they subject to civil service rules. Their goal is to turn a profit, not to advance the public good.

While the emergency situation in the fall of 2008 required the Treasury to engage the help of private firms to act with the necessary speed, the breadth and depth of the outsourcing involved in the TARP inevitably raises questions about accountability, conflicts of interest, and whether certain work should be performed by government alone.

Now, the bulk of TARP's contracting dollars have been spent on law firms, investment management firms, and audit firms. The nature of these firms' relationship to the financial system inevitably gives rise to a wide range of potential conflict issues, including the potentials for conflict with these firms' other clients, self-interested behavior in the management of TARP contracts, and the potential for misappropriation of market-relevant information that comes into contractors' possession as a result of working for the TARP.

Treasury has, to its credit, taken steps to mitigate these concerns and provide greater accountability. Most notably, it posts all TARP contracts to its website. But although this is an important first step, it is not a complete solution. Contractors are, for example, immune to requests under the Freedom of Information Act. They may hire subcontractors and those subcontractors need not be disclosed to the public, nor even to Treasury itself. Important aspects of a contractor's work may be buried in work orders that are never published in any form.

In short, as work moves farther and farther from Treasury's direct control, accountability and transparency to Congress and the public become more difficult.

Congress recognized this risk when it created the TARP, so it tasked the Panel with examining Treasury's use of private contractors. We have considered the issue at length in several of our past reports and today we are digging even deeper. I hope today that we will be able to address the following questions:

One, how has Treasury determined what functions associated with the TARP should be contracted out?

Two, how is Treasury overseeing the performance of TARP contractors?

Three, what measures has Treasury put in place to address contractor conflicts of interest and what has Treasury's approach been to potentially disabling conflicts of interest?

We are joined by three panels of witnesses, including representatives from Treasury, the largest TARP contractors, and government accountability organizations. We are grateful for their presence and look forward to their testimony.

Before I turn the gavel—the gavel over to my colleagues on the Panel, I should note that Superintendent Richard Neiman, our fourth panelist, is not able to be with us today because of urgent matters relating to his duties as the Superintendent of Banks for the state of New York. We miss Superintendent Neiman, but we are cognizant of the fact that all the Panel members have other duties, and particularly Superintendent Neiman's to the citizens of New York for him are at least comparable to those here.

So with that, I would like to offer my colleagues on the Panel an opportunity to make their own opening remarks. Mr. McWatters.

[The prepared statement of Mr. Silvers follows:]

ELIZABETH WARREN, CHAIR
RICHARD H. NEIMAN
DAMON SILVERS
J. MARK McWATTERS
KENNETH R. TROSKE

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Congress of the United States
CONGRESSIONAL OVERSIGHT PANEL

Opening Statement of Damon Silvers

Congressional Oversight Panel Hearing on the Use of Private Contractors in the TARP

September 22, 2010

Good morning. My name is Damon Silvers, and I am the deputy chair of the Congressional Oversight Panel for the Troubled Asset Relief Program (TARP).

I want to begin by noting the absence of our former chair, Professor Elizabeth Warren, who recently resigned from the Panel to take on the difficult and important task of establishing the new Consumer Financial Protection Bureau. The Panel's work is a joint endeavor, and its accomplishments are shared by all of its members and its very dedicated staff. Even so, our work would be impossible without fierce, uncompromising leadership. For nearly two years, Elizabeth Warren provided that leadership. Her insistence that the TARP was created to help every American – not just those on Wall Street – remains the guiding principle of our work. We owe her a deep debt of gratitude.

We are here today to examine Treasury's use of private contractors under the TARP. In the minds of most Americans, the TARP is a government program, designed by Congress and paid for by taxpayers to promote a public purpose: the stability of our economy. But in many ways, the TARP today no longer looks like a government program. Many of its most critical functions are managed by private companies, operating under 83 different contracts and agreements worth about $445 million. Congress authorized the TARP program to contract out certain types of work that would otherwise have been required to be done by the government itself.

To give just one example, Treasury hired Freddie Mac to serve as the compliance officer for its foreclosure mitigation programs. To do the job, Freddie Mac plans to hire 200 people. By comparison, Treasury has only 220 staffers working on all TARP programs combined. Put another way, the vast majority of people working on the TARP today receive their paychecks from private companies, not the federal government.

Private contractors do not take an oath of office. They do not stand for election, nor are they subject to civil service rules. Their goal is to turn a profit – not to advance the public good. While the emergency situation in the fall of 2008 required the Treasury to engage the help of private firms to act with the necessary speed, the breadth and depth of the outsourcing involved in the TARP inevitably raises questions about accountability, conflicts of interest, and whether certain work should be performed by government alone.

The bulk of the TARP's contracting dollars have been spent on law firms, investment management firms, and audit firms. The nature of these firms' relationship to the financial system gives rise inevitably to a wide range of potential conflict issues, including the potential for conflicts with these firms' other clients, self-interested behavior in the management of TARP contracts, and the misappropriation of market relevant information that comes into contractors' possession as a result of working for the TARP.

Treasury has, to its credit, taken steps to mitigate these concerns and provide greater accountability. Most notably, it posts all TARP contracts to its website. But although this is an important first step, it is not a complete solution. Contractors are, for example, immune to requests under the Freedom of Information Act. They may hire subcontractors, and those subcontracts need not be disclosed to the public nor even to Treasury itself. Important aspects of a contractor's work may be buried in work orders that are never published in any form. In short, as work moves farther and farther from Treasury's direct control, accountability and transparency to Congress and the public becomes more and more difficult.

Congress recognized this risk when it created the TARP, so it tasked the Panel with examining Treasury's use of private contractors. We have considered the issue at length in several of our past reports, and today, we are digging even deeper.

I hope today we will be able to address the following questions:

How has Treasury determined what functions associated with the TARP should be contracted out?

How has Treasury overseen the performance of TARP contractors?

What measures has Treasury put in place to address contractor conflicts of interest, and what has Treasury's approach been to potentially disabling conflicts of interest?

We are joined by three panels of witnesses, including representatives from Treasury, the largest TARP contractors, and government accountability initiatives. We are grateful for their presence and look forward to their testimony.

Before we proceed with the testimony, I would like to offer my colleagues on the Panel an opportunity to make their own opening remarks.

STATEMENT OF J. MARK McWATTERS, MEMBER, CONGRESSIONAL OVERSIGHT PANEL

Mr. MCWATTERS. Thank you, Mr. Silvers. I very much appreciate the attendance of the witnesses and I look forward to hearing their views.

The Department of Treasury is authorized under the Emergency Economic Stabilization Act of 2008 to enter into procurement contracts and financial agency agreements in order to discharge its duties under the statute. Financial agency agreements allow Treasury to retain private sector businesses to perform inherently governmental and perhaps other functions and procurement contracts are employed by Treasury to obtain other goods and services from private sector organizations.

Today's hearing will examine Treasury's use of procurement contracts and financial agency agreements to obtain services that Treasury cannot or has chosen not to perform itself. In order to add some perspective to the materiality of the issues before us today, it is worth considering that the potential value of procurement contracts between Treasury and third party service providers totals approximately $400 million, roughly $85 million of which relates to limited competition contracts issued due to unusual and compelling urgency.

It will be interesting to learn the circumstances that justified the issuance of the limited competition contracts, as well as why only four service providers were awarded approximately $250 million in potential value procurement contracts.

It is also worth noting that Treasury has entered into financial agency agreements with Fannie Mae and Freddie Mac that have an obligated value of approximately $220 million. Since Fannie and Freddie were all but nationalized in September 2008, it will be interesting to learn why Treasury chose to enter into significant contractual arrangements with two failed government-sponsored enterprises instead of with solvent private sector organizations, and if Treasury was able to obtain services from the GSEs on an arm's-length basis.

Since Treasury also engaged Fannie and Freddie to modify GSE-owned and guaranteed loans, it is critical that the two GSEs address how they mitigated any conflict of interest that has arisen with respect to their financial agency agreements.

EESA requires Treasury to establish and maintain an effective system of internal controls to provide reasonable assurance of the reliability of financial reporting, including financial statements and other reports for internal and external use. In addition, fundamental questions—fundamental elements of this Panel's mandate are to examine the extent to which the information made available on transactions under the TARP have contributed to market transparency and to ensure that the use of TARP authority is subject to public accountability.

As such, one goal of today's hearing is to determine if Treasury, the procurement contractors, and the financial agents have adopted a set of best practices with respect to the development and implementation of their internal control systems and have taken such other necessary and appropriate action so as to ensure market

transparency and public accountability regarding their procurement contracts and agency agreements.

EESA also requires the Secretary of the Treasury to ensure—to issue regulations or guidelines necessary to address and manage or prohibit conflicts of interest that may arise in connection with the administration and execution of the statute. Although on January 21, 2009, Treasury issued an interim final rule regarding conflicts of interest arising with respect to procurement contracts and financial agency agreements, several questions remain for our analysis.

For example, real or perceived conflicts of interest may arise under any of the following four circumstances: Treasury contracts with a firm and seeks to regulate that firm or industry; Treasury enters into an arrangement with a contractor or financial agent and subsequently intends to hire an employee from one or more of those retained entities; Treasury develops an overreliance on one specific firm because it has entered into multiple arrangements with that firm; and fourth, Treasury hires a contractor or financial agent that needs government support in the future.

It will be helpful to learn this morning how Treasury intends to address each of these conflicts of interest issues.

Thank you for joining us today and I look forward to our discussion.

Dr. Troske.

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Congress of the United States
CONGRESSIONAL OVERSIGHT PANEL

Opening Statement of J. Mark McWatters

Congressional Oversight Panel Hearing on the Use of Private Contractors in the TARP

September 22, 2010

Thank you Mr. Silvers.

I very much appreciate the attendance of the witnesses and I look forward to hearing their views.

The Department of Treasury is authorized under the Emergency Economic Stabilization Act of 2008 (EESA) to enter into "procurement contracts" and "financial agency agreements (FAA)" in order to discharge its duties under the statute.[1] Financial agency agreements allow Treasury to retain financial institutions to perform "inherently governmental" and, perhaps, other functions, and procurement contracts are employed by Treasury to obtain other goods and services from private sector organizations.[2] Today's hearing will examine Treasury's use of procurement contracts and financial agency agreements to obtain services that Treasury cannot, or has chosen not to, perform itself.

In order to add some perspective to the materiality of the issues before us today, it is worth considering that the potential value of procurement contracts between Treasury and third-party service providers totals approximately $400 million, roughly $85 million of which relates to "limited competition" contracts issued due to "unusual and compelling urgency."[3] It will be interesting to learn the circumstances that justified the issuance of the limited competition contracts as well as why only four service providers account for $79 million of the $127 million in obligated value attributable to all the procurement contracts.[4]

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[1] 12 U.S.C. 5211(c).

[2] The adoption of EESA introduced an element of legal uncertainty as to whether financial agency agreements must be used only for "inherently governmental" functions or if they can be used for a broader range of duties as well. As a result, there may be essentially no restrictions on the process Treasury may use for selecting financial institutions as financial agents. Unlike when it hires a contractor, an executive agency is not bound by the Federal Acquisition Regulations (FAR) when it hires a financial agent. The law, however, is well-settled that a financial agent must abide by the principles of agency law, as the financial agent acts an agent for the government, the principal. As a result, the duties that would attach in any other principal-agent relationship attach to financial agents, including the duty of loyalty and the duty of care.

[3] These amounts represent estimates obtained by Panel staff as of August 13, 2010.

[4] These amounts represent estimates obtained by Panel staff as of August 13, 2010.

It is also worth noting that Treasury has entered into financial agency agreements with Fannie Mae and Freddie Mac that have an obligated value of approximately $220 million.[5] Since Fannie and Freddie were all but nationalized[6] in September 2008 it will be interesting to learn why Treasury chose to enter into significant contractual arrangements with two failed government-sponsored enterprises (GSEs) instead of with solvent private sector organizations, and if Treasury was able to secure services from the GSEs on "arm's length" terms. Since Treasury also engaged Fannie and Freddie to modify non-HAMP (Home Affordable Modification Program), GSE owned or guaranteed loans, it is critical that the two GSEs address how they mitigated any conflicts of interest that have arisen with respect to their financial agency agreements.

EESA requires Treasury to establish and maintain an effective system of internal controls to provide reasonable assurance of "the effectiveness and efficiency of operations, including the use of the resources of the TARP," "the reliability of financial reporting, including financial statements and other reports for internal and external use," and "the compliance with applicable laws and regulations."[7] In addition, fundamental elements of this Panel's mandate are to examine the "extent to which the information made available on transactions under the [TARP] has contributed to market transparency,"[8] and to ensure that the use of TARP authority is subject to "public accountability."[9] As such, one goal of today's hearing is to determine if Treasury, the procurement contractors and the financial agents have adopted a set of "best practices" with respect to the development and implementation of their internal control systems and have taken such other necessary and appropriate actions so as to ensure market transparency and public accountability regarding their procurement contracts and financial agency agreements.

EESA also requires the Secretary of the Treasury to issue "regulations or guidelines necessary to address and manage or to prohibit conflicts of interest that may arise in connection with the administration and execution" of the statute. [10] Although on January 21, 2009, Treasury adopted an Interim Final Rule (IFR) regarding conflicts of interest arising with respect to procurement contracts and financial agency agreements,[11] several questions remain for analysis. For example, real or perceived conflicts of interest may arise under any of the following four circumstances:

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[5] This amount represents an estimate obtained by Panel staff. It is current as of August 13, 2010.
[6] The Congressional Budget Office (CBO) estimates that the total subsidy cost for the bailout of Fannie Mae and Freddie Mac will total approximately $389 billion through 2019. Congressional Budget Office, *Budgetary Treatment of Fannie Mae and Freddie Mac*, at 8 (Jan. 2010) (online at www.cbo.gov/ftpdocs/108xx/doc10878/01-13-FannieFreddie.pdf).
[7] 12 U.S.C. § 5226(c)(1)(A)-(C).
[8] 12 U.S.C. § 5233(b)(1)(A)(iii).
[9] 12 U.S.C. § 5201(2).
[10] 12 U.S.C. § 5218(a).
[11] TARP Conflicts of Interest, 74 Fed. Reg. 3431-3436 (Jan. 21, 2009) (codified as 31 CFR § 31). This Interim Final Rule followed Treasury's issuance of the Interim Guidelines for Conflicts of Interest on October 6, 2008, only three days after the passage of EESA. U.S. Department of the Treasury, Interim Guidelines for Conflicts

- Treasury contracts with a firm and then seeks to regulate the firm or its industry.
- Treasury enters into an arrangement with a contractor or financial agent – or that contractor or financial agent enters into an arrangement with a subcontractor – and subsequently intends to hire an employee from one of those retained entities.
- Treasury develops an overreliance on one specific firm because it has entered multiple arrangements with that firm.
- Treasury hires a contractor or financial agent – or that contractor or financial agent hires a subcontractor – that needs government support in the future."

It will be helpful to learn this morning how Treasury intends to address each of these conflict of interest issues.

Thank you for joining us today and I look forward to our discussion.

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of Interest (Oct. 6, 2008) (online at www.treas.gov/press/releases/hp1180.htm). Treasury has not yet issued a final rule.

STATEMENT OF KENNETH R. TROSKE, MEMBER, CONGRESSIONAL OVERSIGHT PANEL

Dr. TROSKE. Thank you, Mr. Silvers.

I would like to start by thanking all the witnesses for agreeing to come here today. Clearly our job as an Oversight Panel is made much easier with your help in understanding the issues surrounding TARP and contracting, and I want to let you know that I appreciate your efforts.

While I recognize that at first glance today's hearing on TARP's exceptional contracting authority does not appear as exciting as some of the Panel's previous hearings, I feel once you begin to study the issues surrounding contracting, including such issues as when and why the government decides to do work internally versus hiring an outside contractor, who the government hires as contractors, and the details of contractor compensation, you quickly discover that these issues are fundamentally important for understanding how to create a financial system that is less prone to crisis and less destructive when crises occur.

Through the very act of hiring businesses to work for the Federal Government, the government may implicitly be providing an advantage to one company relative to its competitors, and this arrangement potentially creates a type of moral hazard that can lead to problems in the market.

An important issue that seems to have received very little attention is when is it appropriate for the Federal Government to contract with firms that it also regulates? For example, through the TARP the Treasury is currently contracting with several financial firms, including BNY-Mellon, Morgan Stanley, and Alliance Bernstein, and the government is often paying them at rates below what the firm could obtain performing similar work in the private sector.

These firms often feel, perhaps correctly, that they are doing the government a favor. Suppose, however, that in the not too distant future one or several of these firms are found to be in financial distress or are discovered not to be in compliance, complete compliance, with regulations. It is hard to imagine that the current—it is not hard to imagine that the current or recent work for the government might influence how regulatory authorities deal with the firms. In turn, this might—this preferential treatment might provide the firm with a distinct advantage over non-contracted competitors in the same situation.

Further, as we all know, various government agencies are writing new rules in response to the recently passed Dodd-Frank Wall Street Reform and Consumer Protection Act. Again, it would not be too hard to imagine that because some firms are working for the agencies that are writing these new rules these firms may have the ability—have greater influence on the rules than their competitors who are outside looking in.

Finally, the line is not always clear between bailing out a firm when it gets into financial difficulty and awarding the firm a government contract. These types of ambiguous actions lead to questions about the government's ultimate motivation when contracting with firms such as Freddie Mac and Fannie Mae, which recently received substantial financial support from the government.

These are examples of the moral hazards that may be created when the government hires private sector firms. If this moral hazard is recognized and priced by the market, this advantage is one more factor that contributes to the creation of systemically risky, too big to fail, firms. The cost of this moral hazard needs to be considered when weighing the decision of whether certain tasks should be performed directly by the Federal Government or by outside contractors.

I want to be clear. I have no reason to suspect that Treasury or any other government agency has behaved inappropriately and I think the evidence is that Treasury has bent over backwards to ensure that they are following standard procedures and rules. However, I do believe that issues surrounding when is it appropriate for government agencies to hire heavily regulated firms as outside contractors or financial agents should be discussed by policymakers, legislators, and the American public.

For all these reasons, today's hearing is as important as the COP's previous hearings examining the bailout of large banks, the bailout of AIG, and the use of TARP money to support, funds to support the auto industry. While I don't think we are going to develop definitive guidelines for when the government should contract with private sector firms, hopefully the work we do here today will encourage that important discussion. I'm looking forward to hearing the thoughts from the witnesses who are appearing before us today.

Finally, in conclusion, let me echo the comments of Mr. Silvers regarding Professor Warren. I too have appreciated the service that she provided to this Panel. On a personal note, I am the newest member of the Panel and Professor Warren made me very quickly feel a very welcome and active participant in this Panel and for that I do thank her.

So thank you very much.

Mr. SILVERS. Thank you, Dr. Troske.

I'm pleased to welcome our first panel, which includes two witnesses from the Department of the Treasury: Gary Grippo, the Deputy Assistant Secretary for Fiscal Operations and Policy; and Ronald Backes, the Director of Procurement Services.

However, before we hear testimony from Treasury I would like to note that we also invited testimony on the next panel from a representative of Cadwalader, Wickersham & Taft LLP, whom Treasury contracted with for many of its most significant legal dealings in the automotive industry, the public-private investment program, and other aspects of TARP. Treasury declined to allow Cadwalader to testify, as Cadwalader's client, objecting to any appearance of Treasury's attorneys in public hearings in other than extraordinary circumstances, but agreed to make the firm available to the Panel for a private meeting.

We disagree with Treasury's decision to object to their counsel testifying. We note the obstacles such an approach places to public oversight of legal contracting in the context of the TARP. The Panel has requested a comprehensive list of Cadwalader clients that have received TARP funds from both Cadwalader and from the Treasury Department. We have yet to receive that list, but we note that Cadwalader's website and other public sources list a sig-

nificant number of current and former TARP recipients as clients of the firm, including Bank of America, Citigroup, and AIG. We will be noting the results of this request and of our meeting with Cadwalader as part of our October report.

With that note, Mr. Grippo, please proceed with your testimony. Statements are limited to 5 minutes. Proceed.

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Opening Statement of Kenneth Troske

Congressional Oversight Panel Hearing on the Use of Private Contractors in the TARP

September 22, 2010

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I would like to start by thanking all of the witnesses for agreeing to come here today. Clearly our job as an oversight panel is made much easier with your help in understanding the issues surrounding TARP and contracting, and I want to let you know that I appreciate your efforts.

While I recognize that, at first glance, today's hearing on TARP's Exceptional Contracting Authority does not appear as exciting as some of the panel's previous hearings, once you begin to study the issues surrounding contracting—including such issues as when and why the government decides to do work internally verses hiring an outside contractor, who the government hires as contractors, and the details of contractor compensation—you quickly discover that these issues are fundamentally important for understanding how to create a financial system that is less prone to crisis and less destructive when a crisis occurs. Through the very act of hiring businesses to work for the federal government, the government may implicitly be providing an advantage to one company relative to its competitors, and this arrangement potentially creates a type of moral hazard that can lead to problems in the market.

An important issue that seems to have received very little attention is when is it appropriate for the federal government to contract with firms that it regulates? For example, through the TARP the Treasury is currently contracting with several financial firms including BNY Mellon, Morgan Stanley and AllianceBernstein, and the government is often paying them at rates that are below what the firms could obtain performing similar work in the private sector. These firms often feel, perhaps correctly, that they are doing the government a favor. Suppose, however, that in the not too distant future one or several of these firms are found to be in financial distress or are discovered not to be in complete compliance with regulations. Is it hard to imagine that the current or recent work for government might influence how the regulatory authorities deal with the firm? In turn, might this preferential treatment provide the firm with a distinct advantage over a non-contracted competitor in the same situation? Further, as we all know, various government agencies are writing new rules in response to the recently passed Dodd-Frank Wall Street Reform and Consumer Protection Act. Again, it would not be too hard to imagine that, because some firms are working for the agencies that are writing these new rules, these firms

may be able to have a greater influence on the rules than their competitors who are on the outside looking in. Finally, the line is not always clear between bailing out a firm when it gets into financial difficulty and awarding the firm a government contract. These types of ambiguous actions lead to questions about the government's ultimate motivation when contracting with firms such as Fannie Mae and Freddie Mac which recently received substantial financial support from the government.

These are examples of the moral hazard that may be created when the government hires private sector firms. If this moral hazard is recognized and priced by the market, this advantage is one more factor that contributes to the creation of systemically risky, too big to fail firms. The cost of this moral hazard needs to be considered when weighing the decision of whether certain tasks should be performed directly by the federal government or by outside contractors.

I want to be clear; I have no reason to suspect that the Treasury or any other government agency has behaved in an inappropriate fashion. However, I do believe that issues surrounding when it is appropriate for government agencies to hire heavily regulated firms as "outside contractors" should be discussed by policy makers, legislators and the American public. For all of these reasons, today's hearing is as important as the COP's previous hearings on examining the bailout of large banks, the bailout of AIG, and the use of TARP to support the auto industry. While I don't think we are going to develop definitive guidelines for when the government should contract with private sector firms, hopefully the work we do here will encourage that important discussion. I am looking forward to hearing the thoughts from the witnesses who are appearing before us today.

Thank you.

STATEMENT OF GARY GRIPPO, DEPUTY ASSISTANT SECRETARY FOR FISCAL OPERATIONS AND POLICY, U.S. DEPARTMENT OF THE TREASURY

Mr. GRIPPO. Thank you, Mr. Silvers. In light of the comments on Cadwalader, I would like, with your permission, to read a statement from the Treasury, this from the General Counsel's Office of Treasury:

"The Department of the Treasury strongly supports the important oversight role of the Congressional Oversight Panel in helping to restore liquidity and stability to the United States financial system. Over the past 22 months, Treasury has complied with every request for information that we have received from the panel, including numerous interviews, briefings, and document productions. Treasury staff has spent thousands of hours working with panel members and their staff.

"In this particular circumstance, the panel requested testimony from one of the private law firms that represents the Treasury. We understand and respect the panel's interest in obtaining information from this law firm. However, lawyers play a very special role which requires them to provide confidential advice to their clients. It is highly unusual for them to testify in public except in extraordinary circumstances.

"Therefore, the Treasury has offered a reasonable alternative, a detailed briefing early next week, which the panel has accepted. The panel members and their staff will be able to speak to the law firm, to ask questions, to gather relevant and detailed information, and to include that information in their public report. We believe that this briefing fully satisfies the panel's need for information and respects the traditional role of outside counsel."

Now let me turn to my own opening statement. Members of the Congressional Oversight Panel, let me thank you for the opportunity to testify today. As the Deputy Assistant Secretary for Fiscal Operations and Policy at the Treasury, a position which I've been in since July of 2007, I'm responsible for overseeing the financial agents designated to support the Emergency Economic Stabilization Act.

Financial agents have been instrumental in implementing the Act and thus in Treasury's efforts to stabilize the financial system. To date, the Treasury has designated 15 financial agents, including commercial banks, broker-dealers, asset managers, and the government-sponsored enterprises, to manage various assets and investments and to help administer the Home Affordable Modification Program. The Treasury designated these agents pursuant to section 101[c] of the Act, which specifically authorizes the Secretary of the Treasury to designate financial institutions as financial agents to carry out the authorities of and perform all reasonable duties related to the Act. The Act itself defines "financial institution" broadly, to include any such institution, including but not limited to any bank, savings association, security broker or dealer, or insurance company.

Unlike contracting authority, the authority to designate financial agents of the United States, both in the Act and in other statutes, is unique to the Treasury. Unlike an arm's length contractor selling goods and services in the market, financial agents are governed by

the principal-agent relationship, under which a financial institution is empowered to act for and on behalf of the Treasury as the principal to carry out certain authorities based on a defined scope of agency.

Financial agents have a fiduciary obligation to the Treasury, including the requirement to act in the best interests of the Treasury and not in their own interests. Accordingly, only financial agents and not contractors have been authorized to perform certain duties under the Act. This approach is consistent with the Treasury's longstanding policy of allowing only financial agents and not contractors to hold and manage public moneys.

The decision to designate a financial agent to perform some activity under the Act, as opposed to engaging a contractor, begins with the consideration of two key questions: One, does the activity entail the direct management of public assets, such as the purchase, valuation, custody, or disposition of investments or cash? Two, does the work entail a close collaboration between the Treasury and the provider such that a fiduciary relationship is required?

Financial agents are engaged when the Treasury needs to obtain the inherent capabilities and special expertise of a financial institution and where the Treasury needs the services of an entity that can act as an extension of the Treasury.

Although the Treasury uses contractors and financial agents under different authorities and for different purposes, in both cases Treasury has the goal of engaging the entity best qualified to perform the function at a price that represents fair value to the taxpayer.

The process for the solicitation, evaluation, and selection of financial agents embodies the best practices for third party sourcing: openness, fairness, competitiveness, and transparency. We've created an Office of Financial Agents with dedicated staff to manage this process. Moreover, all the financial agent arrangements are designed to encourage and facilitate the involvement of small financial institutions. The notices soliciting financial agents and the agreements designating financial agents contain evaluation criteria and requirements related to small financial institutions. Indeed, a majority of the current financial institutions designated as financial agents to help implement the Act, 8 out of 15, are small institutions, including six institutions that are minority or women-owned.

In addition, the directly designated financial agents have themselves engaged 26 small firms as sub-providers, including 18 that are minority or women-owned firms. Moreover, 23 small and minority, women, and veteran-owned broker-dealers have participated as co-managers for the auctions of warrants and the sales of common stock.

We work diligently to identify and prevent any conflicts of interest related to our use of financial agents. In enforcing the TARP conflicts of interest interim rule, we work with financial agents as well as independently to identify and mitigate potential organizational and personal conflicts of interest that may arise during the retention of the agents and during the performance period of their agreements. With one exception, conflicts of interest mitigation plans have been in place before work activity begins, the one excep-

tion being the very first provider hired under TARP, the Bank of New York Mellon, which had a co-signed mitigation plan within 2 days of signing the agreement. We've remained engaged with financial agents to continually assess any new conflicts, to develop changes to mitigation plans over time.

Let me jump ahead and just indicate that we agree with the Panel that contracting and engaging Fannie financial agents is extremely important in the administration of the Act, and I want to thank you for the opportunity to discuss these issues today.

Mr. SILVERS. Thank you, Mr. Grippo. We should note that I extended you the courtesy of some extra time, given that you had a matter you had to take care of first.

Mr. Backes.

STATEMENT OF RONALD BACKES, DIRECTOR, PROCUREMENT SERVICES, U.S. DEPARTMENT OF THE TREASURY

Mr. BACKES. Good morning, members of the Congressional Oversight Panel. Thank you for the opportunity to testify today. As Director of Procurement Services for Treasury's departmental offices, a position I've held since May of this year, I'm responsible for overseeing contract operations supporting Treasury headquarters and aligned clients, including the Office of Financial Stability, which has requirements for contracts that support the Emergency Economic Stabilization Act. From February of 2009 through May of 2010, I served as the contract administration manager for OFS, responsible for implementing and overseeing contract planning and administration for the Troubled Asset Relief Program, TARP.

I'm here today in response to the Panel's request to provide an overview of Treasury's contracts. Treasury acquires products and services pursuant to the Federal Acquisition Regulation, or FAR, as supplemented by agency regulations. Although EESA explicitly authorized the Secretary to waive the FAR to respond to the financial crisis, we made a deliberate decision not to do so for any TARP contracts. Treasury has contracted for document management, legal support, accounting, internal controls, information technology, and similar services in support of TARP, all using FAR-based procurement methods.

The Government Accountability Office has monitored TARP contracting from the inception of the program and has repeatedly recognized our strengths in this area. Rather than making a choice between doing things fast and doing things right, we chose to do both.

In the fall and winter of 2008 during the heat of the financial crisis, we leveraged existing contracts where available, conducted full and open competitions when feasible, or else limited competitions under the authority of the FAR, to ensure an effective and timely response to the crisis. We reviewed potential contractors to ensure they did not have disabling conflicts of interest and maintained acceptable conflict of interest mitigation plans.

As the program matured, OFS developed work requirements beyond those meeting its urgent needs and developed mid- and long-range strategies for contracts to transition to full and open competitions and small business set-asides to meet all the TARP contracting needs. We enhanced existing mechanisms to match con-

tract costs, schedules, and quality, and formalized conflict of interest procedures. OFS developed its acquisition strategy through a Contract and Agreement Review Board, or CARB, chartered in part to review long-term requirements for OFS to ensure consistent and effective planning for contracts and financial agent agreements and to provide a forum for high-level review of acquisition plans to achieve OFS mission and regulatory goals.

Before deciding to use contractor services, Treasury addresses the relevant tradeoffs between contractor and government performance. The decision to acquire contractors through a contract begins with the consideration of whether the required services are other than inherently governmental in nature, whether they can be obtained at a competitive price from the private sector without creating an immitigable conflict of interest, and whether it would be more cost effective for schedule or other reasons to outsource the work.

The contract selection process entails a competitive solicitation and evaluation to identify the proposal or proposals that represent the best value to the Treasury, considering cost and other factors identified in the solicitation. In the case of most contracts awarded in the first year in support of the TARP, Treasury either fully competed the work using General Services Administration, GSA, schedule contracts or held limited competitions pursuant to the unusual and compelling urgency authority of the FAR.

Treasury followed the same basic process for unusual and compelling urgency procurements as for traditional procurements, including the conduct of market research to identify the best qualified firms to whom Treasury released the solicitation, a competitive evaluation, and consideration of conflicts of interest, if any, prior to selection.

For conflicts of interest, Treasury reviews the scope of work and the type of organization that may be selected at the inception of a contract or task order to identify circumstances that might give rise to an organizational or personal conflict of interest. Treasury includes conflict of interest provisions in the resulting contract or task order. Every offeror seeking a contract for services other than administrative services, such as building, leased furniture, newspaper subscriptions, and the like, must provide a conflict of interest mitigation plan and identify actual, potential, or apparent organizational and personal conflicts of interest as part of its proposal. Treasury reviews the plan and, if appropriate, requires additional information and a revised conflict of interest mitigation plan. Contracts, including task orders issued under existing contracts, are not awarded and contract work does not begin unless the associated proposed mitigation plan is determined to be acceptable.

In addition, mitigation plans are revisited and, if necessary, revised if warranted by the circumstances, such as when the business structure of the contractor changes or when additional work is ordered under the contract.

Treasury employs several layers of internal controls associated with contract performance, including contracting officer oversight and monitoring, delegation of day to day monitoring to certify COTRs, and internal management reviews. In addition, OFS char-

tered the CARB to review and monitor administration of all OFS contracts to ensure consistent and effective program management.

As we approach 2 years since the passage of EESA, Treasury has successfully implemented an effective acquisition strategy that enables delivery of timely support for critical legal, financial, and information technology needs and continues to maximize competition and small business participation to support——

Mr. SILVERS. Mr. Backes, can you wind up, please.

Mr. BACKES. Yes, I will. Thank you.

Through these actions, as acknowledged by the GAO, Treasury has strengthened its management and oversight of vendor-related conflicts, substantially increased the share of work performed by small businesses under TARP contracts, and put in place clear procedures to address actual, potential, or apparent conflicts that may arise.

We agree with the Panel that contracting and engaging financial agents is extremely important in the administration of the EESA, and I thank you for the opportunity to discuss this today.

[The prepared statement of Messrs. Grippo and Backes follows:]

Joint Testimony of
Gary Grippo, Deputy Assistant Secretary for Fiscal Operations and Policy,
U.S. Department of the Treasury
and
Ronald Backes, Director of Procurement Services, Departmental Offices,
U.S. Department of the Treasury
Before the Congressional Oversight Panel
September 22, 2010

Members of the Congressional Oversight Panel, thank you for the opportunity to testify. On behalf of the Department of the Treasury (Treasury), this testimony is provided by Gary Grippo, Deputy Assistant Secretary for Fiscal Operations and Policy, and Ron Backes, Director of Procurement Services.

Since joining Treasury's Office of the Fiscal Assistant Secretary in 2007, Mr. Grippo has been responsible for developing government-wide policies on financial management, and for overseeing the operations of Treasury's fiscal bureaus. In this role, he also oversees the financial agents designated to support the Troubled Asset Relief Program (TARP). Prior to this position, Mr. Grippo served at Treasury's Financial Management Service, where he managed the agents that process financial transactions across the Federal government.

Since joining Treasury in February 2009, Mr. Backes has been responsible for implementing and overseeing contract planning and administration for TARP, and most recently for overseeing procurement operations for Treasury's Departmental Offices. Prior to joining Treasury, he served for 15 years as a Federal acquisition professional for the Department of the Army and the National Aeronautics and Space Administration.

As you know, the Emergency Economic Stabilization Act of 2008 (EESA) created the Office of Financial Stability (OFS) to manage the Troubled Asset Relief Program, in response to the financial crisis. Over time, OFS has engaged contractors and financial agents to support Treasury in purchasing troubled assets from financial institutions and in managing those assets. That role has been part of Treasury's broader efforts to stabilize and strengthen the economy while protecting the interests of taxpayers.

After EESA was passed, Treasury began building the infrastructure to effectively manage these agents and contactors. OFS has installed procedures and controls to ensure that Treasury draws from the full spectrum of large and small businesses, selects the most qualified providers, and secures fair value for the funds expended.

OFS uses two separate approaches, contractors and financial agents, for acquiring external services to support Treasury's financial stability programs. Treasury's legal authority for each approach derives from a different source, reflecting the diverse needs Treasury has had when engaging external agents. In addressing the Panel's questions, therefore, it is important to first distinguish between the two approaches:

> Federal Acquisition Regulation: Similar to all Federal agencies, OFS acquires contractor services by and for its use through the traditional procurement process contained in the

Federal Acquisition Regulation (FAR). OFS conducts FAR procurements to acquire document management, legal support and information technology, among other services.

Financial Agency Authority: OFS engages the services of financial institutions through the Secretary's authority to designate financial agents of the United States. An additional source of authority for this approach is found in EESA section 103(c), which states that the Secretary may: "Designat[e] financial institutions as financial agents of the Federal Government… ." Unlike an arm's length contractor selling goods and services, financial agents are governed by the principal-agent relationship, under which a financial institution is empowered to act for and on behalf of Treasury, as principal, to carry out the authorities in EESA, based on a defined scope of agency. Financial agents have a fiduciary obligation to Treasury, including the requirement to act in the best interests of Treasury and not the company's own interests. Accordingly, only financial agents, and not contractors, have been authorized to perform certain duties under EESA. This approach is consistent with Treasury's long-standing policy of allowing only financial agents, and not contractors, to hold and manage public monies.

These two methods are complementary but not interchangeable. FAR procurements are used for the acquisition of goods and/or services from the commercial marketplace. Financial agents serve as an extension of Treasury to act on behalf of the Government in order to address the unique and often urgent needs of TARP and OFS. For this reason, the procedures relating to each of the approaches will be described separately in certain sections of this testimony.

Acquisition Strategy

OFS has centralized strategic decisions with regard to acquisition strategy in a Contact Agreement and Review Board (CARB). One of the central purposes of the CARB is to think proactively—that is, to develop and review long-term needs for OFS that can be addressed through contracts or financial agency agreements. The CARB provides a forum for high-level review of these needs and helps to tailor specific acquisition plans based on that information.

The decision to acquire services through a contract begins with the consideration of the following questions:

1. Are the required goods and/or services other than something that is inherently governmental?
2. Can the services be obtained at a competitive price from the private sector?
3. Can the services be acquired without creating an immitigable conflict of interest?
4. Will it be more cost-effective, for duration or other reasons, to outsource the work?

The decision to use a financial agent, on the other hand, begins with the consideration of two different questions:

1. Does the work entail the direct management of public assets, such as the purchase, valuation, custody, or disposition of investments or cash? (Financial agent authority is used to obtain the infrastructure, inherent capabilities, or special expertise of a financial institution.)

2. Does the work entail close collaboration between Treasury and a provider such that a fiduciary relationship is required? Simply put, does OFS require the services of an agent who can act as an extension of Treasury?

These two sets of questions highlight the different purposes of the two approaches. The first approach described is used for the acquisition of goods and/or services pursuant to a statement of work. The second is used to engage eligible financial institutions to execute transactions and manage financial assets pursuant to a scope of agency.

Selection Process

Although the legal authority underlying procurement and financial agency authority is different, and the threshold questions prior to utilizing each authority are different, in the end, Treasury's goal is to engage the private entity who is best qualified to perform the function at a price that represents fair value for the taxpayer. As such, both approaches follow similar steps of solicitation, evaluation and selection, as follows:

For FAR-based acquisitions, a solicitation is posted on the Federal Business Opportunity website or other Government-wide point of entry, or otherwise transmitted to potential offerors. The solicitation describes the service(s) requested and outlines, in detail, the information to be included in the offeror's proposal and the criteria that will be used to evaluate the proposals submitted. Treasury then convenes a technical evaluation panel to identify the proposal or proposals that represent the best value to Treasury, considering cost and other factors identified in the solicitation. In the case of most contracts awarded in the first year in support of the TARP, Treasury either fully competed the work requirement using the GSA Schedule or held limited competitions pursuant to the "unusual and compelling urgency" authority of the FAR, the latter method utilizing a streamlined process to solicit and evaluate proposals that represented the best value. Nonetheless, the streamlined process followed the same basic process for traditional procurements, including the conduct of market research to identify the best qualified firms to whom Treasury released the solicitation, as well as a competitive evaluation to include a consideration of conflicts of interest, if any, prior to selection.

The process for selecting a financial agent is described in the procedure "Financial Agent Selection and Designation". When appropriate, it begins with the issuance of a public notice, posted on a Treasury website, describing the service and requesting that interested financial institutions respond with written proposals. In the case of special requirements or urgent needs, Treasury may send a solicitation to only those financial institutions that Treasury believes are qualified to meet the requirements. The proposals are evaluated by the selection committee in terms of their responsiveness to the business need, a consideration of potential conflict-of-interest, and the price. Once the preferred firm is identified, the Office of Financial Agents prepares a "Recommendation and Decision Memorandum" that documents the basis of the selection for the Fiscal Assistant Secretary who is authorized to designate the agent. The financial agency agreement and related exhibits are then drafted and executed.

Encouraging Participation of Small Businesses

With FAR procurements, Treasury actively encourages the participation of small businesses and strives to provide meaningful opportunities for their participation. Treasury staff researches

corporate capabilities prior to soliciting offers for goods and services. This research is supported by Treasury's Office of Small and Disadvantaged Business Utilization (OSDBU) and the Small Business Administration (SBA).

Even for those services procured under an unusual and compelling urgency, Treasury has requested proposals from as many sources as practicable under the circumstances. Treasury has also performed outreach efforts to encourage the participation of small businesses, including minority, veteran, and women-owned small businesses. In addition, Treasury establishes goals for dollars obligated to various socioeconomic categories of small businesses. Treasury's publicly available fiscal year 2010 and 2011 goals are (categories in italics are subsets of the initial category):

Category	Goal %
Prime Contracts	
Small Business	28.5%
Small Disadvantaged Business	5%
Women-Owned Small Business	5%
Service-Disabled Veteran-Owned Small Business	3%
HUBZone Small Business	3%
Subcontracts	
Small Business	44.7%
Small Disadvantaged Business	5%
Women-Owned Small Business	5%
Service-Disabled Veteran-Owned Small Business	3%
HUBZone Small Business	3%

The table is published on the OSDBU website: http://www.treas.gov/osdbu

All of the financial agent arrangements are designed to encourage and facilitate the involvement of small financial institutions. The notices soliciting financial agents and the agreements designating financial agents contain evaluation criteria related to small financial institutions. Indeed, a majority of the current financial institutions designated as financial agents to help implement EESA (8 of 15) are small institutions, including six minority- or women-owned financial institutions. In addition, the directly designated financial agents have themselves engaged 26 small and minority- and women-owned firms as sub-providers, as well as 23 small and minority-, women-, and veteran-owned financial institutions to serve as co-managers for the auctions of warrants and the sale of common stock.

Preventing Conflicts of Interest

Treasury works diligently to identify and prevent any potential conflicts of interest related to its use of financial agents and contractors within OFS. In enforcing the TARP conflicts of interest interim final rule (31 C.F.R. Part 31), Treasury works with its contractors and financial agents, as well as independently, to identify and mitigate potential organizational and personal conflicts of

interest that may arise during the retention of financial agents, the awarding of procurement contracts and blanket purchase agreements, and during the performance periods of such agreements and contracts.

At the inception of a procurement contract, blanket purchase agreement, or task order issued under a procurement contract, Treasury reviews the scope of work to be provided under the arrangement and the type of organization that may be selected to perform the services. Treasury identifies circumstances that might give rise to an organizational or personal conflict of interest, and includes conflicts provisions in the procurement contract, blanket purchase agreement, or task order; these are standard provisions that are based on the scope of work and type of organization.

Every bidder seeking a procurement contract or blanket purchase agreement is required to provide a conflict of interest mitigation plan and identify actual, potential, or apparent organizational and personal conflicts of interest as part of its proposal. The mitigation plan is reviewed by Treasury and, if necessary and appropriate, the bidder is required to provide additional information and/or a revised conflicts of interest mitigation plan. Contract and task orders are not awarded unless the associated proposed mitigation plan is determined to be acceptable. The mitigation plan is revisited and, if necessary, revised if warranted by the circumstances (such as when the business structure of the contractor changes, or when additional work is ordered under the contract).[1]

Similarly, financial agents are required to identify actual, potential, and apparent organizational and personal conflicts of interest. Treasury discusses the conflicts of interest with the financial agent and ensures the development of a conflict of interest mitigation plan that is tailored to the scope of work to be performed by the financial agent and the financial agent's business structure. The mitigation plan is revisited and, if necessary, revised if the circumstances warrant it (such as if the business structure of the financial agent changes, or if the financial agent begins to perform work under the FAA for the first time).

During the term of all financial agency agreements and contracts, Treasury remains engaged with all parties (OFA, financial agents, PSD and contractors) to raise awareness of the conflicts of interest requirements to help ensure conflicts of interest are appropriately identified and mitigated. The financial agents and contractors are required by the TARP conflicts interim final rule to continually assess for conflicts, identify and disclose to Treasury any actual, potential, or apparent conflicts of interest that may arise, and to develop changes to their mitigation plans as appropriate. Treasury addresses conflicts of interest identified by contractors or financial agents, and ensures that measures taken to mitigate any such conflicts of interest are sufficient.

Monitoring Performance and Enforcing Compliance

[1] Pursuant to 31 C.F.R. § 31.200(b), administrative services identified by the TARP Chief Compliance Officer under the TARP (e.g. lease, furniture, newspaper subscription, etc.) are not subject to the TARP conflict of interest regulation.

The process for monitoring the performance and compliance of a contractor or financial agent is contained in the respective procurement contract or agreement. In both cases, this monitoring involves routine assessments, self-reporting, and third-party verification.

Treasury employs several layers of internal controls associated with contract performance, including Contracting Officer oversight and monitoring, delegation of day-to-day monitoring to certified Contracting Officer Technical Representatives (FAC-COTRs), and internal management reviews. In addition, OFS chartered the CARB to review and monitor the administration of all OFS contracts and financial agent agreements to ensure consistent and effective performance management. The review board, comprised of OFS and other Treasury personnel, regularly reviews performance data across all OFS procurement contracts and agreements and detailed information regarding individual contract performance. Performance issues are addressed as appropriate by rejecting or withholding payment, issuing cure notices for sub-par performance, stopping work, and considering the performance as an element in future award decisions.

Because financial agents serve as an extension of Treasury, OFS has installed especially rigorous processes to measure performance and ensure compliance:

> Treasury collects quantitative measures on a quarterly or monthly basis to monitor the performance of all 15 agents. This process is administered by the Office of Financial Agents but involves OFS stakeholders in a structured and systematic way. It balances objective measurements (e.g., quantitative counts of work products) and subjective measurements (e.g., survey responses) to create a balanced scorecard of the agent performance. In some cases, the scorecard results are linked to a modest performance incentive paid to the agent.
>
> To ensure compliance, every agreement requires that the agent self-certify annually that they are complying with 10-to-15 selected terms of the agreement. OFS has instituted a program of site visits where Treasury staff annually review the processes and controls of each agent at their office location. In addition, the agreement requires that the agent annually review the effectiveness of their internal controls. Many agents engage an outside contractor to perform a SAS70 audit – or conduct an in-house audit of comparable scope and method.

We agree with the Panel that contracting and engaging financial agents is an extremely important issue in the administration of EESA, and we appreciate the opportunity to discuss the comprehensive regime we have put in place to closely monitor the external agents utilized by Treasury.

Thank you again for the opportunity to discuss these important issues today.

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

Statement from the Office of the General Counsel
U.S. Department of the Treasury
September 22, 2010

The Department of the Treasury strongly supports the important oversight role of the Congressional Oversight Panel in helping to restore liquidity and stability to the United States financial system. Over the past twenty-two months, Treasury has complied with every request for information that we have received from the Panel, including numerous interviews, briefings, and document productions. Treasury staff has spent thousands of hours working with the Panel Members and their staff.

In this particular circumstance, the Panel requested testimony from one of the private law firms that represents Treasury. We understand and respect the Panel's interest in obtaining information from this law firm. However, lawyers play a very special role, which requires them to provide confidential advice to their clients. It is highly unusual for them to testify in public, except in extraordinary circumstances. Therefore, Treasury offered a reasonable alternative—a detailed briefing early next week, which the Panel has accepted. The Panel Members and their staff will be able to ask questions, gather relevant and detailed information from the law firm, and include that information in its public report. We believe that this briefing fully satisfies the Panel's request for information *and* respects the traditional role of outside counsel.

Mr. SILVERS. Thank you both for your testimony.

We will now have a round of questions, 5 minutes with each panelist.

Mr. Grippo and Mr. Backes, in each of your areas of operation can you explain to the Panel how you go about determining what functions—how you went about and go about determining what functions in the TARP program are suitable to be executed internally by government personnel and which ones should be outsourced?

I note—the Panel understands the "inherently governmental" test that applies under traditional contracting. That is sort of obviously not the point in relation to financial agents. But we assume that there are financial agent-type functions that are done internally. So how do you draw those distinctions? Mr. Grippo first.

Mr. GRIPPO. Sure. Mr. Silvers, there are two or three key criteria. The first is whether the government has or can reasonably put in place an infrastructure for a particular function. For example, if we need capital markets expertise and we do not have a trading desk, which we do not, we would naturally look to outsource that function to a firm that does capital markets trading, since that is not a function that the Treasury does.

Secondly, we look to whether we need an objective third party to perform some function. So if we are looking for the valuation of an asset or advice on potential structurings of an investment where we really do want independent advice and the public is looking for us to get independent validation of our actions, we would look to likely designate a financial agent.

Probably the third criteria, which was most important at the outset of implementing TARP, related to time to market. Given the urgent circumstances of the crisis, it was in many cases best to engage a third party to implement something quickly. So as an example, the Bank of New York Mellon, which we engaged within about 10 days of the passage of the statute, we brought to bear dozens of individuals to help us begin implementing the Act.

So the criteria are—do we have the infrastructure or not, do we need an objective or independent third party, and what is the time to market consideration.

Mr. SILVERS. Thank you.

Mr. Backes.

Mr. BACKES. In the realm of Federal contracts it's a little more standard, but at OFS we implemented a Contract and Agreement Review Board, which I mentioned, which brought essentially the OFS personnel and executives across Treasury together to contemplate those specific strategies as to whether we would go to insource opportunities, whether we would go to contract or financial agents, and to deliberate on those, reviewing the short-term need versus the long-term requirement and what we could do, and review strategies for both, getting it today and getting it in the long term.

On a case by case basis, each action that is proposed for a contract will have a specific plan, in which we engage in tradeoffs on whether it makes sense to keep it in house or to go to contract.

Several of the considerations that we engaged in in some of the deliberation, the "inherently governmental" discussion was promi-

nent, as well as whether it was available as a non-personal service contract and precludes us from hiring staff, if you will.

Mr. SILVERS. Can I stop you there for a second. How do you look at legal services in relation to the framework you've laid out? It's not money management.

Mr. BACKES. No.

Mr. SILVERS. And the government obviously has a lot of lawyers. So give me a little insight into that?

Mr. BACKES. Well, legal services weren't seen as an agent. They're let on contract. Legal services are commonly available in the commercial marketplace. So we looked to law firms where Treasury didn't have, at the time, existing Federal expertise within the Federal workplace.

Mr. SILVERS. So you look more broadly than simply what's available within the Treasury Department when you make these—when you go through this type of analysis?

Mr. BACKES. Certainly, certainly.

Mr. SILVERS. But it's peculiar to me—and perhaps you can explain to me—why you don't view lawyers as sort of agents with fiduciary—in a sort of fiduciary context. That's generally how lawyers are understood to operate, although obviously they don't have discretion over funds. Can you explain that to me?

Mr. BACKES. We're not looking at lawyers as individuals.

Mr. SILVERS. Law firms.

Mr. BACKES. When we approach a contract relationship, we look at whether we can create that arm's length relationship that would exist in the commercial marketplace, and we recognize law firms as within that realm. So we can contract for legal services and then they're provided. Those law firms are seen as providing an expertise in a certain area.

Now, I acknowledge your concern in the opening statement that was made regarding Cadwalader and the special relationship, and we did have deliberations about that relationship. But we recognized them as available through contract.

Mr. GRIPPO. And, Mr. Silvers, I would just add that the authority to designate financial agents of the United States, both in the Act and in other statutes, is limited to financial institutions. So there's no statutory authority that I'm aware of that would allow us to legally designate a law firm as an agent or a party standing in our shoes.

Mr. SILVERS. No, I meant the agent in the generic sense, rather than in the specific sense. I clearly understand that they are not within the financial agent space.

With that, my time has expired.

Mr. McWatters.

Mr. MCWATTERS. Thank you.

Gentlemen, Fannie and Freddie failed 2 years ago. They were bankrupt. They would have been liquidated, closed down, but for the fact they were taken into conservatorship, something unusual. The Congressional Budget Office has estimated that the bailout of those two institutions will cost the taxpayers approximately $389 billion. Given that, given that they have not been managed in the best way, why award them contracts that total $220 million? Why not someone else? Why not someone from the private sector?

Mr. GRIPPO. Simply put, we made a determination that there were no other parties with the capabilities and infrastructure to operate a national mortgage modification program. I can point to experiences that we had in October and November of 2008 in making that determination. You recall that one of the original programs under the Act, was to purchase, directly purchase, troubled assets off the books of financial institutions. One of the two programs we contemplated at the time was to buy whole loans off the books of the balance sheets of banks. We actually did an open competition, soliciting any firm, any interested party that could help us implement that program.

I believe that over 70 firms applied for that role. Through the analysis of those applications, it became clear to us that other than the GSEs—which have connections to all the servicers across the country, and which have the information technology capability to manage information related to millions of loans at the loan level, as well as the human capital to implement a national program—it became clear to us and everyone who was part of that evaluation process that if we were to implement a national mortgage program that would involve all banks, all servicers, that really the GSEs were the only ones with the infrastructure to do that.

So early on in the process during the transition and when the new Administration was formulating its own financial stability plan, a consensus was reached that the GSEs were the only ones with the operating capability and the scale and scope of resources to handle the HAMP program.

Mr. MCWATTERS. So even though they were failed business enterprises and they had failed at this business that you're talking about and other private sector participants had succeeded, it was better to pick the ones that had failed, failed fairly dramatically by the way, than to pick someone from the private sector?

I also note that the Government Accountability Office and SIGTARP have issued reports—and I can read part of them, but I'm not sure if it's worth the time—that are fairly critical of Fannie and Freddie. Are you familiar with those reports? Do you have a response?

Mr. GRIPPO. I'm generally familiar with those reports. I would offer the following thoughts. We had engaged an operating capability of the GSEs, their information technology, their ability to deal with dozens, if not hundreds, of servicers in implementing HAMP. We have not designated them as an agent or used those parts of their business related to their credit risk management standards, how they ran their own portfolio, or any other credit risk decisions that they made in the subprime space.

So we were really leveraging an operating capability, which, frankly, given the position of the GSEs in conservatorship and given the public support they were and are under, we felt was actually a good use of those resources to help the Treasury provide stability to the markets and to leverage the entities in conservatorship as best we could to help the mortgage markets.

Mr. MCWATTERS. So even though you're saying that Fannie and Freddie were ready to go, it's my understanding they've had to hire new employees, quite a number of new employees, train new employees, and the like. So I'm trying to connect that to the private

sector industry, particularly in the financial services area, where there's a lot of excess capacity, people willing, ready, and able to work, probably at a decent price. It's difficult to understand why that did not happen.

Mr. GRIPPO. Well, let's take the case of Fannie Mae. We off the bat leveraged literally hundreds of individuals in their IT operations, in their existing call centers, in their existing servicing operations, to implement the HAMP program. So while the enterprises have added personnel over time, the vast majority of people working on key functions, certainly at Fannie Mae, were existing employees of the enterprise.

Mr. MCWATTERS. Okay, thank you. My time is up.

Mr. SILVERS. Dr. Troske.

Dr. TROSKE. Thank you, Mr. Silvers.

Let me build on something you just said because I was sort of struck by it, certainly in relation to the comments I made that sometimes that contracting almost seems as if another form of a bailout. I believe that you just said that, given that they were already in conservatorship, this was another way for Treasury to simply provide them business and help stabilize the market and in some sense prop them up.

So again, in light of—was that a goal for the program? If we have someone in conservatorship already, we might as well give them some business so that they don't suffer any more serious financial difficulties?

Mr. GRIPPO. No, that was not a consideration in engaging them as financial agents. My comments went more to the fact that they had an operating capability that we needed and could leverage for our own policy purposes, and the decision to designate Fannie and Freddie had nothing to do with the desire to prop them up more than we already have.

Dr. TROSKE. Let me push a little, and maybe both of you, more generally on decisions on contracting out and awarding contracts to a single entity versus multiple entities. Certainly I do recognize the distinction between decisions that were made in fall of 2008, when the financial markets were—the financial system was under a great deal of stress, shall we say, perhaps a crisis, and then decisions that were made later, maybe in the early part of 2009.

Do you think it's important to hire only one firm to manage the assets of TARP? You've mentioned the fact that Fannie and Freddie seem to be the only firms that had the scope to adopt a national program. Was there any thought to sort of having multiple firms operating in multiple—different parts of the country? So in some sense you can get information; one firm may be more successful than others and adopt different techniques. That's another form of competition that would allow you to get perhaps the best price.

So why only one firm to handle all our assets or to do loan—to work with the servicers? Why not multiple firms?

Mr. GRIPPO. Well, in point of fact we have engaged multiple firms for many functions. Let me give you two or three examples. We originally hired three asset managers to manage the investments under the Capital Purchase Program, three relatively large institutions. We did go back and hire an additional six asset managers to get more perspective and additional talent and expertise.

So that was a case where, because of our need to hire asset management experience quickly, we hired a limited number, but we went back and expanded the field.

We've done similar things with specific capital markets transactions. So for example, Morgan Stanley has been engaged to lead the disposition of our sale of Citibank common stock, but they have involved 23, I believe, additional firms, most of them small, as either co-managers or part of the selling group. That's an instance where we did engage one party. We needed a lead manager, but we made it clear that we wanted a diversity of views and opinions and additional providers.

So I think we have over time endeavored to engage as many providers as is reasonable to get a diversity of input.

Dr. TROSKE. So in terms of these contracts, and in particular the HAMP program that Fannie is managing, how do you—what's success? What are you looking for from them? How do you—what metrics are you using to judge whether they're successful?

Mr. GRIPPO. Speaking strictly in terms of vendor management and not necessarily policy success of the program, there are two or three things to note. We measure their performance qualitatively against things like how are they helping us contain costs and what is their sensitivity to costs, how responsive are they, what is our business relationship like with them.

In addition to that, there are quantitative measures: How are they processing transactions? How timely and accurate are their reports? How many servicer reviews are conducted? So there's a variety of qualitative and quantitative techniques we put in place to manage their performance.

In addition to that, there are a variety of what I'll call agreement compliance tools we have, where they are required to report to us on internal controls, on risk assessments, on their IT security, on training of employees, on how they have revisited their conflicts of interest mitigation plans.

So both in terms of performance management and agreement compliance, there is a pretty robust regime of documents, standards, and continual reviews with the enterprises.

Dr. TROSKE. Thank you.

We're going to do another round of questions. Let me turn to the conflict of interest subject in somewhat more detail. Mr. Grippo, in your initial remarks you talked about—actually, in response to my initial question you talked about obtaining an objective third party as a reason why you would seek out an outside financial agent. I'm sort of puzzled by that and I want you to address the following issue, and it's sort of multi-dimensional.

In your written testimony, I believe you jointly alluded to the notion that there may be conflicts that can't be managed. It strikes me that there might be many circumstances in which there are no objective private sector third parties, particularly given the types of institutions and types of securities that TARP was dealing with.

What is—when is the government the objective third party?

Mr. GRIPPO. I think I can say that in making a final determination as to whether a conflict exists, or whether it is mitigated, the government is the final party. Even though we ask all of our agents and contractors to identify conflicts and come up with plans,

ultimately we are the ones who are determining whether the conflicts have been mitigated.

I can say that we have not had a case, certainly not with any financial agent, and I'm not aware of any instances with contractors, where we have gone ahead and engaged a third party where there was an unmitigated conflict of interest. All actual and potential conflicts of interests must be directly addressed to our satisfaction before we move forward with engaging a party or doing work.

Mr. SILVERS. Now, some people, including the American Bar Association, have been critical of the process under the 2009 conflict of interest rules that essentially provides for self-reporting. Now, can you tell me when a—two things. One is, when a firm self-reports, what is your check on the accuracy of their self-reporting? Then, two, as they self-report, what do you do with that data? Because I can imagine in the case of, say, Morgan Stanley or Cadwalader that it's essentially a continuous stream of self-reports.

Where does that information go and what is done with it?

Mr. GRIPPO. Let me first put self-reporting in context. We of course issued a regulation on conflicts of interest. The regulated parties in those instances were the providers. So that regulation did not include the things we do ourselves, because obviously we don't need to issue a regulation to govern ourselves.

Nevertheless, independently we evaluate the conflicts posture of all agents and contractors ourselves. So as the institutions are self-reporting, we ourselves, through a pretty extensive compliance office, are looking at the business lines of each vendor, their customers and partners, their affiliates.

Mr. SILVERS. Mr. Grippo, are you saying that basically the ABA didn't understand, that in fact you are doing your own independent assessment of conflicts of your financial agents?

Mr. GRIPPO. We indeed independently review the conflicts posture of all the agents.

Mr. SILVERS. Then can you tell me how—again, what your management process is of the self-reporting that you get, particularly with respect to what the Panel sort of assumes is a fair amount of volume that you're getting in reports from your various agents and, in Mr. Backes' realm, contractors?

Mr. GRIPPO. Yes. There is a continuous stream of self-certifications and reports on conflicts posture, at least quarterly in most cases. Frankly, we have either monthly or quarterly management reviews with certainly all of our agents, where we are asking those firms to bring to us key management officials, attorneys, sometimes internal auditors, to explain any changes in their corporate structure, their customers, their business lines, their key personnel, so that we can make a determination as to whether their conflicts of interest mitigation plan needs to be updated.

Mr. SILVERS. Can I ask you specifically with respect to money management firms and law firms, where the range of conflicts is to my view greatest. What in your experience constitutes an unmitigatable conflict?

Mr. GRIPPO. An unmitigated conflict——

Mr. SILVERS. Not unmitigated, but unmitigatable.

Mr. GRIPPO [continuing]. Would be, obviously, hiring a TARP recipient to manage TARP assets. And in fact, the conflict of interest

mitigation regulation goes specifically to issues like that and in the regulation itself declares these are unmitigated—these are conflicts that cannot be mitigated and we will not permit these kinds of activities.

There are other examples, I believe, in the conflicts of interest regulation like that.

Mr. SILVERS. My time has expired. Mr. McWatters.

Mr. MCWATTERS. Thank you.

Help me understand what unusual and compelling circumstances justified the issuance of $85 million of contracts without going through the usual competitive bidding process?

Mr. BACKES. The urgent and compelling authority that's prescribed by the Federal regulations gives us the ability to streamline the competitive process, not to ignore the competitive process. So in the case of our early contracts, where we needed to bring on private sector expertise quickly to help support our response to the crisis, we went through a process very similar to the formal competitive process. We conducted our market research. We developed a statement of need, a statement of work, and put that out to the firms that we were able to determine most likely to be qualified.

We used resources that were readily available. We used expertise reaching within the Department and also at other agencies where others might have had similar contracts. We used Federal databases of contracts to look for similar contracts elsewhere and then reach out to make contacts very quickly.

The idea at the outset of the program, at the inception, was that we needed to respond quickly, but we did it in a way that we were going to do it, as I mentioned, right.

Mr. MCWATTERS. As the exigencies have dissipated, have you opened these contracts up to competitive bidding or are they long-term contracts?

Mr. BACKES. No. One of the limitations on using that authority is to meet the minimum needs of the government at the time. So we entered into short-term contracts that in other circumstances would be seen as debilitating, because we have to go through a procurement exercise in the near term. Our short-term response was to get contracts in place to help us immediately. Mid- range, we expanded that out to bring in multiple firms.

I want to address a question earlier also. Our preferred method—legal services is a good example—is not to have a single firm available under contract, but to have multiple firms. Therefore, we would have a competitive environment going forward, not locked into a single source for a particular thing, and also the ability to mitigate conflicts. So if a particular firm had or a conflict arose later on, we would have other firms that we would be able to draw upon to meet the need.

Mr. MCWATTERS. Right. But if that is the case, why does one law firm, Cadwalader, have a potential value of their contracts at $147 million? Why isn't that split out among a dozen law firms, or at least four or five other law firms? In fact, $250 million of potential value procurement contracts are shared among Cadwalader, Simpson Thatcher, E&W, and PWC. I can understand the two accounting firms since we only have four left, unfortunately. But the law

firms, there's plenty of law firms and they're happy to take your business the last time I checked.

Mr. BACKES. Yes, and I do appreciate your concern deeply.

To finish the thought, the long-term strategy, which is now bearing fruit, is to have a full and open competition among all of the law firms that are interested in doing business with the TARP. We just recently awarded 13 contracts with a potential value of $99.5 million, I believe is the right number. That $99.5 million is not one ceiling on one contract, but that's the program value. So among those 13 firms, they'll compete for that potential value.

That's also the case in the previous iterations, where we have awarded multiple contracts for particular engagements. In the example of the bankruptcy program, we awarded contracts to three firms who competed for a potential value of $26 million. One firm has achieved significant dollars under the contract because of the work they did and because of their success and their effectiveness at representing us.

Mr. MCWATTERS. Okay. I'd like to—well, I'm not sure if I have time to do this. Well, Professor Stanger—and I hope I'm pronouncing her name correctly—I want to read you guys something: "The business of government is increasingly in private hands and there is a broad consensus that the current Federal contracting system is antiquated, ill-equipped to deal with the surging demands placed upon it. It is not unfair to say that the TARP was a bailout of the financial system, administered by the financial system, with all the potential conflicts of interest that inevitably arise when the regulators are simultaneously the regulated."

Any comments on that?

Mr. GRIPPO. All programs established under TARP, every single investment decision made under TARP, were made by employees of the government. Not a single dollar has been allocated based upon the discretion of a private party. We have made all the investment decisions under this statute.

Mr. MCWATTERS. My time is up. I'll ask Professor Stanger to elaborate also.

Thank you.

Mr. SILVERS. Thank you, Mr. McWatters.

Dr. Troske.

Dr. TROSKE. I'd like to continue with what Mr. McWatters was pushing on. Give me your thoughts on the appropriateness of a regulatory body—and Treasury does have regulatory authority, as do other entities in the Federal Government—while the Federal Government is also simultaneously contracting with firms that it regulates. That seems to me to present a large moral hazard problem that it seems difficult to overcome.

I guess I'd like—you've done this for a while, much longer than me. Give me your thoughts on that.

Mr. GRIPPO. There is a clear separation between the regulatory authority in the Treasury, embodied in the OCC, the OTS, what have you, and the policy and political authority in other areas of the Department. We have taken great pains, and indeed the regulatory agencies would take great pains, to make sure that that separation in the law between those two parts of our business is never breached.

I'll give you one example on how we have implemented contracting and procurement procedures to recognize a similar distinction. In the Treasury order that created the Office of Financial Stability, most of the authorities for implementing the Act were delegated to the Assistant Secretary for Financial Stability, which is a political position. However, decisions related to the designation of agents and entering into contracts were not delegated to the Assistant Secretary for Financial Stability.

In the case of financial agents, that's actually delegated to a career official in the Treasury, who is not subject to any political process. So the ultimate decision in designating any financial agent is by a career government official and not by a political official.

Dr. TROSKE. So let me ask you a little bit about that. In particular, you're contracting with banks, who are regulated by other entities. Is there a process whereby if a bank does something or a financial agent does something that violates some regulation that's set by a regulatory body—does that influence—would you get that information? Would you use that information in judging whether you wanted to continue to do business with this firm? Is that something that you take into account when thinking about their compliance, their regulatory requirements?

Mr. GRIPPO. Yes. One of the requirements for eligibility to be designated a financial agent is that there are no material or debilitating regulatory findings or any findings that would present a reputational risk to the Treasury. So as we evaluate what agents to designate, that is an evaluation criteria. The agents must certify to that over time and there are procedures in place that would allow us, through appropriate information-sharing mechanisms, to validate with the regulator whether a potential agent has that kind of regulatory problem.

Dr. TROSKE. Something that—your answer to Mr. Silvers' question I wanted to ask a little bit about, because obviously I'm not understanding something, so I'd like you to help me. You said that an unmitigatable instance, you would never give a TARP recipient TARP assets to manage or TARP moneys. But wasn't—both Morgan Stanley and Mellon did receive TARP money. So are they not managing TARP assets, or help me understand this?

Mr. GRIPPO. Sure. Morgan Stanley was designated as a financial agent, but well after they had repaid their TARP investment and no longer had any obligation to us as a counterparty.

In the case of Bank of New York Mellon, they were obviously hired as our custodian. However, they were not hired to manage assets or to actually conduct transactions. Asset managers, other broker-dealers, the Treasury itself, would conduct transactions and give specific instructions to Bank of New York Mellon as to what assets to take hold of, what payments to make. So that's a case where Bank of New York Mellon clearly could fulfill that responsibility without having a conflict over those assets.

Dr. TROSKE. I think my time is up.

Mr. SILVERS. The Panel thanks both of you and the Department for your testimony, and if we could then have the second panel come forward, please.

[Pause.]

We are pleased to welcome our second panel, a group of contractors and financial agents providing services to Treasury in relationship to the TARP. Our witnesses are: Joyce Cianci, Senior Vice President, Making Home Affordable, from Fannie Mae; Paul Heran, Program Executive, Making Home Affordable—Compliance, from Freddie Mac; and Mark Musi, Chief Compliance Officer and Ethics Officer from the Bank of New York Mellon.

As with the prior panel, statements are limited—please limit your statements to 5 minutes each. Ms. Cianci, you may begin.

STATEMENT OF JOY CIANCI, SENIOR VICE PRESIDENT, MAKING HOME AFFORDABLE, FANNIE MAE

Ms. CIANCI. Good morning. My name is Joy Cianci and I am Senior Vice President for the Making Home Affordable Program at Fannie Mae. In this role I help to lead Fannie Mae's efforts as the Program Administrator in support of Treasury's Making Home Affordable Program. I appreciate this opportunity to discuss Fannie Mae's role as Program Administrator.

Our role in supporting Treasury's efforts to carry out the MHA Program is a top priority for Fannie Mae. We have moved expeditiously to carry out our responsibilities under the Program, both to help significant numbers of homeowners and to ensure careful stewardship of the public resources committed to this effort.

I will briefly summarize the statement we have provided for the record.

As Program Administrator, Fannie Mae established a dedicated Program Management Office. We assigned dedicated groups to carry out servicer integration, back office support, technology development, financial management, and policy advice. We also are making use of the Company's resources, corporate procurement, and compliance and ethics functions, all on a nondedicated basis.

Let me offer five key examples of our work to implement the Program. First, one of our main duties is to support Treasury's efforts to prepare and distribute the guidelines, policies, forms, tools, and training for the Program. To date we have helped Treasury issue 20 Supplemental Directives to loan servicers. We collaborated with an inter-agency team to build and enhance the Net Present Value Tool used to determine loan eligibility, and we have conducted 124 training sessions or events with key industry participants.

Another key duty is to get loan servicers involved in the MHA Program. We have signed up over 110 servicers that cover about 90 percent of potentially eligible loans in America. We established the HAMP Solution Center to execute those agreements, answer general inquiries about Program guidelines, and resolve borrower cases escalated by third parties. We also maintain a website that provides Program guidelines and secure access to tools servicers need to complete the loan modification process.

A third key duty is borrower outreach. Together with Treasury, we set up a borrower information website, which has received over 92 million page views. We also established a borrower call center through the Homeowners HOPE Hotline. The call center has received more than 1.4 million calls since June 2009 and has translation services available in over 150 languages.

We launched a ground campaign with borrower outreach events in markets hard-hit by the foreclosure crisis, where homeowners can meet with servicers and HUD-approved housing counselors. So far we have held 44 events that have attracted a total of nearly 45,000 homeowners. We also created a public service advertising campaign in English and Spanish, in partnership with the Ad Council.

A fourth key duty is serving as facilitator to the servicer paying agent, Bank of New York Mellon. We calculate the incentive payments to be paid by the agent to servicers, borrowers, and/or investors as appropriate, and to date we have facilitated the payment of $770 million in these incentives, including both GSE and non-GSE payments.

A fifth key duty is serving as record-keeper for executed loan modifications and other Program activities. We developed and launched a dedicated systems platform known as IR2 and we continue to enhance the platform. According to the MITRE Corporation, an independent consulting and research firm engaged by Treasury, we were able to create the IR2 system of records substantially faster, more efficiently, and at a substantially lower cost than comparable systems in the industry.

Now let me touch on two specific relevant topics. With respect to compensation, Treasury pays Fannie Mae for its work according to an agreed-upon budget. The budget is set at cost with no markup for profit. Treasury can withhold payment if we fail to meet established deliverables and milestones, which it has not done to date. Fannie Mae has not received any incentives from the Program.

Finally, in carrying out the Program Fannie Mae strictly enforces its obligation to comply with Treasury's conflict of interest regulations in all required areas. We have established firewalls that restrict the flow of information between Program personnel and other personnel not working on the Program. We restrict access to systems containing Program-related information. We also require employees involved in the Program to sign nondisclosure agreements and we require training, monitoring, and auditing related to our conflict of interest obligations.

In closing, we take our role as Treasury's Program Administrator very seriously. We have a lot more work to do. We are committed to our role in supporting Treasury's efforts to make the Program work for struggling homeowners.

Thank you.

[The prepared statement of Ms. Cianci follows:]

Statement of Joy Cianci
Senior Vice President, Making Home Affordable Program, Fannie Mae
Hearing of the Congressional Oversight Panel
Washington, D.C., September 22, 2010

Members of the Congressional Oversight Panel, thank you for the opportunity to discuss Fannie Mae's work as the U.S. Treasury Department's financial agent and as a Program Administrator for the Administration's Making Home Affordable (MHA) Program.

My name is Joy Cianci, and I am Senior Vice President for MHA at Fannie Mae. In this role, I help to lead Fannie Mae's efforts as the MHA Program Administrator for Treasury under the terms of the Financial Agency Agreement (FAA) of February 18, 2009. Fannie Mae works closely with Treasury as well as our regulator, the Federal Housing Finance Agency, Freddie Mac, the servicers who interact with homeowners, and other partners in this important effort.

Fannie Mae's role as Program Administrator is a top priority for the company. We move expeditiously to carry out our responsibilities under the Program pursuant to the terms of the Agreement, both to help significant numbers of borrowers and to ensure careful stewardship of the public resources committed to this effort. It goes without saying, there are great numbers of homeowners who need help, and we have a lot more work to do - Fannie Mae is deeply committed to carrying out the important role and responsibility we have been given under the Program, we appreciate the opportunity to serve in this capacity, and we take this role very seriously.

My testimony today will focus on Fannie Mae's work as Program Administrator in support of Treasury's Making Home Affordable Program, and I will to limit my comments to our implementation of those duties.

Role, activities and actions as Program Administrator

First, let me briefly recap the various initiatives we are working on as Treasury's Program Administrator. These include:

- HAMP, which is a uniform home loan modification program designed to help eligible struggling homeowners achieve a more affordable payment on their first lien mortgage.

- Second-Lien Modification Program (2MP), which creates a comprehensive solution to help struggling homeowners achieve greater affordability in their mortgages. It offers incentives to servicers and investors to modify or extinguish second-lien mortgages to enable a more affordable overall housing payment for homeowners with second lien mortgages.

- Home Affordable Foreclosure Alternatives Program (HAFA), which provides incentives to servicers and borrowers to pursue a short sale or deed-in-lieu of foreclosure where the borrower may be eligible for a HAMP modification but does not qualify for, or failed to enter into, a permanent modification.

- Unemployment Program, which provides short-term payment relief through forbearance to homeowners struggling to make their monthly mortgage payments because of unemployment.

As Program Administrator, under the terms of the FAA, Fannie Mae's principal activities in carrying out its responsibilities under our Agreement with Treasury include the following:

- Communicating the guidelines and policies for the Program, preparing the requisite forms and tools, and assisting in the training of loan servicers and industry stakeholders on the Program requirements;

- Developing and implementing standard agreements and processes to initiate servicer participation in the Program, and conducting servicer outreach throughout the life of the Program;

- Developing and implementing an overall marketing plan for the Program that targets borrowers at risk of foreclosure;

- Overseeing a customer-service call center to respond to borrower and other inquiries regarding the Program;

- Calculating the subsidies and compensation incentive payments to be paid by BNY Mellon, the paying agent, consistent with Program guidelines;

- Serving as record-keeper for executed loan modifications and other Program activities; and

- Performing other tasks as directed by Treasury from time to time, including providing support for other programs under MHA.

To carry out the MHA Program, Fannie Mae established a dedicated Program Management Office. We also assigned dedicated groups to carry out servicer integration, back office support, technology development, financial management, and policy advice. In an effort to minimize the overall administrative overhead expenses, we are also making use of certain functions that support Fannie Mae's other business activities, including in such areas as human resources, corporate procurement, and compliance and ethics, all on a non-dedicated basis.

Let me offer a few illustrations of how we have carried out the required activities under the Program:

- In preparing and distributing the guidelines and policies for the Program, as well as the requisite forms, tools, and training, to date, we have: assisted Treasury with the issuance of 20 Supplemental Directives; collaborated with an interagency team to build and enhance the Net Present Value (NPV) tool (for determining loan eligibility); and, to date, have conducted 124 training sessions and/or events with key industry participants, including servicers, trade groups, industry professionals and organizations, community partners, and borrowers.

- We launched a HAMP Solution Center to execute Servicer Participation Agreements ("SPAs"), answer general inquiries regarding Program guidelines and the NPV model, and resolve borrower cases escalated by third parties.

- In August 2010, we published a consolidated and comprehensive reference guide called the MHA Handbook, which outlines the requirements and guidelines for the MHA Program. Servicers will be able to conveniently reference the Handbook for all Program guidance. Future versions of the Handbook will be expanded to include policy guidance for all new programs as well as recent policy directives.

- We assisted Treasury in the implementation of a borrower website – including the production of instructional videos and the translation of Program educational materials in seven languages. We also oversee the Homeowner's HOPE Hotline call center efforts to help struggling homeowners determine their basic eligibility for the Program, connect with HUD-approved housing counselors, and escalate their cases for review of MHA guidelines if applicable.

- We support Treasury's outreach efforts in markets hard hit by the foreclosure crisis through a ground campaign that brings together struggling homeowners, servicers and HUD-approved housing counselors in local communities to help borrowers achieve modifications and understand their options. To date, almost 45,000 people have attended these borrower outreach events.

- In serving as facilitator to the paying agent, we calculated the incentive payments to be paid by BNY Mellon to servicers, borrowers and/or investors, as appropriate, under the Program. It should be noted that Treasury does not pay, and Fannie Mae does not receive, incentives under the Program for modifications of Fannie Mae-owned loans.

- In serving as record-keeper for executed loan modifications and other Program activities, we developed, launched, and enhanced a dedicated systems platform know as "IR2," which is the system of record for all Program information. In order to update IR2 to accommodate new programs, Fannie Mae has issued numerous releases and versions of this tool, with each

- In coordinating with Treasury and other parties toward achievement of the Program's goals, we support Treasury by providing data analysis and reporting and performing other tasks as directed by Treasury from time to time.

As we continue to carry out these activities, I would like to clarify and underscore Fannie Mae's role in relation to Treasury and the Program.

The MHA Program is a Treasury–owned Program. As Program Administrator, Fannie Mae plays an important role in support of Treasury and its Program. While Fannie Mae routinely offers advice to Treasury and discusses implementation matters, ultimately it is Treasury that sets policy, issues directives, and is the final decision-maker on all Program-related matters. Treasury also monitors, supervises, and decides whether to accept Fannie Mae's work as Program Administrator.

It should also be noted that other entities also carry out important support functions to Treasury. Freddie Mac – as Treasury's Program compliance agent – conducts examinations and reviews servicer compliance with Program rules and guidelines. BNY Mellon, as Treasury's paying agent for the Program, coordinates transfer of incentive funds to servicers for payment to borrowers, servicers and investors, as applicable. Finally, loan servicers have the most essential role to play in the success of the Program. They are the primary interface with borrowers and are ultimately responsible for executing modifications.

Let me also address several specific relevant topics.

Compensation

Treasury compensates Fannie Mae for its work as Program Administrator according to an agreed-upon budget. The budget is set at cost, with no mark-up for profit.

The cost of employees and contractors working on the Program – including staff providing technology services, servicing operations and NPV modeling and analytics – are compensated as fixed-fee amounts related to our cost of labor. Other than contract labor, which is covered in our fixed fee, our third party costs – including costs for marketing and call center operations – are handled on a cost reimbursement (or pass-through expense) basis. In selecting subcontractors and vendors, Fannie Mae deploys its standard competitive bidding process unless time-to-market pressures dictate otherwise, and has complied with its obligation to engage women-owned, minority-owned, and small businesses. Indeed, in furtherance of our work for Treasury, we have awarded contracts to 19 small and diverse companies.

It should be noted that Treasury can withhold payment if Fannie Mae fails to meet established deliverables and milestones.

Conflict of interest

Fannie Mae strictly enforces its obligation to comply with Treasury's conflict of interest regulations in all required areas – organizational conflicts of interest, personal conflicts of interest, and confidentiality of Program-related information. Fannie Mae routinely enhances its approach to conflicts of interest, and – in consultation with and upon approval by Treasury – has deployed a variety of mitigation techniques, including:

- Firewalls that restrict the flow of information from Program personnel to other personnel that are not working on the Program;
- Restricted access to systems containing Program-related information;
- Restricted access to certain workspaces;
- Nondisclosure agreements;
- Training, monitoring, and auditing;
- Certifications and attestations about compliance with conflict of interest requirements; and
- Required reporting of breaches of Fannie Mae's obligations.

Interaction with Servicers

Servicer participation in the Program begins with registration and the execution of a SPA. Fannie Mae has a dedicated team charged with assisting servicers. The team helps servicers through the details of executing and administering SPAs, including assisting in securing approvals by Treasury, and managing the HAMP registration activities required to give servicers access to Program reporting tools, NPV-related material and tools, and other Program materials.

Servicers are paid an incentive amount based on the type and number of modifications successfully completing the trial period and becoming permanent modifications. Incentive payments are calculated in our system of record and then paid to servicers, borrowers, or investors dependent on the payment type via the Program paying agent, BNY Mellon. Payment information is contained in the Program system of record and electronically communicated to BNY Mellon for distribution on the payment due date.

Our servicer support includes a dedicated team of Fannie Mae personnel, working closely with the participating servicers, day to day, to help them implement the Program. Our teams are available to answer general questions from participating servicers, help them understand basic Program requirements, and escalate issues to Treasury. We also established a servicer support call center, we conduct weekly conference calls with the leadership of participating servicers, and we have provided training through over 275 live web seminars, recorded tutorials, checklists and job aids on HMPadmin.com.

In short, we strive every day to do everything possible to help servicers carry out their responsibilities under the Program and to help more borrowers.

Progress of Program Administration efforts

Finally today, I would like to provide an update on Program Administration results to date in several areas.

- We have signed SPAs with 113 servicers, including the largest, and now have approximately 90% of potentially eligible loans in America covered by MHA SPA servicers.

- We have established a website, www.HMPadmin.com, to provide general guidelines and overview documents available to the public as well as secure access to core tools and documents needed to complete the loan modification process. Since its launch in April 2009, the site has received approximately 2,000 unique visits a day.

- With our assistance, as of the July HAMP servicer performance report, servicers have initiated over 1.3 million trial modifications and nearly 435,000 borrowers have received a permanent HAMP modification.

- We have undertaken an aggressive borrower-outreach effort with Treasury. This effort includes several activities: the establishment of an MHA borrower website (MakingHomeAffordable.gov) that has received over 92 million page views; the establishment and oversight of a borrower call center through the Homeowner's HOPE Hotline, which has received over 1.4 million calls since June 2009 and has translation services available in over 150 languages; and, the design and implementation of a public service advertising campaign (in English and Spanish) in partnership with the Ad Council. In its first phase, the campaign reached over 8 million households, and in its second phase (launched in July 2010), has been distributed to over 33,000 media outlets nationwide.

- In 2009, we designed and implemented the MHA Ground Campaign on Treasury's behalf to reach out to troubled homeowners in markets across the country that have been hard hit by foreclosure. Borrower Outreach Events in each market provide homeowners an opportunity to meet face-to-face with mortgage servicers and HUD-approved housing

- With respect to Fannie Mae's work to develop, enhance, and maintain the IR2 system of record, The MITRE Corporation, an independent consulting and research firm engaged by Treasury, found that Fannie Mae was able to create the IR2 system of record substantially faster, more efficiently, and at a substantially lower cost than other comparable systems in the industry.

- From the Program's inception through August 2010, we facilitated the payment of $770 million in incentives to servicers, borrowers, and investors.

* * *

In closing, as a Program Administrator for the Making Home Affordable Program, Fannie Mae now has the main Program elements and infrastructure in place. Clearly, we have much more work to do to support Treasury's Program. We take our role and responsibility very seriously, and we are committed to the tasks at hand and meeting the challenges ahead of us. I look forward to addressing any questions from the Panel. Thank you.

Mr. SILVERS. Thank you, Ms. Cianci.
Mr. Heran.

STATEMENT OF PAUL HERAN, PROGRAM EXECUTIVE, MAKING HOME AFFORDABLE—COMPLIANCE, FREDDIE MAC

Mr. HERAN. Thank you, Mr. Silvers. Members of the Congressional Oversight Panel, thank you for inviting me to speak today. I am Paul Heran, Program Executive of Making Home Affordable—Compliance. We refer to ourselves as "MHA–C." I lead MHA–C in its examination, compliance, and consulting roles as a financial agent of the U.S. Treasury. I report to Freddie Mac's chief compliance officer. Before joining Freddie Mac, I spent 34 years at Ernst & Young auditing financial services companies. I closed my career at E&Y as the directing partner of their bank audit practice.

MHA–C is responsible for evaluating compliance for non-GSE loans only. Our responsibilities include evaluating and reporting on servicers' compliance with HAMP. We evaluate compliance and we assess the effectiveness of servicers' internal controls assuring that compliance. We also consult with Treasury on observations to improve the program.

To fulfill our compliance role, MHA–C created a new organization in a short period of time. I have established—we have established a comprehensive examination program, a strong partnership with Treasury, and an effective working relationship with servicers. We are providing reports for Treasury and providing effective feedback for servicers. At the same time, we continue to strengthen our own organization and are continuously improving our processes, our procedures, and controls. We are fulfilling our role and responsibilities as the compliance agent for Treasury.

We believe our work with Treasury on key initiatives has significantly improved the effectiveness of HAMP. These key initiatives have included:

Evaluating servicers' use of the NPV model. This model provides a key component of determining borrower eligibility for the program.

Developing and executing what we call the Second Look program to determine that borrowers are properly solicited and evaluated for the program.

Last, we evaluate incentive payments paid to servicers from TARP funds. That is protecting taxpayer dollars.

Treasury actively manages MHA–C. Senior Treasury officials direct and closely monitor our activities. Three Treasury employees are on site full-time at MHA–C offices. All of our principal activities, including protocols for conducting examinations and reporting our observations, are performed under guidelines established by Treasury. I and my senior management team report to Treasury's MHA compliance committee weekly. The committee is staffed by senior Treasury officials leading the MHA program and is chaired by a Treasury official with overall responsibility for compliance. At these meetings we discuss the status of our compliance program, observations from our examinations, and any ongoing challenges.

MHA–C's examination program includes: testing servicers' internal controls to verify that eligible borrowers are solicited and considered for the program; reviewing servicers' use of the NPV model;

examining loan files; reviewing the computation and payment of TARP incentive funds to servicers, investors, and borrowers.

In consultation with Treasury, we select servicers to audit, loans to review, and areas of examination focus. We select servicers to audit on a frequency schedule based on size and risk. We routinely conduct additional short-notice reviews to respond to adverse observations or emerging risks.

At the conclusion of each audit we provide servicers with summaries of observations. These observations may include noncompliance with program guidelines, internal control weaknesses, and in the case of loan file reviews, differences with servicers' conclusions on solicitation and eligibility.

Servicers are generally required to respond to our observations within 30 days. However, depending on the severity of the observations or guidance from Treasury, we may require an accelerated response and corrective action. Also, based on severity of observations, we may conduct additional short-notice reviews.

Decisions to impose financial remedies on servicers are made by Treasury's compliance committee. Although we provide input into the committee's decisionmaking process, we do not participate in deliberations concerning financial remedies. These decisions are made exclusively by Treasury.

Finally, Freddie Mac has established an extensive program to address potential conflicts of interest. In short, Freddie Mac created MHA–C as a separate business unit within the company, staffed by employees dedicated to MHA–C activities only. My written statement provides a detailed summary of this program.

I am proud of the work that MHA–C has done. We have helped improve servicer compliance and have helped homeowners access this very important program.

Thank you again for this opportunity to discuss our role. I am happy to answer any questions.

[The prepared statement of Mr. Heran follows:]

Statement of Paul Heran
Program Executive
Making Home Affordable – Compliance
Freddie Mac

Hearing of the Congressional Oversight Panel
Washington, DC
September 22, 2010

Members of the Congressional Oversight Panel, thank you for inviting me to speak today. I am Paul Heran, Program Executive of the Making Home Affordable – Compliance (MHA-C) division at Freddie Mac.

I am responsible for leading the MHA-C division in its examination, compliance, and consulting roles as a financial agent of the U.S. Department of the Treasury. I report to Freddie Mac's Chief Administrative Officer and Chief Compliance Officer, who in turn reports directly to the Company's CEO. Prior to joining Freddie Mac, I was an audit partner with Ernst and Young (E&Y). During my 34-year career at E&Y, I focused on auditing financial services firms, including mortgage banking companies, and ended my tenure there as Directing Partner of the Bank Audit Practice.

In my testimony, I summarize our key accomplishments to date; outline the role, structure and operations of MHA-C; discuss our working relationship with Treasury; summarize our role in identifying and addressing servicer performance issues in the Home Affordable Modification Program (HAMP); and describe Freddie Mac's compliance with Treasury's rules regarding conflicts of interest.

Key accomplishments to date

Freddie Mac was honored to be asked by Treasury in February 2009 to fulfill the role of compliance agent for HAMP. Our task essentially was to create a wholly new business function and organization, hire staff (which, as noted below, included transferring qualified personnel from the existing Freddie Mac organization), and begin operations immediately. Under the best of circumstances, such an assignment is very challenging. Yet in a very short time, in the midst of the recent financial crisis, Freddie Mac was able to get a comprehensive and effective compliance program up and running.

MHA-C is comprised of highly skilled professionals whose accomplishments include establishing a strong partnership with Treasury, productive and effective arms-length working relationships with the servicers whose HAMP operations we audit, a comprehensive examination program, a series of audit reports for Treasury, and a system of effective feedback to servicers. While our task is by no means complete, and we continue to strengthen and refine MHA-C's processes, procedures and organization, we believe we are fulfilling the important responsibilities Treasury has assigned to us and are contributing to the overall effectiveness of HAMP.

We also believe our work with Treasury on key initiatives has significantly improved the administration and effectiveness of HAMP. These include evaluating the servicers' use and/or reproduction of the Net Present Value (NPV) models (which provide a key component of determining borrower eligibility for HAMP), developing and executing the "Second Look" initiative (to determine whether borrowers have been effectively solicited and evaluated for HAMP modifications), and our evaluation of the accuracy of incentive payments made to servicers from TARP funds.

MHA-C's role, structure and operations

MHA-C is responsible for evaluating compliance for non-GSE loans that are currently administered by over 100 servicers who have operations throughout the United States. Its responsibilities include evaluating and reporting on the compliance of servicers with HAMP's requirements; and consulting and reporting to Treasury on issues and lessons learned to improve the operation of HAMP.

Treasury actively manages MHA-C. Senior level officials within Treasury's Office of Financial Stability direct and closely monitor MHA-C's activities. In addition, at least three Treasury employees are assigned to work full time on-site in MHA-C's office and oversee the activities of MHA-C. All of MHA-C's principal activities, including conducting examinations and reporting our observations, are performed under protocols and guidelines established by Treasury and in consultation with Treasury officials.

Moreover, MHA-C senior management reports on the program's status, issues and challenges at weekly meetings of Treasury's MHA Compliance Committee. The committee is composed of senior Treasury officials leading the MHA program and is chaired by the Treasury official with overall responsibility for compliance. This meeting is followed by more targeted, detailed discussions with the committee chair concerning planned activities, results, and current challenges.

Freddie Mac has created MHA-C as a separate business unit within the Company staffed by employees dedicated to MHA-C activities. MHA-C utilizes office space, computer servers and other equipment that are separate from the rest of the Company to minimize the risk of potential and actual conflicts of interest, which I will discuss in more detail below.

From the start, MHA-C has sought to fill positions with both permanent employees and contractors, reflecting our specific skill set requirements (e.g., extensive backgrounds and experience in auditing, mortgage servicing and other areas), the limited duration of HAMP, and the need to establish our compliance program and operations in a very short time frame. MHA-C currently has 132 full-time, permanent employees and 118 full-time contractors.

Organizationally, MHA-C is composed of the following groups:

- *Testing and Monitoring,* which is responsible for internal control and compliance audits onsite at servicers' locations.

- *Loan File Operations*, which is responsible for the loan file review process (at MHA-C's centralized location), in which a representative sample of files is reviewed. The process includes the evaluation of borrowers both rejected from and accepted into the program.

- *NPV*, which provides evaluation of reproduced NPV models and the use of Treasury's model.

- *Servicer Oversight,* which conducts short notice audits as needed.

- *Reporting and Risk Analytics*, which is responsible for data analysis and identifying resultant compliance trends and patterns at the program and servicer levels.

- *Program Disbursements Testing*, which provides an evaluation of HAMP incentive payments.

- *Quality Assurance,* which is responsible for monitoring the quality of MHA-C's own work product and internal control self-assessments.

- *Internal Operations*, which provides internal operational support.

Compliance examinations

MHA-C's compliance examination program reviews servicers' compliance with the requirements of HAMP. Among other things, the examinations include:

- Testing the servicers' internal controls, which are designed to support HAMP.

- Verifying that borrowers are solicited, that eligible borrowers are identified and included in the servicer's loan modification program, and that ineligible borrowers are not included.

- Reviewing the use of the NPV tool required by Treasury.

- Examining a sample of loan files to validate compliance with HAMP requirements.

- Reviewing the computation and payment of TARP funds to servicers, investors and borrowers.

- Providing useful programmatic information and feedback to Treasury.

MHA-C's review of the NPV model use provides an example of the scope of these examinations. MHA-C periodically reviews usage of the model by servicers and actively monitors all servicers with recoded models. Testing includes both controls over the model use and, in the case of recoded models, the actual calculation of the model. Where issues have been identified in recoded models, servicers have been required to validate results in the Treasury model.

In consultation with Treasury, MHA-C selects servicers to audit, numbers of loans to review, and areas of examination focus based upon risk. Each testing group within MHA-C conducts its activities under an operating model that has been reviewed and approved by Treasury. MHA-C also develops with Treasury a schedule of planned audits and other compliance activities. For these planned activities, MHA-C provides servicers 30 days notice to allow for coordination, document gathering, and required security clearances. However, MHA-C also routinely conducts short notice audits with less advance notice to respond to adverse audit results and address emerging program risks.

While the detailed procedures vary by MHA-C group, at the conclusion of each audit activity, in consultation and based on procedures agreed to with Treasury, MHA-C provides the servicer with summaries of all preliminary observations. These observations may be incidences of noncompliance with program guidelines, internal control weaknesses or, in the case of loan file review, specific differences with servicer conclusions on solicitation and eligibility. Subsequently, MHA-C finalizes audit work papers and prepares additional communications or formal reports to servicers. All workpapers, communications and reports are subjected to MHA-C and Treasury quality assurance reviews. Generally, upon receipt of a formal report, the servicer has 30 calendar days to provide a written response to each observation included in the report. Depending on the severity of the observation and/or guidance from Treasury, MHA-C accelerates communication and may require an accelerated response and corrective action to expedite the remediation. Also, based on severity of observations, MHA-C may conduct additional short notice audits.

MHA-C reports to Treasury

As noted above, MHA-C is in daily and ongoing contact with Treasury regarding the entire spectrum of issues relating to MHA-C's work. Thus much of our reporting to Treasury consists of informal workplace communications, including our participation in weekly Treasury MHA Compliance Committee Meetings. However, MHA-C also provides Treasury with several periodic status reports:

Business Status Reports – A compilation of all the audit work MHA-C has and is performing or scheduled to perform for all servicers.

Second Look Reporting (for detecting loans that may not have been solicited, or may have been inappropriately denied inclusion in HAMP) – Summarizes the servicers that were examined, the number of files reviewed, and the results. These results are reported to Treasury during Compliance Committee meetings.

Budget Reporting – Accrual, invoice, financial results, and contractor reports, as well as quarterly financial forecasts and the annual budget reports.

MHA-C also produces other reports on an ad hoc basis as directed by Treasury.

Actions taken against noncompliant servicers

Following MHA-C's review of a servicer, MHA-C notifies the servicer of actions needed to correct noncompliance with HAMP rules, guidelines or procedures. In consultation with Treasury, MHA-C may direct a servicer to perform remediation activities in response to MHA-C's observations. For example, if a servicer did not uphold its solicitation obligations as defined in the guidelines, MHA-C may restrict a servicer's foreclosure activities until solicitation is completed. Also, if a recoded NPV model is determined to provide unreliable results, a servicer may be required to validate results in the Treasury approved model until the recoded model's reliability can be substantiated.

Decisions to impose financial remedies on a servicer are addressed by Treasury's MHA Compliance Committee. MHA-C provides detail on its observations but does not participate in financial remedy decisions.

Conflicts of interest compliance

Freddie Mac is committed to complying with the conflict of interest requirements and restrictions outlined in MHA-C's Financial Agency Agreement (FAA) with Treasury, related Treasury regulations, and additional requirements provided by Treasury. In the course of fulfilling our duties as compliance agent for HAMP, we have access to confidential and proprietary information about servicers participating in HAMP and evaluate service compliance with HAMP guidelines.

To address potential conflicts of interest related to this work, Freddie Mac has established an extensive compliance program to address both organization and personal conflicts of interest and reasonably ensure the confidentiality of this information. A dedicated team within Freddie Mac's Compliance, Regulatory Affairs and Mission Division has been tasked with the responsibility for implementing a conflicts of interest compliance program that applies to all Freddie Mac officers, employees, and vendors – including those associated with MHA-C.

The compliance program is designed to reasonably ensure compliance with the requirements of the FAA and Treasury's regulations and additional requirements established by Treasury. Organizational conflicts of interest are addressed by establishing MHA-C as a separate business unit within Freddie Mac accountable under the FAA to Treasury. Corporate policies, including an information wall policy and other controls, are designed to restrict the flow of servicer specific and borrower specific information from MHA-C to other parts of the Company including those employees who are implementing Freddie Mac's own Home Affordable Modification Program. Freddie

Mac has also established a series of controls to identify and manage personal conflicts of interest, including the disclosure and review of personal financial information and restrictions on gifts and entertainment from servicers and others.

Furthermore, appropriate business units, including MHA-C, have adopted policies and procedures that further specify conflicts of interest requirements and the processes to comply with those requirements. The obligations under the FAA and Treasury's regulations are regularly communicated through an established communications and training program to all Freddie Mac employees and contractors working under MHA-C or providing advice to Treasury.

On a quarterly basis, Freddie Mac certifies to Treasury regarding organizational conflicts of interest, personal conflicts of interest and confidentiality. In addition, annually, Freddie Mac certifies to the continued accuracy of representations and warranties contained in the FAA. Freddie Mac also has a process of testing key controls to reasonably ensure that they are operating as intended. These controls are also subject to audit by Freddie Mac's Internal Audit Division and further testing by Treasury.

Conclusion

As outlined in my testimony, MHA-C has fulfilled and continues to fulfill the compliance role Treasury set forth. In a very short time, MHA-C has created an effective organization and set of compliance testing programs. MHA-C works closely with Treasury and effectively with HAMP servicers. In so doing, MHA-C has contributed to the progress of HAMP in helping borrowers. MHA-C continues to refine and improve processes and procedures, and will continue efforts to support Treasury and the Making Home Affordable Program.

Thank you again for this opportunity to discuss the role and activities of MHA-C with you. I am happy to answer any questions you may have.

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

Statement from the Office of the General Counsel
U.S. Department of the Treasury
September 22, 2010

The Department of the Treasury strongly supports the important oversight role of the Congressional Oversight Panel in helping to restore liquidity and stability to the United States financial system. Over the past twenty-two months, Treasury has complied with every request for information that we have received from the Panel, including numerous interviews, briefings, and document productions. Treasury staff has spent thousands of hours working with the Panel Members and their staff.

In this particular circumstance, the Panel requested testimony from one of the private law firms that represents Treasury. We understand and respect the Panel's interest in obtaining information from this law firm. However, lawyers play a very special role, which requires them to provide confidential advice to their clients. It is highly unusual for them to testify in public, except in extraordinary circumstances. Therefore, Treasury offered a reasonable alternative—a detailed briefing early next week, which the Panel has accepted. The Panel Members and their staff will be able to ask questions, gather relevant and detailed information from the law firm, and include that information in its public report. We believe that this briefing fully satisfies the Panel's request for information *and* respects the traditional role of outside counsel.

Mr. SILVERS. Thank you, Mr. Heran, for your testimony.
Mr. Musi.

STATEMENT OF MARK MUSI, CHIEF COMPLIANCE AND ETHICS OFFICER, BANK OF NEW YORK MELLON

Mr. MUSI. Thank you. Mr. Silvers and members of the Panel: Thank you for the opportunity to appear before you today. My name is Mark Musi and I am the Chief Ethics and Compliance Officer, BNY Mellon.

You have requested that BNY Mellon testify concerning its role as a financial agent of Treasury in connection with Treasury's administration of the Troubled Asset Relief Program. In particular, we understand the Panel would like us to address compliance policies, procedures, and practices with respect to conflicts of interest and confidentiality stemming from BNY Mellon's role as financial agent for Treasury under TARP. Since our appointment, BNY Mellon has been highly sensitive to the demands of our role and the corresponding importance of having robust policies, practices, and procedures in place to address conflicts of interest and confidentiality concerns.

A comprehensive statement of our policies, procedures, controls, and mitigation plan is incorporated in the financial agency agreement that governs our responsibilities. That agreement sets forth many of the stringent policies, procedures, and mitigation controls we have in place with regard to conflicts of interest and confidentiality issues. Furthermore, on a regular basis our TARP compliance personnel interact with Treasury's TARP compliance oversight personnel to ensure that we are meeting Treasury's expectations with respect to conflicts of interest and confidentiality concerns and monitoring.

I'd like to quickly summarize some of the more significant processes that we have in place to minimize any concerns about conflicts of interest and confidentiality. We have an information barrier policy. Under this policy, TARP-specific material nonpublic information may only be shared with those who need to know the information to perform their duties under the FAA.

We also have a TARP-specific restricted securities list. An issuer's securities are added to this confidential list to facilitate BNY Mellon's surveillance efforts, which help ensure that the information barrier is maintained.

With respect to controls, we implemented enhanced access restrictions to TARP-related electronic and paper files, which segregate and protect the confidentiality of TARP information.

As an added layer of protection, individuals servicing TARP are physically separated from asset management personnel and use separate information technology systems. Also, all BNY Mellon employees and subcontractors are required to execute a nondisclosure agreement prior to accessing any TARP information, and to reinforce these processes, employees servicing TARP receive training specifically tailored to their obligations under the FAA, and this is in addition to other specific compliance-related training that these employees would receive.

Regarding personal conflicts of interest, BNY Mellon applied its existing policies, which provide mitigation controls, including a

comprehensive code of conduct, a personal securities trading policy, and other personal trading restrictions. In addition, BNY Mellon maintains and enforces corporate-wide policies and procedures that address relevant conflicts of interest mitigation controls, such as compliance training, incident reporting, and limitations on communications with employees of Treasury.

Finally, since the inception of the program in October of 2008, both our business and compliance personnel have had routine ongoing discussions with Treasury concerning BNY Mellon's performance under the FAA.

In conclusion, our TARP compliance program is comprehensive and robust and is working as planned. We have a professional and productive working relationship with our client, the U.S. Treasury, and its compliance professionals.

Thank you for giving BNY Mellon the opportunity to appear before you today. I look forward to answering your questions.

[The prepared statement of Mr. Musi follows:]

TESTIMONY OF MARK MUSI

CHIEF COMPLIANCE AND ETHICS OFFICER

BNY MELLON

BEFORE THE CONGRESSIONAL OVERSIGHT PANEL

SEPTEMBER 22, 2010

Mr. Silvers and Members of the Panel, thank you for the opportunity to appear before you today. My name is Mark Musi and I am the Chief Compliance and Ethics Officer for BNY Mellon.

You have requested that BNY Mellon testify concerning its role as a Financial Agent of the U. S. Department of the Treasury ("Treasury") in connection with Treasury's administration of the Troubled Asset Relief Program or TARP. In particular, we understand that the Panel would like us to address compliance policies, procedures and practices with respect to conflicts of interest and confidentiality stemming from BNY Mellon's role as Financial Agent for Treasury under TARP. I am happy to address these issues. BNY Mellon was selected as Financial Agent for TARP by Treasury in October 2008, very shortly after enactment of the Emergency Economic Stabilization Act of 2008. From the outset, BNY Mellon has been highly sensitive to the demands of our role as a Financial Agent for Treasury and the corresponding importance of having robust policies, practices and procedures in place to address conflicts of interest and confidentiality concerns.

Given our long history of servicing the government in various capacities, and the need for a culture of compliance in serving as agent and trustee for public and private entities, the

conflicts of interest and confidentiality policies, procedures and enforcement mechanisms that we have applied in our role as Financial Agent in the TARP program were not new to our way of doing business. Because our principal business is moving, holding, and administering assets for customers, the types of conflicts that arise with firms that have substantial mergers and acquisition and underwriting activities are not present in our company.

A comprehensive statement of our policies, procedures, controls and mitigation plan are incorporated in the Financial Agency Agreement for Custodian, Accounting, Auction Management and Other Infrastructure Services. This agreement, known as the FAA, and executed by Treasury and BNY Mellon, is the master contract that governs our responsibilities and undertakings as Treasury's Financial Agent in the TARP Program.

As set forth in detail in Exhibit E of the FAA, BNY Mellon has applied stringent policies, procedures, and mitigation controls with regard to conflicts of interest and confidentiality issues. Furthermore, on a regular basis, our TARP compliance personnel interact with Treasury's TARP compliance oversight personnel to ensure that we are meeting Treasury's expectations with respect to conflicts of interest and confidentiality controls and monitoring.

I would like to first outline for the Panel the scope of our compliance and mitigation plan in the area of conflicts and confidentiality. Next, I will describe the way in which compliance oversight monitoring is performed on an ongoing basis as well as the regular interaction our TARP compliance officers have with their counterparts in Treasury.

A. Conflicts of Interest and Associated Mitigation Controls

1. Organizational Conflicts of Interest

As Financial Agent, BNY Mellon comes into possession of sensitive and material non-public information. In order to address the concern that BNY Mellon as Financial Agent not use

such information for its own advantage or to favor affiliates or its clients, in addition to our standard conflicts process to comply with applicable securities laws, rules and regulations, we developed procedures that are specific to the TARP program, including:

- Information Barrier Policies – Consistent with our company-wide policy, TARP-specific material non-public information may only be shared with those individuals who need to know the information to perform their duties under the FAA.
- Use of a Restricted Securities List – We have a TARP-specific restricted securities list. The inclusion of an issuer's securities on this confidential list facilitates surveillance of BNY Mellon's activities to ensure that the information barrier is maintained.
- Controls Over Electronic and Paper Files related to Non-Public Information – We implemented enhanced access controls to TARP-related electronic and paper files, which segregate and protect the confidentiality of TARP information.
- Separation of TARP-related Custodial and Infrastructure Services from Asset Management Functions – Individuals servicing TARP are physically separated from asset management personnel. And we use separate information technology systems.
- Non-Disclosure Agreements – All BNY Mellon employees and subcontractors are required to execute a non-disclosure agreement prior to accessing TARP information.

2. Personal Conflicts of Interest

To address concerns that individuals employed by BNY Mellon in connection with its operations as Financial Agent use material non-public information for their own benefit, BNY Mellon applied its existing policies, which provide the following mitigation controls:

- Quarterly Disclosure – All key individuals (as defined in 32 C.F. R. Part 31.201) personally and substantially involved in performing services under the FAA must

disclose quarterly information to our Compliance Department equivalent to the information required on the U.S. Office of Government Ethics Form 450.

- Personal Trading Restrictions – If a security is on our TARP-specific restricted securities list or investment activities in that security by key individuals or their related persons is prohibited, except where it is determined that the key individual is not in possession of material non-public information. This determination may only be made by members of our Compliance or Legal Department.

3. Additional Mitigation Controls

BNY Mellon maintains and enforces corporate-wide policies and procedures that address the following relevant general conflicts of interest mitigation controls.

- Code of Conduct – All employees working on the FAA are required to annually attest to compliance with BNY Mellon's Code of Conduct. In addition, all management employees and others deemed to be in sensitive positions must complete a comprehensive questionnaire designed to identify potential conflicts of interest.
- Training – Employees servicing TARP receive compliance training related to their obligations under the FAA, in addition to their other comprehensive compliance training.
- Monitoring/Compliance – Compliance and business control units regularly test compliance with the various provisions of the FAA.
- Incident Reporting – Employees servicing the FAA are required to promptly report any suspected or known breach of any provision of the FAA, including breaches of the conflicts of interest or confidentiality.

- Restrictions on Gifts and Entertainment Policy – All employees have strict limitations on their acceptance or giving of gifts and entertainment, which are monitored and managed by our Compliance Department.
- Limitations on Communications with Employees of the Treasury – Under the FAA, BNY Mellon does not make any direct or indirect offers of employment or business opportunity to Treasury employees.
- Use of Subcontractors to Support the FAA –BNY Mellon works with its subcontractors and Treasury to assess potential conflicts of interest and receives conflicts of interest certifications from each subcontractor quarterly.

4. Certifications

Quarterly and annually, BNY Mellon as Financial Agent and its subcontractors performing work under the FAA certify compliance with policies governing organizational and personal conflicts of interest, communication with Treasury employees, and confidentiality.

5. Additional Obligations and Controls

- BNY Mellon has a continuing obligation to report any known potential organizational or personal conflicts of interest no later than five business days after discovery.
- In addition to our obligation to disclose to Treasury any conflicts or confidentiality issues, BNY Mellon discloses to Treasury other matters concerning its services as Financial Agent, as required by the FAA.
- Pursuant to the FAA, BNY Mellon's Human Resources Department, working with our TARP business managers, determines that employees servicing TARP and those of its subcontractors are United States citizens or lawful permanent residents.

B. Interaction with Treasury Compliance Personnel

Since the inception of the program in October of 2008, both our business and compliance personnel have had routine, ongoing discussions with Treasury related to BNY Mellon's performance under the FAA. In particular, our compliance personnel are in frequent communications with compliance professionals at Treasury to ensure that we are transparent and fully understand the expectations related to conflicts and confidentiality. We have considered those conversations a vital and important part of fulfilling our obligations as the Financial Agent for TARP.

Conclusion

In conclusion, our TARP compliance program is comprehensive and robust and is working as planned. We have a professional and productive working relationship with our client, the Treasury, and its compliance professionals.

We are proud of our role as Financial Agent for Treasury in this important undertaking, and we look forward to continuing to assist our Government in this program.

Thank you again for giving BNY Mellon the opportunity to appear before you today.

Mr. SILVERS. Thank you, Mr. Musi. It is unprecedented in my experience that a witness finish ahead of schedule.

Mr. MUSI. You're welcome.

Mr. SILVERS. And I can't recall any time that any of us did, either. [Laughter.]

Let me say how much the Panel appreciates all of your testimony. At the risk of embarrassing Mr. Musi further, I particularly found that your testimony addressed what we wanted very thoroughly, and I appreciate that.

We will have two rounds of questions today, as with the prior panel.

First I just want to get something straight. Mr. Heran, you said that your program does compliance and oversight for non-GSE mortgages. Who does it for GSE mortgages?

Mr. HERAN. GSE mortgages is handled by the GSEs themselves, under the supervision of FHFA.

Mr. SILVERS. So that means that for mortgages that are held and securitized by Freddie Mac, that's another department within Freddie Mac, not your department?

Mr. HERAN. That would be another department within Freddie Mac, that's correct.

Mr. SILVERS. All right. This may not be your—this may not be your bailiwick, so to speak, but how can you explain—how can you explain that it's not okay for you to do that with Freddie Mac mortgages and yet someone else within Freddie Mac, it's okay for them to?

Mr. HERAN. You're right, Mr. Silvers, it's not my bailiwick. I'm not sure how the decisions were made. I know that I was brought in to focus on compliance on non-GSE and that's what I'm doing.

Mr. SILVERS. Okay. I'm sure we can pursue that with the appropriate people.

Mr. Heran and Ms. Cianci, can you tell me what you understand your mission, so to speak, to be in the eyes of your, A, your superiors within your firms; and then, B, from the Treasury Department? And is there any difference between the two?

Mr. HERAN. Well, I'll start. I don't believe that there is a difference between the two. I think that management at Freddie Mac wants us to comply with the FAA and all agreements with Treasury. Treasury has the same objective. I can tell you that I view the main responsibility as making sure that every borrower that deserves to be a part of this program gets an opportunity to be a part of this program.

Mr. SILVERS. Ms. Cianci.

Ms. CIANCI. I will also add, this is clearly a top priority for Fannie Mae. We are here to provide high quality service under obligations under the FAA as well and to support Treasury's efforts to make the Program as successful as possible for struggling homeowners.

Mr. SILVERS. How do you measure that?

Ms. CIANCI. We work very closely with Treasury. We provide them with a variety of data regarding our performance under our obligations on a monthly basis. They have a process by which we invoice them and they have the option to pay us or withhold some or all of that payment if they feel that we're not meeting our obli-

gations as they've been set out. To date, they have never withheld that. So we——

Mr. SILVERS. I'm asking you a different—and I'm asking both of you this question.

Ms. CIANCI. Okay.

Mr. SILVERS. How is this measured? You've described general goals and Treasury hasn't fired either of your firms. But how is your performance measured? What are the metrics that are used, either by your senior management within your firm or by Treasury? And what constitutes good?

Ms. CIANCI. I'll continue with the thought that, with respect to Treasury and our performance, I feel there is a constant feedback loop to our expectations and how we're performing against those. There are also numerous third parties that are engaged to review our work. For example, the MITRE Corporation, as I noted in my opening statement, reviewed our work in the IR2 space for 2009. They're presently reviewing our IR2 work for 2010 fiscal year, as well as the homeowner hotline oversight that we provide, our back office operations, our CFO team, our Program Management Office. They're looking for efficiencies in the deliverables and the cost efficiency as well.

Mr. SILVERS. Mr. Heran.

Mr. HERAN. From our standpoint, Treasury is actively involved in measurement at what I will call the lowest common denominator to measure our performance. We touch servicers in a number of ways. We have many different initiatives that, quote, "audit" the servicers. We are measured against meeting the objectives and the number of visits each of these different groups do within the organization. We're managed very closely on that, on virtually a weekly basis.

Mr. SILVERS. My time has expired. I assure you, Mr. Musi, I will come back to you in the next round.

Mr. McWatters.

Mr. MCWATTERS. Thank you.

You know, I cannot pick up the paper or go to the Internet on a daily basis and I do not find an article about a homeowner who's disgruntled by the entire process of dealing with Fannie and Freddie, HAMP, doing a mortgage modification or a refinancing under another program. They often say that: I was asked for certain papers, I submitted the papers, the papers were lost; I was then asked for different papers. They're getting a run-around.

You know, if you read this once or twice you think, well, this is some reporter on sort of a slow news day. But when you read it on a daily basis, it tells you if there's smoke there's probably some fire.

So I'd like your comment on that, and specifically what you can say to the homeowners, who may actually listen to some of this, what you're doing about that to streamline the program, to ask for what you need the first time, to actually receive it, and then make decisions?

Mr. HERAN. I'll take the first stab at that, Mr. McWatters. I share your concern and I deeply sympathize with every borrower that is experiencing those kinds of difficulties with servicers. I in fact am more bothered with it, I believe, than most people would

be, because I've got to do two things. I've got to, one, sympathize; and then, second, try to figure out what can I do differently to help that borrower.

I assure you that every time one of those stories comes out we do go back, reevaluate our processes to try and figure out what can we do differently, what can we do faster. We're continuously striving to improve it.

I can tell you that we do review the servicers for that exact issue, documentation and control. We have cited many servicers for that. We track their performance in implementing improvements to that and I think many of them get better as a result of our procedures. It's a continuing issue. It's been cited in the public report as a continuing issue and we will continue to try to drive enforcement.

Mr. MCWATTERS. Have there been any repercussions to you, I mean, how you've been paid? Have you been penalized by Treasury? I mean, if the private sector did this and they were performing in these ways there would be a contractual clause which basically said, after you read through eight or ten pages, you don't get paid or you get paid a lot less.

Mr. HERAN. I can understand the question. Nothing has come up about paying us for that. Again, our job is to identify the issues, to move the servicers toward compliance with the issues. We can't solve it in and of ourself.

Mr. MCWATTERS. If you can't, who can?

Mr. HERAN. It has to be solved through a combination of ourselves finding it, of Treasury driving enforcement, and of Fannie with its training procedures. It is a network of things that have to take place across many different institutions to make it work better within the servicers.

It's the servicers themselves. The servicers I believe are trying to fix these things. Some of them have more difficulty than others. But it's a comprehensive solution.

Mr. MCWATTERS. Mr. Heran, I'll stay with you a moment. You were an audit partner for 34 years, an entire career, at a large firm. Have Fannie and Freddie, this function, been audited?

Mr. HERAN. Has our function been audited?

Mr. MCWATTERS. Yes.

Mr. HERAN. Our function is under continuous review by Treasury. I would say Treasury actively manages our function. We report to senior officials at Treasury on a weekly basis. Treasury has three individuals that are full-time on site on our premises. Treasury reviews everything that we do, approves every report before it goes out.

Mr. MCWATTERS. If you were hired as a consultant for E&Y to come in to assess that assessment of Fannie and Freddie, would you be satisfied? Would you sign off on that audit?

Mr. HERAN. Would I? I'm sorry, I'm not sure I understand the question.

Mr. MCWATTERS. Well, you said that Fannie and Freddie are being in effect audited by Treasury. If you were a third party, if you were still at E&Y and E&Y was hired and you came in to assess those, including the internal control procedures, the conflict procedures and the like, would you be happy to the point that you could sign off, or would there be any material misgivings?

Mr. HERAN. No, and perhaps I misunderstood the first question. I was trying to describe the level of supervision that we receive, as opposed to an audit. Those procedures are not independent. But the point I'm trying to make is Treasury is actively managing the process, which I would think is different and in fact far more severe than whether they had a third party come in and audit the process.

Mr. MCWATTERS. But there is not a third party?

Mr. HERAN. There is no third party that audits the process.

Mr. MCWATTERS. Okay.

Ms. CIANCI. If I could add. I know the light's blinking, but there have also been—Treasury has directed us to perform an outside audit through the SAS–70 work to measure our controls. We received an unqualified opinion in that space from Grant Thornton with respect to our Program Administrator role. SIGTARP has audited our compliance and ethics performance and, as I described earlier, the MITRE Corporation is doing numerous reviews of our work as Administrator.

Mr. MCWATTERS. Thank you. That's very helpful.

Mr. SILVERS. Thank you, Mr. McWatters.

Dr. Troske, you have questions?

Dr. TROSKE. Thank you.

Let's start with you, Ms. Cianci. I'm still trying to struggle a little with exactly what output you're producing. I'm an economist, so I like to see an exact definition of outputs, since I work best with that. My understanding is you actually aren't the ones modifying the loans. That's the servicers. You're just trying to convince the servicers to do so.

So could you give me a little better—what is it that you are providing, the output that you're producing for the Federal Government?

Ms. CIANCI. It's a very wide scope.

Dr. TROSKE. Okay.

Ms. CIANCI. Let me highlight a couple of notes from my written testimony that gives a little more detail. We routinely provide advice to Treasury as it creates the policy behind the Program and help them produce the Supplemental Directives for the industry. We also are responsible for the registration of the servicers, with over 110 servicers having signed participation agreements, through our HAMP Solution Center.

We prepare the requisite forms and contracts to get them signed up for the Program. We are responsible for implementing a borrower-outreach effort on behalf of Treasury. We are also responsible for implementing an overall marketing plan that targets at-risk borrowers to help them understand the options available and where to go to get help. In connection with that, we helped produce the borrower web site, multiple materials in various languages, and we lead an outreach campaign to troubled borrowers around the country.

We also helped Treasury support a public service advertising campaign targeting troubled borrowers.

Dr. TROSKE. Great. Okay, thank you.

I was struck by something in your written testimony and your spoken testimony as well. You basically say that Fannie is doing

this task at no profit and at cost. It's my understanding you're still a for-profit private sector firm formally. So I guess, why are you doing something that is not providing any profit for your shareholders or whomever? Why would you take on a task that, as a business, that you're doing at essentially—for no profit? Why would you do that?

Ms. CIANCI. When the FAA agreement was entered into, that was our agreement, to be basically made whole for the cost to administer the Program for the public mission.

Dr. TROSKE. Okay. So again—maybe Mr. Musi could tell me. I'm assuming that BNY Mellon is earning a profit when they're performing this work. Is that a fair statement?

Mr. MUSI. We do earn a small profit on this work.

Dr. TROSKE. I would have thought that was fairly standard. If you are actually a private sector firm, a for-profit firm, don't you traditionally need to earn a profit for any actions that you take? Is this just sort of you're volunteering or this is out of a public service sense?

Ms. CIANCI. We indeed are being made whole for our costs associated with the Program. In order to help the Treasury stand up this Program with the urgencies for struggling borrowers, that was the arrangement we entered into.

Dr. TROSKE. Mr. Heran, does Freddie Mac—are you compensated in the same way as Fannie Mae? Is it for cost and no profit for the firm? Do you know?

Mr. HERAN. I do know and that is correct.

Dr. TROSKE. So you too are working essentially and earning no profit for your shareholders for the work that you're doing?

Mr. HERAN. That would be correct.

Dr. TROSKE. I must admit, as an economist I'm sort of shocked by this, or surprised by that, and struggle to understand.

You indicated, Ms. Cianci, that you've received no incentives. So there's nothing in the contract as written that would reward you for doing well, for doing an extraordinary job, for doing the job particularly well, other than the thanks of Treasury? I mean, I'm assuming they'd thank you for it.

Ms. CIANCI. There was a provision in the original contract that provided the potential for incentive compensation. We have not received incentive compensation to date and we're in the process of revising our contract with Treasury.

My understanding is the revised contract will contain no framework for incentive compensation.

Dr. TROSKE. Okay. What was the provision? What goals were you going to try to achieve that would then provide you some incentives? What were you being incented to do?

Ms. CIANCI. We had not addressed that with any specific detail until now. We are in discussions regarding it.

Dr. TROSKE. I believe my time is up.

Mr. SILVERS. We'll now have a second round of questions.

Mr. Musi, can you tell me, in dealing with—in managing the structure of conflict identification and prevention that you described, what is—what are the most serious challenges you face? And secondly, my understanding is that BNY Mellon, A, is a custodian for the TARP and thus has in certain respects less access to

information than, say, a money manager or a law firm might. Can you talk about what you might see as the challenges facing your counterparts in those types of—for those types of contractors and agents for TARP?

Mr. MUSI. When you have access to material nonpublic information—and let me describe that. That is information that, if known to somebody in the public, would allow them to benefit through an investment because it could affect the company that they are choosing to invest in and could be market-moving in terms of their stock price.

We, in our role as custodian and our servicing of the TARP contract, really only have material nonpublic information for a very short period of time, and that's when a company requests to participate in TARP, and from that point forward, when we are notified by Treasury of that, to the point where the funds are actually disbursed. It's usually approximately a 2-week period, and that's where we apply all the controls that I described previously.

The challenge for most companies in dealing with this is how to physically separate employees who would have access to the material nonpublic information associated with TARP and their actions in other parts of the company, primarily to manage assets for themselves or for their clients and, similarly, to make sure that their employees don't benefit from that material nonpublic information and trade on it.

Mr. SILVERS. Do you—what do you—you've been very thorough in outlining what you do up front. What do you do on the back end, so to speak, to monitor trading accounts, to monitor customer trading accounts, to ensure that this is not actually happening despite your best efforts?

Mr. MUSI. We have 200 employees who have been identified as servicing the financial agent agreement, and those 200 employees each are required to have their accounts at an approved broker-dealer, who provides us with feeds of any trades that they enact. Prior to trying to trade, they have to go to our centralized ethics office, which maintains a list of any financial association who is part of the TARP program, and if that name is on the list those employees are prohibited from trading.

If, for example, they did trade anyway, at a broker-dealer that wasn't part of our approved network and who doesn't provide us with on-line feeds of trades and trade confirmations, then it would obviously be up to the SEC to try and identify that. We actually get representations from all of those employees annually that they meet our code of conduct, which prohibits them from trading on inside information or sharing confidential information.

Mr. SILVERS. Do you have any process for liaisoning with the NASD and the SEC in terms of this type of back end monitoring?

Mr. MUSI. If in fact they were concerned about one of our employees for any reason, including being part of the TARP program and trading on that information, they would contact us and let us know that they were investigating them.

Mr. SILVERS. But you don't have a proactive sort of relationship with them around this sort of thing?

Mr. MUSI. We interact with the NASD and the SEC almost daily. But in regards to this, only if there was a particular concern about an individual.

Mr. SILVERS. Thank you.

Mr. Heran and Ms. Cianci, today's Washington Post has a rather extensive and quite disturbing account of efforts to foreclose on homeowners, on American families, based on what appears to be, some people characterize it as fraudulent representations, fraudulent documentation, and the like. This has been the subject of hearings across the way here in the House.

This would seem to raise a number of very serious issues about—in relation to HAMP, particularly the possibility that government money was being paid to mitigate in situations where there was perhaps no basis for doing so, and also the possibility that in various respects recipients of HAMP funds—servicers, lenders—were foreclosing on families when they had no right to do so.

This would appear to have something to do with your job. Can you tell us what you're doing in response to this?

Mr. HERAN. I'll start. Actually, this ties into Mr. McWatters' question about documents, and I'd like to at the same time clarify my response on that. The allegations have not been that Freddie Mac or Fannie Mae are losing documents. When I was referencing that we take these very seriously and we reevaluate our own procedures, it's our evaluation procedures of the servicers. These allegations have been that the servicers have been losing documents.

To the allegations in the Washington Post, this is another example. We take these extremely serious. We are clearly sympathetic to the borrowers. We will reevaluate what we do.

On the surface, on the surface, while it's of great concern because it would be an indication of breakdowns in internal controls and processes in general, I think it is important to keep in mind that the foreclosure decisioning is a different decisioning than the HAMP decisioning. HAMP decisioning actually takes place before a foreclosure is allowed to go forward.

Mr. SILVERS. Yes. But against that—and my time is up, but I cannot resist and hope my panelists will indulge me. Against the shadow of foreclosure, does it not? I mean, isn't what HAMP is doing essentially assisting people who are facing foreclosure?

Mr. HERAN. Absolutely, and HAMP and the servicers' compliance with the rules of HAMP requires a solicitation and an eligibility consideration for those borrowers. The point I'm making, if those procedures are being done correctly, those would precede—there are many, many other conditions of foreclosure, legal and otherwise, that have to take place then between the time that a borrower would not be qualified for HAMP and the time that a foreclosure takes place.

Mr. SILVERS. My time is far over. Mr. McWatters.

Mr. MCWATTERS. Thank you.

Mr. Heran, I understand that you're a conduit, that you supervise what servicers do. But if the servicers are recidivists and they have a history of losing documents and asking for documents again, and once that is communicated to you, it seems incumbent upon you to figure out a way to stop them from doing that, which was my only point. Does that make sense?

Mr. HERAN. Yes, sir. And we do. We reevaluate processes, we reevaluate what they are doing. Some of them come under much closer monitoring. And again, everything that we do, everything that we see, is reported to Treasury.

Mr. MCWATTERS. Can we then expect to see fewer of those reports of mom and pop standing in front of their house, which is being foreclosed even though, they say—and again, I don't know if they're telling the truth or not, but they say—that all the documents were submitted and they did everything they needed to do, but changes were made and they're being foreclosed?

Mr. HERAN. I assure you that I'm doing everything in my power and my group, in enforcing compliance, is doing everything in their power to make sure those complaints are minimized.

Mr. MCWATTERS. I think a lot of the American public would very much appreciate that, maybe more than most things these days.

Ms. Cianci, last month a group of outside analysts discovered that some of the data on redefaults published by Fannie was inaccurate. What has been done to fix that? Was that just a one-off deal? Is that indicative of something more systemic?

Ms. CIANCI. We believe it's absolutely contained to this table that was produced. We're very clearly disappointed in the error we made in the redefault table that was published with the June public report by Treasury, which overshadowed the good performance of the permanent modifications in this Program.

But immediately upon discovering it, we notified Treasury and we took upon a three-phased remediation approach. The first phase was about recoding and validating a revised grid. Treasury engaged the MITRE Corporation to come in and independently code and validate the grid. Fannie Mae assigned four independent teams to recode and revalidate the grid and the Fannie Mae internal audit team, with the help of a third party consultant, similarly oversaw the work.

MITRE expressed strong confidence to Treasury regarding the revised table, and so at the end of phase one the revised table was published on August 6.

In phase two, the internal audit and MITRE Corporation did a root cause analysis and helped to identify some recommendations that would bolster controls regarding our production of data in support of the public report.

We're in phase three right now, which is to implement some of those items to bolster our controls in this space.

Mr. MCWATTERS. So you are addressing it, then?

Ms. CIANCI. We are indeed.

Mr. MCWATTERS. Okay. About a year ago, on October 21, 2009, there was a report by SIGTARP or SIGTARP noted the significant difficulties that Freddie Mac was having meeting its obligations and that Treasury had to develop a detailed remediation plan addressing many of Freddie's contractual obligations, as well as a place—as well as place a Treasury official with Freddie Mac full-time.

What's your response to this, Mr. Heran? I mean, is this problem that SIGTARP identified—it's 11 months old now—has it been basically solved?

Mr. HERAN. Yes, it has been solved. I was part of the solution. As you see in my resume, I have an extensive background in public accounting and auditing financial institutions. I was brought in as part of the solution. We have dramatically expanded our hiring of audit expertise. Two of my five direct reports have been brought in since I got there and they also have Big 4 public accounting experience. So we have addressed the problem and we are doing robust auditing of these servicers today.

Mr. MCWATTERS. Assuming this job you have now will not last forever, when you look back on it how will you define success? How will you know whether or not what you're doing today was successful? What's your principal goal? If you had to write down on a piece of paper, I am here and my goal is this, what would that be?

Mr. HERAN. My goal would be—actually, you addressed it in an earlier question. My goal would be that I do not have borrowers standing on the doorstep that are being evicted from their home that there is any chance that would have qualified for this problem—for this program. There's no question that the program can't address everyone. I measure my performance on making sure that everyone that is eligible gets a chance for this program and those that are not eligible do not get into the program.

Mr. MCWATTERS. One last question. Do you see a substantial uptick in the amount of permanent modifications over the next few months?

Mr. HERAN. That really should be addressed to the program administrator.

Mr. MCWATTERS. Okay, fair enough.

My time is up.

Mr. SILVERS. Thank you, Mr. McWatters.

Dr. Troske, it's your turn. Like myself and Mr. McWatters, you're entitled to a little bit of extra time.

Dr. TROSKE. We'll see whether I take it.

Mr. Musi, as an economist I am somewhat fixated on prices, output, and contracts. I'm not going to ask you what you charge the Federal Government because that's inappropriate. But I do want to know a little bit more about the structure of your contract and how it compares to work that you would do for other entities that aren't public entities, so for private entities.

So I guess I'd start off by asking, how do you determine—how is the price set in this contract? Is it given to you? Is it a negotiation process? How does the price that you get paid compare to what compensation you'd receive if you were working for a private entity?

Mr. MUSI. We worked very carefully with Treasury to establish a price that we thought was fair to us and to them. At the inception of the program, we established a valuation-based pricing mechanism. So it's our cost, plus what we believe and what they have determined to be a reasonable markup. That markup was based on what has been our average pricing for all of the services we provide to all of our clients. So it was on that basis that we represented it to Treasury, and Treasury derived comfort from that.

Dr. TROSKE. So you feel that this is—you wouldn't be getting paid more if you were doing this for someone else other than the Federal Government?

Mr. MUSI. We believe we've priced it fairly and that the services are based on the types of services we render to other institutions and the pricing that we would derive from that.

Dr. TROSKE. What output—what is Treasury looking at when they evaluate your performance, what sort of financial—how do they monitor your performance? What is it that they tell you they're looking for in terms of what you're producing for them?

Mr. MUSI. We produce a very detailed accounting to reflect the costs. So each person who is actually supporting the program—it's literally down to the time card level—would then reflect the amount of time that they put into it, as well as other fixed costs that we have that we know are only associated with the TARP program, and those are the costs that become the basis for the cost-plus calculation.

Dr. TROSKE. Again, what are those people that are working for the program supposed to be producing? I mean, what output are they producing? What is it that you're producing for Treasury? A return on assets, or bills paid promptly on time, or what is it that you're producing?

Mr. MUSI. Our role in this process is functionally a service provider. We basically make payments in accordance with instructions and we take in assets, we custodize those assets, and we pay dividends. So it's a very ministerial, administrative type of role. All of what we're talking about are the costs associated with that administration.

Dr. TROSKE. You seem to indicate that your contract has no sort of financial incentives, that if you do this very well, you do this very well, you get paid additionally. Is there any sort of incentive in the contract that would push you to do certain actions?

Mr. MUSI. I don't believe that the contract has those terms and we are only pushed to serve the requirements that we are committed to serving in the contract, and certainly not to take any shortcuts in the interest of shaving costs.

Dr. TROSKE. Mr. Heran, I want to come back to you about some of the issues Mr. McWatters and Mr. Silvers have raised. When you find a servicer that's not in compliance, that is doing things that you find disappointing, you've said you adjust the process and try to improve and streamline the process so it works better. Do they suffer any penalties? Is there a point at which they do suffer penalties? And what would those penalties be?

Mr. HERAN. There are remedial actions. Every finding that we have goes into a report, depending on the severity of the individual observation or finding. It is followed up on. That follow-up can be, for the less severe, routine, I think the servicers are given 30 days to respond to our findings. We check the validity of those responses.

Where it's more severe, for example in the documentation that we're talking about—or even a better example might be the early, well publicized problems with the NPV model—there is immediate remediation. The servicers—several servicers were directed to cease using what's referred to as their recoded model. That is simply taking the Treasury model and making it more efficient by coding it into the servicer's own system. Many servicers were told, because of the handling of that recoded model, that they needed to

return to the Treasury model until such time as their recoded model could be remediated.

As to the question of remediation other than activities, as I said in my opening statement, we are not part of the deliberations of financial remedies, which I understand have been imposed from time to time by Treasury, but we are not a part of that.

Dr. TROSKE. Mr. Musi, I'd like to return to you. I skipped a question, so I apologize. Tell me a little bit about the procedures that you have in place to ensure that you're monitoring your compliance with FAA more generally and particularly your obligations to Treasury? What are you doing internally to make sure you're living up to the contract?

Mr. MUSI. We have a comprehensive compliance monitoring program, where people within the compliance function check regularly that we are meeting our requirements under the FAA. The employees involved produce attestations that they are following our code of conduct. We have a SAS–70 that is produced annually by an external accounting firm, that covers all of our requirements under the program. And we have quarterly representations and annual representations to Treasury about our role and our services under the agreement.

Dr. TROSKE. Thank you very much.

I'm done.

Mr. SILVERS. Thank you, Dr. Troske.

The Panel very much appreciates all of your testimony and your willingness to appear before us. The second panel is now excused and we will call the third panel. [Pause.]

So we will now move to our third panel, which consists of three individuals with considerable expertise in the field of government contracting. We are pleased to welcome: Professor Steven Schooner, who is the Professor of Law and Co-Director of the Government Procurement Law Program at the George Washington University School of Law.

We are also pleased to welcome Professor Allison Stanger, Professor and Chair of the Political Science Department at Middlebury College; and finally, Scott Amey, General Counsel for the Project on Government Oversight.

So if the panelists have got their seats, as with the prior two panels, witness statements are limited to 5 minutes per witness. Professor Schooner, you may begin when ready.

STATEMENT OF STEVEN SCHOONER, PROFESSOR OF LAW AND CO-DIRECTOR OF THE GOVERNMENT PROCUREMENT LAW PROGRAM, THE GEORGE WASHINGTON UNIVERSITY SCHOOL OF LAW

Mr. SCHOONER. Distinguished Panel members: Thank you for inviting me to join you today. Based on discussions so far, I am disinclined to disregard and not waste your time with my written testimony, which, frankly, is in large part irrelevant based on the discussion so far. So what you'll see in my written testimony is, probably the most relevant thing is footnote 2, which talks about some of the macro-level concerns with the TARP contracts. We'll know over time whether you've bought the next Winstar or Spent Nuclear Fuel set of cases.

But I do want to make just a single discrete point about the contracts before I move into some larger things. First, $445 million sounds like a lot of money, but in the grand scheme of Federal procurement it's the statistical equivalent of nothing. But objectively, looking at what Treasury's done so far, they have been more professional, transparent, and accountable than the Federal Government norm that we've witnessed over the last decade. I think that that's important to keep in mind.

A number of other things that we've talked about. I think, Mr. Silvers, in your opening statement you suggested the high level of frustration with outsourcing, and I think it's just important to keep in mind that this is not just Treasury; this is a government-wide problem. Professor Stanger has written extensively. There's a lot of literature on how dramatic it is at places like NASA, in the intelligence community, at the Agency for International Development.

But I think that one of the things that's really important is one of the most compelling and logical reasons that the government, like other organizations, outsources is for surge capacity, when they just don't have enough resources. Obviously, that's what happened here.

More importantly—and I think this is really important—if we look at the last 20 years of experience, government managers are inclined to outsource, they turn to the private sector, because it is hard, it is slow, to hire new people. The civil service regime is not responsive. They don't have meaningful incentives and disincentives to manage. And after the crisis you're stuck with all of those people.

I think what we've seen with the military reflects how dramatically the small government sentiment in this country has caused us to have a government that's too small to meet our needs.

There was also a question that arose earlier about the outsourcing of legal services and, frankly, I think that's an eminently logical step. The private sector uniformly relies on these types of individuals as their fiduciary agencies and I think—I apologize if I misheard, but I think it's disingenuous to imply that the Federal Government has legal resources available in reserve. They surely don't have them at the Justice Department, and I think that it was perfectly reasonable to turn to the private sector there.

I want to turn very briefly to, I think it was Dr. Troske who brought up the issue earlier about cost reimbursement contracts. Frankly, it's not in the least uncommon in Federal Government contracts to have pure cost reimbursement contracts with no profit. Many of the nation's largest contractors are in fact not-for-profits. But, as you know, many for-profit firms take cost reimbursement contracts or even unprofitable work for a host of reasons. They might do it to maintain their market share, they might do it to initiate, maintain, develop, their client relationships, basically achieving goodwill. They may do it to maintain their workforce in a lousy economy, or they might do it to develop capacity, facilities, or experience.

But I think, going back to the main issues that I think I might have been invited to talk about today, although I'm not even sure at this point, looking ahead, I think that the single biggest challenge that the Treasury faces with regard to the procurement con-

tracts is after contracts are awarded the government customer best protects its interest when it staffs its contract management function with skilled professionals. The problem that we have in a situation where it's all about people is over the last 20 years this is a situation where the government hasn't excelled, hasn't been competent. Frankly, it's been an unmitigated disaster. The government's track record on post-award contract management has been abysmal.

Therefore, if I was going to make a single relevant point today, it's that any prospective investment by the Federal Government generally or the Treasury Department specifically in upgrading the number, the skills, or the morale of their contract purchasing officials or their contract management officials would reap huge dividends for the government and the taxpayers. It's not going to solve the problem overnight, but it's a responsible investment in the future.

Thank you for the opportunity to share these thoughts with you. I just wanted to have you have one more witness who beat the time deadline, and I'm pleased to answer any of your questions.

[The prepared statement of Professor Schooner follows:]

Statement of

PROFESSOR STEVEN L. SCHOONER
CO-DIRECTOR OF THE GOVERNMENT PROCUREMENT LAW PROGRAM
GEORGE WASHINGTON UNIVERSITY LAW SCHOOL

Before the
Congressional Oversight Panel

Oversight in Federal Contracting

Wednesday, September 22, 2010

Key to the success of the Administration's strategy is ***a new level of transparency and accountability*** *that is designed to protect American taxpayers by ensuring proper use of public funds through conditions on lending and executive compensation, and by enhanced reporting requirements.*[1]

Distinguished Panel Members, thank you for the invitation to discuss the Treasury Department's use of its exceptional crisis contracting authority under the Emergency Economic Stabilization Act of 2008 (EESA), 12 U.S.C. § 52. It will come as no surprise to you that the oversight of federal government contracting presents daunting challenges, and the unique nature of the Troubled Assets Relief Program (TARP) leaves you navigating relatively uncharted waters. The potential for a suboptimal result is high.[2]

It is not feasible in this brief document to provide a meaningful summary of the best practices in the field of government contracting. In the interest of brevity, let me suggest two different rubrics for assessing the task you face. The first approach is to ask whether conventional public procurement offers you appropriate measures to judge the

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[1] FinancialStability.gov, specifically, *http://www.financialstability.gov/about/index.html (emphasis added).*

[2] Two examples of situations in which the government has entered into complicated contractual relationships with the private sector – divorced from the Federal Acquisition Regulation and the "normal" executive branch procedures for public procurement – that have soured and consumed, frankly, staggering litigation expenses, may prove instructive: (1) the *Winstar* line of cases, arising out of the Savings & Loan crisis, following the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA); and (2) the spent nuclear fuel cases, arising out of the Department of Energy's breach of the Standard Contract with the nuclear generators due to delays at Yucca Mountain.

performance of Treasury's efforts in this context. In large part, I conclude it does not. The second approach is to inquire whether the commonly available risk reduction and oversight mechanisms employed by the government in public procurement will prove satisfactory. Again, I am not sanguine.

Ultimately, Treasury – with its eyes open, and for good reason – entered into a large number of risky transactions, under severe time pressure. At this point, the moment had passed for the government to best employ the lion's share of the best practices to minimize and avoid risk. Many of those transactions will turn out fine. Some will not. But conventional government contracts experience will not, at this point, prove uniquely informative in reducing the government's risk.

Objectives, Aspirations, Goals, Metrics, Etc.

The first approach begins by asking what you hope to achieve through the procurement process. This may seem obvious, but it is often overlooked.

In advising developing countries on the creation, improvement, and reform of the public procurement regimes, I consistently caution against simply copying other states' procurement codes, regulation, policies, and practices. Instead, I urge them to begin with a stark assessment of what they hope to achieve through the contracting process. There are a number of commonly recognized goals for procurement regimes although, in all fairness, some of these are better described as means or even constraints.[3] Moreover, the key point is most of them require trade-offs or, in other words, more of one typically comes at the expense of another. Although not inclusive, the list includes:

- **Value for Money**: The business of government should focus on getting good value, a good bargain, for the public's money. As your personal experience no doubt confirms, an excessive focus on low price rarely ensures optimal value or the best exchange for the government's expenditure. Sometimes, it is worth paying more – often much more – for better quality goods, services, or construction;

- **Customer Satisfaction**: It seems obvious that the contract should please the end user (of the good or service or construction), but the public procurement regime presents a uniquely complex model populated by numerous customers with potentially inconsistent needs and desires. Unlike a consumer – a monolithic entity that pays for and receives a good or a service – the government customer is a disaggregated group of stakeholders, including the end user, the program manager or head of an agency (responsible for accomplishing a government

[3] Steven L. Schooner, *Desiderata: Objectives for a System of Government Contract Law*, 11 PUBLIC PROCUREMENT LAW REVIEW 103 (2002). This short piece originally was written in conjunction with the Chinese government's efforts to draft a new public procurement law. Although it offers a convenient rubric, it is by no means the last word on the topic.

mission); Congressional appropriators (the legal source of the funds); and, among others, the public – both in a micro and macro sense (the ultimate source of the funds and, at least hypothetically, the ultimate recipient of the benefit(s) of the contract);

- **Competition**: Because we believe in the power of the marketplace and profit as an incentive, we perceive that effective use of competition results in the government receiving the best value in terms of price, quality, and contract terms and conditions;

- **Integrity** or **Accountability** or **Corruption Control**: Bribery, favoritism, and unethical behavior have no place in public procurement. They diminish value for money, and they decrease public trust in governmental institutions;

- **Transparency**: Successful public procurement regimes publicly announce the rules of the games, opportunities to compete for the government's work, and the results or outcomes of the government's expenditures. Ultimately, transparency is the means through which we ensure that government business is conducted in an impartial, fair, and appropriate manner;

- **Risk Avoidance**: As steward of public funds, the government, as a customer, seeks to filter out undesirable or incompetent business partners and, upon selection of a business partner, properly allocate risks – such as cost growth, schedule slippage, and compliance with performance specifications – between the parties through use of certain contract types and remedy-granting clauses, etc.;

- **Uniformity**: Due to its interest in maximizing competition (above), transparency (above), administrative efficiency (below), governments (like any large, complex institution) reap benefits from uniformity. This reduces uncertainty, training and implementation costs, and, of course, the private sector's transaction costs (which, in turn, should reduce the government customer's costs);

- **Administrative Efficiency**: The government customer would rather spend its scarce resources obtaining the goods and services it needs, rather than funding the *process of obtaining* those goods and services. Human capital is expensive, and governments (such as ours) routinely underestimate and under-invest in identifying, recruiting, hiring, training, developing, incentivizing, and retaining top talent to staff the procurement function;[4] and

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[4] See, e.g., Steven L. Schooner & Daniel Greenspahn, *Too Dependent on Contractors? Minimum Standards for Responsible Governance*, 6 JOURNAL OF CONTRACT MANAGEMENT 9 (Summer 2008); Steven L. Schooner, *Contractor Atrocities at Abu Ghraib: Compromised Accountability in a Streamlined, Outsourced Government*, 16 STANFORD LAW & POLICY REVIEW 549 (2005); *Empty Promise for the Acquisition Workforce*, 47 THE GOVERNMENT CONTRACTOR ¶ 203 (May 4, 2005).

- **Wealth Distribution**: Governments routinely (but incorrectly) perceive the procurement system as a costless tool to distribute wealth to favored interest groups. For example, our procurement regime favors, among others: domestic firms (large and small); domestic textile and specialty metal producers; firms from our favored trading partners; small businesses; small disadvantaged business; service-disabled veterans; women-owned small businesses; small businesses in areas of high unemployment (HUBZone businesses); union labor; convict labor; businesses that employ blind and severely-handicapped individuals; Alaska Native firms; Native Americans; Historically Black Colleges and Universities and Minority Institutions, etc.[5]

Many of the tradeoffs are obvious, and permutations are endless. Increasing competition, maintaining transparency, and controlling corruption all typically increase transaction costs, thus reducing administrative efficiency. Many states attempt to reduce risk by awarding contracts to the lowest bidder, often at the expense of customer satisfaction. Wealth distribution, by its very nature, decreases competition, increases the risk of performance failure, and reduces the value for money received and customer satisfaction. Uniformity, while a boon to administrative efficiency, rarely coincides with high degrees of customer satisfaction.

Ultimate Aspiration: Relief? Crisis Avoidance?

The main point I hope to emphasize with this summary is how – to a great extent – this analysis is irrelevant to many of the TARP contracts. After all, this was a *relief* program, not an exercise in pitting business competitors against each other to maximize the government customer's value. The lion's share of these contracts were not intended to exploit the competitive marketplace for the government customer's benefit; rather they were intended, as Treasury suggests, to "spur economic recovery and rescue the financial system [as a] … first phase of a comprehensive cure for the crippling conditions that confronted President Obama as he assumed office…"

In other words, if the ultimate goal of these contracts was to avoid a financial disaster, the procurement community will not – nor should it – be the ultimate arbiter of whether the potential for such a disaster was real, whether it was averted, and to what extent the contracts – individually or collectively – averted that crisis.

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[5] GAO noted that "Treasury has encouraged small businesses to pursue procurement opportunities for TARP contracts and financial agency agreements[,]" and "[t]he share of work by small businesses—including minority- and women-owned businesses—under TARP contracts and financial agency agreements has grown substantially since November 2008."

Transparency and Accountability

As noted above, Treasury asserts that it aspires to a contracting regime that is both transparent and accountable. That's commendable, but transparency and accountability alone cannot a successful public procurement regime make. Indeed, both transparency and accountability are frequently viewed as *constraints* rather than *aspirations* or *outcomes*. Yes, both transparency and accountability are important, but both can be achieved in a procurement system devoid of the characteristics that define the leading public purchasing regimes, specifically, receiving value for money and generating high degrees of customer satisfaction.

Still, Treasury earns strong marks for its transparency efforts. Treasury's website is informative, well organized, visually attractive, and extremely navigable. It offers an impressive array of contracts and includes the full text of those contracts. Indeed, Treasury arguably has set a high mark not only for disclosing all of its contracts, but by organizing them in a meaningful manner.

Conversely, the website is not flawless.[6] (To be clear, these are relatively minor quibbles.) The full text of the various contracts are provided in PDF. While this is superior to not publishing the contracts, these documents are extremely difficult to navigate, particularly because many are lengthy, complicated, and lack a cover sheet or a table of contents. (Contrast this with a standard government contract under the Federal Acquisition Regulation (FAR), organized pursuant to the Uniform Contract Format. 48 C.F.R. §§ 14.201-1, 15.204-1.) Moreover, the President's Open Guidance Directive instructed that "agencies should publish information online in an open format that can be retrieved, downloaded, indexed, and searched by commonly used web search applications...." (M10-06, December 8, 2009.) Along those lines, see the TARP Transactions Reports, rich in their detail, but available in an Excel format.

More importantly, a significant chasm exists between formalistic transparency and meaningful transparency. For example, posting contracts does not provide much insight into how the government's business partners were chosen (or excluded from participation), how the actual agreements were negotiated (and, for example, to what extent were financial representations or assumptions audited or verified), and how the

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[6] Another quibble is that the website does not readily identify government personnel qualified to address specific issues. For example, under Staff, it presents biographical information on two individuals: Treasury Secretary Geithner and Assistant Secretary Allison. Under Contact information, Treasury lists a single telephone contact number for "general information" and another for media inquiries; no email address is provided. (From there, the next step is general contact information at the Treasury Department.) Elsewhere on the various web pages, you can find email addresses for, among others, the Treasury Department's Office of Contract Administration, the Treasury's Office of Small and Disadvantaged Business Utilization, and the Special Inspector General for the Troubled Asset Relief Program (SIGTARP).

parties communicate and resolve issues that arise in the performance of these contracts, etc.

Oversight

On the accountability issue, the jury remains out. The literature on compliance, ensuring integrity, and accountability in federal government contracts is rich and immensely instructive. The starting point is a complex, but now familiar, regulatory structure, the Federal Acquisition Regulation. This regulatory structure provides innumerable tools for managing risk at every stage of the contracting process, including an exhaustive suite of remedy-granting clauses developed, over time, to address the unanticipated contingencies that arise during the performance of contracts. In addition, legal publishers and industry organizations produce a wealth of helpful information.[7]

As noted above, the FAR provides numerous tools for ensuring that the government reduces risk before and after entering into contracts. The regulations require, among many other things, that:

- Only contracting officers, officials that possess certain training and skills, may bind the government in contract;
- Acquisition planning precede the contracting process;
- Contracting opportunities be publicized and efforts made to maximize competition;
- Prior to the award of a contract, the government must determine that the selected contractor is responsible, which, means that the contractor must possess adequate financial resources to perform the contract; be able to comply with the required performance schedule; have satisfactory records of performance, integrity, and business ethics; have the necessary organization, experience, accounting and operational controls, and technical skills; and be otherwise qualified and eligible to receive an award under applicable laws and regulations;
- The government use a contract type intended to protect the government's interest and incentivize contractor performance;

[7] For example, the Organization for Economic Cooperation and Development (OECD) published the OECD PRINCIPLES FOR INTEGRITY IN PUBLIC PROCUREMENT, see, *http://www.oecdbookshop.org/oecd/display.asp?K=5KZ9GX38286C&LANG=EN.* Closer to home, THE GOVERNMENT CONTRACT COMPLIANCE HANDBOOK (authored by the Seyfarth Shaw law firm), now in its fourth edition, "explains each segment of compliance, including offenses and penalties, conducting compliance audits, [and] responding to criminal investigations," etc. The Defense Industry Initiative on Business Ethics and Conduct (DII) offers a wealth of examples of corporate compliance regimes and conducts best practices forums. See, *www.dii.org*. Of course, these are just the tip of the iceberg.

- If the government finds that it has entered into a poor bargain, the government enjoys broad flexibility to modify its agreements and, where appropriate, terminate its relationships with its contractors;[8] and
- Where the contractor fails to live up to its bargain, the government has remedy granting clauses to make itself (financially) whole and, depending upon the circumstances, reduce the likelihood that it will have to deal with the non-performing contractor in the future.

But it is unclear whether this regime is helpful. For example, does having the right to terminate or no longer do business with a non-performing contractor – e.g., a financial institution or automotive company unable to make good on its repayment promises to the government – help keep the economy afloat, maintain investor assets, or help the government recover its funds?

Moreover, as noted above, oversight means many things. Unfortunately, in modern public procurement, both the attention to, and the funding for, contracting oversight disproportionately lies in the form of after-the-fact audit, investigation, litigation, and prosecution. I consistently reject this model and long have advocated instead the familiar principle that an ounce of prevention is worth a pound of cure. Alas, at this point, the government's greatest opportunity to reduce its risk with regard to these contracts has passed.

The Train Has Left the Station, and There's a People Problem

Experience suggests that problems await Treasury and the taxpayers. The government customer's risk is most greatly reduced when – *before* entering into contracts – the government customer take its time, specifically defines its requirements, and carefully chooses its business partner. After contract award, the government customer best protects its interests when it staffs its contract management function with skilled professionals.[9] Both of these appear problematic.

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[8] The government, however, enjoys the flexibility to continue (e.g., not terminate) a defaulting contractor when it is in the government's best interest.

[9] Thus, it is not surprising that the Government Accountability Office recommended that efforts be made to: "ensure that sufficient personnel are assigned and appropriately trained to oversee the performance of all contractors, especially those performing under contracts priced on a time and materials basis, and move toward greater reliance on fixed-price arrangements, whenever possible, as program requirements are better defined over time; AND institute a system to effectively manage and monitor the mitigation of conflicts of interest going forward." Government Accountability Office, *Troubled Asset Relief Program: Capital Purchase Program Transactions for October 28, 2008, through September 25, 2009, and Information on Financial Agency Agreements, Contracts, Blanket Purchase Agreements, and Interagency Agreements Awarded as of September 18, 2009* (GAO-10-24SP, October 2009), an e-supplement to GAO-10-16.

As noted above, the contracts – awarded relatively quickly – already exist. As for post-award contract management, the last decade of federal government contracting does not bode well for Treasury's prospects. Consider some of the major trends:

- Beginning in 1989 and throughout the 1990's, the federal government aggressively sought to reduce its acquisition workforce; among other things this made succession planning all but impossible. While the cuts finally ended, the last decade passed with little or no effort made to restore the acquisition workforce;
- During the 1990's, aggressive reforms were introduced that were intended to change the way the acquisition workforce behaved; but inadequate time and resources were available to train the workforce to implement the changes;
- During the last decade, federal procurement spending more doubled, ultimately increasing at a rate five times the rate of inflation;
- Two significant military actions, in Iraq and Afghanistan, plus natural disasters, such as Hurricane Katrina, placed inordinate strain on the acquisition workforce by dramatically increasing the immediacy of the government's needs and frequently demanding that acquisition professionals perform under extraordinary (e.g., dangerous and substandard) working conditions;
- Faced with relentless demands, the acquisition community had no choice but to shift its focus and its resources to awarding new contracts and, thus, *starving the post-award contract management function*; and
- Over the two decades, the government customer morphed from a purchaser of supplies (deliverables) to primarily a consumer of services; conversely, the government's acquisition workforce, by and large, was neither hired nor trained to efficiently manage that type of work.

Ultimately, a generation of ill-conceived under-investment in the federal government's acquisition workforce, followed by a government-wide failure to respond to a dramatic increase in procurement activity, led to a buying and contract management regime animated by triage, with insufficient resources available for contract administration, management, and oversight. Add in a high volume of TARP contracts, and it is difficult to be optimistic that these contracts will be effectively managed.

The number of parties required to sustain successful public procurement regimes is significant, including, among others: the policy makers, the requirements generators (or those best positioned to describe the purchasing agency's needs), those that perform market research; non-legal and legal personnel that draft the contracts, and negotiators (whose access to information from others in necessary). After contracts are awarded, key players include the contract managers, the community that supports the contract manager (such as contracting officer's representatives, technical specialists, etc.); and, of course, the conventional oversight community, which includes: auditors, agency inspectors general, prosecutors, and adjudicators.[10]

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[10] Of course, it is also common to deploy and rely upon external sources for oversight, such as: private industry (which is interested in ensuring that the government

Nor is this simply a numbers game. Throwing people at the problem isn't enough. Among others, some critical considerations in assessing the relevant human capital or, more specifically, the acquisition workforce (or the individuals responsible for managing these contracts, include: education and experience; ensuring independence; offering meaningful incentives (compensation) and disincentives; providing professional development; identifying and deploying productive supervision and mentoring; and creating and instilling professional standards related to their performance and ethics.

On all of these issues, the federal government lags behind the private sector. In the last few years, we have seen the government – and to some extent, this administration – begin to acknowledge and commit itself to remedying the inadequacies of the acquisition workforce. But it is naïve to expect immediate results.

To the extent that you asked about the transparency and quality control implications of subcontracting and, specifically, what would be needed to ensure effective monitoring of subcontracting, I have little to offer. Traditionally, the government customer delegates the duty of subcontractor management to its prime contractors. As the government's acquisition work shrank relative to the volume of public procurement, the government correspondingly delegated increasing responsibilities to its prime contractors. The lead system integrator model – increasingly disfavored by Congress – represents the culmination of that trend. Ultimately, subcontracting poses all of the same problems as contracting, it's just one (or more) layer(s) removed from direct government oversight and, thus, correspondingly disaggregated.

Conclusion

As I testified (on another matter) earlier this year, after two decades of ill-conceived under-investment in the federal government's acquisition workforce, any prospective investment by the federal government in upgrading the number, skills, and morale of government purchasing officials would reap huge dividends for the government and the taxpayers. Of course, that won't solve your problems overnight. But it's a responsible investment in the future. Thank you for the opportunity to share these thoughts with you. I would be pleased to answer any questions.

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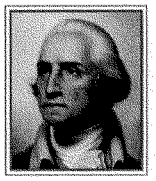
fulfills its end of the bargain), the investigative media, and private attorneys general, commonly known as whistle-blowers (or, pursuant to the False Claims Act regime, qui tam relators). See, e.g., Steven L. Schooner, *Fear of Oversight: The Fundamental Failure of Businesslike Government,* 50 AMERICAN UNIVERSITY LAW REVIEW 627 (2001). There are numerous, significant inefficiencies associated with such third-party oversight, but it nonetheless compensates – at least in part – for inadequate internal oversight.



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is Professor of Law and Co-Director of the Government Procurement Law Program at the George Washington University Law School, where he previously served as Senior Associate Dean for Academic Affairs. Before joining the faculty, Professor Schooner was the Associate Administrator for Procurement Law and Legislation (a Senior Executive Service position) at the Office of Federal Procurement Policy (OFPP) in the Office of Management and Budget (OMB). He previously tried cases and handled appeals in the Commercial Litigation Branch of the Department of Justice. He also practiced with private law firms and, as an Active Duty Army Judge Advocate, served as a Commissioner at the Armed Services Board of Contract Appeals. As an Army Reserve officer, he served for more than fifteen years as an Adjunct Professor in the Contract and Fiscal Law Department of the Judge Advocate General's School of the Army, in Charlottesville, Virginia. Outside of the U.S., he has advised hundreds of government officials on public procurement issues, either directly or through multi-government programs. His dispute resolution experience includes service as an arbitrator, mediator, neutral, and ombudsman. Professor Schooner received his Bachelors degree from Rice University, Juris Doctor from the College of William and Mary, and Master of Laws (with highest honors) from the George Washington University. He is a Fellow of the National Contract Management Association (NCMA), a Member of the Board of Advisors, a Certified Professional Contracts Manager (CPCM), and serves on the Board of Directors of the Procurement Round Table. He is a Faculty Advisor to the American Bar Association's PUBLIC CONTRACT LAW JOURNAL and a member of the GOVERNMENT CONTRACTOR Advisory Board. He is author or co-author of numerous publications including THE GOVERNMENT CONTRACTS REFERENCE BOOK: A COMPREHENSIVE GUIDE TO THE LANGUAGE OF PROCUREMENT (now in its third edition). Professor Schooner's recent scholarship is available through the Social Science Research Network at *http://ssrn.com/author=283370.*

Mr. SILVERS. Professor Schooner, I was going to comment that this seems to be catching. Very dangerous for us Panel members, who have to emulate it.

Mr. Amey, the floor is yours.

STATEMENT OF HON. SCOTT AMEY, GENERAL COUNSEL, PROJECT ON GOVERNMENT OVERSIGHT

Mr. AMEY. Thank you for inviting me to testify before the Congressional Oversight Panel. I'm the General Counsel of the Project on Government Oversight, also known as "POGO." POGO was founded in 1981 by Pentagon whistleblowers who were concerned about weapons that did not work and wasteful spending. POGO has a keen interest in government contracting matters and I'm pleased to share POGO's thoughts about Federal contracting.

Despite many reforms to make contracting easier, the reality of the situation is that contracting has become very complex. Contract spending now accounts for more than $530 billion a year. Oversight has decreased. The acquisition workforce has been stretched thin. Contractors are now performing jobs that were once performed by public servants, and spending on services now outpaces spending on goods.

Dr. Troske's questions to the last panel about metrics and about outputs is very relevant because they're very hard to measure in comparison with when we are buying bullets, boats, ships, airplanes, and such. At times there's been a policy in Federal contracting that switches to quantity rather than quality, especially considering that the government is spending half a trillion dollars on contracts, and now we are asking an already stretched-thin contracting staff to award hundreds of billions of dollars in contracts and grants through the bailout and stimulus programs.

When we discuss Federal contracting there are two questions that need to be asked and answered. The first is what are we buying, and the second is how are we buying it. Good contracting practices include valid market research, requirements definition, competition. Mr. McWatters was asking the first panel about length of contracts and were they recompeted. They're very vital, especially when you're using other than full and open competition contracting vehicles.

Comprehensive negotiations, pre-award audits to verify cost and pricing proposals, access to contractors' cost and pricing data, ongoing oversight, transparency, avoiding risky contracting vehicles, as well as questions about scope of work and is that work being performed. Additionally, consolidation in the contracting arena has forced the government to consider revolving door restrictions and personal and organizational conflicts of interest.

Subcontracting raises many questions as well due to the government's lack of privity. Subcontracting plans are helpful. Access to information about the quality and the scope of work are essential, but often, with multiple layers of subcontractors, oversight is very difficult. According to last month's Congressional report, Treasury has entered into about 108 transactions with contractors and others as of August 31, 2010. In so doing, Treasury has entered into cost-reimbursable, fixed price, time and material, labor hour contracts to procure $450 million worth of services. In those efforts to

stabilize the economy, Treasury is buying services from financial institutions, law firms, accounting firms, consulting firms, to support its response to the nation's economic crisis.

Treasury has issued guidance and promotes the use of competition and the utilization of small businesses. As Professor Schooner said, I think Treasury is probably way above the normal standard when it comes to government contracting as far as most Federal agencies.

Additionally, it has issued TARP conflicts of interest regulations to mitigate or eliminate ethical concerns. Despite those policies and regulations, TARP has a little way to go before it's operating in the best interests of taxpayers. Many TARP contracts appear to be a mixed bag when it comes to competition. Several contracts have been awarded with less than full and open competition and Treasury has to make sure that full and open competition is the rule, not the exception.

One arena that might require additional reforms is the implementation of the conflicts of interest policies. The one thing I'd like to say about that is I think there are a few barriers that they didn't think about as far as assuring that information collected and retained from these entities is publicly available, transparent, to overall keep the faith in the integrity in the overall TARP program.

Also, I would say that there needs to be additional provisions to protect whistleblowers, establish hotlines so that allegations can be brought forward as far as if a conflict of interest is real or apparent, and also harsh enforcement to those who violate the rules, and therefore that would help fill some gaps.

Treasury has been open as far as its TARP policies, procedures, and contracts. Like I said, most contracts aren't posted online, so it is refreshing that contracts are posted online. The only thing I will say is, in going through some of the contracts I did notice that some are GSA schedule contracts and their pricing data has been redacted. Well, GSA schedule contracts have pricing that's online and is publicly available, so I'm not quite sure why those redactions were made. But that may be a little overboard as far as what they're doing.

I would also like to applaud Treasury for converting risky types of contracts, specifically time and materials contracts, into fixed price contracts. But I would still have questions about when those conversions are being made.

Thank you for inviting me to testify today. This hearing is vital to ensuring that TARP is working in the best interests of the government and taxpayers, given the size and scope of the program and the contracting support involved. POGO looks forward to working with the Panel to further explore how the government should improve the contracting system to better protect taxpayers, and I welcome any questions that you may have.

[The prepared statement of Mr. Amey follows:]

Exposing Corruption Exploring Solutions
Project On Government Oversight

Testimony of
Scott Amey, General Counsel
Project On Government Oversight (POGO)
before the
Congressional Oversight Panel
Hearing on
Treasury's Use of Emergency Contracting Authority
September 22, 2010

Thank you for inviting me to testify today before the Congressional Oversight Panel. I am the General Counsel of the Project On Government Oversight, also known as POGO.[1] POGO was founded in 1981 by Pentagon whistleblowers who were concerned about weapons that did not work and wasteful spending. Throughout its twenty-nine-year history, POGO has worked to remedy waste, fraud, and abuse in government spending in order to achieve a more effective, accountable, open, and ethical federal government. POGO has a keen interest in government contracting matters, and I am pleased to share POGO's thoughts about federal contracting policies.

Despite many reforms to make contracting easier, the reality of the situation is that contracting has become very complex over the past fifteen years. Contract spending has grown tremendously, approaching $540 billion in fiscal year 2009,[2] oversight has decreased, the acquisition workforce has been stretched thin, contractors are now performing many jobs that should be performed by public servants, and spending on services now outpaces spending on goods. The dramatic increase in federal contract spending often means agencies spend money quickly—sometimes without the same vigor and oversight as in the past. In addition to the half trillion dollars spent on contracts, agencies and their stretched staffs are now awarding hundreds of billions more in contracts and grants through the bailout and stimulus programs,[3] which is a recipe for waste, fraud, and abuse.

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[1] For additional information about POGO, please visit www.pogo.org.
[2] Available at http://www.usaspending.gov/trends?carryfilters=on&trendreport=default&viewreport=yes&contracts=Y&maj_contracting_agency=&pop_state=&pop_cd=&vendor_state=&vendor_cd=&graphview=list&Go.x=Go (Downloaded September 21, 2010)
[3] The Treasury Department was granted emergency contracting authority under the Emergency Economic Stabilization Act of 2008 (EESA), 12 U.S.C. §§ 5211 and 5217. http://www.law.cornell.edu/uscode/html/uscode12/usc_sec_12_00005211----000-.html and http://www.law.cornell.edu/uscode/html/uscode12/usc_sec_12_00005217----000-.html (Downloaded September 21, 2010)

On a positive note, interest in improving oversight of the federal contracting system has grown in recent years. The White House, agencies, and Congress have all stepped up efforts to ensure that federal contract dollars are being spent wisely, including placing restrictions on risky contract types, eliminating wasteful spending, and promoting contracts awarded with full and open competition.[4] There have also been efforts to increase the size of the acquisition workforce, diminish conflicts of interest,[5] and clarify work that must be performed by government employees.[6]

Numerous Government Accountability Office (GAO) and Inspector General (IG) reports highlight contracting deficiencies and recommend ways to correct them. These reports have found that contract planning, requirements definitions, contract vehicles, administration, and oversight are deficient. These are the leading reasons management of federal contracts at several agencies remains on GAO's "high risk" list.[7]

When discussing federal contracting, there are always two questions that need to be asked and answered:

1. What are we buying? and
2. How are we buying it?

The first question requires a comprehensive look at the government's overall acquisition planning structure and how best to place agencies in a position to meet their missions. Simply stated, what goods and services are required? The "how are we buying it" question places us more in the contracting weeds. The answer to that question often involves a discussion about types of contracts, level of competition, accountability, oversight, and transparency.

This Panel was created by the Emergency Economic Stabilization Act of 2008 (EESA) and vested with broad oversight jurisdiction over the Troubled Asset Relief Program (TARP). Today's hearing looks at Treasury's use of the authority provided in section 101(c) of EESA to contract for services and designate private firms to act as financial agents of Treasury. Treasury is buying services from financial institutions, law firms, accounting firms, consulting firms, and other entities to support its response to the nation's economic crisis through implementation of TARP programs.

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[4] Office of Management and Budget, *A New Era of Responsibility: Renewing America's Promise*, 2009, pp. 35, 38-39. http://www.whitehouse.gov/omb/assets/fy2010_new_era/A_New_Era_of_Responsibility2.pdf (Downloaded September 21, 2010)

[5] Department of Defense, General Services Administration, and National Aeronautics and Space Administration, "Preventing Personal Conflicts of Interest for Contractor Employees Performing Acquisition Functions," 74 Fed. Reg. 58584, November 13, 2009. http://edocket.access.gpo.gov/2009/pdf/E9-27309.pdf (Downloaded September 21, 2010)

[6] Office of Management and Budget, Office of Federal Procurement Policy, "Work Reserved for Performance by Federal Government Employees," 75 Fed. Reg. 16188, March 31, 2010. http://edocket.access.gpo.gov/2010/pdf/2010-7329.pdf (Downloaded September 21, 2010)

[7] General Accountability Office, *High-Risk Series: An Update* (GAO-09-271), January 2009, pp. 77-84. http://www.gao.gov/new.items/d09271.pdf (Downloaded September 21, 2010)

According to its latest monthly congressional report, Treasury has entered into 108 transactions with contractors and others as of August 31, 2010, including:[8]

- 51 Contracts
- 21 Interagency Agreements (IAA)
- 15 Financial Agency Agreements (FAA)
- 13 Blanket Purchase Agreements (BPA)
- 8 Procurements for services such as IT support and office equipment

In so doing, Treasury has entered into cost reimbursement, fixed price, time and materials, and labor hour contracts to procure nearly $500 million worth of services. There were many concerns at the time the EESA legislation was proposed because it included Section 107, which permits the Treasury Secretary to waive Federal Acquisition Regulation (FAR) full and open competition requirements.

Treasury has issued guidance that promotes the use of competition and utilizes small businesses.[9] Additionally, it has issued TARP conflict of interest regulations to mitigate or eliminate ethical concerns. Despite those policies and regulations, the TARP program has a way to go before POGO is assured that it's working in the best interest of taxpayers. For example, Treasury as a whole spent about $4.8 billion in contracts in FY 2009, but only 22 percent of those funds were spent with full and open competition.[10] Including all forms of restricted competition, Treasury only competed approximately 60 percent of all contract dollars awarded.[11] The majority of TARP contracts have also been a mixed bag, with numerous contracts awarded on a sole source basis or with less than full and open competition.[12] Treasury must do more to ensure that full and open competition involving multiple bidders is the rule, not the exception.

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[8] Department of the Treasury, *Troubled Asset Relief Program (TARP): Monthly 105(a) Report - August 2010*, September 10, 2010, Appendix 2. http://financialstability.gov/docs/105CongressionalReports/August%202010%20105(a)%20Report_final_9%2010%2010.pdf (Downloaded September 21, 2010)

[9] According to Treasury, 18 of its 108 transactions with contractors or others have been awarded to small, women-, or minority-owned small businesses. Department of the Treasury, *Troubled Asset Relief Program (TARP): Monthly 105(a) Report - August 2010*, September 10, 2010, Appendix 2. http://financialstability.gov/docs/105CongressionalReports/August%202010%20105(a)%20Report_final_9%2010%2010.pdf (Downloaded September 21, 2010)

[10] Contract Spending by the Department of the Treasury in FY 2009. http://www.usaspending.gov/explore?carryfilters=on&maj_contracting_agency=20&tab=By+Location&contracts=Y&fiscal_year=2010&tab=By+Agency&fiscal_year=2009&fromfiscal=yes&carryfilters=on&Submit=Go (Downloaded September 21, 2010)

[11] The "competitive" label includes contracts awarded through less than full and open competition, including competitions within a selected pool of contractors, offers on which only a single bid was received, or a follow-on contract to a previously competed action.

[12] Government Accountability Office, Troubled *Asset Relief Program: June 2009 Status of Efforts to Address Transparency and Accountability Issues* (GAO-09-658), June 17, 2009, p. 63. http://www.gao.gov/new.items/d09658.pdf (Downloaded September 21, 2010); and Government Accountability Office, *Troubled Asset Relief Program: Additional Actions Needed to Better Ensure Integrity, Accountability, and Transparency* (GAO-09-161), December 2, 2008, pp. 36-37. http://www.gao.gov/new.items/d09161.pdf (Downloaded September 21, 2010)

One area that might require additional reforms is the implementation of the TARP conflict of interest rule that went into effect in January 2009. The rule established policies, procedures and remedies governing organizational conflicts of interest, personal conflicts of interest, gift bans, and safeguarding proprietary information. The rule was criticized for being cumbersome, ambiguous, inconsistent with the FAR, and requiring clarification.[13] POGO agrees that the rule needs some clarification and improvements. The overreliance on retained entities to report organizational and personal conflicts is problematic given the strong potential for conflicts to arise. Additionally, the mitigation efforts and information barriers require constant agency monitoring and review.

Treasury has been open with its TARP polices, procedures, and contracts. Some questions have been raised about the redacted contract pricing information,[14] and although POGO doesn't agree that all cost or pricing data should be protected by the government, protecting proprietary information is the general rule. However, Treasury has also used General Service Administration (GSA) Federal Supply Schedules (FSS), and that information should be made available to the public without redactions. GSA FSS prices are publicly available and therefore Treasury should not withhold them.[15]

One trend that POGO would like to see continued is Treasury's effort to convert risky contract types. For example, the agency entered into a number of time and materials contracts, but has made progress in converting them to fixed price contracts when requirements were established and fixed prices could be determined.[16] Those conversions bode well for Treasury and for taxpayers.

Big Picture Contracting Concerns

Many contracting experts and government officials blame the inadequate size and training of the acquisition workforce for today's problems in the contracting system. POGO agrees that past workforce reductions created a problem in government contracting, but we believe additional problems deserve equal attention. These problems are:

1. Inadequate Competition
2. Deficient Accountability

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[13] "TARP Conflicts of Interest," Regulations.gov. http://www.regulations.gov/search/Regs/home.html#docketDetail?R=TREAS-DO-2009-0001 (Downloaded September 21, 2010)

[14] Paul Kiel, "TARP Watchdog Launches Audit of Bailout Contracts," *ProPublica*, February 9, 2010. http://www.propublica.org/article/tarp-watchdog-launches-audit-of-bailout-contracts-0209 (Downloaded September 21, 2010); and Chris Carey, "Treasury kept quiet about legal services contracts," *BailoutSleuth*, April 24, 2009. http://bailoutsleuth.com/news/2009/04/treasury-kept-quiet-about-legal-services-contracts/ (Downloaded September 21, 2010)

[15] General Services Administration, "Welcome to GSA eLibrary." http://www.gsaelibrary.gsa.gov/ElibMain/home.do (Downloaded September 21, 2010)

[16] Government Accountability Office, Troubled *Asset Relief Program: March 2009 Status of Efforts to Address Transparency and Accountability Issues* (GAO-09-504), March 31, 2009, p. 41. http://www.gao.gov/new.items/d09504.pdf (Downloaded September 21, 2010)

3. Lack of Transparency
4. Risky Contracting Vehicles

Inadequate Competition

To better evaluate goods and services, and to get the best value for taxpayers, the government must encourage genuine competition. At first glance, it may seem that federal agencies frequently award contracts competitively, but the definition of "competitive" includes limited competition and one-bid offers. Consequently, to accurately track or evaluate competition, the definition of "competitive bidding" should be revised to apply only to contracts on which more than one bid was received.

In addition to redefining competition, federal agencies must:

1. Reverse the philosophy of quantity over quality. Acquisition is now about speed, making competition a burden; this is a recipe for waste, fraud, and abuse.

2. Debundle contract requirements in order to invite more contractors to the table. Contracts that lump together multiple goods and services exclude smaller businesses that could successfully provide one good or service, but are incapable of managing massive multi-part contracts. Breaking apart multi-supply or -service contracts reduces the multiple layers of subcontracting which can drive up costs while adding little value.

3. Ensure that waivers of competition requirements for task and delivery orders issued under multiple-award contracts or the federal supply schedule program are granted infrequently.

4. Increase emphasis on sealed bidding to receive the lowest prices.

5. Use reverse auctions more frequently. In a Department of Energy reverse auction for pagers, two companies submitted initial bids for $43 and $51 per pager. At the close of bidding, the government awarded the contract at the price of $38 per pager.[17]

Why is competition in contracting important? In a nutshell, genuine competition between contractors means the government gets the best quality goods and services at the best price. Competition also prevents waste, fraud, and abuse because contractors know they must perform at a high level or risk being replaced.

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[17] Steve Sandoval, *LANL NewsBulletin*, "Reverse auctions save Lab money," January 23, 2007. http://www.lanl.gov/news/index.php/fuseaction/nb.story/story_id/9654 (Downloaded September 21, 2010)

Deficient Accountability

Through the years, the government has placed a premium on speeding up the contracting process and cutting red tape. Those policies led to downsizing the acquisition workforce and gutting the oversight community. When considering the large-scale increase in procurement spending during the past decade, the contracting and oversight communities lack sufficient resources to watch the money as it goes out the door.

Many acquisition reforms also eliminated essential taxpayer protections. For example, one "reform"—commercial item contracting—resulted in federal contracting officials lacking the cost or pricing data necessary to ensure that the government is getting the best value. Commercial item contracts, which prevent government negotiators and auditors from examining a contractor's cost or pricing data, might make sense when buying computers, office supplies, or landscaping services, but have been exploited in some cases, such as complex services and goods that are not readily available in the commercial market.

POGO believes that Congress should:

1. Appropriate money to agencies to end their reliance on the industrial funding fees collected from other agencies for orders placed on interagency contracts. This system creates a perverse incentive to keep costs or prices high. In other words, agencies might not be seeking the best prices because program revenue would be lost.

2. Require contractors to provide cost or pricing data to the government for all contracts, except those where the actual goods or services being provided are sold in substantial quantities in the commercial marketplace.

3. Provide enforcement tools needed to prevent, detect, and remedy waste, fraud, and abuse in federal spending, including more frequent pre-award and post-award audits to prevent defective pricing.[18]

4. Eliminate the Right to Financial Privacy Act provision requiring IGs to notify contractors prior to obtaining the companies' financial records. This requirement "tips off" contractors and can harm the government's ability to investigate federal contracts.[19]

5. Realize that audits are worth the investment. On average, all IGs appointed by the President return $9.49 for each dollar appropriated to their budgets.[20]

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[18] National Procurement Fraud Task Force, Legislation Committee, *Procurement Fraud: Legislative and Regulatory Reform Proposals*, June 9, 2008. (Hereinafter *Fraud White Paper*). http://pogoarchives.org/m/co/npftflc-white-paper-20080609.pdf

[19] *Fraud White Paper*, pp. 4-5.

[20] Government Accountability Office, *Inspector General – Actions Needed to Improve Audit Coverage of NASA*

6. Enhance the acquisition workforce through improvements in hiring, pay, training, and retention.

7. Require comprehensive agency reviews of outsourcing practices, especially for contract-related management and consulting service contracts.[21]

8. Pass the Contracting and Tax Accountability Act of 2009 (H.R. 572) prohibiting federal contracts from being awarded to contractors that have an outstanding tax liability.[22]

9. Hold agencies and contractors accountable when small business contracts are diverted to large corporations and when set-aside dollars don't reach their legally intended targets.[23]

Through the years, measures to ensure government and contractor accountability have been viewed as burdensome and unnecessary. This attitude needs to be replaced with one recognizing that accountability measures are essential to protecting taxpayers, and should be seen as an acceptable cost of doing business with the federal government.

Lack of Transparency

To regain public faith in the contracting system, the government must provide the public with open access to information on the contracting process, including contractor data and contracting officers' decisions and justifications.

The following actions should be taken to provide the public with contracting information:

1. USAspending.gov should become the one-stop shop for government officials and the public for all spending information. This includes actual copies of each contract, delivery or task order, modification, amendment, other transaction agreement, grant, and lease. Additionally, proposals, solicitations, award decisions and justifications (including all documents related to contracts awarded with less than full and open competition and single-bid contract awards),

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(GAO-09-88), December 2008, p. 5. http://www.gao.gov/new.items/d0988.pdf (Downloaded September 21, 2010)

[21] Alice Lipowicz, "DHS draws flak for review of services contracts," *Federal Computer Week*, June 5, 2009. http://fcw.com/articles/2009/06/08/news-dhs-contracts.aspx (Downloaded September 21, 2010)

[22] 111th Congress, "Contracting and Tax Accountability Act of 2009," H.R. 572, introduced by Representative Brad Ellsworth. http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=111_cong_bills&docid=f:h572ih.txt.pdf (Downloaded September 21, 2010)

[23] Department of the Interior, Office of the Inspector General, *Interior Misstated Achievement of Small Business Goals by including Fortune 500 Companies*, W-EV-MOI-0003-2008, July 2008. http://www.doioig.gov/upload/2008-G-0024.pdf (Downloaded September 21, 2010); and Carol D. Leonnig, "Agencies Counted Big Firms As Small," *The Washington Post*, October 22, 2008. http://www.washingtonpost.com/wp-dyn/content/article/2008/10/21/AR2008102102989_pf.html (Downloaded September 21, 2010)

audits, performance and responsibility data, and other related government reports should be incorporated into USAspending.gov.

2. To better track the blended federal government workforce, Congress should require the government to account for the number of contractor employees working for the government using a process similar to FAIR Act inventories of government employees filed by federal agencies.

Risky Contracting Vehicles

POGO is concerned with the government's acceptance of limited competition in contracting as well as its over-reliance on cost-reimbursement, time and material contracts, and commercial item contracts. POGO realizes that there are benefits to these vehicles in certain circumstances, but we are not alone in voicing concerns about how these contract vehicles are used in practice.

POGO believes that risky contracts can work in practice, but only if additional oversight protections are added, including:

1. For commercial item contracts, goods or services should be considered to be "commercial" only if there are substantial sales of the actual goods or services (not some sort of close "analog") to the general public. Otherwise, the goods or services should not be eligible for this favored contracting treatment.

2. The Truth in Negotiations Act (TINA) should be substantially revised to restore it to the common-sense requirements that were in place prior to the "acquisition reform" era. Specifically, all contract awards over $500,000, except those where the goods or services are sold in substantial quantities to the general public in the commercial marketplace, should be subject to TINA. This small step would result in enormous improvements in contract pricing, negotiation, and accountability, and save taxpayers billions of dollars per year.

3. All contracting opportunities in excess of $100,000—including task or delivery orders, and regardless of whether the action is subject to full and open competition, award against a GSA Federal Supply Schedule or an agency Government Wide Acquisition Contract, or any other type of contacting vehicle—should be required to be publicly announced for a reasonable period prior to award, unless public exigency or national security considerations dictate otherwise.

4. All contracting actions, including task and delivery orders, should be subject to the bid protest process at the GAO. While POGO recognizes that many will decry this recommendation as adding "red tape" to the process, we believe it is the only meaningful way to ensure that contractors are placed on an even playing field, and that the public can be confident in agency contract award decisions.

Thank you for inviting me to testify today. This hearing is vital to ensuring that the TARP program is working in the best interest of the government and taxpayers given the size and scope of the program and the contracting support work involved. POGO looks forward to working with the Panel to further explore how the government should improve the contracting system to better protect taxpayers, and I welcome any questions.

Scott Amey, General Counsel

Mr. Amey rejoined the POGO staff in 2003 and directs POGO's Contract Oversight investigations, including reviews of federal spending on goods and services, the responsibility of top federal contractors, and conflicts-of-interest and ethics concerns that have led to questionable contract awards. Mr. Amey has testified before Congress and federal agency panels, submitted public comments on proposed regulations, educated the public by working with the media, and authored reports, alerts, and blogs on contracting issues. Mr. Amey previously worked at POGO in the mid-1990s as a Research Associate, and was one of the organization's most prolific investigators. One of his most notable projects during that time was an investigation into Area 51 that resulted in the Air Force admitting the black facility's existence and submitting to compliance with environmental laws. Mr. Amey also undertook investigations into Boston's Big Dig project and safety concerns at nuclear power plants. Mr. Amey left POGO in 1998 to attend law school, after which he clerked for the Honorable James A. Kenney, III, at the Court of Special Appeals of Maryland from 2001-2003. Mr. Amey received a J.D., magna cum laude, from the University of Baltimore School of Law in 2001, and a B.A. from the University of Pittsburgh in 1993. Mr. Amey is licensed to practice law in Maryland.

Mr. SILVER. Thank you, Mr. Amey.

Professor Stanger.

STATEMENT OF ALLISON STANGER, RUSSELL J. LONG '60 PROFESSOR OF INTERNATIONAL POLITICS AND ECONOMICS AND CHAIR OF THE POLITICAL SCIENCE DEPARTMENT, MIDDLEBURY COLLEGE

Ms. STANGER. Well, I'd like to begin by thanking the Congressional Oversight Panel for the important work you've done to date.

The Troubled Asset Relief Program was in many ways a bipartisan miracle, a heroic and rare instance of Democrats and Republicans working together for the common good. In saving the financial system, the TARP served the interests of every American. Yet, as this Panel has repeatedly pointed out, the manner in which the TARP was executed and the optics associated with its wholly opaque implementation have left an unfortunate legacy.

The economic experts who testified before this Panel all emphasized the moral hazard created whenever some firms are deemed too big to fail. I'd like to argue here today for a broader understanding of the moral hazard that the implementation of the TARP has illuminated: our acceptance of emergency or extrabudgetary government contracting as standard operating procedure and our failure to come to terms fully with the moral and political implications of that development.

We today fund long-term counterinsurgency operations through a series of supplemental appropriations. We stabilize the financial system by granting Treasury emergency contracting authority. We revitalize the economy with an emergency stimulus package. These measures may all have been necessary, but they have one feature in common. Because they all involve extrabudgetary contracting, they have the cumulative effect of rendering our governance and our government spending patterns wholly opaque.

How did this come to pass? Much attention has been paid to the role that big money plays in our politics, from the huge sums spent on lobbying to the influence of campaign contributions. But there is an additional pressure point for corporate influence. Government is now in many ways wholly dependent on the private sector to go about its daily business. Government's increasing reliance on contractors has fed a vicious circle that over time has resulted in a Federal Government that has been effectively hollowed out.

To cite one telling statistic, the Federal Government had the same number of full-time employees in 1963 as it did in 2008. Yet the size of the population has doubled and the Federal budget in that same period of time, in real terms, has more than tripled. Layer trillions of dollars of contracting for the wars in Afghanistan and Iraq, the TARP, and the stimulus package on top of that general picture and you have the perfect storm.

The last decade was marked by an explosion in outsourcing the work of government to the private sector. For example, in 2000 the Department of Defense spent $133.2 billion on contractors. By 2008 that figure had grown to $391.9 billion, an almost threefold increase. If we look at the Department of Health and Human Services, in that same period of time their contract spending more than tripled.

So, viewed in this light, the problems of TARP spending that this Panel has rightly identified are very much associated with government-wide problems. According to the GAO, the number of contractors that supported TARP administration operations grew from 11 at the start to 52 by October 2009, a 473 percent increase in 1 year's time.

Since there can be no self-government when the work of government is largely hidden from public view, these trends demand serious attention. How can we ensure best practices in government contracting? We can begin by insisting that the existing law be upheld. The Federal Funding Accountability and Transparency Act of 2006 (FFATA), co-sponsored by then-Senator Barack Obama, stipulates that all information on how taxpayer money is spent is to be provided on a, quote, "single searchable website accessible to the public, at no cost to access." USAspending.gov is supposed to be that website. FFATA also mandated that information on subawards be available to the public by January 1, 2009. That information is still unavailable.

Without transparency in subcontracts, we are effectively pouring taxpayer money into a black hole, and this applies to Iraq and Afghanistan, I think, as well as the TARP.

I stand ready to be persuaded otherwise, but to date I have found most concerns about the costs of transparency to be misplaced, excessively focused on the short-term at the expense of the sustainable. Some say that transparency is too time-consuming and invites endless dialogue with the public. Since the latter is precisely what self-government requires, the former is not too high a cost to bear.

Others argue that full disclosure compromises business proprietary principles. But when business is serving government, other principles must trump comparative advantage and profit.

In conclusion, when so much of the work of government is in private hands, standard approaches to transparency will no longer suffice. Companies as well as government can operate with the purest of intentions, but if their most important transactions are opaque to the public they will lose trust and effectiveness. Emergency circumstances may make this more difficult, but no less imperative. The twin values of self-government and fiscal prudence depend on it.

Thank you for your attention and I welcome your questions.

[The prepared statement of Professor Stanger follows:]

Testimony of

Allison Stanger
Russell Leng '60 Professor of International Politics and Economics
Middlebury College

At a Hearing on
"Treasury's Use of Exceptional Contracting Authority"

Before the
Congressional Oversight Panel
September 22, 2010

Distinguished members of the Congressional Oversight Panel, I am grateful for the opportunity to share some thoughts with you here today. It is an honor and a privilege to do so.

I'd like to begin by applauding the Congressional Oversight Panel for the important work it has done to date in illuminating the contours and challenges of an enormously significant deployment of taxpayer money. The Troubled Asset Relief Program [TARP] was in many ways a bipartisan miracle, a heroic and rare instance of Democrats and Republicans working together for the common good. It sent a clear message that the weight of the US government was behind the financial system, so there was no point in betting against it. In saving the financial system, the TARP served the interests of every American. Yet as this panel has repeatedly pointed out, the manner in which the TARP was executed and the optics associated with its wholly opaque implementation have left an unfortunate legacy. The economic experts who testified before this panel all emphasized the moral hazard created whenever some firms are deemed "too big to fail."[1] I'd like to argue here today for a broader understanding of the moral hazard that the implementation of the TARP has illuminated: our acceptance of emergency (extra-budgetary) government contracting as standard operating procedure, and our failure to come to terms fully with the moral and political implications of that development. New legislation may well be in order to confront that challenge. But we can begin by demanding that the existing laws be upheld.

The Oxford English Dictionary defines a moral hazard as "the effect of insurance on the likelihood of the insured event occurring; the lack of incentive to avoid risk where there is protection against its consequences." Emergency spending that becomes routine poses a moral hazard, because the costs associated with it (waste, fraud, and abuse) slowly eat away at the trust upon which American democracy depends. We today fund long-term counterinsurgency operations through a series of supplemental appropriations. We stabilize the financial system by granting Treasury emergency contracting authority. We revitalize the economy with an emergency stimulus package. These measures may all have been necessary, but they have one feature in common. Because they all involve

[1] Congressional Oversight Panel, *September Oversight Report: Assessing the TARP on the Eve of its Expiration*, September 16, 2010, especially pp. 95-99. http://cop.senate.gov/documents/cop-091610-report.pdf

extra-budgetary outlays, they have the cumulative effect of rendering our governance and our government's spending patterns wholly opaque.

This dearth of transparency, in turn, creates at least the appearance of another moral hazard with the benefit of hindsight. Wall Street financiers are perceived to have used taxpayer monies to enrich themselves after having taken excessive risks, while ordinary Americans have been left largely to fend for themselves. Since few clear incentives exist to encourage elites to think beyond their own narrow self-interests, why should the average taxpayer trust the privileged to sacrifice for the common good? The result is Main Street's growing distrust of both Washington and Wall Street. In implicitly assuming that the privileged elite is comprised of angels, it is as though we have embedded moral hazard in the very fabric of our politics.[2]

How did this come to pass? Much attention has been paid to the role that big money plays in our politics, from the huge sums spent on lobbying to the influence of campaign contributions. But there is an additional pressure point for corporate influence: Government is now often wholly dependent on the private sector to go about its daily business. Government's increasing reliance on contractors has fed a vicious circle that over time has resulted in a federal government that has been effectively hollowed out. The federal government had the same number of full-time employees in 2008 as it did in 1963, yet the size of the population has doubled and the federal budget in that same period of time has more than tripled in real terms. Every federal contract and grant needs to be managed, yet our government currently lacks the capacity for appropriate oversight. Layer trillions of dollars of contracting for the wars in Iraq and Afghanistan, the TARP, and the stimulus package on top of that general picture and you have the perfect storm.

The last decade was marked by an explosion in outsourcing the work of government to the private sector. In 2000, the Department of Defense spent $133.2 billion on contracts. By 2008, that figure had grown to $391.9 billion, an almost three-fold increase. In 2000, the State Department spent $1.3 billion on contracts and $102.5 million on grants. By 2008, grant spending had grown to $2.7 billion and contract spending had grown to $5.6 billion. In 2000, USAID spent $0 on grants[3] and $478.6 million on contracts. By 2008, those figures had climbed to $5.5 billion and $3.3 billion, respectively[4] (source: USAspending.gov).

The matter appears to be no different on the domestic front. USAspending.gov's home page used to show (more on this oblique reference below) that 76 percent of federal spending in 2009 was on contracts and grants. Figures for the Department of Health and

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[2] Madison wisely pointed out in Federalist 51: "If men were angels, no government would be necessary. If angels were to govern men, neither external nor internal controls on government would be necessary. In framing a government which is to be administered by men over men, the great difficulty lies in this: you must first enable the government to control the governed; and in the next place oblige it to control itself."

[3] USAID's problematic past accounting practices are currently on full public display at USAspending.gov. No data on grants are provided for FY2000-2006. All numbers were retrieved from USAspending.gov on December 1, 2009.

[4] Data quality appears extremely variable, but for general trends, it can suffice. I use 2008 numbers for the comparison, since 2009 aggregate numbers are still a moving target.

Human Services, for example, dramatically illustrate both the explosive growth in contracting and the complete inadequacy of existing federal accounting systems to track government spending in any sort of reasonably transparent and accurate way. In 2000, the Department of Health and Human Services spent $4.1 billion on contracts. By 2008, the same figure had more than tripled to $13.1 billion. However, in December 2009, USAspending.gov listed HHS spending at $405.7 billion on grants in 2000 and just $264.7 billion in 2008. That 2008 aggregate figure was flagged with a different color, indicating awareness of an obvious problem with data quality.[5]

	Contracts in 2000	Contracts in 2008	Change in Contracts	Grants in 2000	Grants in 2008	Change in Grants
Defense	$133.2 billion	$391.9 billion	294%	$2.3 billion	$4.6 billion	200%
HHS	$4.1 billion	$13.1 billion	320%	$405.7 billion	$264.3 billion	-65%
USAID	$478.6 million	$3.3 billion	690%	0	$5.5 billion	N/A
State	$1.3 billion	$5.6 billion	431%	$102.5 million	$2.7 billion	2634%

Viewed in this light, the problems of TARP spending that the COP has rightly identified are very much associated with government-wide problems. The business of government is increasingly in private hands, and, there is broad consensus that the current federal contracting system is antiquated, ill equipped to deal with the surging demands placed upon it. What we know about Treasury's network of contractors and financial agents reflects this trend. According to the GAO, the number of contractors that supported TARP administration and operations grew from 11 at the start to 52 by October 2009—a 473 percent increase in but one year's time.[6] It is not unfair to say that the TARP was a bailout of the financial system administered by the financial system, with all the potential conflicts of interest that inevitably arise when the regulators are simultaneously the regulated.

The underside to this sweeping privatization of government power has become all the more apparent as the gap between the fortunes of Wall Street and of Main Street has widened. Since virtually every contract and grant represents jobs in some representative's district, focused lobbying can deliver bigger and bigger rewards. Special interest campaign contributions make the difference in every reelection campaign, with predictable consequences. The rapidly spinning revolving door between government and

[5] The table that follows comes from David Litman and Allison Stanger, "Acquisition in Crisis: Transforming Workforce and Process in the Public Interest," White Paper for a forum organized by the Partnership for Public Service, January 2010. Numbers have not been adjusted for inflation.

[6] GAO, *Troubled Asset Relief Program: One Year Later, Actions Are Needed to Address Remaining Transparency and Accountability Challenges*, October, 2009. http://www.gao.gov/products/GAO-10-16/.

business is a standing invitation to corruption. The one interest that goes underrepresented in this mix is the public interest.

Writing in Federalist 10, founder James Madison saw what he called the "mischief of factions" being neutralized as the plethora of special interests in vast colonial America cancelled one another out through both federalism and representative government. In twenty-first century America, however, government by contract instead encourages inside the beltway special interests to coalesce and carry the day. Government by contract means that government is entirely dependent on the private sector to conduct its daily business, so effective oversight is too often hostage to a corporate bottom line.[7] Whenever the economy falters, the profit motive encourages businesses to cut safety and security measures unless government insists that they not do so, and our disdain for bureaucracy makes it difficult for government to secure the staffing it needs to ensure that these shortcuts are not taken. Congress and the White House can therefore have the best of intentions yet be unable to escape the quagmire that government itself has in part created through its incessant outsourcing. To be sure that my basic point is not misunderstood, there is no partisan villain in this tale, no conspiracy. We have together constructed a system that no longer functions as the founders intended.

Unfortunately, neither James Madison's proposed extended sphere remedy for the ill effects of factions nor Adam Smith's invisible hand promises any relief from this pernicious laissez-faire brew. If Congress and business continue to pursue their own short-term interests unchecked, it can only lead us to financial ruin and the American people's complete loss of faith in our government. Rescuing government by the people from the current government by checkbook is a project for a generation, but we need to get started now. We can begin by distinguishing between wartime and peacetime contracting, recognizing the unique perils that inevitably arise when the profit motive goes to war, as well as the uncharted territory we have entered in Iraq and Afghanistan, where some things that never should have been outsourced have been (such as moving armed security).[8] But above all, the imperative of radical transparency in all government-business transactions has never been more important. Accountability and our cherished value of self-government now completely depend upon it.

Across the board, then, our unwavering faith in free markets and a penchant for outsourcing have outstripped government's capacity to monitor and assess the effectiveness of its own spending. When government does not have the employees in-house to manage the flow of tasks and money to private actors, it sees itself as having no choice but to resort to what I have elsewhere called "laissez-faire" contracting.[9] Government engages in laissez-faire contracting when it entrusts the private sector with the program design, management, and oversight of the taxpayer dollars it provides. In

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[7] The term "government by contract" comes from Jody Freeman and Martha Minow, ed., *Government by Contract: Outsourcing and American Democracy* (Cambridge: Harvard University Press, 2009).
[8] Allison Stanger, Testimony before the Commission on Wartime Contracting in Iraq and Afghanistan, June 18, 2010. http://www.wartimecontracting.gov/docs/hearing2010-06-18_testimony-Stanger.pdf
[9] Allison Stanger, *One Nation Under Contract: The Outsourcing of American Power and the Future of Foreign Policy* (New Haven, CT: Yale University Press, 2009), p. 163.

this sense, the TARP's emergency contracting authority can be understood as a license for laissez-faire contracting. Bailout funds could be disbursed to private entities who would then decide how best to deploy them to achieve the TARP's goals. Problems arose when the TARP's goals and those of individual firms did not wholly coincide.

The flawed premise of laissez-faire contracting is that market forces are engines of pure efficiency with which government should not intervene—save to bankroll private forces and let them work their magic. It reflects an "ideology according to which the interests of Big Finance and the interests of the American people are naturally aligned – an ideology that assumes the private sector is always best, simply because it is the private sector, and hence the government should never tell the private sector what to do, but should only ask nicely, and provide handouts to keep the private (financial) sector alive."[10] Elites should be trusted to uphold the public interest in their behind-closed-doors dealings, especially when issues are too complicated for ordinary Americans to understand. For this world view, transparency is a time sink that gets in the way of the substantive work, which needs to be done yesterday, so it is transparency that is often the first casualty. But viewed from the outside, one man's time sink is another's instrument of self-government. There can be no self-government when the work of government is largely hidden from public view.

. Until very recently, data on the broadening scope of government-wide procurement were unavailable to the general public. That changed in 2003 with the launch of the General Services Administration's Federal Data Procurement Service (FPDS), which made data on contract spending (both for-profit and not-for-profit) available to registered users. Since FPDS issued annual reports and made them publicly available on its web site, its launch marked the start of a new era of relative transparency.

In 2006, the Federal Funding Accountability and Transparency Act (FFATA) took things a step further when it instructed the White House Office of Management and Budget to create and maintain a searchable database that covers all federal spending in a user-friendly way. The Federal Funding Accountability and Transparency Act of 2006 required "full disclosure of all entities and organizations receiving Federal funds."[11] It is admirably straightforward legislation that comes in at under five pages, with no fine print, making it a symbol of as well as a catalyst for transparency. FFATA stipulates that all information on how taxpayer money is spent is to be provided on "a single searchable web site, accessible by the public at no cost to access" that includes basic information regarding the allocation of federal funds and the purposes to which they are designated.[12]

To public acclaim, FFATA's offspring USAspending.gov came online one month ahead of schedule, in December 2007. For the first time, the public could see in detail how the federal government spends taxpayer money. The web site crossed all sorts of

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[10] Simon Johnson, Congressional Oversight Panel, *September Oversight Report: Assessing the TARP on the Eve of its Expiration*, September 16, 2010, p. 120. http://cop.senate.gov/documents/cop-091610-report.pdf .
[11] Federal Funding Accountability and Transparency Act of 2006 http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=109_cong_bills&docid=f:s2590enr.txt.pdf.
[12] Federal Funding Accountability and Transparency Act of 2006. http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=109_cong_bills&docid=f:s2590enr.txt.pdf.

divides. Not only did Barack Obama, then just the junior Senator from Illinois, and Sen. Tom Coburn, the Republican from Oklahoma, co-sponsor the legislation, but the Office of Management and Budget partnered with OMB Watch, a non-profit organization founded to keep OMB honest, to devise the new web site's software.

The new web site dramatically expanded the scope and quality of information available to the public on contracting and subcontracting. It allowed me, a Vermont resident, to get a good understanding of basic issues without a security clearance. The legislation mandated that OMB's database be expanded by January 2009 to include information on subcontracts and subgrants. USAspending.gov relies on FPDS contracting numbers, but corrects for inaccuracies it detects in its by-agency figures before presenting them to the public.[13]

FFATA was long overdue. Despite the tremendous amounts of money involved, government needed a push to launch a concerted effort to track those flows accurately. Putting together a government-wide system for tracking contracts and subcontracts was spurred by FFATA and remains a work in progress.

Which brings me to the reason I have been using the past tense in referring to agency contracting and grants figures, and my data come from December 2009, not 2010.

The answer is that some time in early 2010, USAspending.gov's platform and interface were totally redesigned. The makeover is supposed to endow USAspending.gov "with greater capacity for fulfilling FFATA requirements."[14] However, the site's FAQs do not include any references to this revamping or the reasons for it. Unless one, like me, had done extensive work with the previous web site, the user would indeed have no idea that anything at all had changed.

What has changed? I am still in the process of answering this question, but one significant change caught my immediate attention and deserves mention here. The old version of USAspending.gov used to have a page entirely dedicated to subcontracts and linked to the home page. The FAQ section told the user that FFATA mandated that information on subcontracts be provided to the public by January 1, 2009. The subcontracts page reported that the site was "under development;" it provided a clear place-holder for important forthcoming information. Today, there is no subcontracts or subgrants page linked to the home page. The category does not even exist in the menu of choices. The extensive references to FFATA and what it by law requires have completely vanished. In short, the old site made it clear that important data were missing and soon to be forthcoming; the new site's architecture makes no explicit reference to aspects of FFATA that have yet to be fulfilled.

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[13] Allison Stanger, "Your Tax Dollars at Work: If You Can Find Them," *Washington Post*, May 18, 2008.
[14] Office of Management and Budget, "Open Government Plan," April 7, 2010, pp. 10-11. http://www.whitehouse.gov/sites/default/files/microsites/100407-omb-opengov-plan.pdf

Given recent revelations that US taxpayer money has been flowing through subcontracts into the pockets of the Taliban[15], the evaporation of the subcontracts page is troubling. Without transparency in subcontracts, we are effectively pouring taxpayer money into a black hole in Afghanistan, with no real means of knowing how well that money is likely to be spent or even who is receiving it.[16] Similarly, without publicly available information about how TARP monies have been used, the TARP is a comparable black hole. FFATA required that information on subcontracts be made available to the public by January 1, 2009 and the old web site made that clear. The new web site effectively camouflages that shortcoming. But FFATA's thwarted intention remains obvious.

The current absence of sub-award transparency is but one aspect of FFATA that has yet to be fulfilled. Despite FFATA's single searchable web site imperatives, both the transparency initiative for the TARP (www.financialstability.gov) and for the stimulus package (www.recovery.gov) have been treated as independent domains, each with separate web sites. One could argue that this preserves the distinction between extraordinary and ordinary spending, but the separateness also effectively camouflages the true dimensions of the government's financial flows. Financialstability.gov and recovery.gov were an important step in the right direction, but the spirit and letter of FFATA mandates an integrated whole and a single web site, and this should be our future goal. The American taxpayer needs one stop shopping for reviewing government spending patterns, whether extraordinary or otherwise. Put another way, these now independent entities should feed into USAspending.gov.

What further unites all three of these transparency-enabling web sites is that none currently provides information at the sub-award level, when each is required by law to do. Again, one could argue that both the TARP and the stimulus package were emergency measures, and hence exempt from FFATA requirements, but this would be tantamount to suspending the law and seems ill advised. These observations underscore a point of the utmost importance: A significant step toward getting the transparency and accountability we need is simply to demand that the spirit and letter of FFATA be upheld and that information be provided to the public in timely fashion, in the manner that FFATA specifies.

Why has the quest for transparency in government spending proven so difficult to date? For starters, the explosion of government outsourcing was not originally accompanied by the development of appropriate accounting systems for monitoring these flows. Getting the work done took precedence over ensuring that the right systems were in place to ensure that the work would be done well. Responding to the requirements of FFATA often meant being asked for data that one had not made a habit of collecting.

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[15] "Warlord, Inc.: Extortion and Corruption Along the U.S. Supply Chain in Afghanistan," Report of the Majority Staff (Rep. John Tierney, Chair), Subcommittee on National Security and Foreign Affairs, Committee on Oversight and Government Reform, U.S. House of Representatives, June 2010. http://oversight.house.gov/images/stories/subcommittees/NS_Subcommittee/6.22.10_HNT_HEARING/Warlord_Inc_compress.pdf.

[16] Allison Stanger, "Addicted to Contractors, *Foreign Policy*, December 1, 2009. http://www.foreignpolicy.com/articles/2009/12/01/addicted_to_contractors

This dynamic is only all the more pronounced under emergency circumstances. All of this is in the process of changing, and dramatic improvements have been made. But data quality was and is a persistent concern, because the government's accounting systems have not yet fully adapted to the new normal, where the majority of the government's work is in private hands. Here Congress could be enormously helpful in providing additional incentives to get us where we need to go sooner rather than later.[17]

I stand ready to be persuaded otherwise, but to date, I have found most concerns about the costs of transparency to be misplaced, excessively focused on the short term at the expense of the sustainable. Some say that transparency is too time-consuming and invites endless dialogue with the public. Since the latter is precisely what we need, the former is not too high a cost to bear. Others argue that full disclosure compromises business proprietary principles. But when business is serving government, other principles must trump comparative advantage and the profit motive. These concerns are all understandable. The world has changed dramatically in a short period of time, and human behavior always lags profound socioeconomic change. But to find it understandable is no reason to accept the status quo as an immovable object. We can and must do better.

In conclusion, when so much of the work of government is in private hands, standard approaches to transparency will no longer suffice. The American people need to be able to see where and how their tax dollars are spent—right through to the sub-award level. Emergency circumstances may make this more difficult, but no less imperative; the twin values of self-government and fiscal prudence depend on it. Companies as well as governments can operate with the purest of intentions, but if their most important transactions are opaque to the public, they will lose trust and effectiveness. President Obama's March 4, 2009 Presidential Memorandum ordering a government-wide review of our contracting practices was a bold step in the right direction. The next step is to ensure that the spirit and letter of FFATA are upheld.

Thank you for your attention and I welcome your questions.

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[17] The Lugar and Cardin transparency amendment that was included in the Dodd-Frank Wall Street Reform and Consumer Protection Act passed on July 21, 2010 is one example of such additional incentives. http://www.sec.gov/about/laws/wallstreetreform-cpa.pdf

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Mr. SILVERS. Thank you to all of you for your testimony. As with the prior two panels, we will do two rounds of questions.

Let me begin with this. Professor Schooner, in your testimony, your oral testimony, you pointed out the fact that $400 billion seems like a lot of money if we're talking about each of our——

Mr. SCHOONER. I'm sorry, $400 million or $400 billion?

Mr. SILVERS. Million.

Mr. SCHOONER. Okay.

Mr. SILVERS. $400 million seems like a lot of money, but actually isn't in the scale of government contracting and certainly in relation to the scale of TARP, an observation that I wholly agree with and I think has a number of implications. The concern that I have and that I would like your thoughts on as a group is not about whether or not some of that money is potentially being wasted, although I think that would be a serious matter. Any waste of the public's money is a serious matter. But rather, the leverage issue, that when private contractors or fiscal agents are given control of or an ability to influence the hundreds of billions of dollars that are involved in the TARP program the consequences of that are very or could be potentially very serious.

That seems to me to be the focal point of this hearing, whether that involves the possibility, given the nest of conflicts involved in any financial services or outside law firm, that decisions would be made either in the interests of that firm or its other clients, who obviously will have continuing and profitable dealings with that firm over time, or the potential in, say, the HAMP program that decisions will be made not in the interest of the public or in the interest of HAMP beneficiaries, borrowers, but in the interests of contractors or their clients.

So this Panel in dealing with this issue of contracting is sort of handed a giant set of questions, issues, data. If those are our concerns, what should we be paying attention to?

Mr. SCHOONER. If you'll indulge me with a two-part answer. The first is you are spot-on when you say that the dollar value of contracts is entirely deceptive and for the most part irrelevant. What's really important is what is the outcome—and I think Scott said this earlier and it's in my written testimony—you're looking for with the contract, and the way that the government, like any customer, gets the outcome it wants is by planning—that means understanding what their needs are—drafting contracts that are intended to achieve those objectives, negotiating to ensure that the contractor has bought into it, and then both incentivizing behavior that you want and disincentivizing behavior that you don't want.

If you look at the long parts of the testimony that you'll see in my testimony and Scott's, we're talking about a lot of the same things, and there's plenty of best practices out there on doing that. To some extent, I think, as we suggested earlier, Treasury is ahead of the curve. So I think that on that specific issue it is important with a contract, just like being a manager, you can get whatever you want, but you have to be clear what your needs are and then you have to incentivize and disincentivize behavior getting there.

Mr. SILVERS. Let me press you on that. I think that seems like a perfectly reasonable generic explanation of how to get—of good contracting practices. But it's not clear to me that you can get

whatever you want in a contract where other interests of the contractor dominate the contract. That's a unique—maybe not unique, but a particular problem to TARP that I think we need help in thinking about how to address.

Mr. SCHOONER. Correct. There are two parts to that. Number one is choosing the contractor and then the other is incentivizing the behavior you want and disincentivizing the behavior you don't want. If you believe that there are certain conflicts that you either want mitigated or avoided, trust me, you can do that with the pricing mechanism. The question is what are you articulating is your highest priority.

Oftentimes—and this is a large problem when the government doesn't have internal capacity—if the best personnel is out in the private sector and you don't control them, you can't necessarily motivate them to do what you want them to do. So you have to make a tradeoff.

So again, one of the things that we talk about in our testimony: You can get complete accountability and you can get complete compliance, possibly at the expense of value for your money. So it's all going to be a tradeoff. But it comes back to the fundamental outsourcing issue, and I don't want to revisit this too long, but, as Allison points out, I think we all agree, the government has become increasingly dependent upon contractors, and I think it was you who earlier raised the issue of inherently governmental functions. The key thing here is this is not a procurement issue. It may be that at the Cabinet level no one wants to talk about it and for the purposes of analysis it gets shunted to the Office of Federal Procurement Policy in Office of Management and Budget because no one else understands it. But these are absolute fundamental leadership issues that have to be confronted at the highest levels.

Mr. SILVERS. My time has run. I'm going to ask the other panelists to respond on the next go-round.

Mr. MCWATTERS. Thank you.

We've all read the testimony from the first two panels, listened to it. I've read your testimony, and it seems to me I can boil this down into four different things. One, I'm concerned about competition or the lack of competition. Two, I'm concerned about accountability. Three, I'm concerned about transparency. And four, I'm concerned about conflict of interest.

As Professor Schooner said a moment ago, you can have perfect accountability if you spend a lot of money having perfect accountability. So that's really not what the goal is here.

So with these four benchmarks, I would like for each of you to reflect to the extent you can and grade Treasury on how Treasury has done on competition, accountability, transparency, conflict of interest. If you don't give an A, explain why. Start with you, Mr. Amey.

Mr. AMEY. Okay. On competition, I would say that I'm open-ended right now, but I would probably say less than an A, if I may hedge my bet with either an A or less than an A, due to the fact that, although all these contracts—in the first panel you talked about how many vehicles there were and how they had selected multiple contractors, but the real question is what is the level of competition after you have all these preapproved contractors on the

list. Are you diving down to get better prices? Are you trying to drive that competition and use that competition against each other to leverage your buying power?

On accountability, again I would say that I am open-ended, but I would say less than an A, due to the fact that obviously SIGTARP is doing its job and also the GAO, but I think the last GAO report was last fall as far as the status of TARP where they really took a look at contracts. I don't know if their mandate has expired, but I would like to see some additional information and data from them about the current level of contracts, with what is active, how much money is still obligated or could be spent in the future.

As far as transparency, I would give them an A, absent the caveat I made before on some of the redactions on pricing data that is already publicly available.

On conflicts of interest, I would say less than an A, because I haven't seen the final rule come out after comments were received based on the 2009 conflicts of interest rule. So I think there are some things that they could tweak there, and also add some transparency to that process to make sure that we can see the reports that are coming in, because I do have some concerns with a program that is so heavily reliant upon the contractors or the agents to report.

Mr. MCWATTERS. Thank you.

Professor Stanger.

Ms. STANGER. I think it's a great question. You may not like my answer, but I think I would throw out the idea of grading Treasury on the TARP, for the simple reason that we were in emergency circumstances, and I think emergency circumstances excuse a lot of things. However, we can also look at the TARP as kind of a window on larger problems, and that's what I tried to do with my testimony.

The point I would make with reference to all four of those concerns, which I think are extraordinarily important, is that transparency facilitates all of them, not just transparency for its own sake. You can get better competition if you increase the information that is out there and make the process more transparent. You obviously will have better accountability if when people act they know that it's going to be in the public domain. Transparency can introduce self-policing behavior that I think is extraordinarily important in a complex economy. And with respect to conflicts of interest, we can't even begin to evaluate conflicts of interest until we can see what the interests are in a particular transaction. To me, when I look at the TARP and try to understand what actually happened, I am in many ways mystified by what happened. I don't know. There's a lot that's inside a black box, and you really can't talk about mitigating conflicts of interest until you can see clearly what the interests are. That's why I come down on the side of radical transparency.

Mr. MCWATTERS. Fair enough.

Professor Schooner.

Mr. SCHOONER. I'll try to be brief, but I'm going to give you three standards. The first is on a global standard they're A-plus across the board. There is no state on the planet that has a public pro-

curement regime as developed as ours and most nations would be stunned by the quality of the work they've done.

In terms of the Federal Government norm, they are well above average and, whether we want to be in the high B's or the low A's, I think that's complicated. But all you have to do—let's keep in mind what Allison Stanger just said: This was done in a hurry and it was really important and everybody was watching it. Compare it to the outcomes with the military contracting in Iraq, the military contracting in the State Department, and the aid contracting in Afghanistan, compare it to the post-Katrina disaster contracting, A-plus work.

Third, from an aspirational standpoint there's always room for improvement on a contract by contract basis. We can all sit down and do better. Give them a little more time and a lot more staff, a little bit of training, and some more best practices, there's plenty of room for improvement.

Mr. MCWATTERS. Fair enough. That was very helpful. Thanks to all three of you.

Mr. SILVERS. Thank you, Mr. McWatters.

Dr. Troske.

Dr. TROSKE. First I'd like to thank all of you for your written testimony. I'm not an expert in this issue and I learned quite a bit in reading it. Professor Schooner, I think I understand why you're here, because I thought your analysis of the things to look for and the tradeoffs that are inherent in trying to achieve one goal versus another were very useful for us to keep in mind. So I do appreciate it. Professor Stanger, as a fellow chair of a department, I appreciate your efforts as well to even come here.

So I do want to—Professor Schooner, so you did—you did say that sort of contracting at no profit is not unusual in the Federal Government. For me that always raises an issue of, okay, so what are they hoping to get at it? I'm not arguing that this is any different than what anybody else is doing. I'm just always concerned to try to understand what's motivating them for performing this service, and if it's not a profit motive then I struggle to sort of—what else are they hoping to get out of it.

So maybe you could help me sort of understand. If they're not working for profit, what are they doing? You hinted at that a little, but maybe you could expand on that.

Mr. SCHOONER. Unfortunately, I think the starting point is that you and I are the wrong people to be having this conversation, to the extent that we work at not-for-profit institutions and profit does not drive the decisions we've made. I don't know your background, but I'm assuming, like mine, you left an opportunity where you were making significantly or a lot more money and had the opportunity to do so every day.

The point that I think I was trying to make earlier is, if we can distinguish on the one hand the large community of not-for-profit firms, which is staggering in government contracts, everything from universities to Federally funded research and development centers to think tanks—there's a lot of sophisticated people with mind-bogglingly wonderful talents that are not necessarily worried about the marginal dollar and are more interested in participating in the single most exciting jobs in the world.

If you take the Jet Propulsion Laboratory or some of the other Federally funded research places, they're there because that's where the action is. That's where the smartest are in the room and it's a privilege.

Having said that, I have not looked at the incentive and disincentive functions in the Fannie and Freddie contracts. Even if there's no incentives, I think there should be disincentives. But again, I don't have any unique examples on those two vehicles.

Dr. TROSKE. I guess I'd push back a little bit. Universities are set up—Fannie and Freddie were set up supposedly as for-profit companies and all of a sudden they seem to be switching in this instance and all of a sudden doing something out of the goodness of their heart. Universities have a traditional nonprofit motive, but I can assure you I don't think my next best opportunity exceeds what I'm getting paid at the University of Kentucky. So I'm not sure I'm as altruistic as you are.

I have raised the issue previously about sort of an inherent moral hazard that exists when you contract with firms that you also regulate. I guess I'd like to hear the three of you give me your thoughts on that, and I'll start with Professor Stanger. Should we be looking at this somewhat differently when—and even if it's not Treasury that's regulating. Even if it's other arms of the Federal Government regulating them, it does seem to me a bit odd.

Ms. STANGER. I would agree with you, and I think the way it has developed is because slowly, over time, contracting has really become the business of government, with contractors performing functions that really are the functional equivalent of those a government employee performs. Yet we have ethics standards and guidelines that apply to Federal employees but don't apply to contractors. So what this means is that, over time, as more of the work of government is in private hands, more of the work of government is outside ethical norms designed to regulate government behavior.

So what you have from this I think—and it's fascinating—is this blurring of the line between the private sector and public service. This idea emerges that you can do both simultaneously. In other words, the assumption is that we can wear multiple hats. We can be working for a for-profit entity, but at the same time serving the public interest in another realm; we can be administering—we can be a financial agent of Treasury, yet at the same time be receiving a bailout from Treasury.

I think we have to think a little bit about that blurring and question it, because I do believe it's extraordinarily difficult to switch hats, that interests enter the equation and often conflicts of interest. When we think about the standards that govern the behavior of government employees, we don't allow that. So let's reflect on what we want to expect from private sector employees who do work for the government.

Dr. TROSKE. I will say one of the things that has struck me about this entire financial crisis and the resulting efforts to stem it is the blurring of those hats.

I'm out of time. I'm going to come back to the two of you in the next round.

Mr. SILVERS. Thank you, Dr. Troske.

We'll move on to our second round of questions. I cannot help but note with a certain amount of irony that each of us has a non-governmental full-time job. Professor Stanger and Mr. Amey, if you could respond to my prior question that Professor Schooner answered, which is that—which is if what we're trying to do here, if our goal—talk about our goals—if what we're trying to do here is to make sure that the assets of TARP are actually being managed to the extent we're asking contractors and agents to manage them, actually being managed in our interests and not the contractors', in the public interest, not the contractors' and agents' interest or their clients' interests, what steps should we be taking? What should this Panel be looking to have happen?

Mr. AMEY. I'll try to start here. Well, I think it really gets to that initial question, what are we buying. It really does lend itself then to that outsourcing question. This kind of will help maybe answer yours, if I may merge the two together, because I'm going to end up in the same spot. That is, with outsourcing and insourcing, does government have the capabilities that it needs to perform the functions and the jobs that it needs to meet its mission. That's been a problem, whether it's been the defense industry—we do have FFRDCs, we do have outside experts that are providing advice, we do have Federal advisory panels that provide the government with the advice that they need to make the decisions that they're making, not just for 5 years out, not in emergency situations, but 10, 15, 20 years out.

That's problematic, because who are we turning to for that? We're turning to the industry. The term here in Washington, "agency capture." Some of these agencies are captured by the industry that they either regulate or oversee.

The fix I think is getting down to the conflict of interest standards. Professor Stanger just said, we have a problem with the transparency in that world and we're also not holding these people accountable to the same standards that Federal employees are held accountable to.

Mr. SILVERS. Let me stop you there. So let's hypothesize for a moment that there is a set—to take legal services, there's a set of knowledge about complex financial transactions that does not reside in the Federal Government, it's just not there, and everyone who has it, who has it with scale of resources—there may be some individuals here and there, like academics, who have it, but anybody who's got a team that has it—has as their clients TARP recipients. I'm not saying that these are necessarily facts, but let's hypothesize them.

What do we do about conflicts of interest in that—with that setup? And by the way, let me say, the TARP recipients are going to be these firms' clients forever and TARP is going to go away.

Mr. AMEY. At that point, I would think that that's where you need to consider like a special government employee model, in which you bring them in, you make them divest from certain aspects of their previous business relationships, personal relationships, divest from certain assets if they have personal assets that they need to, to bring them in and put them in a position where they can make independent judgments that are in the best interests of taxpayers and not on those outside entities or their own out-

side involvement, and at that point try to divest them as much as possible, but bring them in as a government employee for that short time period, and then they can return to the private sector in whatever their old capacity was.

Mr. SILVERS. Professor Stanger.

Ms. STANGER. I think you ask a great question, and there's plenty of room for conflict of interest in all these TARP transactions. There are rules that are supposed to govern conflicts of interest, but they remind me a little bit of international law. You can delineate all these rules and regulations, but the main kicker is who's going to enforce them? To me that's the central question, and that's why again I keep coming back to transparency, because you can set all the rules in place, and they just don't get followed. That is why I am increasingly convinced that getting as much information out in the public domain and encouraging self-policing behavior and encouraging the American people to hold their government accountable is really the key.

Mr. SILVERS. In that vein, do you have any comment on our inability to get the Cadwalader firm before us?

Ms. STANGER. I think that's inexcusable. Maybe I didn't hear you correctly. Who before you?

Mr. SILVERS. The Cadwalader firm. I don't know if you were here earlier.

Ms. STANGER. Yes, I heard that, and they should feel a moral obligation to be here and to provide that information.

Mr. SILVERS. In their defense, I should note that I don't see how they could appear, given that their client objected, absent a subpoena. I'm not sure that—they may feel that moral obligation, but Treasury having barred them, I don't know they could get here.

Ms. STANGER. Well, this is why I think we really just have to change our whole notion of what acceptable levels of transparency are, because so much of the work of government is in private hands. Once we realize the transformation that has taken place, which I try to outline in my book, then that brings you to the realization that without radical transparency, we're slowly losing our capacity for self-government.

Mr. SILVERS. My time is up, but Professor Schooner seems to be very eager to get in and I'd hate to frustrate him further.

Mr. SCHOONER. I want to make a brief point and then another response. On the Cadwalader issue, if this had been something that someone was concerned about in advance, they should have put it in the contract. That's one of the things where if you have a problem, a lot of these things can be dealt with proactively. After the fact, you can't fix them.

But I want to go back to something that Mr. Amey said because I think it's really important. The point that you made about the conflicts and the fact that all of the talent may be in the private sector in a certain sphere. The solution cannot be federalizing the private sector or federalizing the talent pool. I'm not saying you suggested that. But it's a nation founded on private autonomy, and Mr. Amey's suggestion that we're going to take talented people, derail their careers, put them in Federal service, have them divest their holdings for the privilege of being forced into Federal service,

that is not the way this nation operates and it can't be the solution in the long run.

Mr. SILVERS. Professor Schooner, I've got to allow Mr. Amey to respond. I don't think he was suggesting drafting anybody. Or did I mishear you?

Mr. AMEY. No. No, there was no draft there. That's exactly the point, is there are people that would come forward. You have, for whatever reason, Freddie and Fannie operated without profit. That doesn't necessarily make sense in the normal economic model. I think that there are possible ways to get around these conflicts, because just mitigating them and coming up with firewalls—that somebody is in a different building doesn't seem to be adequate to me.

Mr. SILVERS. Once again, I've run over. My fellow panelists will have the opportunity to do so as well.

Mr. McWatters.

Mr. MCWATTERS. Thank you. I don't have much.

Professor Stanger, you make the comment the Federal Government has been effectively hollowed out. I love that statement. How do you fix that? What do you do about that?

Ms. STANGER. It's a super question. I think people just don't realize that the debate we have been having over the size of government misses a key point: government is big today in terms of the amount of money it spends, but it's actually never been smaller in terms of the number of people it directly employs. So the natural reaction when you point this out to people is they immediately say: Oh my goodness, bring it back in house; we need more government employees.

I respond that you really can't turn the clock back, because you've had this shift to government work being done by the private sector. So if you simply bring more government employees in without acknowledging that shift, you're not really going to change anything. You need to have more acquisitions professionals to manage contracts, but they're also going to have to be trained in a wholly different way, because contracting has become, in my view, a strategic issue. It's not procurement, this little realm off to the side, but it's central to what government actually does today.

Mr. MCWATTERS. Yes?

Mr. AMEY. If I may, there has always been the concept that outsourcing a lot of work that used to be performed by government employees was going to add flexibility, was going to cut costs, and was actually going to help upsurges when you needed talent to be brought in immediately. The problem I have with that is I think there is an argument that's being missed, and that is there is flexibility lost by hiring contractors. Contractors can't oversee other government employees. Contractors can't perform inherently governmental work. Contractors can't do certain things. So by hiring additional government employees to perform some of those functions rather than contractors, outside of the realm of inherently governmental—that shouldn't be outsourced in the first place, but things that are closely associated, things that are critical to government functions—by hiring government employees to perform those functions, you may actually add flexibility to the system rather

than the old argument that outsourcing was going to add that flexibility.

Mr. MCWATTERS. Yes?

Mr. SCHOONER. Very briefly, if you're fascinated with this topic I can't encourage you enough to read Paul Light, who is I believe the best chronicler of this topic over the last decade or so.

This is an entirely bipartisan effort by government that now spans two and a half administrations. It's consistent with the global new public management regime. We have not been the leader on this. We are following the rest of the world. Whether we agree with it or disagree with it—I think Allison Stanger is entirely correct—the genie's out of the bottle. We're not going back on this.

The question is how do we effectively manage it, and one of the problems that we're going to have, and it goes back to the other questions, is we have a generation of government leaders that were never trained to manage in a blended workforce. In the public policy schools, no one taught them how to manage contractor employees. The Office of Government Ethics is a generation behind on dealing with the complexities of the workforce today.

It's going to take a long time for us to manage this, but we got there very, very rapidly, and some of the chaos that we have is simply just not being ready for epochal change that has swept the globe.

Mr. AMEY. Add one thought there. The same with organizational conflicts. It's part of the 2009 conflicts of interest rule. The problem with it is—it's a major problem right now. Consolidation in industries, whether it's the defense industry, the IT industry, the medical and health field; I would imagine it's here in the financial industry, that you have a problem where you have fewer people to turn to.

In the old days we used to be able to buy missiles, boats, airplanes from multiple people. Now there's about two companies that work on Federal missiles, the DOD's missile contracts. You know what they did? They competed, there were some issues with ethics there; then they created a joint venture. So at that point we have the United Space Alliance and we have the United Launch Alliance between Boeing and Lockheed. The government doesn't have as many places to turn.

So, as Professor Schooner says, the contracting system necessarily hasn't also transformed to meet the needs of whether it's a blended workforce or the consolidation that exists currently in contracting.

Mr. MCWATTERS. So if the government has been hollowed out, under that standard in my prior question, Professor Schooner, you gave basically A-plusses, Mr. Amey A-minusses, B-plusses, Professor Stanger more of a nuanced answer. So under a system which none of you like, good grades generally. But if we change the whole government contracting system, it could be a different result.

It's just that Treasury today is playing by the game—playing by the standards of today and they're doing a good job by the standards of today.

Mr. SCHOONER. If I may make one simple point on this, it's not that it's the government contracting game today. It's the nature of governance. We have outsourced governance. The procurement

process is merely trying to facilitate a decision that's been made at a much higher political level. The people who are writing and negotiating and managing the contracts didn't make the decision to hollow out the government. They're just trying to fill in the holes.

Mr. MCWATTERS. Sure, sure. I accept that.

My time is up.

Mr. SILVERS. Thank you, Mr. McWatters.

Dr. Troske, your turn.

Dr. TROSKE. Thank you.

Mr. Amey, I'm going to come back to my—I think you did go a little bit towards the issue that I raised, but maybe you could finish up, in terms of, do we think there should be differences and different considerations taken when we're contracting with a heavily regulated firm? Should that play some special role?

Mr. AMEY. I think so. I think we need enhanced conflict of interest rules overall in the government. This isn't just a problem with Treasury's TARP conflict of interest rule. There have been personal conflict of interest rules that have stagnated in the Federal Government. The organizational conflict rule has been proposed and they just ended the comment period. So at that point these are problems overall that the entire Federal Government is facing with how to control contractors, how to handle conflicts of interest both on the personal side as well as on the organizational side.

It's also a problem with the length of these contracts as we talk about, the upsurge is over. After Katrina, the upsurge was over after a month, 2 months. Different people put different time frames. But then you transition over to a reconstruction effort and at that point when do you allow the rules then to take place to be able to better handle those situations.

Some of these contracts that we're entering are 3 years with multiple options, 5 years with options, 10 years with options. Those types of contracts, we may want to ask what are we buying, to get back to is this—is this a service that should be brought back in house and be something being performed by government employees, to avoid those conflicts altogether, without having to nibble around the edges of them.

Dr. TROSKE. Thank you.

Professor Schooner, I'll turn to you.

Mr. SCHOONER. I think the short answer is you absolutely should regulate firms, or you should do contracts differently with firms that you're already regulating. And one of the important things is that requires a lot of money and it requires a certain skill set and it requires a lot of discipline and resolve.

We have plenty of analogies, for example in Federal defense contracting. As Mr. Amey points out, we're basically down to one and a half, two nuclear sub providers. We've basically got full-time government employees that live in those spaces. We've got managers, technical people, auditors and the like. But the key point here, and this is what's so relevant here: That's expensive and it's a resource that could be used somewhere else, and it takes a fair amount of discipline to keep applying money to something that people don't see as value added.

When the head of the agency comes in and says, I need this additional requirement met, the first thing to go is often oversight,

post-award contract management, and all of the little non-perceived value-added duties that don't contribute to the bottom line. That's where you're going to have real troubles in the long term.

Dr. TROSKE. Let me stay with you, Professor Schooner. In your opening statement you did sort of point out that I was pushing Fannie, Freddie, and BNY Mellon about the form of their contracts and the fact that it was cost-plus and didn't seem to have a lot of incentives. Yet, throughout your testimony so far you seem to indicate that putting incentives in those contracts can be quite valuable. As an economist, I 100 percent agree with that.

But you have also correctly pointed out that incentives can be a very dangerous thing, because when you give them an incentive to do something they do that, and that may not be exactly what you want them to do. So give me a little thought about what ways you think those contracts could be restructured to get them to perform in ways that we would like them to perform? What incentives do you think, or disincentives?

Mr. SCHOONER. Let me start. Mr. McWatters was concerned with one of the providers that people were complaining about the fact that they submit forms. So customer satisfaction, I think that's one of the most obvious ones. I put that in my testimony. I have been baffled over an entire career in this place how ineffective the government is at assessing customer satisfaction. J.D. Power and its competitors exist because the marketplace loves customer satisfaction. We know how to gauge it, we know how to quantify it, we know how to reward it and we know how to punish it.

Once the Federal Government embraces that type of metrics-based approach, Federal Government procurement's going to be much better, and this is no different.

Dr. TROSKE. Thank you.

One sort of personal observation, since we talk about employment in the Federal Government. I was actually one of the employees. In a former life I was an employee of the Federal Government, the U.S. Census Bureau. And I can tell you that we had contractors then as well. You didn't know who was a contractor and who wasn't. It's one of the amazing things that the contractors work with the other government employees; you often, unless you specifically ask them, are you a contractor or not, you don't even know.

Mr. SCHOONER. That's a modern era phenomenon, though.

Dr. TROSKE. Yes.

Mr. SCHOONER. It was not supposed to be that way, and in fact the regulations specifically require the opposite. So part of this blended workforce and the management of it is the phenomenon that you discuss.

Dr. TROSKE. I guess since I have a couple extra, a minute or so, maybe, Professor Stanger, I'll ask you. The question about financial performance—and we pushed a little bit regarding Fannie Mae and Freddie Mac. It seems surprising to us that you would contract with a firm that had just gone into bankruptcy. Is that something that you would think you would generally want to take into account when thinking about contracting with a firm? And this blended issue, the comments about, well, we thought that they were already in conservatorship and so this was a convenient way

to contract with them. Were you bothered by that, because I was. So why don't you comment on those thoughts.

Ms. STANGER. Yes, I was bothered by that, because it would seem to me that if you were going to hire somebody to do work for you, you wouldn't want to hire the firm that had gone bankrupt doing the same sort of work. So that immediately raises a red flag.

But I think the only way you can account for that—and I was surprised when they said that it wasn't the case—is that this was part of the general bailout scheme, that you could help that firm by infusing it with additional resources, and you had some confidence that they could do the work well, even though they'd gone bankrupt.

Dr. TROSKE. You seem to want to chime in, Mr. Amey.

Mr. AMEY. Yes, two things. Contracting for convenience is never a good idea. Second is, the government is supposed to contract, by regulation and law, with responsible contractors only, and they're supposed to look at past performance. They're supposed to look at the prospective contractor's integrity and efficiency. So I would ask the question to the contracting officer, what did they look at to make that responsibility determination, both from a past performance perspective as well as an integrity and ethics perspective.

Dr. TROSKE. Thank you.

Mr. SILVERS. Thank you, Dr. Troske.

We have one very brief further question, which has come up a number of times and where we need your guidance as we prepare our next report. There is an issue about the absence of pricing on the Treasury website for some contracts, including some legal service contracts, some financial agent contracts, and the like. We would be interested in your thoughts as to whether they're doing that right or not. We certainly took note of your general view that the disclosure regime here is a very good one, but this particular issue is in front of us. You can either answer it now or provide us with an answer in writing; if in writing, please quickly.

Mr. SCHOONER. My guess is—and I don't want to speak for Scott—but as a general rule, I know that POGO and many of us believe that more transparency is good, and the trend is going that way. So it's going to happen eventually. But I think if there's one simple theme that you want to keep in mind, if you want transparency on things like pricing or what some people view as proprietary data or information, tell the contractor in advance and they can choose. If they don't want to participate in that regime, they don't participate.

But the bottom line is, you want my money, I can put whatever conditions on it I want. So I think it's a simple one. If you wanted it you should have required it.

Mr. AMEY. The Commonwealth of Virginia already does. In their contracts they put a provision in that says that the state can share that type of information, that it will be provided to the public.

I'd like to see more of it. Obviously, there is proprietary information that would need to be protected, but I don't think we can just throw a blanket over it all the time. If we're supposed to be—most of these contracts are commercial contracts. There is a commercial marketplace for them. When you buy a car, you walk in and you see the sticker price, so at that point you see all the markups and

the individual price lines for the different things on it. I don't see a problem with the government requesting that information, and that's what Professor Schooner says: Let's contract around it and allow the talent pool to decide whether they want that contract or not.

Ms. STANGER. To me it's very simple. If it involves taxpayer money, information on pricing should be available to the public.

Mr. SILVERS. Thank you. The Panel appreciates your willingness to take our last question.

With that, we'll conclude the testimony for today's hearing. Thank you to this panel and to all of our witnesses. The Panel greatly appreciates your taking the time and effort to join us today. Thank all of you for being here today.

With that, this hearing is adjourned.

[Whereupon, at 12:56 p.m., the hearing was adjourned.]