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FINANCIAL SERVICES AND GENERAL GOVERNMENT APPROPRIATIONS FOR FISCAL YEAR 2010

HEARINGS

BEFORE A

SUBCOMMITTEE OF THE

COMMITTEE ON APPROPRIATIONS

UNITED STATES SENATE

ONE HUNDRED ELEVENTH CONGRESS

FIRST SESSION

ON

H.R. 3170/S. 1432

AN ACT MAKING APPROPRIATIONS FOR FINANCIAL SERVICES AND GENERAL GOVERNMENT FOR THE FISCAL YEAR ENDING SEPTEMBER 30, 2010, AND FOR OTHER PURPOSES

Commodity Futures Trading Commission
Department of the Treasury
General Services Administration
Securities and Exchange Commission
Small Business Administration

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FINANCIAL SERVICES AND GENERAL GOVERNMENT APPROPRIATIONS FOR FISCAL YEAR 2010

TUESDAY, JUNE 2, 2009

U.S. SENATE,
SUBCOMMITTEE OF THE COMMITTEE ON APPROPRIATIONS,
Washington, DC.

The subcommittee met at 10:33 a.m., in room SD–138, Dirksen Senate Office Building, Hon. Richard J. Durbin (chairman) presiding.

Present: Senators Durbin, Tester, and Collins.

SECURITIES AND EXCHANGE COMMISSION

STATEMENT OF HON. MARY L. SCHAPIRO, CHAIRMAN

STATEMENT OF SENATOR RICHARD J. DURBIN

Senator DURBIN. Good morning. I'm pleased to convene this hearing on the fiscal year 2010 funding request for two key Federal regulatory agencies within the jurisdiction of this Appropriations Subcommittee on Financial Services and General Government, the Securities and Exchange Commission (SEC) and the Commodity Futures Trading Commission (CFTC).

I also want to welcome my friend and my distinguished Ranking Member Senator Susan Collins. We have worked together in many venues, and I'm glad that we're going to share the responsibilities of this subcommittee.

Joining us today to present testimony on the two budgetary proposals are the Honorable Mary Schapiro, Chairman of the SEC, and the Honorable Gary Gensler, Chairman of the Commodity Futures Trading Commission.

Both of these agencies enjoy unique histories, hold specialized and independent responsibilities and take different approaches to markets that serve different purposes, yet the CFTC and SEC both occupy pivotal positions at the forefront of stimulating and sustaining economic growth and prosperity.

We are enduring an extraordinary set of circumstances in our Nation today. We are beginning to slowly emerge from one of the greatest economic crises in decades. After years of struggle, countless families have lost their hard-earned savings, seen their dreams deferred and even denied.

Some may view the subject matter of this hearing as dry as dust, how much money to give to two Federal agencies, but if you step back for a moment and translate their work into the real world, re-

alize that their oversight and their regulation literally protects the savings and futures of American families and ensures that economies in countries around the world will view our economy and the way we run it with respect to as to whether or not the rule of law is going to be followed.

The unprecedented price volatility of our markets for fiscal commodities, such as energy and grains, has hurt our economy, in addition to the previous mention I made of some of the problems that we've had with savings and the like.

Now perhaps more than ever, we need our markets to function transparently and be insulated from manipulation and unfettered excessive speculation. Much remains to be done to stabilize and sustain our financial system.

Chairman Schapiro and Chairman Gensler each bring vast experience to their new leadership posts in this administration and have undoubtedly identified in their brief tenure ways to improve the way we approach regulating securities and futures markets.

As the subcommittee prepares to make difficult funding decisions, I look forward to hearing about the challenges their agencies will face.

In the interest of time, I am going to ask that the remainder of my statement be made a part of the record so that we will have opportunity for testimony and for questions.

[The statement follows:]

PREPARED STATEMENT OF SENATOR RICHARD J. DURBIN

The CFTC and the SEC enjoy unique histories, hold specialized and independent responsibilities, and take different approaches to markets that serve differing purposes. Yet the CFTC and the SEC both occupy pivotal positions at the forefront of stimulating and sustaining economic growth and prosperity in our country.

Market users, financial investors, and the U.S. economy rely upon vigilant oversight by these two agencies in today's evolving—and often volatile—global marketplace.

We are enduring an extraordinary set of circumstances in America today. We are beginning to slowly emerge from one of the greatest economic crises since the Great Depression. After years of sweat and struggle, countless families have lost their hard-earned savings, seeing their dreams daunted, deferred, and even denied.

When a man named Bernard Madoff can, over the span of 10 or 20 years, lure investors into what has turned out to be a Ponzi scheme, causing many of them to lose millions of dollars, and his wrongdoing goes unnoticed by major regulatory agencies, it is clear more has to be done.

When some of the major ratings agencies that gauge whether a company is doing well basically ignore their responsibility and fail to make accurate reports, everyone loses as a result of it.

The unprecedented price volatility of our markets for physical commodities, such as energy and grains, has hurt our economy. Now—perhaps more than ever—we need our markets to function transparently and insulated from manipulation and unfettered excessive speculation.

The Obama administration recently announced a comprehensive plan to significantly regulate credit default swaps and other over-the-counter derivatives. Exempting these investments from regulation has proven to be a costly mistake—contributing to the $180 billion taxpayer bailout of AIG, the collapse of Lehman Brothers, and the demise of Bear Stearns.

This proposal will require far more transparency and responsibility from derivatives traders that have long operated in the shadows.

Things are still very fragile. Much remains to be done to stabilize, repair, and sustain our financial system on which we all depend. It will take time to redeem the lost faith of the American people in the government institutions they expected would protect them. But I believe we are moving forward with resolve toward a brighter economic course.

I appreciate the fact that Chairmen Schapiro and Gensler have each accepted President Obama's call to be part of the economic leadership team to help craft a more reliable regulatory framework and guide us to a better future.

Both Chairmen bring vast experience to their new leadership posts in this administration—and have undoubtedly identified, even in their brief tenures, ways to improve the way we approach regulating in the securities and futures markets.

As the subcommittee prepares to make difficult funding decisions for the next fiscal year, I look forward to hearing about the particular challenges their respective agencies face in today's tumultuous economic environment. I welcome their input on how we can best help to address those needs.

Before hearing from our panelists, I'd like briefly outline the missions of these agencies and their budget proposals:

Turning first to the SEC, its three-prong mission is to protect investors; maintain fair, orderly, and efficient markets; and facilitate capital formation. The SEC is the investor's advocate.

The SEC is responsible for overseeing more than 12,000 publicly traded companies, over 11,300 investment, nearly 8,000 mutual funds with $9 trillion in assets, fund complexes, 5,500 broker dealers with over 174,000 branches, 10 credit rating agencies, and close to $44 trillion worth of trading conducted each year on America's stock and option exchanges.

The strength of the American economy and our financial markets depends on investors' confidence in the financial disclosures and statements released by publicly traded companies. Investors expect the SEC to be the vigilant "cop on the beat." Regrettably, in many respects, we let them down. I have faith in Chairman Schapiro's leadership and tenacity to turn things around.

This subcommittee wants to make certain that the SEC has the necessary resources to effectively fulfill its obligatory singular mission: protecting shareholders.

The SEC's budget request for fiscal year 2010 totals $1.026 billion, an increase of $8.8 million, or 8.8 percent over the agency's fiscal year 2009 enacted level of $943 million. This proposed fiscal year 2010 budget would fund 3,692 FTE, just 40 more than the current year funding permits.

Crucial to the SEC's effectiveness is its enforcement authority. Each year the SEC brings hundreds of civil enforcement actions for violations of the securities laws, such as insider trading, accounting fraud, and providing false or misleading information.

Serious, thoughtful questions have been raised about whether the proposed enforcement budget is adequate to keep pace with the growing demands.

Second, the CFTC: The CFTC is charged with protecting the public and market users from manipulation, fraud, and abusive practices. It is also responsible for promoting open, competitive, and financially sound markets for commodity futures.

The CFTC helps ensure that the futures markets are equipped to better perform their vital function in the U.S. economy—providing a mechanism for price discovery and a means of offsetting price risks.

The CFTC's oversight and enforcement mission becomes tangible when you consider that futures prices impact what we pay for the basic necessities of our daily lives: our food, clothing, shelter, fuel in our vehicles, and heat in our homes.

This year—2009—marks the 35th year since the establishment of the Commodity Futures Trading Commission. At the time of its inception in 1974, CFTC's 500 employees were tasked with the mission of ensuring fair practices and honest dealings on the commodity exchanges of America's then-$500 billion futures industry.

Today it is a $22 trillion industry that looks vastly different. Yes, the traditional agricultural products like wheat, corn, soybeans, and the proverbial pork bellies are still part of the picture. But the landscape has been remarkably altered and diversified with novel and complex commodities . . . everything from grains to gold, currencies to carbon credits.

In the past decade, trading volume has increased more than ten-fold—reaching well over 3.4 billion trades in 2008, and actively traded contracts have quintupled—from 286 in 1998 to 1,521 in 2008. CFTC oversees $5 trillion of trades—daily.

Adding to this challenge is a significantly transformed globalized, electronic, and round-the-clock marketplace. Moreover, the emergence of derivatives and hedge funds have altered the regulatory environment.

Layered on this are new authorities added through the 2008 farm bill, coupled with escalating public angst about record energy and agricultural commodity price hikes and fluctuations, and a growing influx of financial funds into the futures markets.

Further complicating the picture are transactions that the CFTC currently has no power to presently regulate—the vast "shadow" world of over-the-counter derivatives—like credit default swaps.

Surprisingly, what hasn't changed is the number of staff. Despite the phenomenal surge in volume and activity, CFTC staffing levels have simply not kept pace. In fact, staffing levels have dropped by over 20 percent. CFTC's workforce—like its predecessor over three decades ago in the agency's fledgling years—presently numbers only 500.

For fiscal year 2010, the President's budget request funding for the CFTC of $160.6 million. This represents an increase of $14.6 million—a 10 percent hike—above the fiscal year 2009 enacted level of $146 million.

Of the $14.6 million in increased funding for next year, $7.4 million is slated for increased compensation and benefit costs for a staff of 572; $0.2 million will be devoted to increased operating costs for information technology modernization, lease of office space, and other services; and $7.8 million will support the salary and expenses of 38 additional full-time staff.

Last August, I had the opportunity to visit the CFTC's Chicago Regional Office. I met with a group of dedicated staff committed to doing outstanding work under challenging circumstances. I learned first-hand just how thin the staffing is.

The CFTC's Chicago market surveillance staff consisted of 10 economists who conduct daily oversight of each actively traded market and 6 trading specialists who process the daily reports detailing traders' actual positions in each market.

These economists are responsible for surveillance of over 1,250 different commodity futures and option contracts, of which 325 are active, involving 13 different commodity types. The commodities underlying the futures contracts the staff must monitor are highly diverse—including grains, livestock, lumber, currencies, Treasury instruments, equity indexes, single stock future, and dairy. More recently, weather derivatives, real estate indexes, and environmental products such as carbon credits and emission allowances became part of their portfolio.

A single staff economist must cover many markets. For example, one staffer is responsible for 10 grains, one for 90 currencies, and one for the surveillance of over 500 hundred single stock futures. Aside from supervision by the chief of the Chicago surveillance section and Washington, DC supervisory personnel, there is limited redundancy built into the system. As a consequence, each one of those economists is critical.

The six trading specialists maintain an extensive daily data-gathering and verification system by collecting reports from exchanges, futures industry firms, and traders. As our energy debate in Washington throughout the last Congress demonstrated, this data collection is very important to the Commission's oversight and to market transparency.

As I pledged since assuming the Chairmanship of this committee, I am serious about addressing the resource deficiency facing this agency.

I will appreciate hearing from both Chairmen their honest appraisals about the resources they will require to achieve their missions, keep pace with change, and becomes as sophisticated as, if not more so, than the entities they monitor—while responsibly managing taxpayer dollars.

Senator DURBIN. And I now turn it over to my Ranking Republican Member, Senator Collins.

STATEMENT OF SENATOR SUSAN COLLINS

Senator COLLINS. Thank you, Mr. Chairman.

Let me begin by saluting you for your leadership on this subcommittee. I am just delighted to be your new ranking member.

About two decades ago, I spent 5 years in Maine State government as a financial regulator overseeing the bureau of banking, insurance, securities administration, and I have a great personal interest in this area because I know that the decisions made by the SEC and the CFTC do, as you have pointed out, have such an impact not only on our economy but on the daily lives of most American families.

So it's a great honor to serve with you as your ranking member and I very much look forward to working cooperatively with you throughout this Congress.

As we begin to consider the fiscal year 2010 budget requests for the SEC and the CFTC, let me also salute the chairman for his

leadership in securing significant increases for both of these agencies.

Thanks to the work of this subcommittee and the chairman's leadership, the budget for the SEC is now nearly 9 percent above the fiscal year 2007 funding level and the budget for the CFTC is 49 percent above that year.

These increases are extremely important, given that both of these agencies were woefully underfunded for years. I personally believe that they're still underfunded and that more work needs to be done.

I want to congratulate the two chairmen for appearing before our subcommittee today with aggressive agendas for change and reform. I look forward to hearing the details about the budget requests.

As the chairman has indicated, the current economic crisis has left our markets in turmoil and the loss of trillions of dollars of value in these markets has depleted family savings, shuttered small businesses and damaged retirement and pension funds.

I am convinced that we not only need to make sure these two agencies have the resources necessary but that we need to proceed with regulatory reform, as well, in order to restore confidence in our markets and to prevent the root causes of the current financial crisis from springing up once again.

Mr. Chairman, I am going to follow your lead and submit the remainder of my statement, as well, but I am delighted to be joining you to work on these critical issues.

Thank you.

[The statement follows:]

PREPARED STATEMENT OF SENATOR SUSAN COLLINS

Good morning. At this first hearing of our subcommittee, I want to thank you, Chairman Durbin, for your leadership. This Subcommittee has jurisdiction over a diverse group of agencies, many of which have a profound impact on the financial stability of our economy and on the lives of most Americans. So it is an honor to serve with you as Ranking Member of this subcommittee, and I look forward to working cooperatively with you during this Congress.

Mr. Chairman, as we begin to consider the fiscal year 2010 budget requests for the SEC and the CFTC, I want to salute you for your leadership in securing significant increases for both these agencies during your chairmanship of this subcommittee. Thanks to your hard-fought efforts, the budget for the SEC is now 8.9 percent above the fiscal year 2007 funding level, and the budget for the CFTC is 49 percent above the fiscal year 2007 level. These increases were extremely important, given that both of these agencies had been woefully underfunded over the years.

Chairman Schapiro and Chairman Gensler: Congratulations and thank you both for appearing before our subcommittee today. I look forward to hearing the details of your fiscal year 2010 budget requests and the key efforts that you plan to undertake this year. You both have crucial roles in our economy: SEC, by protecting the public through enforcement of securities laws, and CFTC, by protecting market users and the public from fraud, manipulation, and abusive practices related to the sale of commodity and financial futures and options.

Protecting investors is more compelling than ever since many first-time investors have turned to the markets to help secure their retirements, pay for homes, and send their children to college.

Our current economic crisis has left our markets in turmoil. The loss of trillions of dollars in value in these markets has depleted family savings, shuttered small businesses, and damaged retirement and pensions funds.

Chairman Schapiro, I am troubled by reports that an environment of lax oversight and enforcement at the SEC was a contributing factor to the current financial crisis. For example, some investment banks were allowed to become over-extended, which

led to the collapse of several of Wall Street's largest banks. The Bernard Madoff ponzi scheme went undetected for decades, resulting in $50 billion in investor losses. So Madam Chairman, I am pleased that you have developed an ambitious agenda of management reforms for the Commission, and I am interested in hearing what resources you need to accomplish these reforms.

Chairman Schapiro and Chairman Gensler: You both have challenging tasks in front of you. You must improve transparency in our securities markets and uncover fraud and deception, while not over-regulating our markets and hindering our economic recovery. I look forward to working with both of you, and with Chairman Durbin to ensure that you have the resources and the tools you need to ensure investors are protected and that markets are functioning properly.

I look forward to your testimony and I thank you for your service to our Country. Thank you, Mr. Chairman.

Senator DURBIN. Thanks a lot, Senator Collins.

Senator Tester, would you like to make an opening statement?

Senator TESTER. Thank you, Mr. Chairman.

Just to welcome Mary and Gary to the subcommittee today. I appreciate the work that you have done and I appreciate the work you are about to do. I think it's critically important that we have good, solid, reasonable enforcement and I think both of you are up to that challenge.

So with that, we'll move on. Thank you, Mr. Chairman.

Senator DURBIN. Thank you, Senator Tester.

Chairman Schapiro, the floor is yours.

Ms. SCHAPIRO. Chairman Durbin, Ranking Member Collins, and Senator Tester, thank you very much for the opportunity to testify today.

In the short time that I've been at the SEC, we have taken on an active agenda, all with the goal of protecting investors, revitalizing the agency, and restoring confidence in the markets. We are making great strides, yet recognize that we have quite a distance to go.

In the area of enforcement, we have changed our policies so that our investigators do not have to jump over unnecessary hurdles before seeking penalties or launching investigations. We have hired a former Federal prosecutor to lead the Enforcement Division, someone who is focused on bringing significant cases with a meaningful impact as quickly as possible and ensuring that the Division is appropriately organized to do just that.

We have begun to update our management systems, to upgrade our risk assessment capabilities so that we can better detect fraud, and we have expanded and improved upon our training so that our staff will be able to keep pace with the new financial products and strategies created on Wall Street.

Already we are seeing results. Since the end of January, as compared with the same period last year, we have filed nearly three times as many temporary restraining order cases, issued more than twice as many formal orders and opened over 20 percent more investigations into fraud.

Although enforcement is central, it is still just one part of our agency. As you know, we are tasked with overseeing broker-dealers, investment advisors, and mutual funds, and we are taking steps to improve our ability to do just that.

For instance, we are working on a risk-based initiative to improve our oversight methods so that we can better identify and focus resources on riskier institutions. We also are recruiting senior

professionals with new skill sets, such as trading, risk assessment and financial analysis, and we have created an Industry and Risk Management Fellows Program to bring top talent into the agency.

SEC'S RULEMAKING AGENDA

In addition to internal management directives, we also have engaged in an active rulemaking agenda. Last month, the SEC proposed significant changes to the rules governing investment advisors who maintain custody of their clients' assets.

Should the proposals be adopted, advisors with custody will have to undergo a surprise exam by an independent public accountant once a year to verify client assets and any custodian affiliated with an advisor would also be subject to custody controls reviews by an independent accountant. The goal is to expose Ponzi schemes and other frauds earlier.

In the area of short selling, the Commission unanimously voted to propose two distinct approaches to limit short selling. One would impose a permanent market-wide short sell price test, the other approach would impose temporary short selling restrictions upon individual securities during periods of severe price declines.

Later this month, the SEC will consider proposals to strengthen the money market fund regulatory regime. We will focus on tightening credit quality, maturity and liquidity standards for money market funds.

We're also exploring whether more fundamental changes are necessary, such as converting money market funds to a floating rate net asset value to better prevent abuses and avoid runs on the funds.

Additionally, I have asked the staff to undertake a comprehensive review of rule 12(b)(1) which allows mutual funds to use fund assets to compensate broker-dealers and other intermediaries for distribution and servicing expenses.

In the area of proxy access, the Commission already has proposed rules that would enhance the ability of shareholders to nominate company directors and next month we will take up a broad packet of corporate disclosure improvements around compensation policies, the use of compensation consultants, and the interplay between risk-taking and incentive arrangements.

But there is still more to do in the regulatory arena. We have been working closely with other Federal agencies to bring the unregulated world of credit default swaps into the sunlight.

Operating under the limitations of the current legislative structure, we recently issued temporary orders to facilitate the establishment of central counterparties for clearing credit default swaps.

In the coming months, we will also tackle issues related to municipal market reform, stock lending, trading in non-transparent markets or dark pools, and hedge fund oversight. I look forward to working with Congress on these issues.

RESOURCES NEEDED FOR SEC'S MISSION

The financial crisis has reminded us all just how large, complex and critical to our economy the securities markets have become. At the SEC, our 3,700-person staff now oversees more than 35,000 registrants, including about 12,000 public companies, 8,000 mutual

funds, 11,000 advisors, and 5,000 broker-dealers, and it is a number that is growing rapidly.

Nonetheless, during this same period the SEC's resources have fallen. Between 2005 and 2007, the agency saw 3 years of flat or declining budgets and lost 10 percent of its employees. This has an impact.

With support from this subcommittee during the last 2 fiscal years, the SEC has been able to lift its hiring freeze and begin rebuilding its workforce, and I am very grateful for that support.

But even with these important steps, the number of staff remains below the levels of only a few years ago. I believe additional resources are essential to restoring the SEC as a vigorous and effective regulator.

The President has requested a total of just over $1 billion for the agency in fiscal year 2010, a 7 percent increase over this year's level. This budget request would permit us to fully fund an additional 50 staff positions over 2008 levels. These positions would help the SEC's Enforcement Program enhance its pursuit of tips and complaints and fully fund our new Fellows Program that brings in seasoned industry professionals.

In addition to expanding our workforce, the President's request also would enable us to invest more in new technology, a budget item that has dropped by more than one-half in the last 4 years.

Mr. Chairman, I came to the SEC to shape public policy in the interest of investors and to strengthen our Enforcement Program. The measures I have described today are important to those efforts, but what I have also discovered is that we cannot neglect the internal operations of the agency, the processes that guide our work and the agency's infrastructure.

I am committed to a complete review of the internal operations to ensure that we meet the highest standards and that we are fully supporting the important work of our employees. To ensure that we do it right, I intend to bring in a chief operating officer to manage that process.

I want to thank you for your continued strong support of the SEC and its critical mission. I believe that by strengthening our Enforcement Program, enhancing risk-based oversight, and leveraging technology, we can restore investors' confidence in both the SEC and in our Nation's securities markets.

PREPARED STATEMENT

I look forward to answering your questions. Thank you.

Senator DURBIN. Thanks, Chairman Schapiro.

[The statement follows:]

PREPARED STATEMENT OF MARY L. SCHAPIRO

Chairman Durbin, Ranking Member Collins, Members of the Subcommittee, thank you for the opportunity to testify today. I sincerely appreciate the support this Subcommittee has shown the Securities and Exchange Commission, and I am pleased to have the opportunity to discuss with you the Commission's role in helping to address the financial crisis, and to discuss reforms to improve investor protection and restore confidence in our markets.

The last year has been a wrenching time for the investors whom the SEC is charged with protecting. Trillions of dollars in wealth have been destroyed during the economic downturn, and millions of Americans have seen their retirement nest eggs and college tuition funds shrink dramatically as a result. The economic crisis

has challenged faith in our system of capital formation and allocation—a system that has proved over the long term to be the greatest for creating wealth the world has seen.

As an agency charged with protecting investors, maintaining fair, orderly and efficient markets, and facilitating capital formation, we are dedicated to understanding and learning from recent events and from the causes that were building in the system over the years, so that we can do our part to restore market integrity and investor confidence. The SEC must act promptly, decisively, and with resolve. We also must have a renewed commitment to protecting investors; they provide the capital used to fund the productive enterprises that create jobs and wealth. While we have a tripartite mission at the SEC, investor protection is the foundation upon which all our responsibilities are built.

To that end, I've already announced several changes at the agency that will reinforce our focus on investor protection and market integrity and redirect our energies toward restoring investor confidence.

REINVIGORATING SEC ENFORCEMENT

One of my very first actions as Chairman was to end the 2-year "penalty pilot" program, which had required the Enforcement staff to obtain a special set of approvals from the Commission in cases where the staff sought fines against public companies that violated the law. Some enforcement staff had complained that the procedures unnecessarily delayed the prosecution of cases, and discouraged the staff from either seeking a penalty or seeking an appropriately high penalty. At a time when the SEC needs to send a clear message that corporate wrongdoing will not be tolerated, and penalties for securities violations will be stiff, the penalty pilot program was an unnecessary hurdle to more active enforcement.

Another change I implemented to bolster the SEC's Enforcement program was to provide for more rapid approval of formal orders of investigation, which allow SEC staff to use the power of subpoenas to compel witness testimony and the production of documents. In investigations that require the use of subpoena power, time is of the essence; delay can be costly to an investigation. To ensure that subpoena power is available to the staff when needed, the agency has returned to a policy of timely consideration of formal orders by the seriatim process or, where appropriate, by a single Commissioner acting as duty officer.

In addition, I have hired a new enforcement director, a longtime Federal prosecutor who served as Chief of the Southern District of New York's Securities and Commodities Fraud Task Force, charged with focusing our enforcement efforts on bringing meaningful, high impact cases quickly. We are working together on management reforms—including harnessing technology, improving risk assessment, and improving training and supervision for our line law enforcement personnel—so that we can maximize our resources to combat fraud and wrongdoing in our markets. Our Division of Enforcement has been working diligently. Since the end of January,

—We have filed at least 34 emergency temporary restraining orders. During roughly the same period last year, we filed 12.

—We have opened more than 358 investigations. During roughly the same period last year, we opened 292.

—The Commission has issued at least 188 formal orders. During roughly the same period last year, the Commission issued 74.

Since January, we have brought a number of important and complex cases. For example, in the Reserve Fund matter filed in May, we charged certain operators of the Reserve Primary Fund, a $62 billion money market fund whose net asset value fell below $1.00 or "broke the buck" last fall, with fraud for failing to provide key material facts to investors and trustees about the Fund's vulnerability as Lehman Brothers Holding, Inc., sought bankruptcy protection. As part of this action, we are seeking to bring about an expedited, efficient, and equitable pro-rata distribution to shareholders of the Fund's remaining assets, including $3.5 billion originally set aside in the Fund's litigation reserve.[1] We believe this will help Reserve Fund investors recover a larger share of their assets.

In March, we initiated a case alleging fraud in connection with a kickback scheme involving New York's largest pension fund. Namely, we charged New York's former Deputy Comptroller and a top political advisor with extracting kickbacks from investment management firms seeking to manage the assets of the New York State Common Retirement Fund. Since March, we have amended the complaint to add additional defendants, including a former New York State political party leader, a

[1] *SEC* v. *Reserve Management Company, Inc., et al.*, Lit. Rel. No. 21025 (May 5, 2009).

former hedge fund manager, a Dallas-based investment management firm and one of its founding principals, and a Los Angeles-based "finder."[2]

As committed as we are to vigorous enforcement of the securities laws, we are also mindful that the complexity of 21st century markets, as well as the varied nature of frauds and scams, require that the sophistication and tools available to our Enforcement and Examination programs keep pace. Important questions have been raised concerning the agency's handling of tips or whistleblower information related in particular to the activities of Bernard Madoff. Clearly this is something we must learn from, and I am committed to addressing it. Former Chairman Cox asked the SEC Inspector General to look into what happened, what failed to happen, and to report back to the Commission. We expect to receive the IG report this summer and will promptly take all appropriate actions and address any remaining shortcomings.

It is clear that, regardless of any findings of the Inspector General, the agency must improve its ability to process and pursue appropriately the hundreds of thousands of tips and referrals it receives annually. In February, we retained the Center for Enterprise Modernization which began work immediately on a comprehensive review of internal procedures to evaluate tips, complaints, and referrals. We are in the process of creating a system that will centralize this information so we can track it, analyze it and more effectively identify valuable leads for potential enforcement action and compliance exams.

STRENGTHENING EXAMINATION AND OVERSIGHT

In addition to these changes, it is essential that we work to improve our risk-based oversight of broker-dealers, investment advisers and mutual funds. Our Office of Compliance Inspections and Examinations (OCIE), together with other agency staff in the Office of Risk Assessment, are presently working on an initiative to identify the key data points that would facilitate an improved risk-based oversight methodology to allow the staff to identify and focus on those firms presenting the most risk. OCIE has improved training and, under a newly authorized program, 268 examiners are now participating in the training and certification program offered by the Association of Certified Fraud Examiners, to identify the warning signs and red flags that indicate evidence of fraud and fraud risk. OCIE is also recruiting additional individuals with experience in different facets of the industry, such as trading, risk assessment and compliance. These steps taken together will expand the knowledge base of our inspections staff, better enabling them to conduct oversight of complex trading strategies and products that exist in our markets today.

I have also launched an Industry and Markets Fellows Program in our Office of Risk Assessment. Through this program, we have begun recruiting fellows with extensive experience in such areas as equity and fixed income securities trading, structured products, complex derivatives, financial analysis and valuation, fund management, investment banking and financial services operations.

IMPROVING TRANSPARENCY AND INVESTOR PROTECTION

The agency is working hard in other areas as well. In the area of accounting standards, the SEC staff completed a congressionally-mandated study of fair value accounting. The staff issued guidance to financial institutions so that they can give fuller disclosure to investors, particularly with respect to hard-to-value assets. The staff has also continued to work closely with the Financial Accounting Standards Board to deal with such issues as consolidation of off-balance sheet liabilities, the application of fair value standards to inactive markets and the accounting treatment of bank support for money market funds. FASB recently took steps to clarify treatment of off-balance sheet items in a manner designed to increase market transparency.

In the area of combating false rumors and manipulative activity in the marketplace, the agency initiated examinations of the effectiveness of broker-dealers' and investment advisers' controls to prevent the spreading of false information. When concluded, the results of these examinations will be used by regulators to assist firms in crafting and implementing robust policies and procedures to prevent the spreading of false information.

In the wake of recent Ponzi schemes and other investment adviser abuses, the Commission last month proposed significant changes to the custody requirements for investment advisers. These proposals focus on the value of an independent public accountant serving as another set of eyes to better assure the safekeeping of investor assets. One proposal would require all advisers with custody or control of client

[2] *SEC* v. *Henry Morris, et al.*, Lit. Rel. No. 20963 (March 19, 2009), Lit. Rel. No. 21001 (April 15, 2009), Lit. Rel. No. 21018 (April 30, 2009); Lit. Rel. No. 21036 (May 12, 2009).

assets to engage an independent public accountant to conduct an annual "surprise exam" to verify those assets exist. A second proposal would apply only to investment advisers whose client assets are not held by a firm independent of the adviser. In such cases, the investment adviser would be required to be subject to a review that results in a written report—prepared by a PCAOB-registered and inspected accounting firm—that, among other things, describes the controls in place relating to custodial services, tests the operating effectiveness of those controls and provides the results of those tests. These reports are commonly known as SAS–70 reports. The reports would include an opinion of an independent public accountant issued in accordance with the standards of the PCAOB, which will provide an important level of quality control over the accountants performing this review. In addition, advisers would be required to publicly disclose the name of the accountant conducting these reviews, so that our staff can better monitor compliance and assess adviser compliance risks. Accountants also would be required to disclose the reason for any termination or resignation from performing these reviews, which should highlight any "red flags" for regulators and investors.

At my request, our staff is also developing investor-oriented enhancements to the municipal securities area. It is time for those who buy the municipal securities that are critical to State and local funding initiatives to have access to improved quality, quantity and timeliness of information. On a related note, so called "pay-to-play" practices by investment advisers to public pension plans must be curtailed. I have asked the staff to revisit the Commission's 1999 proposal to address harmful pay-to-play practices, and I expect that the Commission will consider that proposal this summer.

COMBATING ABUSIVE SHORT-SELLING

In my brief tenure as Chairman, the issue of short selling has outpaced any other in terms of the number of inquiries, suggestions and expressions of concern we have received. On April 8, 2009, the Commission unanimously voted to propose two distinct approaches to short selling restrictions. One approach would impose a permanent, market-wide short sale price test, while the other would impose temporary short selling restrictions upon individual securities during periods of severe declines in the prices of those securities. On May 5, 2009, the Commission held a public roundtable to solicit the views of investors, issuers, financial services firms, self-regulatory organizations and the academic community on key aspects of these proposals. The Commission is committed to conducting a thoughtful, deliberative process to determine what is in the best interests of investors, including examining a variety of trading and market related practices such as securities lending.

We also recognize that strong rules and vigorous enforcement are needed to curb abusive short selling and restore confidence in our markets. The Commission has been focused on the issue of abusive "naked" short selling since before my arrival in late January, and the Commission's regulatory actions have led to a significant decline in failures to deliver securities on time following a short sale. Moreover, our Division of Enforcement has a number of active investigations involving potentially abusive short selling in a variety of contexts.

FILLING REGULATORY GAPS

In an effort towards bringing the unregulated world of credit default swaps into the sunlight, the Commission, working in close consultation with the Board of Governors of the Federal Reserve System and the Commodity Futures Trading Commission ("CFTC") and operating under the limitations of the current legislative structure, recently issued temporary orders to facilitate the establishment of central counterparties for clearing credit default swaps ("CDS") by LCH.Clearnet Ltd., ICE US Trust LLC, and Chicago Mercantile Exchange Inc. The Commission is committed to increasing investor protection and reducing systemic risk by facilitating the development and oversight of central counterparties to clear CDS.

We have also been working with the CFTC and Treasury Department to fill regulatory gaps in this area to help increase transparency and minimize risks associated with certain derivative products, including CDS, as well as market participants transacting in these products. I look forward to working with Congress to make the necessary legislative changes to ensure that these markets and market participants are appropriately regulated.

In addition, we are closely examining the broker-dealer and investment adviser regulatory regimes and assessing how they can best be harmonized and improved for the benefit of investors. Many investors do not recognize the differences in standards of conduct applicable to broker-dealers and investment advisers. It is essential that comparable and effective protections be afforded to investors, whether they

turn to a broker-dealer or an investment adviser for assistance in accessing the securities markets.

Finally, hedge funds and other unregulated private pools of capital have flown under the radar for far too long. We are currently examining whether these funds, their managers or both should be subject to SEC registration and oversight, so that investors, regulators and the marketplace have more complete and meaningful information about the funds and their market activities. I look forward to working with Congress on this important issue.

STRENGTHENING SHAREHOLDER RIGHTS

We have launched an agenda of proxy reforms with a proposal approved by the Commission for public comment that would significantly support shareholders' rights to nominate company directors. Next month we will take up a broad package of corporate disclosure improvements, all designed to provide shareholders with important information about their company's key policies, procedures and practices, including compensation policies and incentive arrangements. With this additional information, shareholders will be better able to hold directors accountable for the decisions that they make. For example, the Commission will consider proposals to enhance disclosure of director nominee experience, qualifications and skills, so that shareholders can make more informed voting decisions. The Commission will also consider proposed disclosures to shareholders about why a board has chosen its particular leadership structure (whether that structure includes an independent chair or combines the positions of CEO and chair), so that shareholders can better evaluate board performance. Also, shareholders should understand how compensation structures and practices drive an executive's risk-taking. The Commission will be considering whether greater disclosure is needed about how a company—and the company's board in particular—manages risks, both generally and in the context of compensation. The Commission will also consider whether greater disclosure is needed about a company's overall compensation approach, beyond decisions with respect only to the highest paid officers, as well as about compensation consultant conflicts of interests.

IMPROVING MONEY MARKET AND MUTUAL FUND REGULATION

Later this month, the SEC will consider proposals to strengthen the money market fund regulatory regime. The proposals will focus on tightening the credit quality, maturity and liquidity standards for money market funds to better protect investors and make money market funds more resilient to risks in the short-term securities markets, like those that unfolded last fall. In addition, we are exploring whether more fundamental changes are necessary, such as converting money market funds to a floating rate net asset value, in order to protect investors from abuses and runs on the funds.

In addition, on June 18, the SEC and the Department of Labor will hold a joint hearing on target date funds. Target date funds and other similar investment options are investment products that allocate their investments among various asset classes and automatically shift that allocation to more conservative investments as a "target" date approaches. These funds have become quite popular, and growth in target date fund assets is likely to continue since these funds can be default investments in 401(k) retirement plans under the Pension Protection Act of 2006. However, target date funds have produced some troubling investment results. The average loss in 2008 among 31 funds with a 2010 retirement date was almost 25 percent. In addition, varying strategies among these funds produced widely varying results. Returns of 2010 target date funds ranged from minus 3.6 percent to minus 41 percent.

These returns cause concern for investors and regulators alike. I can assure you that SEC staff is closely reviewing target date funds' disclosure about their asset allocations. In addition, in connection with our joint hearing with the Department of Labor, we will consider whether additional measures are needed to better align target date funds' asset allocations with investor expectations. Among other issues, we will consider whether the use of a particular target date in a fund's name may be misleading or confusing to investors and whether there are additional controls the SEC should impose to govern the use of a target date in a fund's name.

I also have asked the staff to prepare a recommendation on rule 12b–1, which permits mutual funds to use fund assets to compensate broker-dealers and other intermediaries for distribution and servicing expenses. These fees, with their bureaucratic sounding name and sometimes unclear purpose, are not well understood by investors. Yet in 2008, rule 12b–1 was used to collect over $13 billion in investors' funds out of fund assets. It is essential, therefore, that the SEC engage in a com-

prehensive re-examination of rule 12b–1 and the fees collected pursuant to the rule. If issues relating to these fees undermine investor interests, then we at the SEC have an obligation to step in and adjust our regulations.

In addition to these initiatives, the agency continues to annually review 5,000 corporate filings, over 1,000 SRO rules, and nearly 3,000 new investment company portfolio disclosures. We establish the standards for 13 securities exchanges, 4 securities futures product exchanges, FINRA (a national securities association), the Municipal Securities Rulemaking Board, 10 nationally recognized statistical rating organizations, 10 registered clearing agencies, approximately 600 transfer agents, and securities information processors. Despite the extreme volatility and uncertainty in the markets over the past year, transactions continue to trade at both record volumes and record speed.

SEC RESOURCES

The financial crisis has reminded us just how large, complex, and critical to our economy the securities markets have become in recent years. Whereas the dollar value of the average daily trading volume in stocks, exchange-traded options and security futures was $10 billion a day in February 1989, over the last 20 years it has grown to over 25 times that size, reaching approximately $251 billion a day in February 2009. And not only has the size of our markets exploded, the number and size of its participants have jumped as well. For example, since 2005, the number of registered investment advisers has increased by 32 percent, and their assets under management have jumped by over 70 percent to reach more than $40 trillion as of the beginning of this fiscal year. Broker-dealer operations have expanded significantly in size, complexity, and geographical diversity, as exemplified by the 67 percent rise in the number of broker-dealer branch offices. In all, the SEC's 3,652 staff now oversee more than 35,000 registrants, including about 12,000 public companies, 8,000 mutual funds, 11,300 investment advisers, 5,500 broker dealers, and 600 transfer agents. By comparison, other financial regulators often have close to parity between the number of staff and the number of entities they regulate. For additional detail, attached to this testimony is an appendix, "SEC Staff Levels Have Not Kept Pace with Industry Growth."

Yet at the same time that the securities markets have undergone such tremendous growth, the SEC's resources have fallen further and further behind. Between fiscal year 2005 and fiscal year 2007, the agency experienced 3 years of flat or declining budgets, losing 10 percent of its employees and severely hampering key areas like our enforcement and examination programs. In the context of rapidly expanding markets, I believe these reductions in the SEC's staff seriously limited the agency's ability to effectively oversee the markets and pursue violations of the securities laws.

With support from this subcommittee, during the last 2 fiscal years, the SEC has been able to lift its hiring freeze and begin rebuilding its workforce. By increasing the SEC's appropriation for this fiscal year, approving a reprogramming of additional resources, and just recently supporting emergency supplemental funds for the agency, this subcommittee has expressed its strong support for the SEC and its mission. I am very grateful for that support.

However, even with these important steps, the number of staff with which the SEC can detect fraud, prosecute wrongdoing, ensure proper disclosure, conduct strong oversight of the markets, and take other actions to protect investors, is still significantly below the levels of only a few years ago. Under the SEC's current funding level, the agency's workforce still will fall about 200 staff, or about 5 percent, short of the fiscal year 2005 level.

I believe additional resources are essential if we hope to restore the SEC as a vigorous and effective regulator of our financial markets. The President is requesting a total of $1.026 billion for the agency in fiscal year 2010, a 7 percent increase over the fiscal year 2009 funding level. This proposal would permit the SEC to fully fund an additional 50 staff positions over 2008 levels, enhance our ability to uncover and prosecute fraud, and begin to build desperately needed technology.

Specifically, these positions would help the SEC's Enforcement program enhance its pursuit of tips, complaints and other leads, thus increasing the resources the SEC can dedicate to frauds that citizens bring to our attention. They would also allow us to hire more trial lawyers and staff with specialized skills that will help our Enforcement program's efficiency, expertise and success. The Examination program would hire market experts to strengthen risk-based oversight of the investment management industry and expand its inspections of credit rating agencies. Our Division of Trading and Markets would strengthen its oversight of entities that play critical roles in our markets, such as broker-dealers, exchanges, clearing cor-

porations, and other self-regulatory organizations. And the President's Budget would allow us to expand our Office of Risk Assessment by fully funding our program to bring in seasoned industry professionals to help uncover hidden risks to investors.

Although expanding our workforce is a critically important step, I believe we also must give our staff better tools to conduct oversight of vast financial markets. That is why the President's request for fiscal year 2010 also contains funds for additional investments in our information systems. Investments in new systems have dropped by more than half over the last 4 years, and as a result the SEC has a growing list of technology needs that have gone unfunded. With the additional IT funds provided under the President's Budget for fiscal year 2010, I would plan to focus on several key projects:

First and foremost, we would use additional funds to enhance our systems for handling tips, complaints and referrals. Although the SEC has a number of different processes to track this kind of information, there is no central repository or system through which this information comes together to ensure it is handled consistently or appropriately. Nor is there any present capability to mine the data to find connections, patterns or trends that would enable us to more intelligently focus our enforcement efforts.

The SEC also plans to improve our ability to identify emerging risks to investors. We have many internal data repositories from filings, examinations, investigations, economic research and other ongoing activities. But the SEC needs better tools to mine this data, link it together, and combine it with data sources from outside the Commission to determine which firms or practices raise red flags and deserve a closer look.

Finally, we would invest in our multi-year efforts to improve the case and exam management tools available to our enforcement and examination programs. These systems would give our senior managers better information on the mix of cases, investigations, and examinations, so they can apply resources swiftly to the continually evolving set of issues and problems in the markets. In addition, these tools will provide better support for line staff in these programs, so they can be more productive and better able to match the sophisticated systems used by the financial industry.

I came to the SEC to shape public policy in the interest of investors and to strengthen our enforcement program. The things I have described in this testimony are important to those efforts. But what I have also discovered in the past 4 months is that much attention needs to be focused on the internal operations of the agency, the processes that guide our work, the agency's infrastructure and how we are organized. I have been disappointed to find that in some areas of our internal operations, we fall short of what the taxpayer has a right to expect of us, and what our employees have a right to expect of a world class organization. I am committed to a complete review of areas large and small, including FOIA operations, call centers operations, records management, and others, to ensure that we meet the highest standards and that we are fully supporting the important work of our employees in these operations. Doing this will take time and energy and focus. To ensure that we do it well and thoroughly, I intend to bring in a Chief Operating Officer to manage the process. Federal agencies do not manage themselves; we must be actively engaged in that process everyday.

In one area, we have already made progress: we are moving to build an internal compliance program that is second to none. The public appropriately holds the SEC to a very high standard for integrity and professionalism, and we hold ourselves to that very high standard as well. That is why I have initiated several steps to guard against inappropriate securities trading by SEC staff, as well as to avoid any appearance of inappropriate trading. Among other steps, the agency has drafted new internal rules that would prohibit staff from trading in the securities of companies under SEC investigation, regardless of whether an employee has personal knowledge of the investigation, and require preclearance of all trades. The SEC also is contracting with an outside firm to develop a computer compliance system to track, audit and oversee employee trades and financial disclosures in real time. Finally, I consolidated responsibility for this area within our Ethics Office and authorized the hiring of a new chief compliance officer. To further enhance the SEC's financial controls, the agency also will continue its multi-year efforts to build an automated, integrated financial management system.

I want to thank you for your continued strong support for the SEC and its critical mission. I believe the steps I have outlined here—strengthening our enforcement program, enhancing risk-based oversight of the markets and leveraging technology—are essential for restoring investors' confidence in both the SEC and in our Nation's securities markets.

I would be happy to answer any questions you may have.

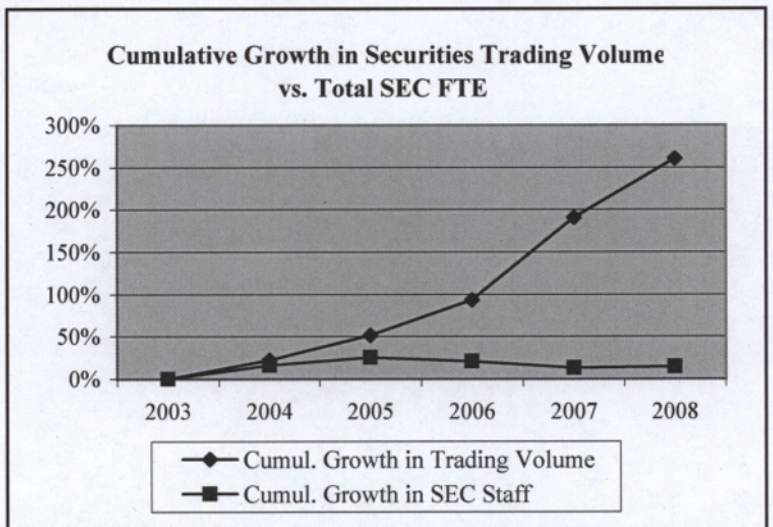
APPENDIX: SEC STAFF LEVELS HAVE NOT KEPT PACE WITH INDUSTRY GROWTH

(Tables show cumulative growth relative to 2003 levels)

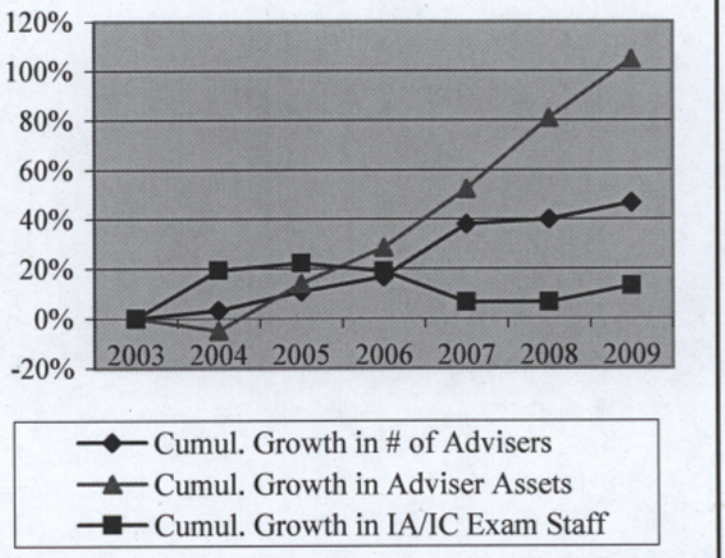
The SEC's staff of 3,652 FTE (estimate for fiscal year 2009) oversees more than 35,000 entities. These include:

—11,300 investment advisers;
—5,500 broker-dealers;
—8,000 mutual funds;
—About 600 transfer agents;
—Clearance and settlement systems;
—11 securities exchanges;
—12,000 public companies;
—10 credit rating agencies;
—FINRA, MSRB, and PCAOB.

The following charts display how various aspects of the markets have grown since 2003, relative to the SEC's staff:

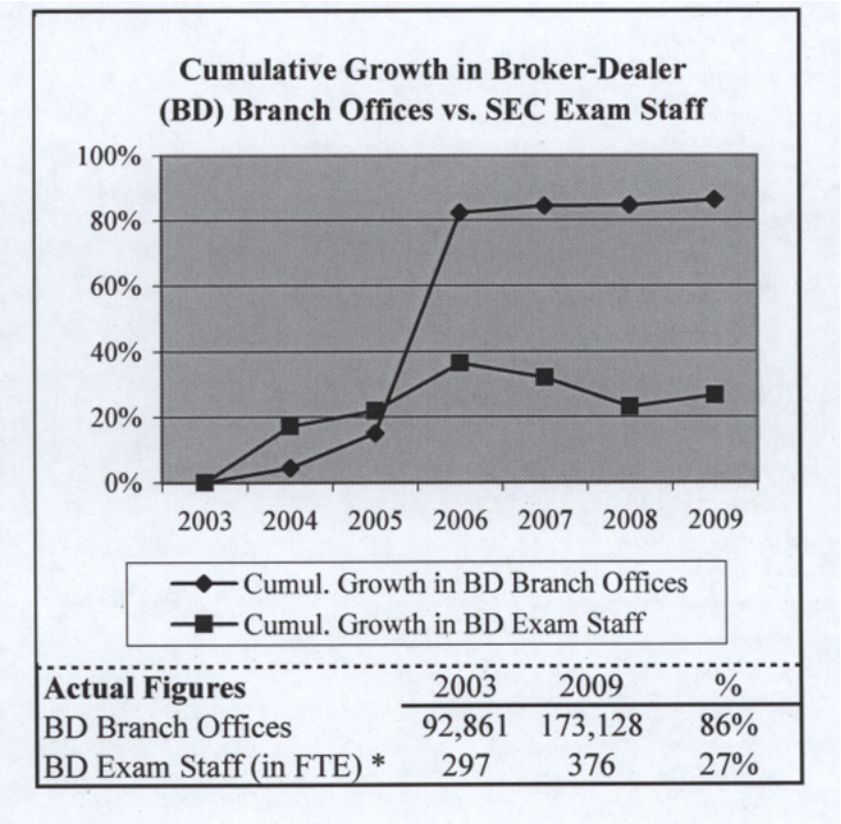


Actual Figures	2003	2008	%
Volume (in trillions)	$23	$82	261%
SEC Staff (in FTE)	3,060	3,511	15%



Actual Figures	2003	2009	%
Number of IAs	7,700	11,300	47%
IA Assets (in trillions)	$21	$43	105%
Exam Staff (in FTE) *	399	452	13%

* The FTE figures for FY 2009 are estimates.



Actual Figures	2003	2009	%
BD Branch Offices	92,861	173,128	86%
BD Exam Staff (in FTE) *	297	376	27%

BUDGET AND WORKFORCE OF THE SEC

Senator DURBIN. We'll have 5-minute rounds here, and I'm sure we'll have several questions.

It seems to me that there are two things we're dealing with here just on the surface. First, the number of people working in your agency. It appears that over the years, as Senator Collins noted, we've allowed the number of professionals working there to decline in real terms and certainly decline precipitously in relation to the volume of trade that you have to keep an eye on.

Between 2005 and 2007, the SEC lost 10 percent of its employees, if you can imagine at that moment in time, undermining the agency's ability to oversee the markets, and at the same period of time, the market ballooned in size and complexity.

Registered investment advisors grew 32 percent, assets jumped by over 70 percent, and so we're seeing the caseload or at least the area that needs to be regulated is growing and the number of people to keep an eye on it is diminishing.

So there is, in the first instance, the question of the right number of people working at the agency, and the second issue goes to—I don't know how to characterize it—I guess the internal culture of the agency.

Bernard Madoff was a wake-up call. The fact that this man could swindle as many people as he did with impunity for so long to me is nothing short of amazing.

According to SEC data, in fiscal year 2008, the SEC staff handled over 600,000 tips sent by individuals to your Enforcement Complaint Center. I did a calculation. I think that's more than 2,000 a day for every business day. People sending in items you ought to look at. Well, that to me is an overwhelming number and perhaps you could put it in some kind of perspective.

Now, some have taken a look inside your agency and asked whether the enforcement function within the agency is a healthy one. Is there a risk-averse culture within the SEC to step up and say, you know, we ought to take a look at this Mr. Madoff or people like him?

So let me ask you at the outset, number 1, what would be the optimal number of people that you believe you need to do an effective job at the SEC in light of the volume of business that you have to regulate, and second, do you perceive a cultural problem within the agency when it comes to enforcement?

Ms. SCHAPIRO. Thank you very much, Mr. Chairman.

I think you've really summarized very well with respect to the staffing pressures on the SEC, the current situation.

With over 35,000 regulated entities and 3,700 staff, it's a job that we really can't do in the way I think the public would like to believe we can do in the sense of routine onsite presence in many regulated entities. That's going to really require that we leverage third parties.

So, for example, in the rules I discussed related to the custody of customer assets by investment advisors, a huge problem in the Madoff area, we're going to rely on PCAOB-registered accounting firms to leverage our capability to ensure the customer assets are being protected by the custodians and by the investment advisors, and we will look for every opportunity we can to leverage third party resources.

But at the end of the day, we do need significantly more staff, I believe, over the next several years to keep up with the growth and the complexity of this industry, and if there are additional responsibilities as a result of regulatory reform that accrue to the SEC in the context of hedge funds, credit default swaps or other areas, that, of course, will require sufficient additional resources because we can't stretch any thinner than we already are.

So I do believe—and if you look at our 2011 budget request, you will see we've asked for a significant ramp-up in the number of full-time equivalents (FTE), close to 400 FTE and 1,000 new positions, and I believe that if we're able to achieve that number in 2011 or over the course of the next several years, that will go a long way toward getting this agency to the appropriate size to handle the job that's in front of it.

I don't think there's any danger that we're about to become too big in any event.

I think, with respect to your second question, the Madoff fraud is a tremendous tragedy. It's really a tragedy of epic proportions and I think it really will put the onus on this agency to prove that it is capable of managing the responsibilities that it has been given

under the law and it's really critically important for us to ensure that both our culture, our operations, and our procedures, our staff and our skill sets are up to the task.

You pointed out, for example, that we get somewhere around 600,000 to, in peak years, 1½ million tips a year. We can't manage those that come into the organization through a wide variety of entry points. We don't have databases that are connected so that we can do a trend analysis of those tips and complaints or connect that data to external sources of data to see what might be developing more broadly in the marketplace.

Right after I started, I brought in the Mitre Corporation's Center for Enterprise Modernization to do a complete review of how we handle tips and complaints. They've concluded the first round of their work and we're now in the implementation phase of some short-term and intermediate-term remedies and processes to help us manage tips and complaints.

But it's also about leadership and it's about freeing our Enforcement Division to do the kind of job that I know they're capable of doing.

I was at the SEC 15 years ago when the agency had a really first-class reputation for aggressive enforcement and I know we're capable of that again. We have a new Enforcement Director who's very committed to bringing large cases in a timely way that have the maximum investor protection impact.

It's about enabling our enforcement staff through technology and the right skill sets to bring those kinds of cases, that when a whistleblower presents them with information, as had happened in the *Madoff* case, they have the ability to understand it and pursue it. It's about being a little bit humble about the information that comes to us and appreciating that there may be real value in what's being presented to us.

We're also going to seek whistleblower legislation to enable us to reward whistleblowers, as the Internal Revenue Service (IRS) and other agencies do, when they bring us well-formed cases and documentation, a fraud that we can then pursue, and it's about filling the regulatory gaps, through such as the custody requirements I just spoke of, so that we are sure that the regulatory regime, coupled with aggressive enforcement, coupled with the tools and the skill sets, combine to create an agency that's absolutely committed and focused on investor protection.

I'm sorry. That's a very long answer.

Senator DURBIN. No. It's a very good answer, and I thank you for it, and I'm going to turn to Senator Collins and return in later rounds.

Senator COLLINS. Thank you, Mr. Chairman.

Ms. Schapiro, you talked about the increased number of positions that you have requested as part of the fiscal year 2011 budget, but in fact, the President's budget for this coming fiscal year does not allow you to hire any new positions, is that correct?

Ms. SCHAPIRO. That's correct, Senator. The increase in the 2010 budget covers the annualized costs of the increases in the fiscal year 2009 budget that we were able to have as a result of the approval of our reprogramming requests and taking $17 million of

unobligated funds from prior years, dedicating those to staffing, additional staffing in 2009.

The annualized costs of those additional 50 positions that we're bringing on this year are the increase in the 2010 budget.

Senator COLLINS. Do you need new positions for the upcoming fiscal year?

Ms. SCHAPIRO. Well, I would say that we're, first of all, extremely grateful to the President for the increase in the 2010 budget and it's a meaningful increase for this agency, and as I pointed out, 2011 we sought a much greater increase.

The opportunity to start to move toward that 2011 budget earlier would be a wonderful opportunity for us to bring that number of staff on over a 2-year period rather than all in 2011, if Congress ultimately approves that number.

Senator COLLINS. Because I am troubled that the current funding level supports a staff that is 5 percent lower than your peak level back in fiscal year 2005.

If you look at the growth of regulated entities and if you look at the amount of money involved, if you look at the number of American families who now have savings in the stock market, the fact that these staffing levels are below what they were 5 years ago is troubling to me.

So are you saying that it would be helpful to be able to ramp up those staffing starting in the next fiscal year rather than waiting to fiscal year 2011?

Ms. SCHAPIRO. Absolutely, it would be helpful. The reprogramming request, in addition to allowing us to get a little bit of a jump on 2010, enabled us to do some technology investment.

We need fundamentally more investment in technology at the SEC to support our Enforcement and Examination Programs and we can use more boots on the ground in Enforcement and Examination, absolutely.

INVESTOR PROTECTION AND EDUCATION

Senator COLLINS. Aggressive enforcement is absolutely critical, but there's another way that's important for protecting investors, particularly smaller investors who may be less sophisticated in choosing their investments, and that is through a robust education effort.

You've spoken a lot about the need to protect investors and I know that in my State, I've seen thousands of individuals who have seen their retirement nest eggs shrink, money set aside for their children's college education virtually disappear, and they're wondering what can be done about it. They're seeking more information.

Several years ago, the SEC used to conduct very valuable educational sessions, town meetings, outreach to seniors groups.

What are your plans to reach out to investors, particularly small investors or senior citizens, in two ways; one, to help them better understand risk and suitability requirements, but, two, to help them spot scams?

Ms. SCHAPIRO. It's a wonderful question, and I'm very committed and personally quite passionate about investor education and had a program at my former employer, FINRA, as Senator Tester

knows, where we did investor forums which the SEC used to do years ago around the country and to great success and with tremendous participation all over the country.

The SEC has a small program that does that now. Commissioner Walter in fact did an investor forum just last week with our Boston office in the State of Maine.

My plans would be, given sufficient resources, that we dramatically increase that program, that we enable our offices around the country to provide local education in senior citizens centers, community centers, local high schools, and that we really take a leadership role in the Federal Government in educating investors about the kinds of questions they need to ask when they're being offered investment products, about the kinds of scams and pitfalls that they need to be on the alert to.

I'm very concerned, given the current environment and the amount of money people have lost in their retirement plans and in their other investments, that they will be reaching to try to make that money back through some particularly risky investments. I have no doubt that the scam artists have already figured this out and are beginning to prey on people's real fears about their financial futures.

I think the SEC can play a critical role here, bringing together other agencies of the Federal Government but also on its own, reaching out very directly as well as through the development of content put on websites and in investor forums.

Senator COLLINS. Thank you. Glad to hear it.

Senator DURBIN. Senator Tester.

Senator TESTER. Thank you, Mr. Chairman.

Chairman Schapiro, you come into an agency, the SEC, that has been around about 75 years and to be honest, from my perspective, probably come into it at a time when it's hit an all-time low as far as both morale and effectiveness. So you've got to rebuild this agency, I think, maybe not from the ground up but from the foundation up.

We've talked about manpower levels. If you have the technology that you spoke about, do you have a figure in mind about what the right number of people are for this agency, considering the massive workload?

Ms. SCHAPIRO. I think it's very hard to give an exact number. As I said, our 2011 budget request seeks 1,000 additional positions which would take us to just under 5,000. That would still be smaller, for example, than the Federal Deposit Insurance Corporation (FDIC) which regulates about 5,000 to 6,000 banks.

Senator TESTER. Okay.

Ms. SCHAPIRO. I do think there's also practical limitation on how many people you can just bring on board and train——

Senator TESTER. Right.

Ms. SCHAPIRO [continuing]. At any given time. The faster that we can move toward a substantial increase like that I think the better.

Senator TESTER. Okay.

Ms. SCHAPIRO. It also depends largely on our ability of effectively utilized technology to save on human resources.

Senator TESTER. Right on. Consumer confidence is one of the things that everybody's concerned about. Nobody—you know, we've lost a bunch of money. People's confidence is shaken.

RESTORING INVESTOR CONFIDENCE

What do you see as being two or three of the major things that you have to do in your agency to have consumer confidence back at a level that's reasonable, and, quite honestly, what do you see we need to do, the two or three things that we need to do to help re-establish consumer confidence with the groups that you regulate?

Ms. SCHAPIRO. I think it's a great question. I think enforcement is just a part of what we do, but it's a very visible part, and I think it's really critical for investors to see that there is a cop on the beat who's trying to ensure that the playing field is level, that the insiders aren't taking advantage of the rest of the participants in the marketplace.

So we need to have a very timely enforcement response to the problems that arise in the marketplace and short of doing that, I think people won't have confidence. We can write all the rules we want, but if nobody's enforcing them, we're not going to restore investor confidence.

I think investors also need to have complete confidence in the transparency of corporate disclosure. They need to believe that the companies in whose stock they are buying are getting then the accurate numbers and the accurate disclosure and information about that company's prospects so they can make informed decisions about where to put their money.

And I think we have to have a focus on consumers issues, on mutual funds sales, on sales practices generally, on the issues around fees and fee structures and disclosures that investors really care about at the end of the day.

We'll be announcing later this week the creation of an Investor Advisory Committee for the first time in many, many years at the SEC that will give investors a regular way to interact with the Commission on policy issues that are of interest to them.

I think we have to reorient everything we do toward rebuilding the investor confidence in both the agency and in the fairness of our markets.

Senator TESTER. What do we need to do, Congress?

Ms. SCHAPIRO. I think supporting the agency, quite honestly, as the appropriators with sufficient resources to accomplish what we need to do and hold our feet to the fire that we're delivering on the commitments that we're making to the American public.

Senator TESTER. Have you been able—I mean, there's been talk about the future roles of the SEC, the CFTC that we'll hear from shortly, after a regulatory modernization has been done.

Assuming that that goes forward, can you talk about the challenges, opportunities, possible consequences of merging your two agencies?

Ms. SCHAPIRO. Sure. And, you know, I have the unique position of having been Chairman of the CFTC and now Chairman of the SEC. So in honesty, I can tell you I've argued both for and against merger over the years.

I think it's obviously a decision that's ultimately for the Congress about whether or not to combine the two agencies. Short of that, I believe that with Gary as Chairman of the CFTC that we can have an incredibly positive and constructive working relationship, to ensure that products and practices don't fall between the cracks of the two agencies and that we don't leave large swaths of the financial markets unregulated and unaccountable to the American public——

Senator TESTER. Do you think that would be—excuse me. Do you think that would be done better if you were combined?

Ms. SCHAPIRO. I think—in my personal view, there is a logic and an efficiency that can be achieved from the merger of the two agencies, but short of that, I also think that the two agencies can do a better job of working together to ensure the protection of investors.

Senator TESTER. My time is up, but we'll be back.

Senator DURBIN. I was just advised by my colleague that there's a vote on and I'm going to try to continue asking until someone returns, but I ask the indulgence of our witness and those in the audience as we try to balance a few things here.

ADDRESSING RESOURCE CONSTRAINTS

The numbers of investigative attorneys at the SEC decreased 11.5 percent between fiscal years 2004–2008 and some believe that that's resulted in delayed cases, reducing the number that can be brought to trial and potentially undermining the quality of cases that are pursued.

How have resource constraints impacted the effectiveness of the SEC?

Ms. SCHAPIRO. There's no question but that—and there's a recent Government Accountability Office (GAO) report that suggests this, as well, that the resource constraints have hindered the ability of the Enforcement Division to pursue as many cases in as timely a way as I would like to see.

In addition, there are some procedural difficulties placed in the path of the Enforcement Division over the last several years that slowed cases down and discouraged, if not explicitly, implicitly seeking penalties from corporate issuers in certain kinds of cases, and we've eliminated those hurdles and cases can be started much more quickly now. Investigations can be pursued with the approval of one commissioner, not the full Commission sitting in a meeting.

We've eliminated what was called the Penalty Pilot Program completely and we are reorganizing the Enforcement Division under the leadership of our new Director in a way that we hope will eliminate some layers of management and some of the stovepiping that's existed over the years and allow us to be more nimble and more aggressive, pursuing much larger cases, particularly those arising out of the financial crisis.

Senator DURBIN. On another issue, there was a mindset for a long period of time that as long as the economy was expanding and wealth was being created, we didn't dwell and ask a lot of embarrassing questions, but with the downturn in the economy, downturn in the fortunes of many families and the investment of our Federal Government into many of the largest businesses in Amer-

ica, there appears to be an awakening on the part of the average person about how many corporations are being managed and particularly in the area of executive compensation.

CORPORATE GOVERNANCE

I won't go into chapter and verse about bonuses given to executives who have nothing to show for it, other than failure, but let me ask you, what is the SEC currently doing to improve the accountability of corporate directors and enhanced disclosure of executive compensation?

Ms. SCHAPIRO. Mr. Chairman, I've made corporate governance one of my highest priorities in the last 4 months. We are engaged in a couple of things.

First of all, in May we approved for comment a proposal that will facilitate the ability of shareholders to nominate on the company's proxy directors to serve on the corporate—on the company's board and it's out for comment now. It will be highly controversial, but if ultimately approved and not challenged in court, it will greatly facilitate the abilities of shareholders to elect nominees to corporate boards and thereby hold directors more accountable for their oversight of the corporation.

With respect to compensation in particular, as you know, we already require disclosure of all plan and non-plan compensation by the senior-most officers of a company.

Next month we will be considering amendments to the compensation disclosure rules that will simplify something called the summary compensation disclosure table to provide more information there about compensation.

It will require disclosure about the overall compensation approach within the company. There will be enhanced disclosure about the use of compensation consultants who are sometimes in a conflicted position in advising both the compensation committee and the company's management, and we're going to require disclosure about the linkage between compensation plans and risk-taking by executives, traders and others within the company, so that investors will be able to understand how risk-taking which was such an important component of the financial crisis has been potentially incentivized in some companies.

CREDIT RATING AGENCIES

Senator DURBIN. On another issue, in late 2006 the Credit Rating Agency Reform Act gave the SEC exclusive authority over rating agency registration and qualification. In the less than 3 years since enactment the SEC has undertaken no fewer than five rulemakings to implement the law. These rules, which are all still relatively new, extend from registration and recordkeeping to disclosure and managing conflicts of interest.

Yet, even though the credit rating agencies were under SEC's purview, rating agency performance in the area of mortgage-backed securities backed by residential subprime loans and the collateralized debt obligations linked to such securities has shaken investor confidence to the core.

It used to be that credit ratings were kind of like the gold standard in terms of whether you could trust a business to be in solid financial shape. Well, I think a lot of questions have been raised.

What are you doing at the SEC now to restore consumer and investor confidence, and what improvements are needed in the way that you monitor credit rating agencies?

Ms. SCHAPIRO. There's no question but that credit rating agencies played a significant role in facilitating, I guess, in some ways the financial crisis.

The agency has engaged, as you point out, in many rulemakings, most recently the rule in 2008 which required a series of disclosures about performance statistics, the different kinds of models that were used for initial ratings versus surveillance ratings, documentation, disclosure of conflicts and so forth.

The Credit Rating Agency Reform Act, which Congress passed in 2006, specifically does not allow the agency to regulate the substance or the procedures or the methodologies of the rating agencies and something we're looking at is whether we need to ask Congress to reopen that legislation to provide greater authority.

Senator DURBIN. Who does?

Ms. SCHAPIRO. Nobody. But nonetheless, despite the limitations in the law, we are looking at doing a couple of things.

One is my perhaps my greatest concern in this area is something called ratings shopping which allows the creator of a structured product to get preliminary ratings from multiple rating agencies and then select the one they want to rate the product, presumably that being the highest rating they've gotten.

Senator DURBIN. Wish I could have had that for my report card in grade school.

Ms. SCHAPIRO. Don't we all?

Senator DURBIN. Shopping teachers.

Ms. SCHAPIRO. Exactly. If you'll give me an A, I'll take your class is what it amounts to.

So we're looking at what we can do with respect to rating shopping. Removing references potentially to ratings in the Federal securities laws and regulations which gives an air of credibility and respectability to ratings that perhaps they don't entirely deserve, looking at whether we should require different symbols for rating structured products versus rating plain vanilla corporate debt, and we're looking at more detailed disclosure about how ratings have performed over time.

So there's some things the SEC clearly can do and we are doing. We held a roundtable with rating agencies just about 1 month ago to explore some of the failures of the different business models and some of the—not the failures of the different business models but the different business models, some of the other failures that have become clear over the last year.

We're moving ahead with what we can do and we will come back to Congress if we believe at the end of the day we need more authority.

Senator DURBIN. Thank you. I'm going to ask that the subcommittee stand in recess for just a few moments and as soon as Senator Collins returns, I'm going to ask her to resume the hearing. I apologize, but it just so happens we have a rollcall vote.

The subcommittee will stand in recess.

Senator COLLINS [presiding]. The hearing will reconvene.

In Senator Durbin's absence, he's permitting me to continue the hearing. I'm certain he'll be back very soon. He's just voting.

Ms. Schapiro, last September the SEC's inspector general issued a report on its investigation of the Consolidated Supervised Entity Program, the CSE Program, through which the SEC monitored the five major investment banks.

This inspector general report found that the SEC has severely understaffed its CSE Program and thus could not effectively manage its responsibilities to monitor or question these investment banks.

As you know, I'm particularly concerned that an investment bank like BearStearns was allowed to have a leverage ratio of 30:1, truly astonishing, and yet it appears that there was not a system in place, other than a very loose voluntary system that the SEC had, to monitor these banks, and in many ways this report was truly prescient since just a few months after it was issued none of these investment banks existed anymore. They all had either failed, been acquired or merged into bank holding companies.

REGULATION OF LARGE INVESTMENT BANKS

Let me ask you a number of questions about this. First, does the SEC have the right mix of staffs to conduct the kind of oversight of a large investment bank? A lot of the SEC's employees are attorneys which is obviously very useful and helpful on the enforcement side, but does it need more auditors, more economists to have the expertise to analyze complex financial data and risk models? So the first question is the mix of expertise.

Ms. SCHAPIRO. I believe that we haven't historically had enough financial analysis experience, experience with structured products and complex derivative products.

In the last couple of months that's been an area of focus for recruitment, not just in the Enforcement Program but also in the Trading and Markets Division which has responsibility for broker-dealer risk oversight. So that even though the CSE Program is discontinued, there are still a large number of—not maybe a large number but a number of large investment banks and broker-dealers for whom the SEC still has responsibility.

That's an area that we are building and increasing our capability in in a very conscientious and sort of directed way and have been working on over the last couple of months. It's really important for us to have that capability.

Even with the presence ultimately of a systemic risk regulator, that's the result of regulatory reform, it will be important for the SEC, as the day to day regulator of over 5,000 broker-dealers, to have the capability to really understand the financial and operational status and condition of those brokerage firms.

Senator COLLINS. Second, how should—I realize these large investment banks don't exist any more but they could reappear. How should they be regulated for safety and soundness?

I cannot imagine a federally or State-chartered bank being allowed to have a leverage ratio of 30:1.

Ms. SCHAPIRO. I think the answer is they need to be regulated on a consolidated basis. So that, as you know, the securities laws are generally geared toward the protection of customer assets within the broker-dealer, but there are affiliates of the broker-dealer, there's a holding company structure, there are a lot of other entities where significant risk can be taking place, and it's important that the regulator of the entire entity have a view into what's going on in all of the related parts of the operation, so not just in the broker-dealer but also in the holding company affiliates and subsidiaries.

It is that consolidated view that will allow our regulator to make a judgment about whether leverage is excessive, capital is sufficient, the quality of management across the enterprise is up to the task.

Senator COLLINS. Another reform that we need is the ability to identify and prevent what I refer to as regulatory black holes, and the emergence of credit default swaps or other exotic and poorly disclosed derivatives certainly indicates that the current system has not been sufficient to prevent gaps in regulation of products or practices that can have consequences for the entire financial system. That's why I support having a council of regulators to look at systemic risk.

ROLE OF A SYSTEMIC RISK REGULATOR

What do you think are the advantages and disadvantages of a council approach versus vesting in the Federal Reserve the authority to be the systemic risk regulator?

Ms. SCHAPIRO. Well, I'm very much in agreement that the existing regulatory regime is riddled with holes and that there are large parts of the financial marketplace that were really not under the regulatory umbrella at all or in any meaningful way and credit default swaps is an example. Hedge funds and some other private pools of pooled funds would fall into that category, as well.

As you know, I like the concept of a council, whether it's a standalone council or in conjunction with a systemic risk regulator, because it brings a diversity of perspective that I think is really important to identifying where gaps may be arising, where new products may be being created in the intricacies between regulatory authorities, so that we can avoid those potentially harming the system.

And when you have a council of regulators, where you've got securities regulators, for example, which is very much focused on investor protection and transparency and bank regulators very much focused on prudential standards and safety and soundness, and insurance regulators with yet another perspective, I think you have a better chance of capturing the entire financial landscape and the potential places where those new products are arising, where those new gaps are being created.

At the same time I think there needs to be the ability, whether it's a council or a single system risk regulator or a combination, to step in and raise standards when necessary, where the functional regulator may not be aggressive enough in requiring higher capital standards or reining in leverage, that there be the ability ultimately to protect the system, to force those kind of changes.

Senator COLLINS. Thank you. Senator Tester. It's nice being temporarily chairman.

Senator TESTER. Thank you. Thank you, Senator Collins, and you're doing a fine job, I might add.

ENFORCEMENT OF THE SECURITIES LAWS

Secretary Schapiro, I'm sure you read the article yesterday in the Washington Post that dealt with enforcement actions of the SEC over the past few years. If that article's true, it is more than just a little bit distressing.

You have stated the imperative to take the handcuffs off the Enforcement Division. That article yesterday would imply to me that I don't care how much money we put at the agency, if people on top are making arbitrary decisions about how to not do their job appropriately, no amount of money is going to make it work correctly.

You're not going to do that, I know that. I've met you and long before when you were in FINRA, as you stated in your opening statement, in Montana and did a fine job education-wise and you have done a fine job in this position.

But could you just give me a little bit of insight on how this budget would help you accomplish the goal of taking the handcuffs off the Enforcement Division?

Ms. SCHAPIRO. I'd be happy to. I should say that in my 4 months at the agency, I talk a lot about enforcement. I've done some town halls with the staff. I e-mail with the staff.

I will tell you that the response has been tremendous eagerness and enthusiasm on the part of employees to get back to what we do and what we can do so well and——

Senator TESTER. Good.

Ms. SCHAPIRO [continuing]. Particularly in the enforcement context.

I think what the budget will enable us to do is have more people to bring the cases that need to be brought. We are not in danger of running out of cases. So on a very simplistic level, more people will enable us to do that.

Bringing in the right skill sets so that we're not risk averse, so that we're not afraid to tackle the most complex trading strategies or the most complex products or the most complex frauds will be important. So we need to train our people better in more sophisticated methodologies. We need to bring in the right kinds of skill sets, as well, and we need to support our people with technology.

The amount of data that comes into the agency that is unmanageable, even in the course of one major litigation, is extraordinary and we have our people wasting their times archiving e-mails and dealing with millions and millions of records when we should be able to rely almost solely on technology to do that.

We need technology to help us sort out the tips and complaints that we get, as I spoke about earlier.

Senator TESTER. The ranking member talked about potentially inadequacies of this budget. In a previous line of questions, you said you can't bring on everybody you need because it's simply impossible to manage that influx of people.

Is the budget adequate to get to where you need to go? I'm sure you have goals, either written or mental, where you want this agency to go. Is this budget adequate to get you where you need to be a year from now?

Ms. SCHAPIRO. As I said, we are genuinely grateful to the President for the increase the 2010 budget represents over 2008 and 2009. We've asked for a very significant increase in 2011 and the ability to get to that number sooner, we could handle, and I think it would make a difference in our ability to do our job.

REGULATION OF SHORT SELLING

Senator TESTER. Okay. Uptick rule. Can you discuss the Commission's effort to reinstate the Uptick rule, what's the likelihood, timing and opposition to that?

Ms. SCHAPIRO. I would be happy to do that. This is an issue of enormous, enormous public interest, and it's an issue of investor confidence, as well.

As you know, the SEC took the Uptick rule off a couple years ago after careful study and evaluation. In some ways it was a model rulemaking to eliminate it.

Nonetheless, that coincided with dramatic increases in volatility in the marketplace and investors have been clamoring for us to revisit this issue. In April, the Commission voted unanimously to seek public comment on two different approaches to short selling.

One is essentially the reinstatement of the Uptick rule as we used to know it, with some variations. The other is a short sale circuit-breaker that would be kicked into effect if the price of a stock declined by, say, 10 percent in a day, no short selling thereafter for a period of time.

We've already gotten 3,000 comment letters. The comment period closes in about 2 weeks, and then we will wade through those comment letters and hopefully bring back to the Commission a proposal for consideration.

At the same time we're looking at a couple of other issues. There's a rule, it's a temporary rule that expires in July that's had a very, very positive effect on eliminating or diminishing the fails to deliver in securities and short sales, requiring them to be closed out the next day. I expect the Commission will make that a permanent rule this summer, and we're looking at some other issues, like the potential for pre-borrow requirement.

So we are actively focused on short selling and will continue to do so.

Senator TESTER. Do you anticipate that the proposal you're going to take back to the Commission will be voted on when?

Ms. SCHAPIRO. I think we're looking at August for a vote. The comment period closes toward the end of June. With 3,000 comment letters at this point, I expect significantly more and we'll have to evaluate those, so some time this summer.

Senator TESTER. After the Commission votes on the rule, is it typically an immediate effective date?

Ms. SCHAPIRO. Generally not, if it requires technology changes at either exchanges or brokerage firms.

Senator TESTER. Would this?

Ms. SCHAPIRO. Yes, the reinstatement of the Uptick rule requires significantly more technology work than the circuit-breaker would.

Senator TESTER. Okay.

Ms. SCHAPIRO. So it could be quite dependent upon which of the two approaches.

Senator TESTER. One last and it has to do with this. Who's opposing the Uptick rule from going back into effect?

Ms. SCHAPIRO. I haven't been through the comment letters, to be honest, but I would say historically there's certain kinds of algorithmic traders, some kinds of hedge funds that are large short sellers that oppose it. There are——

Senator TESTER. That are for the most part unregulated at this point in time, right?

Ms. SCHAPIRO. That might be right.

Senator TESTER. Okay.

Ms. SCHAPIRO. There are others who believe that short selling plays a very legitimate role in the marketplace in terms of adding liquidity. It has impacts on options market-makers and others. So there is opposition to reinstatement.

I think the pure weight of the comment letters will tell us that there is much more support for doing something, whether it's the Uptick rule or the circuit-breaker.

Senator TESTER. Thank you.

FEE COLLECTIONS BY AND FUNDING OF THE SEC

Senator DURBIN [presiding]. Thank you. Chairman Schapiro, just for some perspective here, the SEC is fairly unique in that it collects a lot of money in fees and if I'm not mistaken, that number is somewhere a little north of or around $1.4 billion, is that correct?

Ms. SCHAPIRO. The 2009 expectation is, yes, about $1.35 billion.

Senator DURBIN. Okay. And the appropriation for your agency is around $1 billion, a little over $1 billion.

Ms. SCHAPIRO. Yes, 2009 $916 billion, including the reprogramming request.

Senator DURBIN. So you are a cash generator——

Ms. SCHAPIRO. We are.

Senator DURBIN [continuing]. In terms of the revenues into the Treasury.

Ms. SCHAPIRO. And historically a very significant cash generator.

Senator DURBIN. And if the argument can be made that the industry is paying your agency to do its job and we've started this testimony here today arguing that you needed more people to do your job, it might be fair for those who are being regulated saying we're doing our part, in fact we're sending you about 40 percent more than you're actually spending in this agency.

Would that be a fair comment?

Ms. SCHAPIRO. It might be.

Senator DURBIN. Okay. Well, this concerns me because if we were going in the other direction, we'd be arguing, well, we need to come up with some revenue source here to provide the regulatory structure to make sure that the Government's doing its job, but in fact the marketplace that you regulate is creating the revenue opportunity.

Ms. SCHAPIRO. That's correct, and actually that doesn't include penalties and fines that are paid into the Treasury in those instances where we don't create a fair fund to distribute back to investors. So there's actually additional funding over the fee generation.

Senator DURBIN. Okay. Let me go to a few more specific questions.

Broker-dealers who sell stocks and bonds on commissions and investment advisors who offer advice are regulated under different Federal laws. The key difference is the rules governing their standard of conduct. Investment advisors held to a fiduciary standard which requires them to make investment decisions in the best interests of their clients. Brokers, in contrast, are held to something called a suitability standard under which they can sell securities as long as they are suitable to their clients.

Interesting little distinction there, but the variations between brokers and advisors has been blurring in recent years and it's raised concern among some regulators that customers won't be able to tell the difference.

I understand that you're taking a look at this.

Ms. SCHAPIRO. Absolutely. There's really no good reason for people not to get the same fiduciary protection and the same standard quality of regulation from people who are essentially giving them the same service but are called by different names.

Senator DURBIN. Let me ask you a question. First, let me preface it by saying I asked my staff this. I said, now is this for Chairman Schapiro or Chairman Gensler. They said, well, you better ask her. So here's a hedge fund issue for you.

The Pension Protection Act of 2006. Would this be your jurisdiction?

Ms. SCHAPIRO. The Pension Protection Act is largely administered by the Department of Labor, but there are elements that intersect with the SEC.

Senator DURBIN. Okay. Let me give you the situation. You tell me if this is something that you think falls in your jurisdiction.

This Pension Protection Act made it easier for hedge funds to take pension money without registering it as an ERISA fiduciary, meaning they don't have disclosure and other requirements of other pension plan managers. Is this your field?

Ms. SCHAPIRO. This is the Department of Labor, I believe.

Senator DURBIN. Okay. Let me stop at that point and save this for the Department of Labor then.

REGULATION OF DERIVATIVES

Derivatives, contracts between two investors, betting on whether a stock, bond or other security will go up and down in value have ballooned into one of the world's largest trading markets, estimated to be tens of trillions of dollars, yet it's largely outside the regulatory umbrella. Losses, as we know, at AIG have led to a Government bailout of $170 billion or $180 billion.

On May 13, President Obama unveiled a plan to regulate this market which had four stated goals.

What do you consider to be the role of the SEC in this regulation?

Ms. SCHAPIRO. This is such an important area for both the SEC and the CFTC and, as you point out, the Treasury letter of May 13 lays out some requirements that we hope will be embodied in legislation with respect to credit default swaps and other standardized over-the-counter derivatives.

It will be very important to have standardized clearing mechanisms, potentially exchange trading of standardized contracts, promote transparency, have adequate margin and collateral requirements in place for these transactions and subject the dealers in these instruments to regulation.

Exactly where the lines between the SEC and the CFTC fall, I think, are something we'll be discussing certainly over the next several weeks, but it is clearly my view, and I believe Chairman Gensler's view and the Treasury's view, that we need to work together to ensure that we bring credit default swaps and other OTC derivatives firmly under the Federal regulatory umbrella and how we exactly draw those lines will be something we'll be discussing and obviously Congress will have a deep interest in, as well.

Senator DURBIN. I'll ask a question that relates to last week it was reported that two attorneys from SEC's Enforcement Division engaged in suspicious trading in stocks of companies under SEC investigation, according to a March 3 report by the SEC Inspector General David Kotz.

Mr. Kotz concluded that the SEC previously had essentially no compliance system in place to ensure that its employees did not engage in insider trading themselves. On May 22, the SEC issued a press release outlining how the agency would increase accountability.

How will this new process impact the current SEC workload? Will it require additional resources or staff to implement?

Ms. SCHAPIRO. Thank you for asking that question. It's really an important area.

When I learned about this inspector general report in March, I immediately set in motion—and some things were already underway, I should say—a number of changes to our process which was acceptable under the Office of Government Ethics rules but clearly not sufficient in my view.

We now require all trades by employees to be pre-cleared. We've created a restricted list that prohibits an employee from trading in any stock of a company that's under investigation by the SEC, whether they know anything about the investigation or its existence or not.

We prohibit any ownership in stocks of broker-dealers, investment advisors, publicly traded exchanges, and we're requiring employees to authorize that their brokers in duplicate trade confirmation statements to the SEC where they will be incorporated into a computerized system that will make monitoring compliance with all of these new rules much more effective, and we'll be hiring a chief compliance officer. I expect we'll sign the contract for the new system in the next several days and it should be operational in 1 to 3 months.

The new rules requiring pre-clearance of all trades by the Ethics Office and the creation of the prohibited list and so forth are pend-

ing at the Office of Government Ethics and have been there for about a week. We jumped on this immediately.

Senator DURBIN. Thank you very much.

Senator Collins.

Senator COLLINS. Thank you, Mr. Chairman.

CONSUMER PROTECTION

Ms. Schapiro, there is an idea that is being discussed to consolidate the consumer protection functions of a variety of regulators under a single entity and one such proposal would result in the SEC losing its consumer protection responsibilities.

I personally don't think this makes any sense at all because to me, the whole reason we have an SEC is to act to protect consumer investors.

What are your views on creating a single consumer protection entity that would include the SEC's responsibilities?

Ms. SCHAPIRO. I think that it certainly is one of the ideas that's being bandied about and there are many, and I think discussions continue to be very vigorous and ongoing throughout the regulatory community about the right approach here.

I think the one thing everybody agrees on is that we must have a reorientation toward consumer and investor protection among all of our financial regulatory agencies. So whether we have the creation ultimately of a single entity or we just reheighten and refocus within the bank regulatory agencies and the SEC on the protection of the end users of financial products, we, I think, all agree that we have to go down that path.

My view is that, and it's been reported that, I don't want to create new gaps in the regulatory system and I fear that moving mutual fund regulation out of the SEC and into a new agency has the potential to do that.

Mutual fund—investor protection and the mutual fund concepts, it's about more than the end product of the sale to the investor. It's really about what's the governance of the mutual fund. What's the quality of execution that the mutual fund is getting when it's buying stocks for its portfolio? What's the quality of the disclosure of those companies that the mutual fund is buying? What's the quality of the disclosure that the mutual fund itself is making?

These are all a piece. They're all woven together to create the fabric of investor protection in the mutual fund space and so I want to be sure we don't damage that fabric.

That said, whatever Congress in its wisdom and the administration working together to create that will protect investors better and consumers better, we intend to, you know, play as strong a role as we can.

Senator COLLINS. Thank you. Mr. Chairman, I'm just going to ask one final question, if I may, and that has to do with the credit rating agencies. I understand you, too, brought this issue up, but, unfortunately, I wasn't here. I was voting when you did. So I apologize if this is redundant.

I'm very concerned about the role that was played by credit rating agencies in this crisis as far as their ratings of subprime mortgages of mortgage-backed securities.

It seems to me that the current system has so many inherent conflicts of interest built into it, not the least of which is that the credit rating agencies are being paid by the firms that are marketing the securities.

What are you looking at to improve the integrity of the credit ratings process?

Ms. SCHAPIRO. You very correctly highlight that in the issuer paid model where I create a security and then I ask you to rate it and I pay you for that rating and I pay you on an ongoing basis for future ratings, if I'm happy, has profound conflicts of interest and we are looking in particular, as we discussed earlier, at the rating shopping phenomenon which allows me to select the ratings agency that provides or promises to give the highest rating and we're also looking at more robust disclosure about fees that are paid and the conflicts of interest that exist in the issuer paid model.

We held a roundtable about 1 month ago. We brought in all different kinds of rating agencies to talk about their different business models and the pros and cons of each and we've gotten a lot of very good ideas from that process and we're hoping this summer to pursue some additional rulemaking in this area.

We will focus on rating shopping. We will focus on disclosure. We will also look at whether we need to eliminate references in SEC rules which creates a market for rating agencies and gives a certain amount of credibility and stature to ratings that perhaps they don't always deserve.

Senator COLLINS. Thank you. Thank you, Mr. Chairman.

Senator DURBIN. Senator Tester.

Senator TESTER. Yeah. I just do want to get to the CFTC Chairman, but I just want to just close by saying thank you. Thank you for what you've done, thank you for what you're going to do.

I would ask that, you know, as these budgets come forward, 2005 to 2007 budgets were visited about here on a couple different occasions, somebody dropped the ball. Congress probably had a part to do with it. Your predecessor may have had a part to do with it.

But it ended up in a disaster and we need to make sure that you have the resources, no more, no less, but just the resources you need to do your job, and I think that, as a friend of mine pointed out last week, we need to quit thinking in Government in silos, we need to start thinking about the consumer and whoever is consuming that product, whether it's in education or housing or in this case securities, and make sure that Government works for the betterment of everybody.

But I really want to thank you for the work you've done so far. It's very impressive, and I look forward to working with you in the future.

Ms. SCHAPIRO. Thank you very much.

Senator DURBIN. Thank you very much, Senator Tester.

Chairman Schapiro, thank you for your testimony.

Ms. SCHAPIRO. Thank you, Mr. Chairman.

ADDITIONAL COMMITTEE QUESTIONS

Senator DURBIN. We'll be working closely with you and your agency as we put together the appropriation bill.

Ms. SCHAPIRO. Thank you.

[The following questions were not asked at the hearing, but were submitted to the Commission for response subsequent to the hearing:]

QUESTIONS SUBMITTED BY SENATOR RICHARD J. DURBIN

STAYING ON THE CUTTING EDGE OF TECHNOLOGY

Question. With rapid acceleration of electronic innovations in the securities markets, the Securities and Exchange Commission faces the challenge of keeping abreast of advancements. In the face of aggressive efforts of trading firms to invest in new technology, it is critical that SEC investigators understand the nuances of modern trading operations.

Does the SEC have sufficient resources to hire the best and brightest financial technologists?

Have you identified specific gaps in SEC's workforce expertise when it comes to electronic trading?

Answer. As you may know, the SEC has launched a new initiative with existing resources to broaden the skill sets within its workforce, ranging from financial analysis to complex trading strategies. As part of this effort, the SEC is recruiting seasoned industry professionals into our enforcement, examination, and risk assessment programs, through efforts such as the Industry and Market Fellows and the Senior Specialized Examiner programs. The SEC is also implementing enhancements to the SEC's existing training programs, in areas such as the examination program which is enhancing staff expertise in topics such as fraud detection, complex financial products, and trading and where more than a third of the staff have signed up for training to become Certified Fraud Examiners. If Congress were to approve additional resources for the SEC, then the agency would look to expand these recruiting and training efforts very significantly.

A key repository at the SEC for expertise on trading systems is the Automated Review Program within the Division of Trading and Markets. The program conducts examinations of the trading systems of markets and clearing agencies, to assess the data's confidentiality, integrity, and availability. The program has been able to stay on top of this rapidly evolving field, through efforts such as the CYBER CORPS program, which has served as a great resource for identifying talented IT professionals, and through the NSA, which has provided non-commercial software and technical training. Over the past few years, the program has increased its expertise in IT security and launched new initiatives in the areas of cyber security, auditing intermediaries in credit default swaps, and international markets. The Division now plans to implement new source code review of trading systems and more sophisticated penetration testing, to the extent resources are available.

EXPEDITING FAIR FUNDS DISBURSEMENTS

Question. Under the "Fair Funds for Investors" provision (Section 308(a) of Sarbanes-Oxley), the Securities and Exchange Commission is required to return money to investors victimized by securities fraud. Previously, disgorgements and penalties were deposited into a U.S. Treasury General Fund.

Answer. The Fair Funds provisions of the Sarbanes-Oxley Act of 2002 gave the Commission authority to increase the amount of money returned to injured investors by allowing civil penalties to be included in Fair Fund distributions. Prior to Sarbanes-Oxley, only disgorgement could be returned to investors.

Question. What improvements have been realized so far from the creation of a specialized office on "Fair Funds" disbursement?

Answer. The Commission established the Office of Collections and Distributions (OCD) to, among other things, expedite the distribution of Commission recoveries to injured investors. The Office is responsible for overseeing the distribution of funds to investors who have been injured by securities law violations, implementing the Enforcement Division's collections and distributions programs, and conducting litigation to collect disgorgement and penalties imposed in certain Enforcement actions. In addition, the Office tracks, records, and provides financial management assistance with respect to the funds and provides overall case management services for the Division.

The Office has helped streamline the distributions process and enhance its internal controls, and it has overseen the distribution of approximately $3.2 billion to injured investors to date. Among the Office's recent initiatives has been to issue standardized, step-by-step guidance to enforcement staff on developing and imple-

menting distribution plans in both civil actions and administrative proceedings. In addition, the Office has consolidated collections and distributions information onto the enforcement program's internal website so that is more accessible to staff nationwide. In collaboration with other SEC offices, OCD has created templates to standardize the reporting of periodic and final accountings for distributions of disgorgement funds and Fair Funds, as well as to facilitate the examination of administrative expenses. In order to manage receivership expenses, the Office also developed billing instructions for receivers. OCD conducts training for the staff on the use of both the standardized reports and the billing instructions.

Question. SEC's financial tracking system (Phoenix) was established to improve management of distribution of Fair Funds to victims of securities law violations. Is the "Phoenix" system fully functional at this time? What remains to be done to improve its capabilities?

Answer. To date, the Phoenix system has only been partially deployed. Under the functionalities that are already operational, Phoenix assists with tracking and recording the disgorgement and penalties ordered in Enforcement actions. However, the Phoenix system does not yet track and record distribution information. This function is currently performed in a limited way within CATS 2000, the SEC's case tracking system, which is itself slated to be replaced.

To that end, the agency is developing business requirements for a new module that would record and monitor distribution-related information, including information reported on the newly developed standardized accounting reports. Once fully built, this module would enable the SEC to track a distribution fund's current status or phase in the distribution process, enhance reporting and internal controls over the accuracy and integrity of distribution data, and provide better information about the investment of Commission funds with the Department of the Treasury's Bureau of Public Debt. This effort also will support integration with the agency's core financial management system.

The SEC expects to finalize and deploy the distributions module in fiscal year 2010, depending on the availability of sufficient funding.

Question. I note that SEC is currently reviewing its performance measure of the percentage of Fair Funds and disgorgement dollars designated for distribution to victims within a year. What are the challenges? What is hampering SEC's ability to track the timeliness of the fund distributions and maintain accurate data?

Answer. As noted in the Commission's fiscal year 2010 budget justification, this measure is currently under review and may be adjusted in the future. One of the primary challenges with respect to such a measure has been the SEC's inadequate systems to collect, analyze, and report on distributions (described above), which have hampered the Commission's ability to track the timeliness of the fund distributions and maintain accurate data.

Question. What portion of this year's budget (fiscal year 2009) and the proposed needs for fiscal year 2010 will be devoted to the Fair Funds distribution project?

Answer. The first major expense associated with Fair Funds distributions is information technology, most notably the Phoenix system. In fiscal year 2009, the SEC expects to obligate approximately $0.1 million in ongoing maintenance and support related to Phoenix. For fiscal year 2010, the agency estimates that distributions-related projects will cost approximately $3.2 million. These projects include efforts to develop new collections and distributions tracking functionalities, enhance the current Phoenix system, integrate Phoenix with the enforcement program's new HUB tracking system and the core financial system, and conduct ongoing system maintenance.

A second component of the SEC's distributions-related costs is the expense associated with the Office of Collections and Distributions. OCD's costs amount to approximately $6.0 million in fiscal year 2009 and $6.2 million in fiscal year 2010. However, it is important to note that the Office performs a variety of functions in addition to distributions, including assisting with collection of delinquent debts and maintenance of internal controls.

The final element is the substantial staff time spent on distributions functions within other parts of the SEC. For example, within the enforcement program (outside of OCD), attorneys spend considerable time on the development, oversight, and implementation of distribution plan actions, while support staff perform data input for all cases. In addition, the SEC's Office of Financial Management aids with funds investment and disbursement, as well as internal controls; the Office of the General Counsel reviews and comments on distribution-related documents; and the Office of Economic Analysis evaluates the methodologies for measuring investor loss. Although the staff time involved is significant, the SEC does not currently track costs at this level.

QUESTION SUBMITTED BY SENATOR BEN NELSON

RULE 151A, ISSUED JANUARY 16, 2009

Question. On January 16th of this year, the Commission issued a new rule regarding indexed annuities and certain other insurance contracts. This rule takes effect on January 12, 2011.

What level of resources will the SEC devote in fiscal year 2010 to preparing to implement this rule? Can you calculate the cost to the Commission of the work necessary to fully implement this rule so that it can be operational on January 12, 2011?

Looking ahead to the next fiscal year (fiscal year 2011), in taking on this additional regulatory responsibility, will additional staff be required? What will additional staff needs and additional regulatory responsibility mean for the Commission's budget?

Answer. The release adopting this rule (Rule 151A) articulated the Commission's determination that investors in certain indexed annuity contracts are entitled to the protections of the federal securities laws. The rule includes a new definition of "annuity contract" that, on a prospective basis, will define a class of indexed annuities that are outside the scope of Section 3(a)(8) of the Securities Act, which provides an exemption under the Securities Act for certain insurance contracts. These indexed annuities will, on a prospective basis, be required to register under the Securities Act. With few exceptions, indexed annuities historically have not been registered as securities. The new definition will apply to indexed annuities that are issued on or after the January 12, 2011, the effective date of the rule.

The staff is currently considering how to tailor disclosure requirements for indexed annuities. As with any other rulemaking, if the staff determines to recommend that the Commission propose new disclosure requirements, resources will be applied to develop a proposal, analyze public comments on the proposal, determine whether to recommend adoption of the proposal and consider whether and how it should be modified to reflect commenters' concerns.

In addition, the Commission encouraged insurance companies, sellers of indexed annuities, and other affected parties to submit specific requests for guidance regarding the implementation of the rule. We anticipate that any responses to such requests will require staff resources.

The Division of Investment Management also anticipates reviewing filings for approximately 400 new indexed annuity contracts in the first year.

In all, the Division of Investment Management believes the implementation of Rule 151A will require an allocation of seven staff positions during the first year, with that number likely to decrease in the years following the initial implementation. The estimated cost of these seven positions is $1.6 million for fiscal year 2011. As discussed above, these staff will perform further rulemaking as appropriate, provide interpretive advice, and review disclosure filings.

QUESTIONS SUBMITTED BY SENATOR SUSAN COLLINS

Question. Chairman Schapiro, recently many news outlets have issued stories about the administration's proposal to move some consumer-protection powers outside of the SEC. Reports state that that you are opposed to such a proposal. A May 20th Wall Street Journal article quotes you as saying that such a plan would ". . . be hugely expensive and highly inefficient . . ." Would you discuss your objections?

Answer. I did not believe that investors would be better protected by separating some securities products from others, potentially creating gaps in the regulatory and enforcement regime. Securities products are different from consumer credit products: generally they are not guaranteed and include a number of inherent risks, including the loss of principal. The administration's white paper outlining its consumer protection plan appears to recognize this, and I do not object to that approach.

Question. Secretary Geithner recently laid out a framework for overseeing the derivatives market including rigorous reporting requirements. Such a proposal would give the SEC and CFTC new authorities to regulate derivatives. What are your thoughts on the plan and the role of the SEC in the regulation of derivatives?

Answer. I agree with the Secretary's approach. Both the SEC and CFTC have a role in regulating derivatives products. We continue to work together and make progress on how such a regime might work to best fill gaps in the regulatory framework and prevent regulatory arbitrage. I look forward to working with Congress to make the necessary legislative changes.

Question. Two veteran enforcement lawyers at the SEC are currently under investigation for insider trading. A May 16 a Wall Street Journal article quotes a report by the SEC Inspector General saying that "the SEC has 'essentially no compliance system' to detect potential insider trading." As a result of the investigation into the trading activities of the two attorneys', the SEC has proposed the imposition of new rules on employee trades. How does this investigation affect your confidence in the ability of the SEC staff? In your estimation, do the recent troubles at the SEC signify fundamental problems within the organization, and if so how do you propose to rectify the issues?

Answer. I have the utmost confidence in the ability of the SEC's staff and their unflagging dedication to the protection of investors. Time and time again, I have been impressed by the staff's talent, integrity, and enthusiasm for the agency's mission. However, it became clear to me soon after joining the agency that the SEC's system for ensuring compliance with employee trading rules was not sufficient. The report by the agency's Inspector General concerning trading activity by certain employees reinforced my belief that the SEC should have a trading compliance system that is second to none.

I know the agency's staff shares my belief that, in light of the SEC's mission, it is vital that we conduct ourselves according to the highest standards of ethical conduct when it comes to our own financial holdings and transactions. To that end, we have taken several significant steps to strengthen the SEC's compliance system and reduce the potential for even the appearance of inappropriate securities trading:

—We have proposed new rules concerning employee trading. These rules will, among other things:
  —Require the pre-clearance of all trades.
  —Prohibit all trading in the securities of a company under SEC investigation, regardless of whether the employee is aware of the investigation.
  —Require all employees to authorize their brokers to provide duplicate trade confirmation statements to the agency.
  —Prohibit the ownership of securities in publicly-traded exchanges and transfer agents, in addition to existing prohibitions against owning securities in other firms directly regulated by the Commission.
  —Require employees to certify that they do not have any non-public information about the company whose securities they are trading.

  These rules were submitted to the Office of Government Ethics ("OGE") on May 22, 2009, and we await OGE's comments.

—We recently retained an outside firm specializing in automated compliance systems to develop a new computer compliance system for the agency, which will automate and simplify the transaction reporting process and make it easier to verify and monitor employee trading.

—We are creating a new Chief Compliance Officer position, and have already received applications from a number of excellent candidates for the new position.

—I have consolidated responsibility for the oversight of employee securities transactions within the SEC's Ethics Office and devoted additional staff resources to monitor, review, and spot-check these transactions.

These measures will bolster and modernize the agency's compliance program, and help the talented and committed staff do its critical work of protecting investors without distraction.

Question. The fiscal year 2010 budget request does not include an increase for the SEC Inspector General. Considering the likelihood of an increased workload at the IG's office, as the SEC increases surveillance and monitoring of employee trading, do you think that the IG will need additional funds?

Answer. The Inspector General submitted a request for three additional positions only a few days before the publication of the SEC's Congressional Justification for fiscal year 2010, and therefore these additional positions were not reflected in the document. However, I have since approved the addition of these personnel, which would bring the OIG to a total of 19 positions. When these new staff are combined with the two positions approved for OIG in January 2009, the Office will have grown by a total of 73 percent within this calendar year, which is the highest growth rates of any SEC office during this timeframe.

Question. Please provide a breakdown of the tips and complaints the SEC received in fiscal year 2007 and fiscal year 2008, to help explain the large decline in that year.

Answer. As you mentioned, the number of tips and complaints received by the SEC's Office of Internet Enforcement declined significantly between 2007 and 2008, from about 1,586,000 to about 615,000 in 2008. Unfortunately, the SEC has not had a tracking system that can break down those figures into their component parts or support rigorous analysis of underlying trends.

The SEC's initiative to bolster its systems for tracking tips and complaints, working with the Center for Enterprise Modernization, will help the agency perform much better analyses in the future. Such analyses will help the SEC understand the overall statistics on tips and complaints and identify trends among specific firms or practices that can provide valuable information for potential enforcement action and compliance exams. The SEC also is working to streamline and standardize the agency's handling of tips and complaints, so they can be addressed more consistently and effectively. Nevertheless, for the 2007–2008 period, the SEC is reliant on anecdotal evidence to explain the decline in tips and complaints during that timeframe.

In general, the number of complaints the agency sees is related to the volume of spam and commercial email traffic received by investors. A number of factors likely affected this volume during the 2007–2008 timeframe. First, the SEC's initiative starting in 2007 to combat spam-driven stock manipulations was reported to have been a major contributor to reducing the amount of spam.[1] Under this initiative, the SEC suspended trading in the securities of dozens of companies that had been the subject of spam stock promotions and initiated several spam-related enforcement actions. According to a private-sector Internet security report, a 30 percent decrease in stock market spam "was triggered by actions taken by the U.S. Securities and Exchange Commission, which limited the profitability of this type of spam . . ."[2]

Another major factor is the growing use and sophistication of commercial-grade spam email filters, blacklists, and experimental "data mines," which radically diminish the number of mass investment solicitations received by the average investor. Additionally, tough state and federal anti-spam laws, and high-profile prosecutions under those laws, likely helped to deter spammers.[3]

General market conditions also likely played a role in the decline in tips and complaints. Email stock promoters' activities lend themselves best to the promotion of obscure, thinly-traded stocks, such as the tech stocks that flourished during the late 1990s market "bubble." Since the collapse of that bubble, it seems fewer investors have been interested in these microcap stock promotions.

It is important to note that, while the number of tips and complaints went down significantly in 2008, the figure is still 146 percent higher than it was 5 years previously. By comparison, the number of full-time equivalents in the SEC's enforcement program increased by only 23 percent during that period. Also, while the quantity of complaints the SEC received decreased between 2007 and 2008, the SEC believes that the quality of complaints has increased dramatically. Thus, the agency's workload from these complaints has actually become greater over the past year, despite the reduced number of complaints relating to spam.

ADDITIONAL SUBMITTED STATEMENT

[CLERK'S NOTE.—The subcommittee has received a statement from the Investment Company Institute which will be inserted into the record at this point.]

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[1] "SEC makes inroads against financial spam; Crackdown pays off as e-mail campaigns slow," by Matt Krantz, USA Today, Oct. 5, 2007 at p. 7A.

[2] http://eval.symantec.com/mktginfo/enterprise/white_papers/ent-whitepaper_internet_security_threat_report_xii_09_2007.en-us.pdf. Copyright 2007 Symantec Corporation. All rights reserved. Symantec, the Symantec Logo, BugTraq, Symantec Brightmail AntiSpam, and Symantec DeepSight are trademarks or registered trademarks of Symantec Corporation or its affiliates in the United States and other countries. Apple, Mac OS, and QuickTime are trademarks of Apple Inc., registered in the United States and other countries. Safari is a trademark of Apple Inc. Microsoft, ActiveX, Windows, and Windows Media are either registered trademarks or trademarks of Microsoft Corporation in the United States and/or other countries. Sun, Java, and Solaris are trademarks or registered trademarks of Sun Microsystems, Inc. in the United States and other countries.

[3] See http://www.msnbc.msn.com/id/18955115/(arrest of Robert Alan Soloway); http://www.sophos.com/pressoffice/news/articles/2008/02/japan-spam.html (Yuki Shiina); http://spamkings.oreilly.com/archives/2006/03/stock_spammers_stung_by_secret.html ("g00dfellas" spam gang).

PREPARED STATEMENT OF THE INVESTMENT COMPANY INSTITUTE

The Investment Company Institute[1] appreciates this opportunity to submit testimony to the Subcommittee in support of the administration's fiscal year 2010 appropriations request for the Securities and Exchange Commission (SEC). We commend the subcommittee for its consistent past efforts to assure adequate resources for the SEC. For the reasons expressed below, we urge Congress to provide appropriations at least at the funding level requested by the President.

As SEC Chairman Mary Schapiro noted in her testimony, the recent financial crisis has served as a reminder of the importance and interconnectedness of the securities markets to our nation's economy and the financial health of millions of Americans. The crisis also demonstrated that the current regulatory system is not up to the challenges posed by modern financial markets and needs to be significantly strengthened and modernized. It has led to broad support for reform of the U.S. system of financial services regulation, including numerous calls for Congress to close regulatory and disclosure gaps to ensure appropriate oversight with regard to hedge funds, derivatives, and municipal securities. Toward these ends, it is critically important to provide the SEC with the resources necessary to assure its ability to soundly and effectively regulate securities offerings, market participants, and the markets themselves. And, to the extent that the scope of the agency's responsibilities is expanded with respect to hedge funds, derivatives, and/or municipal securities, it will be imperative that it have sufficient staffing and resources to effectively perform all of its oversight functions.

More generally, the ongoing policy discussions about regulatory reform have highlighted why adequate funding for the SEC should continue to be a Congressional priority. Unlike other financial regulators, the SEC is specifically charged with protecting investors. The agency seeks to fulfill this mission in many different ways, including through the disclosure and substantive rules it adopts and administers, through examinations of regulated entities, and through its enforcement program, to name a few. In the wake of the financial crisis, it is essential to provide the SEC with the resources it needs to successfully pursue its investor protection mission.

Mutual funds and other registered investment companies have a strong stake and vested interest in having a well-funded and effective SEC. Registered investment companies are an integral part of our economy. They represent, as a whole, the largest group of investors in U.S. companies, holding 27 percent of the outstanding stock in U.S. companies at year-end 2008. Registered investment companies also held the largest share of U.S. commercial paper—an important source of short-term funding for major U.S. and foreign corporations. In addition, they continue to be one of America's primary savings and investment vehicles for middle-income Americans. Today, over 93 million investors in more than 53 million U.S. households own shares of registered investment companies; the median household income of these investors is $80,000. And, since 1990, the percentage of U.S. retirement assets held in mutual funds and other registered investment companies has more than quadrupled. These millions of Americans continue to recognize that mutual funds are the best means of achieving their long-term financial goals. They deserve and benefit from continued vigilant regulatory oversight of mutual funds and other registered investment companies.

The administration's fiscal year 2010 budget proposes SEC funding at a level that represents a 7 percent increase over fiscal year 2009. Chairman Schapiro explained in her testimony that this would permit the SEC to fully fund an additional 50 staff positions over 2008 levels, enhance its ability to uncover and prosecute fraud, and allow it to begin to build desperately needed technology. More specifically, Chairman Schapiro stated that the additional funding would allow the SEC to hire seasoned industry professionals and market experts to strengthen and expand the SEC's Office of Risk Assessment, improve its examination program, and bolster its oversight of the investment management and broker-dealer industries. We have strongly supported precisely these types of measures.[2] It is essential that the agency

[1] The Investment Company Institute is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds (ETFs), and unit investment trusts (UITs). ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. Members of ICI manage total assets of $10.18 trillion and serve over 93 million shareholders.

[2] See Letter to The Hon. Mary L. Schapiro from Paul Schott Stevens dated February 18, 2009 (attaching recommendations for SEC priorities under Chairman Schapiro's leadership). See also *Financial Services Regulatory Reform: Discussion and Recommendations*, which is available at http://www.ici.org/pdf/ppr_09_reg_reform.pdf. Chairman Schapiro also noted in her testimony that she intends to improve the overall management of the SEC, including by hiring a Chief

have greater ability (and resources) to attract and retain professional staff having significant prior industry experience. Their practical perspectives would enhance the agency's ability to keep current with market and industry developments and better understand the impact of such developments on regulatory policy. The new Industry and Market Fellows Program is an encouraging step in the right direction, but we also believe that the agency should build strong economic research and analytical capabilities and should consider having economists resident in each division.

We are particularly pleased that a key strategic priority for the SEC's Division of Investment Management will be to strengthen and improve the money market fund regulatory regime. Last November, we convened a high level industry working group to study the money markets. In March, the group made a series of comprehensive recommendations that responded directly to weaknesses in current money market fund regulation, identified additional reforms that will improve the safety and oversight of money market funds and position responsible government agencies to oversee the orderly functioning of the money market more effectively.[3] We look forward to working with the SEC on this critically important issue.

In conclusion, the SEC and the fund industry share a common objective of assuring that mutual funds remain a vibrant, competitive and cost effective way for average Americans to access the securities markets and realize their long-term financial goals. Future regulatory and oversight actions by the SEC will play a key part in this process. It is therefore critically important that the SEC have sufficient resources to adequately fund the staffing of the agency and to take other steps to fulfill its mission of protecting the nation's investors, including the over 93 million Americans who own mutual funds. Accordingly, we urge Congress to provide appropriations at least at the funding level requested by the President.

We appreciate your consideration of our views.

Operating Officer to manage the organization. We also supported this idea in both our February 18, 2009 letter to Chairman Schapiro and *Financial Services Regulatory Reform* white paper.

[3] See *Report of the Money Market Working Group*, submitted to the Board of Governors of the Investment Company Institute on March 17, 2009, available at http://www.ici.org/pdf/ppr__09__mmwg.pdf.

COMMODITY FUTURES TRADING COMMISSION

STATEMENT OF HON. GARY GENSLER, CHAIRMAN

Senator DURBIN. I'd like to invite Chairman Gensler from the Commodity Futures Trading Commission to come forward.

This year, 2009, marks the 35th year since the establishment of this agency. At this time of its inception in 1974, CFTC's 500 employees were tasked with ensuring fair practices and honest dealings on the commodity exchanges of America's then $500 billion industry in 1974.

Today, it is a $22 trillion industry and it looks a lot different. The traditional agricultural products are still there, but the landscape has been diversified with novel and complex commodities, from grains to gold, currencies to carbon credits.

In the past decade trading volume has increased more than tenfold, reaching over 3.4 billion trades in 2008. Actively traded contracts have quintupled from 286 in 1998 to 1,521 in 2008.

CFTC oversees $5 trillion of trades every single day. So we don't want you to stay at the table too long. We want you to get back and keep an eye on those trades, but we invite you, Chairman Gensler, to give your testimony at this point.

Mr. GENSLER. Thank you, Chairman Durbin, Ranking Member Collins, and members of the subcommittee, Senator Tester.

I'm pleased to be here today to discuss our budget and especially pleased to learn that Senator Durbin recently visited our Chicago office which very encouraged the staff and I thank you for it.

I'm also grateful to each of you for your individual support on my recent confirmation. It's an honor to serve the country in this capacity.

I come before you having served as Chairman just 6 calendar days, but with full knowledge of the failures of our regulatory system, failures that affected all Americans, failures that we must ensure do not happen again, and as Chairman, I will use every authority available to protect the American people from fraud, manipulation, and excessive speculation.

I will also work with Congress on new authorities to bring much-needed transparency and regulation to the over-the-counter derivatives marketplace.

I am grateful on behalf of the agency for the $146 million recently appropriated for this Commission. This boost has allowed us to get back to beginning to address the alarmingly low staffing levels there are at the agency. Our size, however, is still roughly equivalent to the Commission that was established 35 years ago.

Today, the futures market is dramatically different, as Chairman Durbin just outlined, being some 45 times larger than it was 35 years ago, and much more complex as well.

Just 10 years ago the CFTC was near its peak staffing levels, near 580 full-time equivalents. It's shrunk over 20 percent in the

past years, but with your help the fiscal 2009 funding will permit us to get back to where we were in 1999.

Since 1999, however, volumes have gone up fivefold, the number of contracts have gone up sixfold. The complexity, of course, I don't need to tell you, has gone up dramatically. We've gone from open outcry pits to electronic trading which is in some cases harder to monitor. We've also lived through the worst financial crisis in 80 years and seen the results of an asset bubble in commodity prices.

In short, the Commission remains an underfunded agency and we're very grateful to the President's budget of $160.6 million in recognition of some of these needs. If I could just share with you some of the things that have been highlighted to me in my first 6 days. I think we still need to ensure that our enforcement effort is larger to ensure robust enforcement of our laws. Currently, we have about 141 attorneys in our Enforcement Division. I believe this is still quite lower than what's required, given the financial turmoil we've lived through.

We must ensure greater transparency. I believe that commodity index funds did contribute to the asset bubble that we've just lived through. To bring greater transparency will require more economists. It's going to require announcements in our weekly commitments in traders' reports. We'll also need to upgrade our systems as well.

We must ensure that position limits consistently applying across the board, and that we're reviewing hedge exemptions and no action processes in that regard.

Our information technology (IT) systems and particularly our mission critical systems on positions and transactions have not been upgraded for quite some time and I've looked forward to working with this subcommittee on getting funds to try to upgrade these mission critical systems.

And also, we need to ensure timely review of new products and rule change filings. This has lagged a great deal and just last year with the new farm bill, the review of significant price discovery contracts will be important moving forward.

These are only a few of the funding priorities, but I wanted to give the subcommittee a tangible sense of some of the things that we're grappling with and struggling with.

With that in context, the $14.6 million of additional funding, about one-half of that is to stay at current services and one-half of that in the President's budget, fortunately, is for 38 new full-time equivalents to bring us back just above where we were 10 years ago, to about 610 full-time equivalents. These positions are essential. The increase, however, still won't allow us to fully address these complex markets and what we need to do.

Before I close, I would like to highlight that the additional funding needs will also accompany much-needed regulatory reform. I, along with other regulators, and the administration feel we need to broaden reforms in the over-the-counter derivatives marketplace and bring it all under the regulatory umbrella. I look forward to working with this subcommittee and Congress for funding those new authorities to make sure they're properly implemented.

PREPARED STATEMENT

And with that, I thank you very much and I look forward to answering your questions.

I hope my written testimony can be entered into the record.

Senator DURBIN. Of course. It will be.

[The statement follows:]

PREPARED STATEMENT OF GARY GENSLER

Thank you, Chairman Durbin, Ranking Member Collins, and other members of the Subcommittee. I am pleased to be here to testify on behalf of the Commodity Futures Trading Commission, and I appreciate the opportunity to discuss issues related to the Commission's 2010 Budget. I am also grateful to have had each of your individual support for my recent confirmation. It is a great honor to serve my country in this capacity.

I come before you today having only served as CFTC Chairman for 6 calendar days, but with the full knowledge of the failures of our financial regulatory system; failures that affected all Americans and failures that we must ensure never occur again.

The last decade, and particularly the last 21 months, has taught us much about the new realities of our financial markets. We have learned the limits of foresight and the need for candor about the risks we face. We have learned that transparency and accountability are essential and that only through strong, intelligent regulation can we fully protect the American people and keep our economy strong.

As Chairman of the CFTC, I will use every tool and authority available to protect the American people from fraud, manipulation and excessive speculation. I also look forward to working with Congress to establish new authorities to close the gaps in our laws and bring much-needed transparency and regulation to the over-the-counter derivatives market. I firmly believe that doing so will strengthen market integrity, lower risks, protect investors, promote transparency and begin to repair shattered confidence in our financial markets.

I would like to thank the Committee for the $146 million recently appropriated for the CFTC for the 2009 fiscal year and special thanks to Chairman Durbin for visiting our Chicago office last year. As a result of this much needed boost in funding, the Commission has begun to address our alarming staffing levels; levels that recently reached historic lows.

At present, the Commission employs about 500 career staff—roughly equivalent to when the Commission was created in 1975. Three decades later, the futures market has changed in every way: with respect to volume, complexity, risk and locality. What was once a group of regional domestic markets trading a few hours 5 days a week is now a global market trading 24/7, and what was once just a $500 billion business has exploded to a $22 trillion annual industry.

Ten years ago, the CFTC was near its peak staffing level at 567 employees, but shrunk by 20 percent over the subsequent 8 years before hitting a historic low of 437.

With the increase in fiscal year 2009 funding the CFTC can reach 572 employees.

While this is a start, I believe that merely raising our staffing levels to the same as a decade ago will not be enough to adequately fulfill all of the agency's missions. In the last 10 years, trading volume went up over five fold. The number of actively traded futures and options contracts went up over six fold, and many of these are considerably more complex in nature. We also moved from an environment with open-outcry pit trading to highly sophisticated electronic markets.

In addition to the dramatic evolution of the futures industry, we have experienced the worst financial crisis in 80 years. We also experienced, in my view, an asset bubble in commodity prices. The staff of the CFTC is a talented and dedicated group of public servants, but the significant increase in trade volume and market complexity, as well as rapid globalization, commands additional resources to effectively protect American taxpayers.

For all of these reasons, I feel it is appropriate for our staffing levels and our technology to be further bolstered to more closely match the new financial realities of the day.

In short, despite the recent increase in funding, the Commission remains an underfunded agency. The President's Budget recommendation of $160.6 million is recognition of this need. Specifically, the Commission needs more resources to hire and retain professional staff and develop and maintain technological capabilities as sophisticated as the markets we regulate.

I'd like to identify some of my priorities and provide some illustrations of how resource limitations have constrained the Commission. Among my priorities will be to:

—Ensure robust enforcement of our laws. Currently, the Commission's enforcement program consists of 122 employees—the lowest level since 1984. Though fiscal year 2009 funding will get us back to 141 enforcement employees, this is still below the agency's peak of 167 and well below what we need given the current financial turmoil. Any financial downturn reveals schemes that could only stay afloat during periods of rising asset values. Our current, and much larger, downturn is exposing more leads than the Commission can thoroughly and effectively investigate. This is true both as it relates to fraud and Ponzi schemes as well as staff intensive manipulation investigations. The regulations we enact to protect the American people are meaningless if we do not have the resources to enforce them;

—Ensure greater transparency of the marketplace. Also, I believe that commodity index funds and other financial investors participated in the commodity asset bubble. Notably, though, no reliable data about the size or effect of these influential investor groups has been readily accessible to market participants. The CFTC could promote greater transparency and market integrity by providing further breakdowns of non-commercial open interests on weekly "Commitments of Traders" reports. The American public deserves a better depiction of the marketplace. The temporary relief from higher prices does not negate this need, especially given that a rebounding of the overall economy could lead to higher commodity prices;

—Ensure position limits are consistently applied. The CFTC has begun a review of all outstanding hedge exemptions to position limits. This review will consider the appropriateness of these exemptions and look for ways to institute regular review and increased reporting by exemption-holders. The Commission also has begun a review of the process and standards through which no-action letters are issued. As part of these reviews, CFTC staff will consider the extent to which swap dealers should continue to be granted exemptions from position limits;

—Ensure the Commission has the tools to fully monitor the markets. We must upgrade the Commission's mission critical IT systems for the surveillance of positions and trading practices. Neither is robust enough nor have they been upgraded to reflect the vast increase in volume and complexity. Our systems must begin to produce the surveillance reports needed to meet the analytical needs of our professional staff and the transparency needs of the public; and finally

—Ensure timely reviews of the many new products and rule change filings of the futures markets. These have lagged due to the growth and complexity of markets and the added responsibilities extended to the Commission in the 2008 Farm Bill. The Farm Bill requires staff to review all contracts listed on Exempt Commercial Markets (ECMs) to determine if they are significant price discovery contracts—if they are, then any ECM that lists such a contract must also be reviewed to determine compliance with a stringent set of core principles under the Commodity Exchange Act.

Other examples that I believe are illustrative of the difficult tradeoffs caused by resource constraints are:

—The Commission does not conduct annual compliance audits of every Designated Contract Market (DCM)—rather only periodic reviews on average, every 3 years;

—The Commission does not conduct annual compliance audits of every Derivatives Clearing Organization (DCO)—rather periodic reviews are conducted of selected core principles that are rotated and completed every 3 years; and

—The Commission does not conduct routine examinations of Commodity Pool Operators, Commodity Trade Advisors, and Futures Commission Merchants—a function currently performed by Self Regulatory Organizations. If the Commission were to perform direct periodic audits our staff would better understand the operations of brokers and managed funds and could better assess compliance with the law and regulations.

These are only a few of our important funding priorities and the workload challenges imposed by resource limitations. There are, of course, others. I hope that this helps the Committee to understand, in a tangible way, the challenges the Commission faces in regulating the futures markets the way the Nation requires.

Although the work of the Commission can be highly technical in nature, the mission of the agency is quite straightforward. The CFTC is charged with:

—Protecting the public and market users from manipulation, fraud, and abusive practices and

—Promoting open, competitive and financially sound futures markets.

With that context, I would like to address the specifics of the fiscal year 2010 Budget request. The fiscal year 2010 Budget proposes an increase of $14.6 million. Approximately half of the increase is needed to maintain our fiscal year 2009 level of operations into fiscal year 2010. The balance would fund an additional 38 positions.

Twenty-six of the 38 staff would be allocated to principal program areas. Specifically, we would allocate 11 positions to Enforcement, 8 to Market Oversight, 6 to Clearing and Intermediary Oversight, and 1 to the Chief Economist's office. The remaining 12 positions will provide critical mission support in the areas of legal analysis and counsel, technology support, international coordination, legislative and public outreach, and human capital and management support.

The additional 38 positions are essential to addressing some of the limitations I mentioned earlier. This increase, however, will not provide the Commission with the critical mass of professional and technical expertise needed to ensure that the growing markets remain free of manipulation and fraud.

For example, our enforcement staff needs to be significantly expanded to:

—Ensure that crimes are punished to the fullest extent of the law;

—Develop strategies aimed at quickly identifying and eradicating fraudulent schemes, such as Ponzi and foreign exchange "boiler rooms"; and

—Importantly, pursue resource-intensive investigations and litigations involving manipulation, including energy-related market abuses, so wrongdoers will not believe they are immune from enforcement simply due to the complexity of an enforcement action.

Insufficient resources in the enforcement division force it to be too selective in the matters it investigates.

Our market oversight operation needs additional highly-skilled economists, investigators, attorneys and statisticians to:

—Analyze trading reports quickly and thoroughly, identify potential market problems or trader violations promptly, and avoid market disruptions and pricing anomalies;

—Conduct timely and complete reviews of regulated entities to ensure compliance with all core principles;

—Examine exchange self-regulatory programs on an on-going and routine basis with regard to trade practice and market surveillance; and

—Ensure their compliance with disciplinary, audit trail, record-keeping and governance obligations.

Our clearing and intermediary oversight program needs additional auditors, analysts, and attorneys. This would allow us to:

—Ensure clearing systems protect against a single market becoming a systemic crisis;

—Protect investors' funds from being misused or exposed to inappropriate risks of loss; and

—Guard against abusive sales practices that harm customers and undermine market integrity.

Our economic research program needs more economists to review and analyze new market structures and off-exchange derivative instruments, especially in light of novel and complex products and practices that call for state-of-the-art economic analysis. Further, additional resources would enhance our economic and statistical analysis, improving transparency of markets and better supporting the Commission's enforcement and surveillance programs.

We also need to transform the current legacy information technology systems into robust systems capable of efficiently receiving and managing massive amounts of raw data as well as transforming them in to useful analytical and research tools.

The Commission has made a substantial investment in technology over the past 2 years—focusing first on upgrading obsolete computer hardware to industry standards. We need technology, however, that is as modern and dynamic as the technology-driven markets we are charged with overseeing. Our investment in technology must be more than just periodic equipment upgrades and maintenance. The Commission must leverage resources by employing 21st century technology to protect the American people.

As the Commission informed this Committee in February of this year, the agency believes it needs $177.7 million for fiscal year 2010 to perform its present duties. I look forward to working with this Committee to secure the funding necessary to meet our current regulatory responsibilities.

Before I close, I would like to briefly highlight funding needs that might go along with much needed regulatory reform. The CFTC along with the administration and other financial regulators is committed to working with Congress on broad regu-

latory reform. This is particularly true for the markets that the CFTC currently regulates and the markets that may soon come under our regulation.

Specifically, we must urgently regulate the over-the-counter derivatives market and address excessive speculation through aggregated position limits.

President Obama has called for action by the end of this year to strengthen market integrity, lower risks, and protect investors. The future of the economy and the welfare of the American people depend on a vibrant Commission to assist in leading the regulatory reform ahead. Additional funding will be necessary to properly implement these reforms.

I look forward to working with the Members here today and others in Congress to accomplish this goal.

Thank you very much. I would be happy answer any questions you may have.

STAFFING

Senator DURBIN. Chairman Gensler, thank you for being here and we're glad that you're on the job, and it strikes me that if we look at your recent arrival and the recent arrival of a lot of money into your agency, that you're really going to be tested quickly in terms of whether or not you can gather together the professional staff to do your job and the added responsibilities that you mentioned in the farm bill. I don't know if you have had a chance to look at the inspector general's report on your agency but that was, I think, one of the major points made by that report, as to whether or not you would have the human capital necessary to monitor the complex situations that you face.

Now, there's been some problems in the past at CFTC when it comes to Federal pay parity, where the Government basically said let's start treating all the professionals in our agencies alike and CFTC seemed to be lagging in the past in bringing the income levels up to meet the pay parity standard.

You mentioned my visit to the office in Chicago and I'm glad I did it. I don't know how many other Congressmen or Senators have been there, but it's an eye-opener. It's a small staff but it's an amazing staff and I was very impressed. There are some people we have working for our Government in that office who do such exceptional work.

One man they introduced me to, I've forgotten his name unfortunately, and they told me what his responsibility was each day and they said he is the go-to guy. He watches all of these transactions going and he's the one who monitors them and if he weren't here, you know, I'm not sure how good a job we'd do. It would take a lot more people to try to do what he does every day. I said, "Does this man take a vacation?" They said, "Yes, he does and we try to hang on until he gets back."

It's that kind of person and that kind of responsibility which leads me to ask, now that we've sent you a substantial amount of money in this year's fiscal year bill, in the omnibus bill, and now that we've told you you need more professional people and now that you're looking at this pay parity issue, how are you trying to fit these pieces together into some coherent way of expanding your agency in a manner that is consistent with rewarding the good performance of people there and bringing onboard the kind of folks that you need to meet these new electronic markets?

Mr. GENSLER. Senator, I think you're right in these are important challenges. Just being in the job for 6 days, what I see are talented staff facing significant challenges ahead.

Senator DURBIN. Incidentally, you're new to this, but it's always great to start your answer with Senator, you're right. Please proceed.

Mr. GENSLER. Senator, you're right. As I understand it, the agency's been able to fulfill all of the job postings—about 95 job postings. There's confidence, at least within the staff, as to what might be achieved by September 30. We all know there's a summer and August and so forth, but all the postings are up. Some of the recruiting has already occurred and people have been coming in.

But I also agree with Chairman Durbin that this agency, which was so sorely underfunded and actually shrank over 20 percent in the face of this complexity during the last 8 years, has too many jobs that are being done by one person or not enough. As an example, when I asked, well, how large is the group that oversees clearing, this really important function in futures. I was told that there is a nine-person staff out in Chicago, which is part of that larger staff, I said, "Is that enough?" Well, you know, everybody said, "Well, that's what we have. We've had to make tough choices."

So I think that's very important. I'm committed to make sure that taxpayer dollars are put to work most appropriately and efficiently, but I do have confidence in what I've seen in 6 days, that there's a plan of action for these hires.

Senator DURBIN. What about the pay parity issue?

Mr. GENSLER. On pay parity, as I understand it, we've been able to bring up to a figure of about $4 to $4.5 million.

Senator DURBIN. I might say that there——

Mr. GENSLER. I'm sorry Senator, let me just correct this. There is $1.4 million in the fiscal 2010 budget specifically with regard to that.

STUDENT LOAN REPAYMENT

Senator DURBIN. One obscure little thing which I accomplished when Senator Collins was chairing the Governmental Affairs Committee.

Senator COLLINS. Governmental Affairs.

Senator DURBIN. Governmental Affairs Committee, when it started, was the whole question of student loan repayment as an incentive to bring in professionals to Federal agencies.

The SEC is one of the best agencies in Government on this front, 385 of their staff, 181 of whom are attorneys have used the student loan repayment, and I believe this brings them into Federal Government where their services are very valuable. Otherwise they might not be able to consider it.

CFTC has not instituted such a program, probably for lack of money, and I'm wondering if you expect to be able to provide that benefit as part of recruitment in the future.

Mr. GENSLER. The answer is yes, sir, I think that we tried to do—I think it was just a small amount this year, $200,000 in this fiscal year.

Senator DURBIN. I see.

Mr. GENSLER. In fiscal 2009, actually.

Senator DURBIN. Well, I think it can be a major part of attracting really talented college graduates who otherwise would be lured to something that may pay a little more just to defray their costs.

Mr. GENSLER. The agency shares that view.
Senator DURBIN. Thank you.
Senator Collins.

UNDERFUNDING

Senator COLLINS. Thank you, Mr. Chairman.

Mr. Gensler, Senator Lieberman and I, as the chairman and ranking member of the Homeland Security and Governmental Affairs Committee, held three hearings last year looking at speculation in the commodities markets, and I want to talk about some of our findings as a result of those hearings.

The first we've already discussed at some length and that is that the CFTC has been woefully understaffed. We were told by the Commission that there were more than 3 billion futures and options contracts that were traded last year, I guess it would have been the year before last, and that was up from 37 million in 1976 when the Commission was first created, so 37 million to 3 billion contracts, and yet the Commission was operating with fewer employees than it had 30 years ago. Just an untenable situation.

Now, the Acting Chairman of the Commission in February wrote to the Office of Management and Budget (OMB) Director in protest of the budget that had been handed down by OMB of having a budget of $160.6 million and he described it as perilously inadequate. He went on to say that it would not allow the Commission to implement all of its responsibilities. That is the budget that we're talking about today.

Do you disagree with the letter that was written by the Acting Chairman or do you share his concerns?

Mr. GENSLER. I share the concerns that this agency is both underfunded, as you and Senator Lieberman's panel determined last year. I think, as the Acting Chairman Mike Dunn did an excellent job these past 4 months laying out that this agency needs more. We're very appreciative of the President's budget and the 38 additional employees, but I don't think it's really yet up to the task that the American people expect or how we're going to protect against fraud, manipulation, and, as your hearings looked at, the burdens of excess speculation in these markets.

SPECULATION

Senator COLLINS. Let me turn to the speculation issue. As a result of the hearings that we held, Senator Lieberman and I introduced a bill that directed the CFTC to establish position limits that would apply to an investor's total interests in a commodity, regardless of whether they originate on a regulated exchange, the over-the-counter market or on foreign boards of trade that deal in U.S. commodities.

Do you support establishing position limits, having the Commission do it rather than the exchanges?

Mr. GENSLER. I think, Senator, that it's important that we bring a broader view of this even than was being discussed then, that we have the over-the-counter derivatives marketplace under regulation, but, in addition, that the position limits that are set—for instance, if it was for crude oil, that it would look across markets and aggregate not only internationally, as you were discussing, but also

with the over-the-counter derivatives marketplace. There may be contracts that are really quite similar, as you addressed in the farm bill, but more broadly as we work with Congress later this year and try to get aggregate position limit authority for Federal regulators to look across markets and across futures and swaps.

INDEX TRADERS

Senator COLLINS. What our hearings demonstrated was that speculation in the commodities markets by noncommercial investors, not individuals or entities that are actually taking possession of the commodity at some point, but entities, like pension funds, university endowments and other institutional investors, has grown enormously from 2003 to 2008.

In just that 5-year period the total value of their futures contract and commodity index funds investments soared from $13 billion to $260 billion. So you have this influx of money from speculators. There's always been speculation in the commodities futures markets.

I understand that and I understand that speculation is useful for hedging risk, but we're talking now about speculation from individuals who are not the traditional buyers and sellers of the commodity, and I understand that those investors' intention is to provide good returns as a hedge against inflation, asset diversification, but the effect of that activity cumulatively appears to drive up the price for some of the traditional users of the commodity markets.

Just a week ago Maine's fuel dealers were in my office saying that they believe excessive speculation by noncommercial players is once again driving up the cost of oil. That's a tremendous issue in a State where 80 percent of the families use home heating oil to stay warm.

So two questions. First, what is your general opinion on whether the influx of funds from nontraditional players is putting artificial price inflation or causing prices to go up beyond what they otherwise would, and second, what, if anything, should we do about it?

Mr. GENSLER. Two excellent questions. I do think that, looking back, in that period that you named and when oil prices peaked last summer, that a contributing factor, not the only factor because there were many factors, but a contributing factor to the commodity asset bubble was index investors and other financial investors.

We have also lived through other asset bubbles in housing, unfortunately, in the stock market in the late 1990s and then again maybe last year. So in a similar way, I think financial actors contributed to this but were not the only cause.

I do think that the Commodity Futures Trading Commission, at its core and has been for 70 plus years, one of its missions is to make sure that markets' integrity is sound, that there's not manipulation and fraud but also that the burdens of excessive speculation be guarded against through position limit authority.

So in terms of that mission, the Commodity Futures Trading Commission is not a price-setting agency, but it is an agency that has to guard to make sure that the markets are operating free of manipulation, free of fraud, and that through the position limit au-

thority the Congress first granted back in the 1930s, that there's some limit to the actors within the marketplace.

Senator COLLINS. Thank you.

Senator DURBIN. Senator Tester.

Senator TESTER. Thank you, Mr. Chairman, and thank you for those questions, Senator Collins.

I've just got a follow-up that goes right under her question and that is, do you think the marketplace right now is being impacted by—I'm talking about the oil marketplace is being impacted by trading of nontraditional traders?

Mr. GENSLER. Senator Tester, again I've only just been in the job for 6 days and mostly been preparing for this Appropriations hearing and a hearing for Thursday on other matters, so I haven't formed a view.

I do think that, just as the asset bubble broke last year with this financial crisis, that part of what we're seeing is with some confidence coming back in the stock market and in other investment markets, just as Senator Collins mentioned, some investments of firms and others are having more confidence in the value in the commodities marketplace.

But again, I've only been there 6 days and haven't, you know, been able to meet with economists and sort through the specifics of this market.

It is likely that, as economy—if we're able to get out of this recession and get away from the financial crisis, the commodity prices will move and I'm not saying where, but a lot will change in the economy, as well.

Senator TESTER. Being a farmer, I don't mind having commodity prices go up. I can tell you that the price of gasoline at the pump in Montana over the last 6 weeks has probably went up a buck a gallon. I don't see that kind of increase at the barrel level. I can still hear about ships floating around out in the ocean full of oil.

I can't make any sense of what's going on and what further frustrates me is that last year, during the last Congress, we had people in, and you're right, it was a multifaceted thing, but very, very few people would step up to the plate last year and say part of this—a good part of this is caused by speculation in the marketplace.

It was all supply and demand, supply and demand, supply and demand, and that was part of it, but I think a good part of it was just flat speculation and greed.

Mr. GENSLER. Senator Tester, as I just mentioned to Senator Collins before you arrived, I believe that index investors, hedge funds, and other pension and financial investors were a contributing factor in this asset bubble of last year. I just haven't been able to tease out exactly what's happened in my first 6 days.

Senator TESTER. I look forward to further communication, either in committee or outside the committee, on that issue because I think it's really important. I think it's really important that we make sure that we have honest markets here.

Mr. GENSLER. I fully agree with that.

MERGER

Senator TESTER. Okay. I asked a question to Secretary Schapiro about the discussions of future roles of your agency and the SEC

as we conduct a regulatory modernization effort, if they were combined, if CFTC were combined with SEC.

Can you just tell me some of the challenges, opportunities, possible consequences?

Mr. GENSLER. You said if.

Senator TESTER. That's right.

Mr. GENSLER. Well, thank you for your question, Senator. I think whether it's in Government or in commerce, it's important to consider that a merger just for merger's sake is probably not much reason to do that, whether it's in Government or in commerce.

Senator TESTER. Yeah.

Mr. GENSLER. I think some of the challenge is that each of these agencies, agencies that date back to the 1930s, have a mission to protect against fraud manipulation but with different missions.

At the CFTC, its core was around farmers and ranchers, which you know a great deal about, to protect their markets so they can hedge a risk, buy the seed and plant a crop knowing that the market pricing mechanism is honest.

That's at the core of the CFTC and if, for any reason, Congress and the President working together wanted to merge these agencies, which again I'm saying merger for merger's sake probably isn't it, we'd have to really protect that root mission, that we're protecting the pricing mechanism for farmers, ranchers, commercial users, all the users of the futures and derivatives marketplaces that the CFTC oversees.

Senator TESTER. Okay. If the President's working group recommends combining the two agencies, if again, and you believe that they should be separated, would you support the working group's regulatory modernization proposal?

Mr. GENSLER. I chair an independent regulatory agency. My responsibility, I think, to the American public would be to tell you what I believed at that time. So I think I would speak out openly and share with this subcommittee and the rest of the Congress what I thought.

DERIVATIVES REGULATION

Senator TESTER. All right. Good. Derivatives. You've been involved in a conversation on regulating or deregulating derivatives for over a decade in past positions that you've held.

Could you give me a quick synopsis, because I'm already out of time, on how your opinion of derivatives and the regulation has evolved over the last 5 to 10 years?

Mr. GENSLER. It has evolved, Senator. I think now that we must bring under regulation the over-the-counter derivatives marketplace through two complementary schemes.

One is the dealers or institutions that actually deal in these swaps, if I may call them, and that's nearly 100 percent of the market, probably in 20 or 25 big institutions. We know their names and you're familiar with them.

We should police for fraud manipulation. We should get 100 percent of the record, both for standardized and customized swaps and set capital standards at the Federal level and margin requirements through the dealer side.

But, in addition, in an additive way, also regulate the markets and then we can lower risk, we can lower risk if we have standard products go through central clearing and we can promote transparency and this is critical that we promote transparency through having regulated exchanges, as well.

Senator TESTER. Okay. Thank you very much, Mr. Chairman.

Senator DURBIN. Chairman Gensler, as you look at the volume of work that you're faced with, the new responsibilities, what do you think is the—let me state it this way.

What would you recommend as the optimal number of people that you need in your agency to do that job effectively?

Mr. GENSLER. Under the current authorities, because, of course, we'll work together with Congress and with the rest of the administration on new authorities,—thank you, Senator Tester.

Under the current authorities, the agency put forward, as Senator Collins said, an appeal letter in February that was speaking to—I think it was about 650 full-time people under that $177 million.

I don't know yet, again through just 6 days, whether that's going to allow us to fully cover, but I agree with Acting Chairman Dunn that it's more toward that number of people and it may be as high as some figures I've seen inside that are a little higher than that, closer to the 700-person figure.

ENFORCEMENT PENALTIES: AMOUNT, RECOVERY AND DETERRENCE

Senator DURBIN. When Chairman Schapiro was here, I noted that the fees collected by her agency within the marketplace generated about 40 percent more than the annual appropriation for her agency.

Similarly, in your situation, the penalties that have been assessed for wrong-doing and the amounts collected, I've seen varying estimates of this amount, but they appear to be over the last 8 years somewhere between $1.5 and $2 billion your annual appropriation, for last year $146 million, in comparison there.

So could you say to me, I mean, or could we say to those who are observing this hearing that when your agency does its job and ends up with a trustworthy marketplace, it also is engaged in enforcement actions which bring in more revenue than the actual budget of the agency?

Mr. GENSLER. I think, Mr. Chairman, that the agency—we could say to those looking at this is a sound investment of a $160 million for the next year of taxpayer money because in helping police these markets, enforcing these markets, bringing integrity to the markets, making sure that they're fairly priced in the marketplace is the crucial thing.

But in addition, you're right, there are enforcement actions that have penalties. The penalties are at least greater than the budget. The collections tend to be a little less than that, as you know.

Senator DURBIN. How well is the CFTC able to measure the deterrent impact of these enforcement actions?

Mr. GENSLER. It's a challenge to measure the results, but we believe that the stronger we are in enforcement, just as Chairman Schapiro said, in finding some of those cases that you can really

bring the wrong-doers to bear is critical to make sure that the markets operate better.

Senator DURBIN. What is your recovery rate?

Mr. GENSLER. As I understand it, the collections on the large manipulation cases are very high. The collection on the Ponzi schemes and fraud cases, unfortunately, is very low because so often those individuals behind those cases don't have any money, but I believe it's somewhere in the 30 to 40 percent when you average out high recoveries on complex manipulations and low recoveries on these Ponzi schemes.

Senator DURBIN. I'd like your thoughts, and maybe you can share them with me in separate communication, about whether the current penalty structure is in fact at a level consistent with creating a deterrent and what additional remedies or instruments you may need for that recovery rate to improve, and I understand that, as you said, some recovery is going to be extremely difficult.

But if you would take a step back and look at those two aspects, the deterrence and recovery, and give us your thoughts on that, I would appreciate that very much.

Mr. GENSLER. We will follow up with you, Mr. Chairman.

Senator DURBIN. Thank you.

Senator Collins.

DERIVATIVES REGULATION

Senator COLLINS. Thank you, Mr. Chairman.

Just two final questions from me. Senator Levin and I have introduced a bill that would repeal the language that prohibits the Commodity Futures Trading Commission from regulating derivatives, and I understand that the administration's new proposal would give both the SEC and the CFTC new authority to regulate derivatives.

What are your thoughts on this plan and the role of the CFTC in the regulation of derivatives?

Mr. GENSLER. I wish to applaud you and Senator Levin on that bill. I believe that we have to have, working with Congress, significant amendments to the Commodities and Exchange Act and seeking the same goal, to bring all the over-the-counter derivatives marketplace under regulation.

I think the Commodity Futures Trading Commission has the lead expertise on derivatives. Futures are a form of derivatives and these things that are now called over-the-counter swaps are another form of derivatives.

Working with Chair Schapiro, I'm hopeful that we can present a unified front and, as she said, you know, there's the boundary issues are important.

I think it's critical that we not have any gaps in regulation, but we believe at the CFTC and I believe interest rate swaps, currency swaps, commodity swaps, equity swaps, credit default swaps and any swaps invented in the future that are just a blip on the radar need to come under this regulatory regime.

There may be areas where a swap is more security-like, like a single issuer credit default swap, where, of course, we need multi-agency work, insider trading and SEC, you would want very much involved in things like that.

Senator COLLINS. Actually, I would argue that the credit default swaps were more like an insurance product and yet they were not regulated by State insurance agencies either.

Mr. GENSLER. They had many insurance attributes. There were many lessons, unfortunately, out of this crisis. You were earlier asking Chair Schapiro, but I think one of the great lessons of AIG was that there was unregulated institutions. That's why I am for regulating all derivative dealers, whether they're affiliated with banks or not.

But then these products, as you say, credit default swaps, have attributes of insurance, like monoline insurance. They have attributes of securities.

Senator COLLINS. Exactly.

Mr. GENSLER. They have attributes of derivatives that the CFTC is the expert on.

Senator COLLINS. Which is why we need this council of regulators approach because the problem now is the marketplace is always going to be innovating and we want it to be innovative and producing new kinds of products and we need a system where just because a product is new does not mean that it falls into a regulatory black hole and no regulator ends up having responsibility and no regulator or regulators is looking at the impact across the financial system.

When you think of a credit default swaps situation, here we have a new product that grows into the trillions of dollars, jeopardizes the entire financial market, and yet it doesn't fall under securities, it doesn't fall under insurance, it doesn't fall under the Consumer Product Safety—I mean the Commodity Futures Trading Commission. So clearly, we need to resolve that.

Let me just turn to another loophole that our hearings took a look at and that's the so-called swaps loophole that allows financial institutions to evade position limits on commodity contracts that regulators are using to prevent unwarranted price swings or attempts at manipulation.

What should be done to close that loophole?

Mr. GENSLER. I think that explicit authority should be given to the Federal regulators, with the CFTC taking the lead on position limits, to bring the over-the-counter derivatives marketplace under a regulatory regime: that we regulate all of the dealers to make sure that they are not manipulating, that we're policing fraud, that we're policing position limits, aggregate position limits, as I referred to earlier, that we, amongst the regulators, have an enormous opportunity to see 100 percent of the transactions.

INTERNATIONAL

Senator COLLINS. Finally, do you have sufficient funds to pursue your international responsibilities?

What I'm thinking of is there is a problem with foreign exchanges and what rules they're going to play by, particularly if they're dealing with U.S. commodities which they are, and particularly when they have a presence in the United States.

I don't know whether that's an issue you've looked at yet, but the SEC seems to be far more active in that area than the CFTC is.

Mr. GENSLER. Well, Senator, you're right that we've had to make as an agency tough trade-offs, an agency that shrunk 20 percent in the last years, but thankfully with this year we'll start to move back.

There's a small Office of International Effort but it's very small, I think four or five people at the CFTC. We do share your concern and share the view that we have to make sure that foreign boards of trades that are influencing these markets and are in our markets have consistent regulation, come under the position limits and other authorities here.

Though the CFTC has moved forward in this regard, we do think that it's important to work with Congress to embed in statutes some additional authorities with regard to foreign boards of trade.

Senator COLLINS. Thank you. Thank you, Mr. Chairman.

Senator DURBIN. Thank you, Senator Collins.

ADDITIONAL COMMITTEE QUESTIONS

Chairman Gensler, thanks for your testimony. We're going to keep the hearing record open until next Wednesday, June 10, at 12 noon for subcommittee members to submit statements and/or questions, and we ask that the information we requested you do your best to comply with at a convenient time.

[The following questions were not asked at the hearing, but were submitted to the Commission for response subsequent to the hearing:]

QUESTIONS SUBMITTED BY SENATOR RICHARD J. DURBIN

MOST SERIOUS MANAGEMENT CHALLENGES IDENTIFIED BY INSPECTOR GENERAL

Question. The Reports Consolidation Act of 2000 requires the Inspector General to summarize the "most serious" management and performance challenges facing the Commodity Futures Trading Commission (CFTC). In the Inspector General's assessment report of November 14, 2008, the Inspector General identified two management challenges for fiscal year 2009.

The first concern is with the Modernization of Electronic Market Surveillance. The Inspector General explains that while market surveillance has always been an integral part of CFTC operations, the past years have witnesses the transformation of futures trading from an open outcry trading floor based system to an electronic system. In fact, in 2008, electronic trading accounted for 84 percent of total exchange traded derivatives.

The second area is the Efficient Acquisition and Integration of Skilled Human Capital. The Inspector General cites the fact that recent economic turbulence has simulated an interest in applying the historically successful centralized clearing mechanism to the bilateral and complex swap markets. The Inspector General expressed skepticism that the CFTC currently has the human capital to monitor these complex markets and that situation may demand review of existing hiring procedures.

Chairman Gensler, have you had an opportunity to review the Inspector General's analysis?

What is your reaction?

What is your plan for prioritizing these two key items in your management agenda?

Answer. Yes, certainly the need to modernize electronic market surveillance will require additional technological capabilities. It is also apparent that if the Congress entrusts the Commission with significant additional responsibilities, the Commission will need to expand its staff and pay particular attention to needed skill sets. The Congress provided the Commission with substantial additional funds for fiscal year 2009. At this point we have almost completed hiring the new staff funded for this year. I asked the staff to provide the following information on the modernization of electronic market surveillance:

In late 2008, the CFTC contracted with the Promontory Group to review the market surveillance program. Commission staff is finalizing its assessment of the Promontory report and preparing recommendations for the Commission. The objective is to ensure that the CFTC has an effective approach to surveillance, from both a programmatic and operational perspective.

The CFTC also is in the process of modernizing its trade surveillance system in order to perform its statutorily mandated oversight functions and to keep pace with the explosive growth in electronic trading. In 2007, the CFTC's Division of Market Oversight ("DMO") and Office of Information and Technology Services ("OITS") embarked on a multi-year plan to develop a new trade surveillance system ("TSS"), to replace the Commission's antiquated system. TSS is designed as a database of exchange data maintained by the Commission which can be evaluated with off-the-shelf alert and analysis tools. A contract was awarded to Actimize in 2008 to deliver such a product. OITS expects to have all of the exchanges connected to the Actimize tool by the end of the first quarter 2010.

A challenge to the Commission in implementing TSS has been a lack of data uniformity. To resolve this problem, in May 2007, DMO formed a subcommittee through the Joint Compliance Committee to discuss and formulate a plan for using "FIXML" as a standardized format for trade data submitted to the Commission and to formulate a FIXML transition plan. In December of 2008, a schedule was presented to all exchanges for submission of trade data in FIXML by the end of 2009.

The Commission has also been working to better link its trade surveillance and market surveillance systems. Currently, the Commission is unable to connect accounts identified by large traders with their intra-day transactions. To resolve this problem, the Commission has issued an advanced notice of proposed rulemaking to solicit comments on the collection of account ownership and control information from exchanges. Such information would be used to improve DMO surveillance by serving as an adjunct to the CFTC's ISS (large trader position data) and TSS databases.

ADEQUACY OF FUNDING TO PERMIT PAY PARITY

Question. In response to the 1980s banking crisis, Congress passed the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) (Public Law 101–73) which provided for pay parity among federal financial regulatory agencies.

The Commodity Futures Trading Commission was granted comparable pay authority (Public Law 107–171) with other financial agencies to level the playing field with a goal of attracting the best and brightest talent. Despite the authorization, the CFTC has not been fully funded to the level of comparable agencies covered under the law.

During recent years, the Commodity Futures Trading Commission's budget situation has resulted in hiring freezes and has not permitted a meaningful review by the IG to determine its effect on employee retention and whether new hires are appreciably more experienced or better qualified.

Chairman Gensler, what has been the practical impact of the CFTC's not having sufficient annual budget authority to accomplish pay parity for your workforce?

Answer. The Commission is currently near pay parity with the other FIRREA agencies with regard to pay, having implemented merit pay and new pay ranges. There are several areas where we need to align the Commission with the FIRREA agencies; these include personnel benefits and possibly some job reclassification.

The implementation of pay parity without sufficient budget authority has had the same practical effect as meeting all other resources challenges without sufficient budget authority—the Commission froze and/or restricted hiring and deferred investment in Information Technology. These steps were taken after exhausting all other savings from administrative efficiencies.

Question. To what extent has the CFTC's inability to compensate staff at comparable levels led to departures of experienced personnel to positions in other Federal financial regulatory agencies?

Answer. Since the Commission is currently comparable with other FIRREA agencies with regard to pay, and nearly comparable with regard to benefits, the Commission is no longer losing, as it once did, a significant number of staff to other financial regulatory agencies as a result of inadequate compensation. However, those past losses tell us it is important that the Commission maintain comparability with these agencies.

Question. What funding level would permit the CFTC to move toward providing pay parity?

Answer. The fiscal year 2010 budget includes approximately $1.4 million that would permit the Commission increased contribution to personnel benefits package thereby making it more comparable to FIRREA agencies. Funding would also permit

the Commission to reclassify selected positions if an ongoing review concludes that is appropriate to support parity and to improve recruitment and retention.

Question. As CFTC Chairman, what are your goals in this area?

Answer. As a new Chairman I look forward to reviewing the findings and recommendations of the Commission Pay Parity Governance Committee before advancing any new goals of my own. However, I am committed to ensuring that the Commission receives adequate funding to stay comparable with our fellow financial regulatory agencies.

Question. When does the CFTC plan to institute a student loan repayment program as a recruitment and retention tool?

Answer. Our goal is to implement a student loan repayment program by the end of the year.

Question. What resources would that require?

Answer. We have initially set aside $200,000 for the implementation of this program.

DERIVATIVES MARKET REGULATORY REFORM

Question. Derivatives—contracts between two investors betting on whether a stock, bond, or other security will go up or down in value—has ballooned into the world's largest trading market, estimated to be in the tens of trillions of dollars. Much of the activity is not currently under a regulatory apparatus.

This market has also helped catalyze the current economic crisis. Losses on one type of derivative known as credit-default swaps helped topple American International Group (AIG), prompting a government bailout that has grown to $180 billion.

On May 13, President Obama unveiled a plan to regulate the derivatives market. This proposal includes new rules to restrict banks, hedge funds, and other investors, and has four goals: (1) force the trade of most derivatives through a regulated clearinghouse and require traders to report activities and hold a minimal level of capital to cover losses; (2) improve oversight by ensuring clearinghouses and firms dealing in derivatives provide copious information to regulators about their trades; (3) empower regulators to force traders to submit detailed information and pursue cases of fraud and manipulation; and (4) prevent derivatives from being marketed to groups that may not understand their complexities.

How would expanded derivatives regulation impact the CFTC workload? What budgetary considerations need to be considered?

Answer. We must establish a comprehensive regulatory regime to cover the entire over-the-counter derivatives marketplace. This will help the American public by: (1) lowering systemic risk; (2) providing transparency and efficiency in markets: (3) ensuring market integrity by preventing fraud, manipulation, and other abuses; and (4) protecting the retail public. I envision this will require two complementary regimes—one for regulation of the dealers and one for regulation of the market functions.

The Department of the Treasury, on behalf of the Administration, has submitted legislation to Congress to regulate the over-the-counter (OTC) markets. Although some improvements are appropriate to ensure that we best meet the goals stated above, the Administration's comprehensive proposal is consistent with regulatory reforms that the CFTC has proposed in testimony to Congress. The Administration's proposal will lower risk by requiring capital and margin on dealers and mandatory clearing of all standardized products. It will enhance market integrity by protecting against fraud, manipulation, and other abuses and establishing new authorities to set aggregate position limits. It will promote transparency and market efficiency by requiring recordkeeping and reporting for all derivatives and requiring that standardized derivatives be traded on transparent trading platforms.

Of course there would be a need for some additional resources at the CFTC to handle this expanded regulatory obligation. Until the nature and scope of the regulation of OTC derivatives markets is determined by the Congress, the resources necessary for implementation cannot be predicted with certainty.

Whatever the cost of regulation, it will pale in comparison to the cost of doing nothing. If the current financial crisis has taught us anything, it is that that the derivatives trading activities of a single firm can threaten the entire financial system. The costs to the public from the failure of these firms has been staggering, $180 billion of American taxpayer financial support for AIG alone. The AIG subsidiary that dealt in derivatives was not subject to any effective federal regulation.

MEMORANDUM OF UNDERSTANDING BETWEEN CFTC AND SEC

Question. Last year (March 11, 2008), then-Commodity Futures Trading Commission (CFTC) Acting Chairman Walter Lukken and then-Securities and Exchange Commission (SEC) Chairman Christopher Cox entered into a formal "Memorandum of Understanding" (MOU) setting forth several principles designed to guide interagency collaboration. The premise of this agreement was to seal some of the regulatory gaps and better accommodate new products that blur the lines between the futures and the securities worlds.

The MOU establishes a permanent regulatory liaison between the CFTC and SEC; requires quarterly joint meetings of staff; sets up a framework for extensive information sharing and exchange confirms existing enforcement policies; creates guidelines for new financial products that combine elements of securities, futures, or options; and addresses jurisdictional overlaps.

Chairman Gensler, can you describe some of the benefits to the CFTC since entering into the MOU with the SEC in March 2008?

Answer. The MOU has provided a formal mechanism to assure dialogue among senior staff of the two agencies regarding the treatment of novel derivative products and other issues of mutual regulatory interest. In addition, following on the MOU, the CFTC and SEC Divisions of Enforcement undertook efforts to improve coordination and cooperation. Specifically, in the summer of 2008, the CFTC and SEC Divisions of Enforcement appointed senior staff to serve as liaisons for their respective agencies, and also established quarterly meetings to discuss issues related to investigation and litigation dockets for matters of common concern. The enhanced cooperation between the CFTC and SEC Divisions of Enforcement is also reflected in the May 2009 joint training session for enforcement staff in which experts from both agencies discussed strategies regarding the agencies' coordination, investigation and prosecution of several recent Ponzi fraud matters.

Question. What impediments hinder CFTC's ability to oversee and regulate new products that have mixed characteristics of futures and securities?

Answer. Neither the CFTC nor the SEC currently has regulatory jurisdiction with respect to OTC derivatives transactions, some of which are relevant to both the futures and the securities markets. In areas where jurisdiction does exist, further enhanced communication between the CFTC and SEC staff—specifically, ongoing communications regarding whether activity detected by one agency implicates the jurisdiction of the other agency—will improve the CFTC's ability to oversee and regulate such new products.

Question. How do intend to collaborate with SEC Chairman Schapiro in advancing the goals of this MOU?

Answer. In addition to direct communications with Chairman Schapiro, as we have done in discussing regulatory reform with respect to OTC derivatives, I anticipate that Chairman Schapiro and I will actively direct and guide our respective staffs to fulfill the objectives of the MOU. We will work cooperatively and collaboratively to remove unnecessary duplication and other regulatory roadblocks to innovative market developments, while assuring that there are no regulatory gaps that endanger the public interest. The agencies' focus on this goal is currently reflected in our joint harmonization project, including the unprecedented joint meetings recently held by our two Commissions.

Question. Do you envision the need for any modifications to the agreement to strengthen the current interagency relationship?

Answer. The MOU was intended to be a "living" document. Just as the agencies have entered into an Addendum to the MOU with respect to novel derivative products, additional Addenda may be considered as the agencies address new issues and harmonization on a going-forward basis.

ENFORCEMENT ACTIONS TO PRESERVE MARKET INTEGRITY AND PROTECT MARKET USERS

Question. Detecting and deterring against illegitimate market forces requires CFTC's steady vigilance and swift response. Over the past 8 years, CFTC has assessed over $2 billion in civil penalties against perpetrators of various fraud schemes. For instance:

—To address manipulation, attempted manipulation, and false reporting in the energy arena, the CFTC filed 43 enforcement actions against 73 entities or individuals in the December 2001 to September 2008 period resulting in $445.5 million in assessed civil penalties.

—To address misconduct in connection with commodity pools and hedge funds by unscrupulous and unregistered operators and advisors, from October 2000 and September 2008, the CFTC filed 73 enforcement actions against 24 entities, with $564.13 million in penalties assessed.

—To combat the problem of foreign currency (forex) fraud, between December 2000 and September 2008, on behalf of nearly 26,000 affected customers, the CFTC has filed 98 enforcement actions, charging 374 entities or persons, culminating in over $562 million in civil monetary penalties and $454 million in restitution.

How well is the CFTC able to measure the deterrent effect of these enforcement actions?

Answer. Measuring the deterrence effect of enforcement actions remains a challenge to the CFTC and other law enforcement agencies. The CFTC has undertaken a number of actions to increase deterrence as noted below by staff:

—The CFTC maximizes the deterrent effect of its enforcement program through: the filing of enforcement actions, cooperative enforcement, public outreach and investor education. In cases of ongoing fraud, the CFTC's objective is to bring its enforcement action as quickly as practicable in order to stop the fraud, freeze assets, and preserve books and records. The CFTC also leverages the impact of its enforcement actions by working cooperatively with federal and state criminal and civil authorities who often bring their own actions based upon the conduct that violates the Commodity Exchange Act and CFTC Regulations. Whenever the CFTC files an enforcement action and obtains a final judgment in one of its enforcement actions, it publicizes these events through press releases and media interviews. To alert market users and the public to the dangers of fraud, the CFTC has issued a number of Consumer Advisories warning the investing public of potential risks and scams, and has posted these Advisories on its website. The CFTC also seeks to maximize the deterrent effect of its enforcement program by tracking industry trends. For example, the CFTC's Acting Director of Enforcement gave Congressional testimony in June 2009 regarding the observed uptick in fraud involving solicitation of retail customers for purported off-exchange transactions in precious metals, and certain energy and agricultural products. The fraudsters appear to have drafted customer agreements to make them appear to be spot contracts outside of CFTC jurisdiction and not futures contracts covered by the Commodity Exchange Act.

—The CFTC remains committed to developing improved performance measures to reflect the deterrence effect of its enforcement program. For example, the CFTC has requested funds every year since the fiscal year 2007 OMB budget request thru fiscal year 2010, to study the performance measurement issue, however, funds, to date, have not been approved.

Question. How rapidly are you able to collect restitution, disgorgement of ill-gotten gains, and civil monetary penalties imposed against violations of the federal commodities laws?

Answer. When the CFTC files enforcement actions that include allegations of fraud, its general practice is to seek a statutory restraining order to immediately freeze the defendants' known assets, including trading and bank accounts, homes and other real property and cars. These assets are then preserved for purposes of customer restitution or disgorgement at the conclusion of a successful prosecution. The CFTC Division of Enforcement may also request that the federal district court order defendants to make an accounting, which assists the CFTC in tracking money flows and identifying additional assets for recovery. The CFTC also names as relief defendants in its enforcement actions persons known to have received funds derived from the fraud and to which they have no legitimate claim, and seeks to freeze and recover these funds for return to customers as well. At the conclusion of litigation, and in the event of a remaining judgment, the Commission follows an established protocol to ensure that matters are appropriately referred to the Department of Justice and Department of the Treasury for collection.

Question. What is the annual recovery rate?

Answer. Staff has supplied the following information:

Below is a table that sets out the CFTC's annual recovery rate for civil monetary penalties assessed for fiscal years 1992 through 2008.

CIVIL MONETARY PENALTIES [1]

[Fiscal year 1992-fiscal year 2008]

Fiscal year	Penalties imposed	Penalties collected
1992	$3,207,277	$2,285,664
1993	3,313,100	3,514,715
1994	4,112,407	3,134,266
1995	11,201,100	9,430,239
1996	1,335,000	1,526,000

CIVIL MONETARY PENALTIES [1]—Continued

[Fiscal year 1992-fiscal year 2008]

Fiscal year	Penalties imposed	Penalties collected
1997	4,532,000	1,752,636
1998	132,623,756	125,803,781
1999	85,863,311	22,165,368
2000	179,811,562	3,299,362
2001	16,876,335	3,170,252
2002	9,942,382	5,922,387
2003	110,264,932	87,699,077
2004	302,049,939	122,468,925
2005	76,672,758	34,163,077
2006	192,921,794	12,364,509
2007	345,614,139	12,137,848
2008	234,835,121	140,745,252

[1] The discrepancy between the amount of civil penalties imposed and the amount collected is accounted for by the following factors: (1) when courts order the defendants to both pay restitution to victims and a civil monetary penalty to the Government, established Commission policy directs available funds to satisfy restitution obligations first; (2) in fraud actions, it is not uncommon that the proceeds of the fraud have been dissipated and/or that the penalty far exceeds the defendants' represented financial ability to pay; (3) delinquencies assessed in default proceedings against respondents who are no longer in business and who cannot be located or are incarcerated; (4) penalties imposed in one year may not become due and payable until the next year; (5) a penalty may be stayed by appeal; (6) some penalties call for installment payments that may span more than 1 year; (7) penalties have been referred to the Attorney General for collection; and (8) collection may still be in process.

Question. What has been the impact of more sophisticated information technology to monitor and detect fraud more readily?

Answer. In the enforcement arena for fraud cases, information technology assists in asset tracing, account reconstruction, and electronic data recovery of financial records. Improvements in information technology have improved the CFTC's search capability for evidence of illegal activity involving Internet websites, instant messages, e-mail and audio.

In the regulatory arena, as discussed above, the CFTC is currently implementing its new trade practice surveillance system (TSS). TSS is designed as a database of exchange trade data maintained by the Commission upon which off-the-shelf alert and analysis tools can be connected. A contract was awarded to Actimize in 2008 to deliver an alert and analysis tool that has the capability to perform sophisticated pattern recognition and data mining to automate basic trade practice surveillance, and to detect novel and complex abusive practices. TSS also will fill a vacuum in inter-market surveillance which only the Commission can address, e.g., where NYMEX and NYSE Liffe both list metals contracts.

Question. Are there any statutory or administrative impediments that prevent the CFTC from doing more to combat fraud?

Answer. As noted above, the CFTC has observed an upswing in retail customer complaints regarding potential fraud involving off-exchange transactions in precious metals, energy products and agricultural commodities. It appears that fraudsters are drawing upon the adverse precedent of a line of cases under *CFTC* v. *Zelener*, 373 F.3d 861 (7th Cir. 2004), in which the Seventh Circuit held that certain contracts were spot transactions beyond the jurisdiction of the CFTC. Congress addressed this problem in the CFTC Reauthorization legislation included in the 2008 Farm Bill with respect to Zelener-type foreign currency transactions. A similar fix is needed if the CFTC is to effectively prosecute boiler rooms offering Zelener-type contracts in metal, energy, and other commodity contracts to retail customers (and is included in the Administration's proposed OTC derivatives reform legislation).

In addition, in the wake of the decision in *CFTC* v. *Wilshire*, 531 F.3d 1339 (11th Cir. 2008), defendants in fraud cases increasingly are asserting that federal courts lack authority under the Commodity Exchange Act to award restitution based on customer losses suffered as a result of the fraud. Wilshire held that the proper measure of restitution is the gain to the wrongdoer, rather than the losses suffered by customers. In cases where the fraudster retains only a small portion of the monies fraudulently induced from customers, this limit on restitution threatens the CFTC's ability to obtain make-whole relief for defrauded customers.

Staff advises that additional statutory measures that may increase the CFTC's ability to combat fraud include, among others, the following:

—Amendment of the Privacy Act to clarify that CFTC investigators may seek promotional material and verbal sales solicitations without identifying themselves as CFTC employees or providing personal information as to their true identity.

—In Section 4n of the Commodity Exchange Act, provide authority to require accountants to maintain records of audit activity concerning commodity pools that would be available for inspection by the CFTC.

—Clarify that the CFTC need not show criminal intent in actions based on conversion under Section 9(a)(1) of the Commodity Exchange Act.

Question. Is the current penalty structure designed to serve as an effective deterrent?

Answer. Yes. Commission staff supplies the following background:

—Section 6(e) of the Act, 7 U.S.C. § 13a–1(d), instructs the Commission to impose a civil monetary penalty that is appropriate to the gravity of the violation. Commission precedent has long recognized the importance of deterrence in preventing violations, most recently in In re DiPlacido [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶30,970 (CFTC Nov. 5, 2008) ("[g]iven the gravity of DiPlacido's offenses and potential maximum fine, the focus of the Commission's analysis shifts to assessing a specific penalty appropriate to the level of gravity and suitable to deter future violations"). Indeed, the Commission signaled the paramount role that deterrence plays when it emphasized that "[i]n imposing monetary sanctions, the primary focus of the Commission's analysis has been deterrence." In re Murlas, [1987–1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶24,440 at 35,929 (CFTC Apr. 24, 1989) (emphasis added).

—Also, in last year's CFTC Reauthorization legislation, Congress increased the maximum civil monetary penalty for manipulation, attempted manipulation, and false reporting to $1 million per violation. See Title XIII of the Food, Conservation and Energy Act of 2008, Pub. L. No. 110–246, 122 Stat. 1624 (June 18, 2008); 7 U.S.C. § 13(a).

Question. What additional remedies or authorities might be useful to boost your recovery rate?

Answer. Staff has advised that additional statutory measures that could potentially boost the CFTC's recovery rate include, among others, the following:

—Similar to provision for non-payment of penalties imposed in CFTC administrative enforcement actions (see Section 6(e)(2) of the Commodity Exchange Act), provide that a defendant's non-payment of civil monetary penalties imposed in enforcement actions in federal court shall result in the non-paying defendant automatically being prohibited from trading and automatically suspending any applicable registration until the defendant pays the full amount of the penalty, with interest to the date of the payment.

—Provide that collection of judgments and orders in fraud actions shall not be subject to State homestead exemptions or other State or local impediments to collection.

—Provide that disgorgement and restitution awarded in CFTC enforcement actions are non-dischargeable in bankruptcy.

—Add disgorgement as an available sanction in administrative enforcement proceedings.

PERFORMANCE GOALS/MEASURING OUTCOMES

Question. The Commodity Futures Trading Commission (CFTC)'s performance-based budget for fiscal year 2010 delineates four specific goals tied to the agency's overall mission. For each of the goals, several outcomes are specified.

First Goal.—Of the $160.6 million in appropriations requested for fiscal year 2010, the CFTC would designate $48.2 million (or 30 percent of the total funding) and 185 FTE to meet the first goal—to ensure the economic vitality of commodity futures and options markets.

The outcomes to be achieved as a result of the investment made related to this goal are markets that accurately reflect the forces of supply and demand for the underlying commodity, are free of disruptive activity, and are effectively and efficiently monitored to ensure early warning of potential problems or issues.

How does (or will) the CFTC measure whether and how well these outcomes are achieved?

Answer. The Commission has developed nine performance measures intended to measure progress in achieving the stated outcome objective. The performance results along with an annual performance analysis and review are included in pages 46–55 of the Fiscal Year 2008 Performance and Accountability Report available on the CFTC website at: www.cftc.gov/aboutthecftc/cftcreports.

Question. How does the CFTC intend to meet a performance goal of "no price manipulations or other disruptive activities that would cause loss of confidence or negatively affect price discovery or risk shifting"?

Answer. This goal is fundamentally tied to the Commission's mission and is a priority of the Commission market surveillance and enforcement efforts as noted by staff below:

—Continuous monitoring of market activity is the principal way the Commission seeks to protect the economic function of the markets. Effective market surveillance requires sufficient staff with expertise in each of the diverse markets under the Commission's jurisdiction. The Commission takes preventive measures to ensure that market prices accurately reflect fundamental supply and demand conditions, including the routine daily monitoring of large trader positions, futures and cash prices, price relationships, and supply and demand factors in order to detect threats of price manipulation.

—As discussed above, the CFTC maximizes the deterrent effect of its enforcement program through: the filing of enforcement actions, cooperative enforcement, public outreach and investor education. The CFTC also leverages the deterrent impact of its enforcement actions by working cooperatively with other federal criminal authorities who often bring their own actions based upon the conduct that violates the Act and CFTC Regulations.

Question. When it comes to a performance goal of "improving effectiveness and efficiency of market surveillance" what indicators will be used to determine if you have indeed reached this goal and how well? What is the baseline from which progress is to be measured?

Answer. A strategic priority of the Commission is to enhance the Commission's technological capability, improve data standards, and enhance in-house human analytical and decisionmaking capability—each in order to recognize, understand and adapt to market changes early on. Indicators of success will be progress in achieving the following tasks: upgrading ISS to get more timely market position information and to integrate trading data with position data; developing capability to provide real-time margin and settlement information; promoting data standards throughout the industry; developing and implementing sophisticated trade surveillance systems; developing automated capability to analyze and integrate off-exchange data as it relates to surveillance and investigations; developing a recruitment plan to address required skills; identifying needed competencies and developing a training plan that empowers employees to react quickly in understanding and resolving regulatory matters. Each of these tasks represents a strategic need of the Commission that is not currently being met adequately.

Question. Second Goal.—Of the $160.6 million in appropriations requested for fiscal year 2010, the CFTC would designate $42.9 million (or 27 percent of the total funding) and 160 FTE to meet the second goal—to protect market users and the public. The three outcomes to be achieved as a result of the investment made related to this goal are better detection and prevention of violations of commodities laws, high standards for professionals, and expeditions handling of customer complaints.

How does the CFTC plan to increase the probability of violators being detected and sanctioned?

Is this readily measurable?

What is the baseline against which future performance will be gauged?

Answer. Having sufficient resources to pursue violations is key to increasing the probability of violators being detected and sanctions. The Commission has developed four performance measures to assess progress in detecting violators. The performance results along with an annual performance analysis and review are included in pages 58–63 of the Fiscal Year 2008 Performance and Accountability Report available of the CFTC Web-site at: www.cftc.gov/aboutthecftc/cftcreports.

Like all enforcement programs, we face a challenge in establishing overall performance measures that indicate the percentage of violative activity deterred, since no way has yet been devised to measure the total universe of violative activity that exists. The Commission keeps extensive records on the number of investigations opened and cases filed during the year, the number and amount of sanctions obtained, as well as the number of cases filed by criminal and civil law enforcement authorities that included cooperative assistance from the Commission. However, these statistics do not measure complexity of the matters opened and filed. For example, the Commission met its performance target in fiscal year 2008 with regard to the number of enforcement investigations opened. However, commencing in 2002, the complexity of Commission investigations has increased substantially over prior years (including the Commission's investigation of alleged energy market manipulation). As a result of these investigations, the complexity of the Commission's cases filed and litigated also has increased substantially since 2002. The Commission's performance target tries to take into account both of these factors but they cannot be predicated with precision.

Question. How will the CFTC ensure there are "zero unregistered, untested, or unlicensed commodity professionals (unless they are exempt from registration)"?

Answer. There are several complementary aspects to the Commission's program that ensure compliance with registration requirements as summarized by staff below:

—*Registration and NFA Membership*.—Under Section 17 of the Commodity Exchange Act ("CEA"), the National Futures Association ("NFA") performs registration functions on behalf of the CFTC. NFA registers members through its Online Registration System ("ORS") a web-based registration and membership filing and processing system. With certain exceptions, all persons and organizations that intend to do business as futures professionals must register under the CEA. The primary purposes of registration are to screen an applicant's fitness to engage in business as a futures professional and to identify those individuals and organizations whose activities are subject to federal regulation.

In addition, all individuals and firms that wish to conduct futures-related business with the public must apply for NFA membership or associate status. Mandatory membership serves an important function: NFA Bylaw 1101 prohibits members from conducting customer business with non-NFA members.

—*Testing*.—Individuals who are applying for NFA membership as a sole proprietor FCM, IB, CPO, CTA or for registration as an AP of any of these categories must satisfy proficiency requirements. Applicants generally must have passed the National Commodity Futures Examination (NCFE or Series 3) within the 2 years preceding their application.

—*Ethics Training*.—The CFTC Statement of Acceptable Practices (see Appendix B to Part 3 of the Commission's regulations) for ethics training allows flexibility, permitting firms to tailor their training programs to best suit their particular operations. In an Interpretive Notice to its Compliance Rule 2–9, NFA states that good business practice dictates that employees receive periodic training to keep them cognizant of new developments in technology, commercial practices and regulations, and their ethical implications.

—*Oversight*.—NFA conducts ongoing audits of its registrants for compliance with NFA rules. In turn, Commission staff pursues formal and ongoing oversight of NFA's compliance and registration programs. Formal oversight activities involve periodic reviews of NFA programs and inspection of records and interviews with NFA staff.

NFA pursues statutory disqualification and other disciplinary matters through Registration, Compliance & Legal Committee ("RCLC") cases. On a quarterly basis, Commission staff meets with NFA to provide guidance on registration issues generally, and to review the past quarter's RCLC cases.

These oversight activities are designed to protect market participants and the public interest by ensuring that persons who deal with customers and those who handle customer orders and funds meet the standards for fitness and integrity established under the Commodity Exchange Act.

Question. What type of tracking system is in place to demonstrate that this outcome has been achieved?

Answer. Currently, there are more than 67,000 individuals and companies registered with the CFTC in some capacity. Although it would be impossible to track the negative (i.e., that there are unregistered individuals conducting business), through its oversight of NFA's registration program, the Commission ensures both that qualified applicants are properly registered, and that unqualified applicants (or registrants) are denied registration (or have their registration revoked). Through the quarterly meetings of the Registration Working Group involving CFTC and NFA staff, the Commission ensures that standards for such actions are applied consistently, and gives guidance when questions arise.

Question. With regard to meeting timeframes for resolution of customer complaints, how does the CFTC track disposition of complaints, proceedings, and appeals in order to show that the targets are achieved in the caseload?

Answer. The various Divisions at the CFTC (Enforcement, Clearing and Intermediary Oversight, Market Oversight, and General Counsel's Office) each operate an "officer of the day program" to receive, and address or refer, inquiries (including complaints) from members of the public. The Office of Proceedings handles and tracks the disposition of adjudicatory matters at the hearing level. With respect to adjudicatory appeals to the Commission, pending cases are maintained with the Secretariat, with monthly status reports issued by the Office of General Counsel.

Question. Third Goal.—Of the $160.6 million in appropriations requested for fiscal year 2010, the CFTC would designate $38 million (or 24 percent of the total funding) and 144 FTE to meet the third goal—to ensure market integrity in order to foster open, competitive, and financially sound markets

The outcomes to be achieved as a result of the investment made related to this goal are that clearing organizations and firms holding customer funds have sound financial practices, commodity futures and options markets are effectively self-regulated, markets are free of trade practice abuses, and the regulatory environment is flexible and responsive to evolving market conditions.

How will the CFTC work to ensure zero loss of customer funds as a result of firms' failure to adhere to regulations and ensure that no customers are prevented from transferring funds from failing firms to sound firms?

What mechanisms does the CFTC have to monitor self-regulatory organizations to ensure that no funds are lost as a result of the failure of SRPs to comply with their rules?

Answer. Again, the Commission has several complementary programs that address the protection of customer funds held by FCMs) and derivatives clearing organizations ("DCOs"). They are summarized by staff below:

—*Protection of Customer Funds—Statute and Regulations*.—The Commodity Exchange Act and Commission regulations require each FCM to segregate from its own assets all money, securities or property deposited by customers to margin or secure futures and option on futures positions traded on designated contract markets or funds that accrue to customers from these open positions. Each FCM also must set aside in accounts (i.e., "secured accounts"), separate from its proprietary accounts, sufficient funds deposited by customers trading on non-United States futures markets to meet its obligations to customers trading on foreign markets.

—*Notification*.—Commission regulations also require each FCM to perform daily calculations demonstrating compliance with the segregation and secured amount requirements. Any FCM that does not maintain sufficient funds in segregated accounts or in secured accounts, as applicable, to meet its obligations to its customers (i.e., is "under segregated") is required to provide immediate telephone notice, confirmed immediately in writing, to the Commission and to the FCM's self-regulatory organization ("SRO") that conducts financial surveillance over the firm.

—*Commission and SRO Responsive Action (Direct Examinations)*.—Upon receipt of a notice, Commission staff work with the applicable SRO to determine the facts and to assess whether the situation is a temporary under segregation that can be immediately rectified by the FCM infusing additional funds into segregated or secured accounts, or indicative of a more serious issue that may require prompt SRO or Commission action to protect customer funds. In certain situations, Commission and/or SRO staff may conduct an immediate onsite examination of the firm's books and records to assess the FCM's compliance with its financial requirements.

—*SRO Oversight*.—The Commission conducts periodic reviews of SROs' financial surveillance programs. The SROs' financial surveillance programs include routine examinations of FCMs to assess their compliance with Commission and SRO minimum financial requirements and related reporting requirements, including minimum capital requirements and compliance with the segregation and secured amount requirements. The Commission and SROs also may conduct an examination of an FCM on an exigent basis in response to an FCM filing a notice that it is not in compliance with the customer funds segregation or secured amount requirements. Experience has demonstrated that if the Commission and SROs can react promptly at the initial signs of weakness in the financial condition of an FCM, it is more certain that customer funds will be protected. In this regard, open futures and options on futures positions may be expeditiously transferred to another FCM if the FCM that is experiencing financial difficulties has properly segregated and secured customer funds.

—*Communication With SROs*.—Commission staff hold periodic meetings with the financial surveillance staff of the SROs for the purpose of discussing emerging issues and to coordinate examination procedures and policies. This includes an annual review of the detailed SRO audit programs, which are submitted to the Commission for review.

The resources requested by the Commission for the protection of customer funds would allow Commission staff to conduct more frequent assessment of the SROs' execution of their financial surveillance programs. Additional resources would also allow the Commission to conduct more frequent direct examinations of FCMs for compliance with financial and other requirements, including the segregation of customer funds.

—*Risk Surveillance Program*.—The Commission's risk surveillance and DCO review programs also serve to protect customer funds by (i) identifying traders that pose risks to firms and firms that pose risks to DCOs, and (ii) taking steps

to mitigate those risks thereby decreasing the likelihood of default. Additional resources would allow the Commission to enhance these programs.

Question. What are the advantages and disadvantages of "regulatory restructuring" from the perspective of the CFTC?

Answer. Exchange traded futures and options contracts are derivatives relied upon by the nation's businesses for price discovery and risk management. The CFTC's mission is to protect market users and the public from fraud, manipulation, and abusive practices related to the sale of commodity and financial futures and options, and to foster open, competitive, and financially sound futures and option markets. Like exchange traded futures, OTC swaps and similar transactions are derivatives. Like futures, OTC derivatives are used for risk shifting purposes. In recent years the OTC market has grown to far exceed the exchange traded market in size. Bringing OTC dealers and markets under CFTC regulatory oversight will greatly enhance the ability of the Commission to fulfill its mission and to protect the price discovery and risk shifting functions of derivatives markets. Additionally, bringing the OTC dealers and markets under federal regulation will significantly improve financial integrity and transparency, qualities that were lacking in the collapse of firms like AIG and Lehman Brothers.

Question. Fourth Goal.—Of the $160.6 million in appropriations requested for fiscal year 2010, the CFTC would designate $31.5 million (or 19 percent of the total funding) and 121 FTE to meet the first goal—to facilitate agency performance through organizational and managerial excellence, efficient use of resources, and effective mission support.

Among the outcomes to be achieved as a result of the investment made related to this goal are a productive, technically competent, competitively compensated and diverse workforce, a modern and secure information system, and an organizational infrastructure that effectively and efficiently responds to and anticipates both the routine and emergency business needs of the agency.

How does the CFTC intend to measure progress and the extent to which these outcomes have been achieved?

Answer. The Commission has developed 18 performance measures intended to measure progress in achieving the stated outcome objective. Of the 18 measures 11 results were determined to be effective, one was determined to be moderately effective, and six were determined to be adequate. The performance results along with an annual performance analysis and review are included in pages 91–110 of the Fiscal Year 2008 Performance and Accountability Report available of the CFTC Website at: www.cftc.gov/aboutthecftc/cftcreports.

QUESTION SUBMITTED BY SENATOR SUSAN COLLINS

Question. Excessive speculation in the commodities market is prohibited under CFTC's statutes. However, determining what constitutes excessive speculation is a thorny question. Last year, as oil and other commodities skyrocketed on the futures market, many in Congress became concerned that these market prices were more reflective of the activity of speculators than commercial interests in the underlying product. Last year, under the leadership of Chairman Lukken, the CFTC stated that despite the rapid increase in prices, the data did not reflect manipulation by speculators. Critics, however, contend that in this arena, the CFTC is simply outmatched. It lacks the manpower and resources to effectively collect the large volume of data in the commodities markets and to effectively analyze that data. Do you believe the CFTC needs more resources to gather relevant data and effectively analyze it to better understand the role and the effects of speculators?

Answer. The Commission examines markets by studying the behavior of commercial and non-commercial traders. In determining the status of traders, the Commission has traditionally accepted their self-classification. The Commission has begun to examine trader patterns to ascertain the general accuracy of these classifications. Commission assessments of the self-classifications are staff intensive and in order to accomplish them expeditiously and on a sustained basis, additional resources will be required.

On another front the Commission relies on market positions information that is updated daily. Without intraday position information, the Commission cannot examine any price effect occurring on the same day as a position change. This problem could be addressed were position information available throughout the trading day. Obtaining and processing such information will require additional resources for both staff and data processing capacity.

SUBCOMMITTEE RECESS

Senator DURBIN. Thank you very much for coming in.

Mr. GENSLER. Thank you, Mr. Chairman, Ranking Member Collins. Thank you so much.

Senator DURBIN. Thank you very much.

The subcommittee hearing is hereby recessed.

[Whereupon, at 12:27 p.m., Tuesday, June 2, the subcommittee was recessed, to reconvene subject to the call of the Chair.]

FINANCIAL SERVICES AND GENERAL GOVERNMENT APPROPRIATIONS FOR FISCAL YEAR 2010

TUESDAY, JUNE 9, 2009

U.S. SENATE,
SUBCOMMITTEE OF THE COMMITTEE ON APPROPRIATIONS,
Washington, DC.

The subcommittee met at 10:30 a.m., in room SD–138, Dirksen Senate Office Building, Hon. Richard J. Durbin (chairman) presiding.

Present: Senators Durbin, Lautenberg, Nelson, Tester, Collins, and Bond.

DEPARTMENT OF THE TREASURY

OFFICE OF THE SECRETARY

STATEMENT OF HON. TIMOTHY F. GEITHNER, SECRETARY

OPENING STATEMENT OF SENATOR RICHARD J. DURBIN

Senator DURBIN. Good morning. My apologies. I was on the floor, defending the administration, that's all I can say. To my colleagues, I apologize.

Please convene this hearing to examine the fiscal year 2010 funding request of the Department of the Treasury, including the Internal Revenue Service (IRS). Mr. Secretary, thank you for joining Senator Collins and my other colleagues this morning. We know that IRS Commissioner, Doug Shulman, is also here and prepared to testify.

And I am going to waive the remainder of my opening statement, in the interest of time, and to allow my colleagues to say few words so that we can catch up with the schedule.

Senator Collins.

STATEMENT OF SENATOR SUSAN COLLINS

Senator COLLINS. Thank you, Mr. Chairman. Secretary Geithner, Commissioner Shulman, I am very pleased to welcome you to this hearing and I thank you for your service to our Nation.

Mr. Secretary, you have so many challenging responsibilities that it's difficult to know where to begin. You're responsible for reinvigorating bank lending to consumers and small businesses, stabilizing the housing markets, overseeing the automobile industry and encouraging sustainable economic growth. Most important, you must try to protect American taxpayers and their investments and pro-

mote the long-term financial security of the United States at a time of unprecedented debt.

The current financial crisis is rooted in a tangled web of high-risk financial instruments backed by high-risk loans, issued by high-risk individuals. To emerge from this crisis and to overcome its effects, we must restore trust in our Nation's financial institutions and financial markets. And, in my view, that will require significant reforms in our system of financial regulation, an issue that I want to discuss with you today.

Several developments are shaking American's trust in the economy. First among these is the dangerous increase in our Nation's long-term debt. While I supported the short-term fiscal stimulus as necessary to get our economy back on track, I am troubled that the President's budget proposes to double the debt in 5 years and triple it in 10. I am concerned that the long-term debt proposed by this administration poses a threat to the sustainability of our economy. Where will the money come from to pay these debts? China, where you have recently visited? Saudi Arabia? Sovereign wealth funds? Will this public debt crowd out private investment and slow the recovery? Who ultimately will pay for this—our children and our grandchildren? We need to assess what we're doing to our country's long-term financial health.

Finally, Mr. Secretary, I remain very concerned, as I indicated to you in our conversation yesterday, about the management accountability and transparency of the troubled asset relief program (TARP) fund. Originally, TARP was envisioned as a fund to prevent our largest banks and financial institutions from failing and to increase liquidity in our credit markets. Today, however, TARP encompasses 12 different programs, not just for banks but also for insurance companies and automobile manufacturers, and involves Government funds combined with private funds adding up to almost $3 trillion.

It is disturbing to me that we really cannot assess what impact TARP funds has had on recipients, and whether TARP has truly increased lending. And the Treasury Department has yet to articulate how it will measure whether this injection of capital has been an effective use of taxpayer dollars. I am concerned that we're being asked simply to trust that this large infusion of capital into the economy will lift us out of a severe financial crisis, whose complex origins are still being untangled.

Secretary Geithner and Commissioner Shulman, you both face great challenges in managing the Federal Government's finances and attempting to reinvigorate our economy. These truly are extraordinary times. I pledge to work very closely with you, as well as with our chairman, to make sure that you have the staff, the authority, and the resources that you need to serve the American people.

Thank you, Mr. Chairman.

Senator DURBIN. Thank you, Senator Collins. I am going to invite my colleagues to make brief opening statements.

And Senator Lautenberg, I recognize you.

STATEMENT OF SENATOR FRANK R. LAUTENBERG

Senator LAUTENBERG. Thanks very much Mr. Chairman. Greetings Mr. Geithner, Secretary Geithner. You've taken on a formidable task and, so far, I think that the score in the ball game is going your way, but we are quite a distance from the ninth inning.

As we meet today, the economy is slowly beginning to show signs of a possible recovery and the challenges still remain. This recovery will require strong reforms to place our financial system on a firm footing. We've got to give the regulators the tools that they need to predict and prevent financial crisis.

And we've got to change corporate culture. That says, the people, the leadership at the top, can often take its compensation without regard for what happens with the employees or the future investing for the well-being of the company and taxpayers.

I am still on the board of the Columbia Business School and some time ago I gave them the chair, I was out of the Senate for a couple years, I took a hiatus, and what I proposed was that salaries at the top be related to salaries at the bottom. And instead of letting the ratio slip as it has, from 40 times typically in the eighties, to 400 times recently at times, and also—and I don't know, Mr. Secretary, what kind of latitude you have or what kind of authority you have to suggest conduct in the CEOs office. But one of the things I think we have to look at while we change this corporate culture is to make it clear that, when an executive retires, that the reward ought to be, my view, in the performance of the company after the leader leaves. And the bonuses should be expanded as time goes by, and not simply related to the stock price. Because stock price may be at the expense of investing in the future of the business.

Anyway, we're glad to see you here and urge you to carry on and work hard. Thank you.

Senator DURBIN. Senator Nelson.

STATEMENT OF SENATOR BEN NELSON

Senator NELSON. Thank you, Mr. Chairman. Secretary, we are glad you're here. We appreciate the efforts that you are providing and that the progress that we hope will come will, in fact, come.

When I go home, I have people come to me complaining about the bailouts, complaining about TARP, complaining about putting the auto industry into bankruptcy and they're all concerned about that. They're concerned also about the growing deficit and the increasing budget. The one thing that they are now becoming alarmed about is the Government ownership of stock. And when we come to the questions, I've got some questions about that. Because they come to me and say, look, aren't we drifting into socialism at a rapid rate. And I assure them that our goal is not to hold the stockholdings or warrants or any other financial instruments that we shouldn't be holding. That our goal is to get these companies so that they are functioning on their own, so that they are either publicly traded or that they are privately owned, but not Government owned. So, I'll be asking you for reassurance on that side.

Because I hope and I believe that our goal is just as I've stated it, to help these companies get on their feet and, when on their

feet, to become private once again, not to have that kind of public ownership that we currently have. So I'll be anxious to get your take on that.

Thank you, Mr. Chairman.

Senator DURBIN. Senator Tester.

STATEMENT OF SENATOR JON TESTER

Senator TESTER. Thank you, Mr. Chairman. Commissioner Shulman, Secretary Geithner. It's good to have Secretary Geithner and Commissioner Shulman here today. I've gotten to visit with Secretary Geithner on several occasions and I look forward to the one today.

We have just, we have just experienced, over the last little over 1 year, the biggest economic downturn since the 1930's. We have seen irresponsibility on Wall Street, we have seen irresponsibility in Government, with a lack of regulation. In some cases, no regulation. We have stepped forth with the TARP program, we have stepped forth with the recovery bill. You are in the eye of the storm.

I look forward to visiting with you about all those things that impact the economy and where we're going from here. And I appreciate your coming in front of the subcommittee.

Thank you.

Senator DURBIN. Senator Bond.

STATEMENT OF SENATOR CHRISTOPHER S. BOND

Senator BOND. Thank you very much, Mr. Chairman, Ranking Member Collins. Welcome, Secretary Geithner.

Everybody knows, over the past year, we've had a major economic storm raging with great damage to everybody. The Federal Government has responded to the economic crisis with aggressive and unprecedented, but unfortunately, I believe, ad hoc actions through taxpayer-funded bailouts of too-big-to-fail private corporations, a $1 trillion stimulus, foreclosure rescue programs, just to name a few.

We've seen some positive signs of green shoots, but there are some wondering whether they will wither away due to continuing problems in the housing sector, consumer debt remaining high, significant de-leveraging occurring in the financial sector, and lingering questions about the solvency of banks. Are we seeing a "dead cat bounce" in the markets?

Economic and financial experts are telling us that economic recovery cannot occur or be sustained until we address the root cause, the credit crisis. That's what TARP was supposed to do, but it got off on the wrong foot last fall, in my view, and it's still there. And President Obama told us in January we can't have a recovery until we get the toxic assets out.

These are questions that I want to follow-up with. The size of the stimulus also is now causing questions from the Federal Reserve. If we get in a position of monetizing our debt, we will face an unprecedented disaster and go the way perhaps of Argentina. And tripling the debt in 10 years seems to me to be a very risky approach.

We've seen the United Kingdom, which was recently warned about its credit rating. Perhaps that is the canary in the coal mine for our Nation's own future.

Thank you, Mr. Chairman.

Senator DURBIN. Thank you very much, Senator Bond.

[The statement follows:]

PREPARED STATEMENT OF SENATOR CHRISTOPHER S. BOND

Thank you Chairman Durbin and Ranking Member Collins for holding today's hearing on the Department of the Treasury and the Internal Revenue Service (IRS). I welcome both Treasury Secretary Timothy Geithner and IRS Commissioner Douglas Shulman and thank them for appearing before our subcommittee.

Over the past year, a major economic storm has raged across America causing hardships and damage to families, communities, and businesses. Families have lost their jobs and homes. Retirement savings have plummeted turning 401(k)s into "201(k)s." Students have seen their college savings evaporate. And, our financial and auto industries have been shaken to their core.

The Federal Government has responded to the economic crisis with aggressive and unprecedented, albeit ad hoc, actions through taxpayer-funded bailouts of "too big to fail" private corporations, a trillion dollar stimulus, and foreclosure rescue programs, just to name a few.

In recent weeks, some have identified positive signs of economic recovery or "green shoots." But other experts believe that these green shoots may just wither away due to continuing problems in the housing sector, consumer debt remaining high, significant deleveraging occurring in the financial sector, and lingering questions about the solvency of some of our big banks. As they say in the financial industry, we may be experiencing a "dead cat bounce."

Economic and financial experts believe that true economic recovery cannot occur or be sustained until the root cause of the crisis is addressed—the credit crisis. The financial system cannot be fully repaired unless the toxic assets are cleansed from the balance sheets of financial institutions. I strongly agree.

Unfortunately, the administration has failed to develop or execute a credible plan to cleanse the toxic assets that continue to choke our financial institutions. The center-piece of the administration's financial rescue plan to remove the toxic assets—the Public-Private Investment Program or "PPIP"—remains sidelined, and based on the recent comments by leaders such as Secretary Geithner's successor at the Federal Reserve Bank of New York, the growing sentiment is that it will never be launched.

Due to fundamental flaws with the design of PPIP that placed most of the risk at the taxpayers' feet, it is frankly no surprise that this program has stalled and is not likely ever to be implemented.

It cannot be emphasized enough that a well-functioning credit market must be restored for economic recovery. Too much money has been thrown at our financial institutions without removing the toxic assets, and further delay only makes the problem worse as we have seen with Japan in the 1990s. The good news is that we can face this 800-pound gorilla by using a true-and-tried approach that helped our Nation recover from the Savings and Loan Crisis.

Unfortunately, the administration has resisted the creation of a Resolution Trust Corporation approach but continues an ad hoc, incremental approach to our "too big to fail" financial institutions without any semblance of an exit strategy.

But when it comes to our domestic auto industry, the administration has not shied away from taking a different approach. It fired the head of General Motors and orchestrated the bankruptcy of both GM and Chrysler.

The creation of jobs will be an essential ingredient to economic recovery and President Obama has staked his performance on this measure. The administration's main effort to create jobs was a trillion dollar "stimulus" bill with the promise of saving or creating at least 3 million jobs, which would prevent the unemployment rate from rising above 7.8 percent. Clearly, this estimate was overly rosy as the most recent jobs report showed that unemployment had reached 9.4 percent.

To be fair, the sliding economy necessitated a significant fiscal stimulus. But instead of stimulating the creation of jobs, so far, it only seems to be stimulating the growth of Government programs and ballooning our debt.

While the lack of stimulus is extremely troubling, what is truly alarming is the administration's future budget plan, which promises more spending that will double the debt in 5 years and triple the debt in 10 years. This means that our children are going to inherit an obligation where interest payments on the debt—around

$800 billion annually—are likely to be the largest single item of the Federal Government. These figures are certainly not funny to future generations, but it is difficult not to laugh when administration officials publicly claim that lending money to the U.S. Government is still safe.

Frankly, our country's fiscal health and viability are serious matters that must be addressed sooner than later. There are recent signs of investor concern about our Nation's fiscal health. Interest rates on 10-year Treasury notes have recently shot up. This means that the Government's cost to borrow money will increase by tens of billions of dollars. One of the most stable and industrialized nations in the world, the United Kingdom, was recently warned about its credit rating. What is happening in the United Kingdom should be viewed as a "canary in the coal mine" for our own Nation's future fiscal situation. Even Federal Reserve Chairman Ben Bernanke recently called for our Nation to begin planning now for the restoration of fiscal balance.

The good news is that we still have the opportunity to change course, but we can only do so if there is the will to confront the most treacherous political landmines, such as entitlement spending. Much has been said publicly about the importance of our fiscal health and the commitment to tackle spending matters. However, action speaks louder than words, and until I see action, many Americans, including myself, will continue to sound the alarm.

Thank you.

Senator DURBIN. Mr. Secretary, the floor is yours.

SUMMARY STATEMENT OF HON. TIMOTHY F. GEITHNER

Secretary GEITHNER. Chairman Durbin, Ranking Member Collins, and members of the subcommittee, it's a pleasure to be before you today, my first time appearing before you about the Treasury's budget. I look forward to building a close working relationship and I look forward to having a chance to answer the many important questions you raised in your opening statements.

While we see some initial signs of economic improvement, I think you could say that the force of the storm is weakening a bit. And although the financial system is beginning to heal, our country faces very substantial economic and financial challenges.

Now the President and the administration are working to meet these challenges. We are working hard to get Americans back to work, to get our economy back to a growth path again, by committing to restoring fiscal discipline to ensure and sustain recovery and by making the long-neglected investments in healthcare reform and energy and education necessary to improve the productive capacity of our economy and to ensure that, over the longer term, we enhance the competitiveness of the U.S. economy.

To achieve these goals, we are working to repair and reform our financial system so that it works for, not against, recovery. We are working to restore growth and meet our fiscal goals by redesigning our Tax Code, bolstering enforcement. We are working to advance our interests globally, working with other countries to promote economic recovery and financial repair and to ensure more open markets for U.S. businesses.

And to protect our Nation's national security interests, we are deploying all of the tools at our disposal to exclude terrorists, proliferators, and other illicit actors from the international financial stage and thereby secure our financial system and prevent threats to our security.

Now, the fiscal year 2010 budget you have before you will allow Treasury to pursue these core missions. The $13.4 billion request includes a $676 million, or 5.3 percent increase over the enacted 2009 levels.

Just a few brief highlights about the budget request. Of the increase we are seeking, $14 million would go to bolstering the staffs of our domestic finance and tax policy offices. Now, these offices, domestics finance and tax policy, are at the center of the administration's efforts to support strong design, rigorous analysis, improve the financial system, reform the financial system, and implement reforms to our tax policies and Tax Code.

We include in the budget a $137 million request to more than double our community development financial institutions, our community development financial institutions (CDFI) fund, to ensure that the benefits of our financial efforts reach beyond major banks and businesses to help economically distressed communities. These communities were underserved by our financial system even before the current crisis and they have been deeply hurt by the job losses and business failures that the crisis has exacerbated.

We propose a total of $332 million for new IRS enforcement efforts, including $128 million to add nearly 800 new IRS employees to combat offshore tax evasion and improve compliance with the U.S. international tax laws by businesses and high-income individuals. Another $130 million would go to bolster the security of the IRS's information technology, improve the efficiency of its business systems, and upgrade its fraud detection capabilities.

Now, although not directly under the jurisdiction of the subcommittee, I just wanted to note also that our budget includes funds to meet our international obligations and to help us craft a global response to the crisis in this more integrative global system we live in today.

Now, as we seek these additional funds to respond to our Nation's immediate challenges, we've cut back on some programs that are either ineffective or we believe can be safely deleted. Just one example, even as we are trying to increase capital investment for the IRS, our budget would reduce the Department-wide Treasury's Department-wide capital investment account by 65 percent, for a modest savings of $17 million.

Now, just before I end, I want to say a few words about the Treasury staff. I have the honor of leading a team of exceptionally smart and dedicated individuals who are working very hard to make our Government more effective. They're performing a great service to our country under challenging circumstances. I am very grateful to them and I think if you look at the scale of what we've set in motion, just in the last 6 months, they have done extraordinary things in a very short period of time.

PREPARED STATEMENT

Thank you, Mr. Chairman, I'd be happy to answer any questions.

[The statement follows:]

PREPARED STATEMENT OF TIMOTHY F. GEITHNER

Chairman Durbin, Ranking Member Collins, members of the Subcommittee, I appreciate the opportunity to testify before you for the first time as Treasury Secretary on the President's fiscal year 2010 budget request for the Department of the Treasury.

While we see some initial signs of economic improvement and the financial system is beginning to heal, our country faces very substantial economic and financial challenges.

President Obama and his administration are working to meet these challenges by getting Americans back to work and getting our economy to grow again; by restoring fiscal discipline to ensure a sustained recovery, and by making the long-neglected investments in health care, energy and education needed to enhance America's global competitiveness and produce more balanced, sustainable growth over the long-term.

TREASURY'S KEY PRIORITIES

To achieve these goals, we are repairing and reforming our financial system so that it works for, not against, a recovery that serves all Americans.

To restore growth and meet our fiscal goals, we are redesigning and bolstering enforcement of our tax code so that it is both fairer and more efficient.

To advance our interests globally, we are working with other nations to promote economic recovery and financial repair, and to ensure more open markets for U.S. business.

And to protect the country, we are deploying all of the tools at our disposal to exclude terrorists, proliferators, and other illicit actors from the international financial stage, and thereby secure our financial system and combat threats to our security.

The fiscal year 2010 budget that you have before you will allow Treasury to pursue these core missions assigned to the Department by the President and the Congress. The $13.4 billion request includes a $676 million, or 5.3 percent, increase over enacted 2009 levels.

Of this increase, $14 million would go to bolstering the staffs of our Domestic Finance and Tax Policy offices, which are at the epicenter of administration efforts to support rigorous analysis and implementation of revenue policy and to redesign and improve our tax policies and tax code.

Some $137 million would be devoted to more than doubling our Community Development Financial Institutions (CDFI) Fund to ensure that the benefits of our financial repairs reach beyond our major banks and businesses to help economically distressed communities. These communities were underserved by our financial system even before the current crisis, and have been deeply hurt by the job losses and business failures that the crisis has spawned.

A total of $332 million would be devoted to new Internal Revenue Service (IRS) enforcement efforts, including $128.1 million to add nearly 800 new IRS employees to combat offshore tax evasion and improve compliance with U.S. international tax laws by businesses and high-income individuals. Another $130 million would go to bolster the security of the IRS information technology, improve the efficiency of its business systems and upgrade its fraud detection capabilities.

Although not directly under the jurisdiction of this Subcommittee, our budget also includes funds to meet our international obligations to help us in mounting a global response to the crisis and in creating mutually reinforcing growth around the world.

As we seek these additional funds to respond to our Nation's troubles, we have cut back on some programs that are either ineffective or that we believe can be safely delayed.

For example, while the Earned Income Tax Credit (EITC) continues to be one of the most effective anti-poverty programs that the Federal Government administers, the Advanced EITC, a related program which provides benefits in advance of filing a tax return, has been prone to exceptionally high levels of error and low use by those eligible for it. Accordingly, our budget proposes to end this latter program for savings next fiscal year of $125 million.

Similarly, even as we seek to increase capital investment for the IRS, our budget would reduce the Department-wide capital investment account by 65 percent for a savings of $17 million.

The Treasury budget would reduce the number of international economic attachés from 20 to 16, saving $2 million next fiscal year. It would absorb a portion of our non-pay inflation through more efficient use of contracting and other cutbacks, saving $18 million. It would take advantage of the growth of efficient electronic filing of tax returns to reduce the IRS processing budget by $8 million next fiscal year.

Given we have had control over the budget for fewer than 5 months, the reductions that I have just described represent a first attempt to do more with less. As we begin work on the Budget for fiscal year 2011, Treasury has prepared itself for a more rigorous assessment of its spending.

I have already issued guidance to Treasury senior staff that says, in part: "To afford any new investments, we will have to take new approaches to solving old problems. I expect each bureau and policy office to identify opportunities for innovation

that will transform how Treasury fulfills its missions in order to both improve performance and reduce cost."

In addition, the President has announced his intention to nominate Dan Tangherlini to be our Assistant Secretary for Management and Budget. Consistent with the President's mandate, I will look to Mr. Tangherlini to scour the Treasury's budget for efficiencies and cost savings. He comes to the job with an impressive track record of working on budget, management and performance issues with District of Columbia Mayor Adrian Fenty, and I am convinced that he will bring the same results-oriented approach to the Federal Government.

REPAIRING AND REFORMING THE FINANCIAL SYSTEM

The President has assigned the Treasury to repair key sectors of our economy so that they help revive growth and produce broadly shared prosperity.

The Treasury has been working to repair and reform every major element of our financial system, and to fill gaps in the system so that it benefits all Americans.

Last month, Federal banking supervisors announced results of the stress tests that we asked them to conduct on our 19 largest financial institutions. The aim of these assessments was to ensure that these institutions have sufficient capital buffers to absorb the losses that they could suffer under worse-than-expected economic conditions and continue to make the loans necessary to sustain recovery.

The clarity and transparency provided by the tests has helped improve market confidence in the banks, making it possible for them to collectively raise nearly $90 billion through private equity offerings, bond issuances without Government guarantees and sales of business units.

On housing, Treasury is working with HUD to bolster our housing markets by helping to drive down mortgage interest rates and by assisting responsible homeowners to refinance into more affordable mortgages or modify their at-risk loans to avoid preventable foreclosures.

In terms of the non-bank financial sector, Treasury is working to revive critically important securitization markets for both new and old asset-backed securities.

We have begun to boost new consumer and business lending by re-starting the markets for asset-backed securities that financed almost half of all lending in this country before the crisis. There were more securities of this type issued the 4 months after we launched our effort than in the preceding 9.

Additionally, Treasury is about to join with private investors in seeking to restart the markets for legacy mortgage loans and securities that are now stuck on bank balance sheets, keeping these institutions from making new loans to families and businesses.

As we have made repairs to the financial system, we have understood that repair alone is not enough. We must also reform the system so that it is less prone to crises of the dimensions that we now face.

In the next few weeks, we will outline a comprehensive plan of reform that will include systemic risk regulations to ensure that no large and interconnected firm or market can take on so much risk that its failure could destabilize the entire financial system. The plan calls for bolstering consumer and investor protections. And it will streamline our out-of-date regulatory structure so that our regulatory system matches the size, shape and speed of our modern financial system. Together, these changes will help prevent another crisis of the magnitude that we have just lived through, and give the Government new tools to better cope with similar problems should they occur in the future.

In addition to the financial system, Treasury is helping to ensure that the Nation has a viable auto industry in the future. We are working with General Motors and Chrysler to make sure these companies make the changes necessary to again prosper. As President Obama has said "we cannot . . . must not . . . and will not let our auto industry simply vanish."

The resources for administering key elements of both our financial and auto repair efforts were authorized by the Emergency Economic Stabilization Act.

These activities are being handled by our Office of Financial Stability (OFS), which is focused on ensuring that TARP funds serve the public purpose of economic and financial stabilization; that they are fulfilling this purpose in ways that protect taxpayers; and that we can provide a clear account to the Congress and the American people about the effectiveness of the funds' use.

In order to administer TARP and ensure compliance by TARP recipients, OFS has had to quickly assemble a substantial staff. OFS staffing levels, which were at 88 when I arrived in office, had risen to approximately 165 by the end of last month and are expected to rise to 225 by next fiscal year. The office's budget for next fiscal year will total $262 million, a 6 percent decline from the current fiscal year's $279

million. The change is largely due to a decline in estimated spending on contracts as part of the program's initial start-up.

While TARP is proving effective at improving the immediate stability of the financial system, the scope of the issues that this administration and this Department face extend beyond TARP to include striking the delicate balance between intervention and allowing market participants latitude to operate; devising a new financial regulatory structure for the future; and working through the tough problems of what form our Government-sponsored enterprises, Fannie Mae and Freddie Mac, should take as we emerge from this difficult period.

All of these issues fall to Treasury's Office of Domestic Finance, which, together with OFS, is having to operate on new policy terrain, tackling problems that the country has not faced in generations and for which we have few guideposts in our immediate past.

That is why the workload of the Office Domestic Finance has already expanded greatly, and is all but certain to expand still further. And it is why we are seeking to modestly increase its size and bolster its expertise in several critical areas.

Our budget requests an additional $8.7 million for the office to add 26 full-time equivalent (FTE) positions to the staff. This represents a 26 percent increase from the office's current fiscal year staffing of 101.

The additional funds will be used to create two new Deputy Assistant Secretary positions, one for housing finance, small business and consumer issues, and a second for capital markets. These two new officials will lead teams that will perform the economic and institutional research necessary to ensure that we understand all of the policy options in each of these areas and choose the most effective ones for solving our problems.

As we seek additional funds for Treasury, we must also seek them for the frontline institutions that will sustain our economic recovery and ensure that its benefits are broadly shared.

Our budget would more than double the resources of the Community Development Financial Institutions (CDFI) Fund to $243.6 million. The fund's mandate is to help low-income, economically distressed communities that were poorly served by our financial system even in economic good times, and—although they had nothing to do with causing current conditions—have been significantly hurt by the economic and financial fallout of the crisis that we now face.

The $136.6 million, or 128 percent increase in funding, would allow this program to support financial institutions in making job-creating investments and in providing access to capital in communities that are often considered too risky for mainstream financial institutions to serve. By targeting lenders and borrowers in these communities, the Fund would help some of our most vulnerable populations weather the crisis and benefit once recovery is underway.

The aim of the fund is to make sure that we provide distressed communities with more than simply Government grants and aid. We must also build the capacity of their local financial institutions to ensure that capital is flowing to homebuyers and businesses so that they can finance their own economic futures. Since its inception in 1994, the fund has directed nearly $1 billion to distressed communities, and allocated $19.5 billion in tax credits through its New Markets Tax Credit program.

Financial institutions funded through the CDFI program make loans to small businesses and micro-enterprises and take equity positions in them. They provide mortgages to low-income homebuyers, and finance developers of low-income housing and community facilities, such as charter schools, health clinics and child care centers.

One example can be seen right here in the Anacostia neighborhood of Washington, DC. City First Bank—a local CDFI—and Charter Schools Development Corporation partnered to provide a $13.3 million New Markets Tax Credit for the Thurgood Marshall Academy, the city's first charter school focused on law, serving 360 students in grades 9 through 12 and achieving a 100 percent college acceptance rate for its first three graduating classes.

Historically, the CDFI program has been heavily oversubscribed and has had to turn away qualified applicants. For example, in the current fiscal year, the program for CDFI financial and technical assistance awards is budgeted at $55 million, but it expects to receive applications for more than $500 million in funding.

REDESIGNING THE TAX SYSTEM FOR FAIRNESS AND EFFICIENCY

The President has asked Treasury to redesign and bolster enforcement of our tax code so that it supports growth, sets the stage for our return to a sustainable fiscal path, and accomplishes these goals in a manner that is fair, efficient and supportive of our society's broadest goals.

To make good on the President's assignment, our budget requests a modest increase in funding for Treasury's Office of Tax Policy and more substantial increases to expand IRS enforcement activities and to improve its information technology.

Treasury has moved quickly in implementing the more than 30 tax provisions of the President's economic recovery plan. Treasury also has played an integral role in designing the tax provisions of the President's fiscal year 2010 budget, and it will play a similar role in implementing these.

The President has made clear that he will not seek any major revenue increases until 2011 when the recovery should be firmly in place. He has, however, been equally clear that once recovery is underway, we must get our fiscal house in order or risk having Government borrowing crowd out productive private investment. Treasury and the White House will work with Congress to make the tax changes that are necessary to reduce deficits and to do so in a manner that is fair to all Americans.

As part of our efforts to make sure that the tax system is working for recovery and is operating fairly, we have designed new policies to curb the use of off-shore tax havens, close the international tax gap, remove tax incentives for companies to shift jobs overseas, and replace these incentives with ones that encourage creation of jobs at home.

Our tax work on the recovery plan, the fiscal year 2010 budget, and these international tax issues are just the beginning of an ambitious agenda for this administration.

On healthcare, the President has made clear that the road to fiscal discipline and to solvency for Medicare and Social Security runs through overall healthcare reform. Although much of the cost of the President's reform plan will be covered by savings from the system, we will need to design programs to cover some of the costs in ways that are fair to all Americans and do not harm the economy. Treasury is deeply involved in this effort and in the related work to expand coverage and improve our healthcare system in other important ways.

On retirement and economic security, Treasury and, in particular, the Office of Tax Policy, is taking the lead in developing and actively working with Congress to flesh out the initiatives proposed in the President's budget to help enhance retirement security and savings for the half of working Americans who have no retirement provisions beyond Social Security. These proposals would make it easier for people to save for their own retirement, either through their workplaces or on their own, and would move us toward universal retirement savings coverage.

On climate change, Treasury is already working closely with Congress to design the auction mechanisms that will be needed to implement the administration's greenhouse gas cap-and-trade program.

Our Office of Tax Policy has been deeply involved in all of these issues from the outset of the administration. Like our Office of Domestic Finance, its workload already has substantially increased and is certain to grow as the health reform, retirement security and climate change debates get underway in earnest.

At the moment, the Office of Tax Policy's career staff includes 30 lawyers and 44 economists as well as support staff for an overall staffing level of 93. This is lower than its usual complement of over 100 professionals.

Our fiscal year 2010 budget would increase the office budget by $4.9 million to add 15 full-time equivalent (FTE) positions in order to increase overall staffing to 108, and would therefore represent a return to historical norms. The additional staff is needed to perform analysis and revenue estimates for new policy proposals, conduct research for, among other things, congressionally mandated studies, and develop regulations and guidance for new legislation.

The vast majority of the new funds that we request in this budget are for improving the enforcement efforts and the information technology of the IRS.

As I have said, $332 million would go to new IRS enforcement efforts, including $128.1 million to improve international tax compliance. The balance of these funds would be used to support three critical programs: 755 employees to increase examinations of tax returns for businesses and high-income individuals; 300 employees to expand the IRS document matching program, which compares tax returns to other forms such as W–2s and 1099s; and an additional 491 employees to improve collection operations and build two new IRS automated collection center sites.

Turning to IT, our Budget requests a $90 million increase in funding to protect taxpayers' personal records from the increasing number and sophistication of Internet-based attacks. With these funds, the agency will deploy state-of-the-art, automated tools to improve record access management, risk assessment and system auditing. This effort would address concerns noted in the past by both the Government Accountability Office and the Treasury Inspector General for Tax Administration.

Our budget also requests an additional $18 million for systems to help the IRS return review program detect noncompliance and fraudulent refunds, and a $22 million increase to continue modernizing the agency's core taxpayer account database and modernized the e-File web-based platform.

REENGAGING WITH THE WORLD ON ECONOMIC ISSUES

The President assigned Treasury to ensure that this country reengages with the world, not just on issues of war and peace, but also on the current crisis, and on issues crucial to our common economic futures.

This is a global crisis. Recovery here depends on recovery abroad. We are working closely with other major economies to put in place the fiscal stimulus and make the financial repairs necessary to ensure U.S. and global recovery.

The United States is seeking to mobilize the financial resources of the better-off nations to help the emerging and developing economies that have been especially hard-hit by this crisis. We are doing this for more than simply humanitarian reasons; as recently as last fall, these economies accounted for fully 42 percent of all U.S. exports.

Last month, the President and leaders of the other G–20 nations agreed on the need to make more than $1 trillion in financial resources available to support global growth and trade.

Those funds include our commitment of up to $100 billion for an expanded New Arrangements to Borrow, a permanent back-up mechanism that provides the International Monetary Fund with supplemental resources to help emerging markets and developing nations weather the crisis.

As part of our effort to rekindle global growth for the sake of our own recovery, we are seeking to meet our past and present financial commitments to the multilateral development banks that help emerging and developing countries.

Although the funds to do this are not directly within the purview of your Subcommittee, I mention them to illustrate how Treasury's entire budget is tailored to let us fulfill the missions that the President has set out for us. Our budget request includes $2.5 billion for international programs, most of which would serve to meet our past and present commitments to the multilateral development banks.

Our financial reform effort in the United States must be matched by similarly strong efforts elsewhere in order to succeed.

CONCLUSION

Before I end, let me say a word about the Department's staff. I have the honor of leading a team of smart and dedicated individuals who are working to make our Government more effective and our society fairer, who are following a long tradition of debating policies fearlessly on their merits, doing what is right and not what is expedient, and drawing on the best ideas and expertise that are available. They are performing an incalculable service to our country in these challenging times, and I am immensely grateful to them.

The Department of the Treasury is responsible for promoting the Nation's economic prosperity and protecting its financial security. We advance our interests around the world through the strength not only of our economy but of our ideas.

This President and Treasury have already begun the hard work of recovery and reform. Our fiscal year 2010 budget will allow us to pursue these critical goals, and deliver the balanced and sustainable growth that the American people seek and deserve.

MORTGAGE FORECLOSURE

Senator DURBIN. Mr. Secretary, many of the questions we'll ask will be policy questions, somewhat global in scope. I will try to bring those home to the actual budget aspects of this hearing as best I can.

Let me start with a topic that you won't be surprised that I'm interested in, mortgage foreclosure. I have brought before the Senate, twice now unsuccessfully, an attempt to change the bankruptcy code so that we can create more incentives for renegotiating mortgages to avoid foreclosure. I failed in both efforts and, in the last effort, was opposed by virtually all of the banking institutions

of the United States, save one, Citigroup, that supported our efforts.

The Mortgage Bankers Association reported last week that about 12.07 percent of mortgage loans were delinquent or in foreclosure in the first quarter, the highest level ever recorded since the survey was launched in 1972. Also, for the first time, most mortgages in foreclosure were prime loans, 49.8 percent, compared to 43.2 percent subprime, which we initially identified as our major concern. Foreclosures bounced up 32 percent to 342,000 during the year over year period ending in April, according to Realty Track.

The Obama administration's "Making Home Affordable" program has resulted in only 55,000 mortgage modifications in the last 2 months. According to The Washington Post, experts say foreclosure prevention programs will not be successful unless they address homeowners who owe more than their properties are worth.

I sense that this was the catalyst that led us into this recession. It is my feeling that the previous administration and, so far, this administration has failed to come up with an approach which is dramatically, could dramatically turn around this increasing number of mortgage foreclosures. A year ago, the estimate was 2 million, this year it's 8 million. Ultimately, one out of every six home mortgages faces foreclosure based on current predictions.

Do you agree that we need to strengthen incentives to modify more mortgages to turn this economy around? And wouldn't it help, wouldn't that help spur participation in the Treasury's own mortgage modification program? And can you suggest a better method to give homeowners more leverage than to change the bankruptcy code?

Secretary GEITHNER. Senator, you're right that housing is at the center of this crisis and, of course, millions of Americans are losing their homes, including many who were very responsible and are suffering simply because of the actions of those borrowers who lived way beyond their means and those banks that made a bunch of loans they should not have made.

And I agree with you that I think this Government should have moved earlier to address this crisis. We were late, as a country, and behind the curve. I do believe though that the President's program is a, does provide a very powerful set of incentives to induce a substantial increase in successful modifications. We are at the very early stage of implementing that program.

It's true we've been in office now almost 6 months, but—and this program was laid out, in terms of its detail, only a few months ago, but there is a substantial increase in efforts to put out notifications to potentially eligible borrowers and I expect to see a very substantial acceleration of the pace of modifications.

Now, this program does create significant incentives for servicers to participate. It also does reach homeowners that are significantly underwater. It won't reach all homeowners. There are some homeowners that simply borrowed—got themselves to the point where they've got a completely unsustainable mortgage and are unlikely to retain their house. But the program is designed to reach homeowners that are living today with significant amounts of negative LTV's, or high LTV's, negative equity.

Now, the program has been successful in helping bring down interest rates, working alongside the Fed. It has been successful in substantially increasing refinancing so that more Americans can take advantage of those lower rates and, as I said, we are just beginning to see the effects of these very substantial incentives we put in place to encourage modifications.

Realistically, I don't think we are going to know, until probably early fall, whether we've got the incentives right and whether they will prove powerful enough. But our judgment is that this is the best package of incentives which offers the best return for the taxpayer's resources we are going to use to help address the housing crisis.

Senator DURBIN. I would just say that I have asked this question of your predecessor; in perhaps a little different form, and still remain skeptical that the voluntary approach to mortgage renegotiation is going to save us from this crisis that we are facing.

I think, until we get an honest approach that really results in substantial renegotiation of mortgages, that the real estate industry and the housing industry are going to continue to be weak. I don't know how we can build a strong American economy if our homes are losing value and we see our neighbors facing foreclosure as we find across this country.

Secretary GEITHNER. Senator, I understand your concern and I commend you for your leadership and focus on this issue from an early perspective. But this program is a dramatically different program from what was tried in the previous administration. The financial incentives that we put in place here are very substantial. And it came alongside a substantial change in policies by Fannie and Freddie to help allow for refinancing, even for homeowners who were slightly underwater.

So, I think that we all want to see results. And you should judge us by our results. And it will take a little longer though to judge whether this is as powerful as we expect it to be. Now, I think if you just step back and look what's happened in the housing market over the last 6 months or so, partly because the effectiveness of the recovery program and confidence and partly because of the impact of the Fed's programs and the Treasury's programs, the pace of decline in house prices has started to slow. And that is early signs of us being able to look to the other side of this.

But realistically, I think you are going to still see a very challenging period ahead for many homeowners, many more Americans are still at risk of losing their homes and that's why we want these programs to work.

Senator DURBIN. Senator, I might say that each member will have 5 minutes and probably more than one go-round.

Senator Collins.

TROUBLED ASSET RELIEF PROGRAM

Senator COLLINS. Thank you, Mr. Chairman.

Mr. Secretary, I want to follow-up on the discussion we had about the use of TARP funds. It troubles me that banks have received billions of dollars without having to demonstrate that they've increased lending as a result and without having to be fully

accountable and transparent in the expenditure of the funds they have received.

I mentioned to you that I've seen, in my State, a large recipient of TARP funding constrain credit, to actually cut off lines of credit, to cease lending to a nonprofit hospital in my State, and a major retailer.

So I don't see, on the grassroots level, the benefits of putting billions of dollars into financial institutions, the intent of which was to prevent this constrained credit. In addition, the Special Inspector General for TARP, in his report in April, criticized the Treasury for not adopting recommendations to require that all TARP recipients account for the use of the funds.

So, I'd like to ask you to comment on why the Treasury hasn't made, as conditions for receipt of TARP funds, requirement for increased lending and full transparency?

Secretary GEITHNER. Senator, excellent question. Could I just start by saying that we, you know—this is a crisis produced, in significant part, by two things.

One is, families across the country substantially increased the amount they borrowed. So household debt rose dramatically as a share of our overall economy. And we had pockets of excess leverage, too much lending buildup, across the financial system. Now we are going through a very deep recession. In any recession, the demand for credit falls because economic activity falls. In a recession that follows a long credit boom like this, you would normally have expected the credit to fall quite sharply. That's an important context because it's hard to know how best to measure the full impact of these programs. Because again, it would have been, under any circumstance, we would have had a period where borrowing would fall, as homeowners, as families decided to go back to living within their means, decide to save more, reduce their debt outstanding. And lending would fall as the weaker parts of the financial system decline to a more sustainable level.

Now, it is very important to us that we have better ways of measuring the impact of these programs. So when we came into office, we put in place a much more comprehensive reporting so that all banks that received TARP assistance have to report monthly on what is actually happening to lending behavior. We started with the major banks and we extended that out to all TARP recipients and you will be able to see monthly now, on the Treasury website, what banks are actually doing in terms of lending. And that is the ultimate measure of the impact of these capital assistance programs.

We are very committed to improving the overall quality, transparency, and accountability across these programs and each of the programs we have designed provides for an exceptionally careful level of oversight, and a level transparency so people can measure the actual impact and effects.

Now, if there are other things that we can do to strengthen that, we will do it. Because nothing is more important to the credibilities programs than a better sense among the American people that they have the chance to judge and measure impact.

Now, just to finish quickly, where do you begin. My own judgment is that the programs that the Congress authorized last fall,

and the actions that my predecessor took initially to put capital into the U.S. banking system, were absolutely essential to prevent a catastrophic financial collapse. If you look back to that period of time, lending absolutely stopped. And because lending stopped, and because confidence was so badly damaged, basic business stopped. And it happened around the world. And when that capital was put into those banks initially, that was the first step in beginning to lay a foundation for recovery and repair.

We cannot know with certainty what would have happened in the absence of that action, but my judgment is that, without those actions, you would have faced the prospect of a catastrophic failure in the U.S. financial system and much, much, more damage to economic activity than we already saw.

Now today, we're seeing, over the last several weeks, we are seeing some very impressive and encouraging signs of improvement in the overall credit conditions. So if you look at concern about risk and exposure to banks, and if you look at the ability of banks to go raise equity to replace the Government's investment, if you look at what's happening to the borrowing in businesses across the country. If you look at what's happening to mortgage rates, the interest rates, there have been substantial improvements in those basic measures of these programs. So, my sense it is early days, as I said, and this is just the beginning, but I think where the Government has acted, you can see very tangible benefits in improvement.

Now, we have a ways to go. This crisis took a long time, the conditions of this crisis took a long time to build up and it will take a long time to work through, but I think these programs are having, are achieving traction and they're the right mix of programs. And we will do everything we need to do to make sure that we are adopting sensible recommendations by not just the SIGTARP, but by the congressional oversight panel and the Government Accountability Office (GAO) who are looking very, very carefully at all these programs.

Senator COLLINS. Thank you.

Senator DURBIN. Senator Lautenberg.

EXECUTIVE COMPENSATION

Senator LAUTENBERG. Thank you, Chairman.

Mr. Geithner, the financial crisis that we're seeing was, in my view, due in significant part to the poor management of these companies and particularly I am pained by the outcome of the management years in the automobile industry who refused to see what the public appetite was, when we refused to be competitive, and thus jobs have been lost and an industry practically destroyed that we loved and admired for so many years.

When we look at the risks taken by corporate executives, decisions made, many of these executive pay packages insulate CEOs from the risk and, again, I may, I don't want to take you out of your bailiwick, but to avoid this excessive mismanagement, should executive compensation be tied to the long term health of the company? Where do we have a right to interject our views?

Secretary GEITHNER. Senator, this is a very important issue. And I agree with you that I think, although many things caused this

crisis, what happened to compensation and the incentives that created risk-taking did contribute in some institutions to the kind of vulnerability we saw in this financial crisis. And my view is that we need to help encourage substantial reforms in compensation structures, particularly in the financial industry because of the dependence of the economy on a well-functioning, more stable, better set of judgments by financial institutions.

I think boards of directors did not do a good job. I think shareholders did not do a good job in terms of disciplining compensation practices. And I think a centerpiece of sensible reforms would be to tie compensation to better measures of long-term investment and return and to adjust them to reflect the risk, to reflect risk. That's part of the reforms and we are, as part of our broader regulatory reform proposals, our proposals to reform the whole framework of renewed regulation in the United States, will include some suggestions for trying to encourage reform in compensation practices.

Senator LAUTENBERG. Where does the start begin? Is it in Treasury or is it IRS or the Securities and Exchange Commission (SEC)? How do we get things introduced into the governance of these things?

Secretary GEITHNER. Well, as you'll hear from us in the next few days, the SEC has some important responsibilities and obligations in this area and some tools and authorities they may seek in this area. The bank supervisors, under the leadership of Chairman Bernanke and others, have already initiated a process to define standards and principles that supervisors would use to help bring about reforms in compensation practices in the financial industry.

Those are two ways we can have influence over the shape of practice in these areas. There are other ways, too, but my own sense is that the core will be those two authorities.

Senator LAUTENBERG. Senator Nelson mentioned something about the Government owning shares in these companies and its, I think it has to happen. Who, for instance, would vote the shares? Would the Government be, the American Government, be likely to appoint the board of directors and have them make a decision?

Secretary GEITHNER. Senator, this is an enormously important set of questions. As we said before, the President and I have said, we are an extremely reluctant investor, an investor. We do not want to be in the business of managing these companies on a day-to-day basis. We would like to make sure that we have the ability to get out as quickly as we can and have these companies emerge on their own as viable entities without our assistance on an ongoing basis and the capacity to go raise capital in the markets to repay the Government's investments.

To underscore that, we are—we've designed a set of policies and mechanisms that will ensure that people understand we only intend to use our voting rights for a very limited number of core judgments about financial structures of the firm, to make sure that there's a strong board and management in place at the time that we take our equity investments so that the taxpayers' interests are protected. So we have confidence in their ability to oversee a sufficiently robust restructuring plan.

We do not want to leave the impression or the reality in place that the Government of the United States will, will be able to and

will have the capacity to exercise judgments over the day-to-day operations of these businesses. We think that would be damaging to franchise value, damaging to the interests of the taxpayers in trying to make sure that we can get out as quickly as possible. And our hope is that we design a set of institutional protections to avoid that risk.

Senator LAUTENBERG. Thank you, Mr. Chairman.

Senator DURBIN. Thank you. Senator Bond.

Senator BOND. Thank you very much, Mr. Chairman.

FAILED BANKING INSTITUTIONS

Mr. Secretary, a lot of us in the heartland are wondering why you are treating failed banking institutions differently from General Motors and Chrysler? The administration has orchestrated forcing car companies into bankruptcy, but they seem to be reluctant to force failed large financial institutions, like Citi, into restructuring. Now, we've seen in the past that large organizations, not as large as Citi, but IndyMac has gone through a Federal Deposit Insurance Corporation (FDIC) cleansing program and this one is outside of politics. And when you do it through the FDIC, you don't get the political questions that are asked, you don't get the political involvement in it. And, as The Wall Street Journal asked today, if Citi is not forced into an FDIC-like restructuring, you know, how can you ensure taxpayers that failed banks will not continue to return for billions and billions of bailouts, which I think all of us have heard great concerns from our constituents about.

Secretary GEITHNER. Senator, I share those concerns and I think it's important to acknowledge that the actions that the Government has had to take, over the last 12 months in particular, to help protect the economy from this financial crisis have created, well, they have been exceptional and extraordinary, and they have created the risk that, unless we reform the system, we are going to face a greater risk of financial crises in the future, because we will have created a moral hazard that might make the system more vulnerable in the future.

I am deeply worried about that, I share that concern. And that is why it is so important that we put in place stronger protections against constraints on risk taking in the future. A centerpiece of what the President will recommend, in terms of financial reform, will be a set of much more conservative set of constraints on risk taking across the financial system, more evenly enforced with a more effective oversight. And, as part of that, we need to have a better capacity to deal with potential failure of large institutions.

Now the system that you referred to, the system that the Congress helped to put into place, built around the FDIC, strengthening in the wake of the savings and loan (S&L) crisis, is a very effective process, but it was designed to deal with relatively small banks and thrifts and was it not designed for a crisis of this severity. That is why we do not have—and that system was not designed to deal with a more complex set of failures, for example like AIG.

That's why a centerpiece of what the President will recommend would be a stronger capacity to resolve, address, better manage the risks to the system posed by those types of institutions.

Now, I just want to underscore just a couple things about context. Now, when I came into office, the Government of the United States had already invested roughly $200 billion in our Nation's banks. As I said to Senator Collins, I think that was a necessary thing to do. We would never want to do that, but it was the correct thing to do.

TOXIC ASSETS

Senator BOND. Mr. Secretary, I'm running out of time but I think everybody would agree, the Federal Reserve came up and flooded the system with money, we put—the TARP money in. But now we're past that. And unless we take some steps to deal with too-big-to-fail, we're going to have a moral hazard. And I'm also worried about the PPIPs, a lot of people saying that the banks aren't participating because it looks like it's going to be political. And if they get in—who would want to get in partnership with the Federal Government when they see what some of our fellow Members of Congress are doing?

Are you going to be able to get any of these toxic assets out with PPIP? Where are the participants?

Secretary GEITHNER. Senator, again, I want to underscore that you are right. This issue of too-big-to-fail moral hazard is a really important thing. And that's why the President wants to move so quickly on legislation.

Now on the issue of these legacy assets, that are still on the books of the Nation's banks. You're right that there is some concern in the market still about participation and whether that brings some risk of political conditions imposed in the future. And that could limit participation in the beginning and that would be an unfortunate thing. I think we all have a responsibility to act to reduce that sense of risk and uncertainty about the rules of the game.

It's also true that banks have found it more easy to raise equity than they thought. And that, combined with a slight improvement in confidence in the system, may also reduce participation. In my judgment though, these funds still are an important part of the necessary framework of tools to help get our country through this crisis. And I believe it is important that we go ahead and put them in place, even if we see participation somewhat more limited than people would have expected because of both the political concerns and because the basic improvement——

Senator BOND. I would hope that we would use the FDIC model I and others and Senator Dodd have proposed, beefing up the FDIC, we need to use them. And I'll have further questions for the record.

And Mr. Chairman, I would ask that my full statement and all of my good advice in it be included in the record, in the hopes that somebody might read it someday.

Senator DURBIN. Well, we'll look forward to reading that and it will gladly be inserted. Thank you, Senator Bond.

Senator Nelson.

AUTOMOBILE INDUSTRY

Senator NELSON. Thank you, Mr. Chairman. Secretary Geithner, you mentioned that we are reluctantly in a position of holding the shares of General Motors and perhaps in a position of controlling other institutions, but we are doing so reluctantly.

I am so reluctant to be one of those holders of that stock that I am introducing a resolution, as a sense of the Senate resolution, that we begin the process to divest ourselves of that stock ownership over a reasonable period of time, making clear that we are only a temporary shareholder and that we should take obviously all steps to protect the American taxpayer dollars and begin to divest the ownership as expeditiously as possible and call for a GAO study to help determine the period of time that it may take to return General Motors and Chrysler to solvency and complete the divestiture.

I think that says what I would like to say. In addition, I've heard it said that, for those who worry that somehow we are drifting into socialism, that socialism is where the Government wants to take over profitable ventures, as opposed to being where we are right now.

Apart from the levity, I think it is probably accurate. And so I hope that the administration will be supportive of every effort to make public statements that this is a temporary situation, not one that is optimum or optimal in terms of what we would prefer to do, but where we are at the moment but to make certain also that we are not going to stay there one day longer than we should in that position of ownership.

And I'm encouraged where you say that we won't exercise day-to-day judgment over many of the decisions and opportunities that the industry will have.

I've got some other questions about that and that relates to the dealerships. I know they're very concerned about summarily being dismissed after decades of relationships with the auto industry. Is there any effort to try to establish some sort of a recognition of the rights, and not just contractual rights, but the rights of dealerships in this dismissal where any compensation is being directed toward those dealerships to soften the blows?

It's not taking their position that is so important, it is recognizing that, in small communities all across America, particularly Nebraska, where dealerships are going to be lost, people are going to lose their jobs as well. In small communities where job replacement can be even more difficult than in the urban centers. I wish you might comment on that.

Secretary GEITHNER. Senator, can I just begin where you began to say, and I think you said it right, in terms of the Government stake in these entities, where we take a stake, temporary, clear path to exit, not a day longer than is necessary, no ongoing role in day-to-day management.

And, in that context, this broader question about the impact of communities of the substantial reduction in dealerships that the automobile companies have decided was necessary to get back on the path of viability. I just want to underscore that these were their judgments, based on a careful analysis of what was necessary,

again, to get them down to a cost basis that was more attainable over time.

But I understand the concern about the impact and would be happy to explore with you and talk to my colleagues about—to make sure you have responses to your thoughtful questions about with the companies themselves might be able to do to help to soften the blow.

Senator NELSON. I appreciate that. Thank you.

Secretary GEITHNER. But it has to be their judgment——

FINANCIAL REGULATORY REFORM

Senator NELSON. Of course, of course.

In terms of financial regulation, can you give us a preview of what you have planned for financial regulation? For example, are there any plans to change the State-based regulation of insurance? Will you propose an Office of Insurance Information or a similar position or will you seek authority to regulate insurance at the Federal level?

Secretary GEITHNER. Senator, I don't want to get ahead of the President of the United States on this. He is going to layout a comprehensive set a proposals next week. In that context, we will lay out our judgment about what we think is the most practical way to help begin the process of ensuring more effective supervision of at least parts of our insurance industry. But I don't want to get out in front of him. But we'll be taking a careful look at what is the most practical way to help to begin that, begin progress against the objective.

Senator NELSON. Well, as you take a look at the case of AIG, although it's an insurance holding operation, keep in mind that the insurance subsidiaries were profitable. That they didn't have bad assets. That this is not, this is not something that has rippled through the insurance industry. But focus on what happened with the Glass-Steagall modifications that permitted AIG to do what it did.

And so let's don't cure problems that don't exist as we try to take a "comprehensive approach". Let's just make sure that it is not so comprehensive that the sweep in regulatory schemes and mechanisms that are currently working.

Secretary GEITHNER. Senator, I completely agree and we are bringing a broader pragmatic spirit to this exercise and try to focus on things that were central to the crisis, not things that were not. On things that are necessary to do, not just those, not those that would be desirable to achieve over time.

Now, we may not all agree on the judgments we're making, but that's the pragmatic framework we're trying to make.

Senator NELSON. Apparently, you are making a commitment not to have collateral damage, right?

Secretary GEITHNER. Well, that is something of an obligation that we all share and we would be very careful to try to avoid that, but Senator we did have really systematic failures across the regulatory framework of the United States and we are going to have to change a lot of things to address those failures.

Senator NELSON. Thank you. Thank you, Mr. Chairman.

Senator DURBIN. Thank you, Senator Nelson. Senator Tester.

TROUBLED ASSET RELIEF PROGRAM: RESERVE FUND

Senator TESTER. Thank you, Mr. Chairman.

So many questions, so little time. Secretary Geithner, in your budget there's a financial stabilization reserve of $250 million. In front of the Banking Committee last week, Herb Allison was there. He is going to oversee the TARP, hopefully. He talked about, he called it head room, I interpret it as being reserve, of $100 billion. Can you tell me why we need $250 million in the budget?

Secretary GEITHNER. Senator, could I just begin by saying that I announced this morning that banks have, we've indicated to banks, the Fed indicated to banks that they have the right to repurchase $68 billion, return $68 billion of those initial investments and those will be coming back into the general fund. Now the way the EES legislation is designed, that does create additional flexibility to allow us to use those funds, if we believe there's a strong, compelling case. And since were—things are getting better in the financial system, I think, to be realistic, there's a lot of risk ahead for us and we need to be careful, to remind people that that flexibility authority is important.

Now, in the reserve fund. The President put in the budget this additional reserve fund, in an abundance of caution, against the possibility that we could face a deepening crisis. Now, we do not expect, at this time, to come back to Congress to ask for authority to use those resources.

I began by pointing out the $68 billion repayment thing, because it does provide some modest encouragement, I think, that we are going to be able to get through this without having to put you in the position of coming back for substantial additional funds.

Senator TESTER. We appreciate that. I guess the question is out of $700 billion, $250 million, even though it's a ton of money, is like spitting in the ocean.

Secretary GEITHNER. Well, you're right. We are a $14 trillion economy. This is a very severe financial crisis, the worst in generations, and financial crises are expensive to solve, particularly if you wait to solve them.

Senator TESTER. All right. I interpret by your answer to the last question that you anticipate the money that is going to be paid back will go into the general fund and not reinvested in the troubled banks.

Secretary GEITHNER. By law, it goes to the general fund but it also goes, as the law is written, and I think this was wise, it does give us flexibility to use that, again, if we think there's a compelling case.

EXTENSION OF TROUBLED ASSET RELIEF PROGRAM

Senator TESTER. Okay. In the end—well, you have an opportunity to extended it to the fall of 2010, the TARP program.

Secretary GEITHNER. We do.

Senator TESTER. Do you anticipate that that trigger will be asked for?

Secretary GEITHNER. I don't know at this stage. There's a range of exceptional programs we put in place, as Senator Collins just said, and some of them expire at the end of October and some of

them have a longer fuse on them. Some of them can be extended. We will have to make that judgment as we get a little more——

Senator TESTER. If you ask for an extension, I assume it applies to all the money and not just a portion? Is that correct?

Secretary GEITHNER. That's right. The way the law is structured, the authority is about the $700 billion and it applies to the full $700 billion.

TRANSPARENCY OF THE TROUBLED ASSET RELIEF PROGRAM

Senator TESTER. Okay. You talked about, and it has been referenced before, about reluctant investor, not involved in day-to-day decisions. It has been pointed out to me that some of the TARP funds are being used by banks for speculation in the oil market and the commodities market. Is there enough transparency now that they are using the TARP funds for you to know that?

Secretary GEITHNER. Well, I think that's really a question that I would have to refer to the supervisors. The supervisors of those banks that receive assistance have the full capacity to judge what kind of risk they're taking generally and whether those risks are appropriate, given the conditions of the——

Senator TESTER. I know you don't want to be day-to-day, and I don't want you to be in on the day-to-day decisions. The question is, do you think that's an appropriate use of TARP monies?

Secretary GEITHNER. Look, I want to make a big distinction between banks and others. Banks, because the risks they pose to the economy and because of the protections they enjoy, they are subject to a very intensive level of supervision and regulation by the Nation's banking authorities. That was not strong enough in some cases and needs to be stronger, but that is a perfectly legitimate public policy interest because of the interest of the system. So, I would distinguish that from the role of the Government as temporary shareholder.

Senator TESTER. Okay. In the previous question, you said that, as far as closing down dealerships, that was their decision. Who is they?

Secretary GEITHNER. The companies themselves. And their boards.

Senator TESTER. Okay. In the plan for General Motors, the investment of billions of dollars into that, were there any assurances that they wouldn't move manufacturing overseas?

Secretary GEITHNER. In the context of General Motors, the company has publicly committed to lay down a path for production in the United States as a share of total production. And in those plans, they've indicated that they expect production to be maintained at current levels, and perhaps expand slightly as they build this new plan for small cars.

So their plans now are, and these were part of the framework established for a bunch of reasons, they expect production in the United States to not just level off, but to expand slightly.

Senator TESTER. Okay. Thank you.

REPAYMENTS UNDER THE TROUBLED ASSET RELIEF PROGRAM

Senator DURBIN. Thanks, Senator Tester. Going back to the repayment of TARP, which is $68 billion which was announced this morning. What is the expected return on investment for taxpayers?

Secretary GEITHNER. The way the terms were initially established, these preferred investments came with a 5 percent coupon. I don't have my press statement with me, but the Treasury has already earned several billion dollars in terms of those dividend payments on the preferred.

Now, the full terms for the Government include the value of the warrants that Treasury took as part of these investments. We are in the process of going through a judgment about what fair market value for those warrants is likely to be and in the release we put out this morning, I'm not sure we made an estimate, but some of the estimates now are in the several billion dollar range for those initial banks that are repaying.

Government—so people will bring all sorts of financial prisms to judge the return, of course you have to look at the returns to the country, not just in terms of the direct financial returns to country which are significant. They really are significant. But you have to look at the broader benefit in avoiding a financial collapse because there is dramatically more credit available today than there would have been if these banks were forced to shrink dramatically.

Senator DURBIN. That's the second question. Assuming that you wouldn't allow repayment, if there's any question of soundness in the institution, what kind of assurance do we have that these banks that return this money are going to be issuing credit, which was one of the original goals?

Secretary GEITHNER. Right. Well, the judgment on the law was made by the Federal banking industry's responsible, so they did a very careful process of judging whether they really could prudently repay this money. And the figure I announced this morning reflects the judgment of the Federal banking agencies. That means these banks are in the position now where they can make normal business judgments about lending. And I think, by many measures, lending is very—expanding credit is a very economic thing to do today.

But as I said, we are in recession that followed a huge boom in credit. So it's going to be, for many parts, many families, many businesses, borrowing will decline as we go through this. And that is a healthy, necessary thing. It makes it very hard to judge, because you don't know what would have happened in the absence of investments, what lending would have been produced.

But I think you have a different financial system today that is substantially stronger than it was 2, 3, 6, 9 months ago and is in a much better position to provide the credit necessary to help us get through this recession and to get back on a growth path again.

CREDIT CARD INTERCHANGE FEES

Senator DURBIN. Mr. Secretary, we recently enacted or passed in the Senate an historic credit card reform bill, which I commend my colleague, Senator Dodd, although the Banking Committee worked

so hard on it. It's been 25 years or more since we've done anything in that field.

There was the third rail in this discussion which we couldn't bring up and couldn't discuss for fear it would explode the whole process, interchange fees. Interchange fees are the fees that are charged by credit card companies and imposed on retailers, and there's very little room, when it comes to the retailers, to negotiate these fees. Approximately 2 percent of our purchases using credit cards are paid back to the credit card company in interchange fees and the retail establishments across America are very concerned about this because they have little or no voice in that.

I'd like to ask you two questions about interchange fees. First is a more general question about what the Treasury is doing, if anything, to look into the interchange fee system.

But then, in particular, since it turns out that the Federal Government is now accepting credit cards, it turns out that there are 200 Federal entities that accept credit cards, Amtrak, the Postal Service, the Treasury's financial management services, it turns out that our Government paid these credit card companies over $200 million in interchange fees to Visa and MasterCard, in fiscal year 2007.

I have repeatedly asked the credit card industry and the banks to demonstrate that the rates that they've established are legitimate to process the card transactions and unfortunately they have not been able to provide any data or information to suggest that the amount charged, even to the Federal Government, represents a reasonable fee. In fact, the GAO report on this recently said that the FMS tried to negotiate lower interchange fees with Visa and MasterCard and negotiations were not successful.

So, in addition to the general question of interchange fees on retail establishments across America, what is the status of your effort to make sure that Uncle Sam isn't paying too much to these credit card companies for the use of the credit cards?

Secretary GEITHNER. Senator, this is a very complicated question and, to be honest with you, I have not thought about this very much yet. But I would be happy to spend some time with you and your staff, understanding your concerns about this and taking a careful look at both questions you raised.

If I'm not mistaken, I think you asked the GAO to do a study of one of these dimensions and of course we would look carefully at the conclusion of this study. But I am happy to commit to spend some time on this and see if we can—see if there are some sensible things that we can do to protect the Government's interests, not just to address the broader reform question you raised.

STAFFING OF THE TROUBLED ASSET RELIEF PROGRAM

Senator DURBIN. If Senator Collins would just bear with me for one more question. I think, with the establishment of TARP under the previous administration and the continuance under this administration, there has been a shift of personnel within the Department of the Treasury to deal with the obvious demands, administrative demands.

Can you give me a general impression of whether or not this has created dislocations in other parts of the Treasury Department

which need to be addressed and whether the repayment or the payback on these TARP funds is some indication that we be getting out of this business and can get back to business as normal?

Secretary GEITHNER. The way that the EESA legislation was written it provided funding for the administrative resources required to design and run these programs and we have substantially increased resources, using that authority, to staff that part of Treasury, the Office of Financial Stability.

But we are also going to have to increase, as we proposed in the budget, the rest of the domestic finance staff. Because they have got this greatly expanded, much more complicated set of challenges in a range of policies, including the one you just raised. And we did announce several weeks ago the appointment of a new Deputy Assistant Secretary for Consumer Policy Issues in the financial sector.

I do not believe that we've had to devote resources from other parts of the Government to these financial crisis imperatives on a scale that would jeopardize our capacity to carry out those broader responsibilities. And we will be very careful to avoid that risk. But there are parts of the Treasury, as I suggested, where we think that we are going to need to have some modest increases in baseline, like tax policy, which is outside of domestic finance. And I think, with that support, I think we will be in a stronger position to meet these broader objectives.

But my basic answer to your question is, no, I'm not concerned now that we've had a substantial diversion of resources, as important as the financial crisis is, at the expense of other core priorities of the Government.

Senator DURBIN. Senator Collins.

AUTOMOBILE DEALERSHIP TERMINATIONS

Senator COLLINS. Thank you, Mr. Chairman.

Mr. Secretary, I want to follow up on the questions that Senator Nelson asked you with regard to the decision of General Motors and Chrysler to terminate dealerships.

This decision has been perplexing to many of the automobile dealers in my State. Everyone understands that General Motors and Chrysler have to restructure and shed costs in order to survive, but the dealerships in Maine tell me that they pay for the cars, that they pay for the shipping, that they own their own showrooms, and they pay for their sales people. So, they've raise the question of how does this save money for the automobile manufacturers to have fewer people promoting their products? Could you shed some light on this for us?

Secretary GEITHNER. Senator, that is an excellent question and I have spent some time, I've never run an automobile company, but I've spent some time trying to——

Senator COLLINS. Until now.

Secretary GEITHNER. I don't expect to be running one now either. But I've spent some time looking at this and I guess I would say, I'm not sure this is going to be convincing or persuasive to you, but if you look at the broad consensus, people who looked at what was going to be necessary to put these companies back on a better financial foundation, I think there is a very broad consensus that, to do that, they need to get the distribution costs down and the dis-

tribution system more efficient. And that's why the companies themselves, at the center of their plans, have proposed very substantial reduction in the number of dealers.

Now, I know that it's—I'm not sure that's persuasive, but my sense, again, in reading a bunch of and listening to people who study these companies look at them and say, a very broad sense, that this is a part of, an important part, to get them down to a cost basis to allow them to be viable. Now that comes with enormous damage in those communities, and it is a wrenching adjustment, but the reality is that these restructuring programs will leave the country with many, many more dealers then what would have existed in the absence of these programs.

The balance, it may not be perfect, but I think that my sense in looking at it is that this is a necessary part of their efforts to get back to a path where they don't need the Government.

Senator COLLINS. Was the decision to reduce dealerships made by the manufacturers or was it imposed upon them by the auto industry task force?

Secretary GEITHNER. It was not imposed by the auto industry task force. It was a judgment made by those boards of directors and their management, again, about what was a critical part of a restructuring plan.

Senator COLLINS. Thank you.

FINANCIAL REGULATORY REFORM

I'd like now to return to the issue of financial regulatory reform. I introduced a bill in March to create a council of regulators to act as a systemic risk monitor. I know that the other model for that is to have the Federal Reserve assume that responsibility. I think there's widespread consensus that we do need to have a systemic risk monitor so that someone, or some entity, is looking across the financial system and identifying high-risk practices, policies, or products and regulatory black holes, so that we don't have the problem of no one regulating faulty credit or swaps or the next product that comes along.

The reason that I support the council is I believe there's value in bringing many perspectives to the table and many areas of expertise. The Fed frankly has its hands full. There are also issues about congressional oversight. We want the Federal Reserve to be independent in order to set monetary policy. If it's also going to be the systemic risk monitor, there's going to have to be more congressional oversight of its operations.

So tell me, I know you don't want to precede the President in announcing his plan, but discuss with me the pros and cons of the two approaches.

Secretary GEITHNER. Well, I should begin by saying, although I am not going to get ahead of the President, that we share many of the objectives you laid out.

I think a necessary part of the solution for the U.S. financial system will be a more effective body to bring together the responsible supervisory agencies, alongside the Fed, to make sure we are looking across the system as a whole, that we are keeping abreast of changes in the structure of the system so that we can better limit

the risk in the system. And I think a council has a lot of merits in that context.

And I don't believe it is necessarily desirable for us to concentrate all authority for dealing with the future risk of the system in one part of our complicated governmental structure.

So, although we are going to propose some important streamlining consolidation simplification of the oversight regime, we are not going to propose to concentrate all the authority for systemic issues in only one place. It's too complicated really to do that.

I think the really important thing is, again, is that we have more effective oversight over the core institutions that are critical to the system, that we bring critical markets like derivatives under an effective framework of oversight and protections there, that we have much better enforcement with tougher rules for enforcement for consumer investor protection. That we have better tools for managing future crises. And we are going to have to have tougher constraints on risk-taking involving better constraints on leverage and capital, so that you have thicker shock absorbers, thicker cushions against future crises. We are more able to let firms fail. The system is more robust to potential failure.

So, those are broader objectives in our approach. But you'll find many of the concerns and objectives you laid out present in our recommendations.

Senator COLLINS. Thank you.

Senator DURBIN. Senator Tester.

TERMINATION OF AUTOMOBILE DEALERSHIPS

Senator TESTER. Thank you, Mr. Chairman. I don't want to beat this horse, but I will just say this. And I like ya. There's an overwhelming attitude in this country that bigger is better. And I think what we're allowing General Motors and Chrysler to do, by closing down these small dealerships, is putting all the forces into a few big dealerships because, number one, it is easier to deal with a few people than it is a lot. And number two, it will reduce competition. And I've got to tell ya, if the dealership is making money, I don't see any criteria for shutting them down. And that's my only editorial comment I will tell you.

And the only other thing to keep in mind is, in rural America, it's a heck of a lot different than it is in urban America. You shut down some of these smaller dealerships in some of these small towns that are making money, that General Motors is making money off of, its going to have an incredible impact on the economy. That's all. And I know you aren't making that decision, but if you could pass that along to the powers that be, I would appreciate it.

Secretary GEITHNER. Message heard and received.

Senator TESTER. Okay. Thank you.

FEDERAL DEFICITS

Chairman Bernanke talked restoring fiscal balance. Could you just comment on that and where you see us going over the next few years, assuming the economy gets turned around?

Secretary GEITHNER. It is critically important for this country, it's central to the prospects of recovery, that we put in place a

framework that gives confidence to Americans and investors around the world, that we are going to have the ability, the will and ability, to bring our fiscal deficits down to a sustainable position over the medium term. And that's why the President, in his initial budget, laid a path for dramatic reductions in the deficit to bring them down over a 5-year period to a level at which our overall debt is not growing and can start to come down.

Senator TESTER. I just heard the Government will triple in 10 years not more than one-half an hour ago.

Secretary GEITHNER. Well, you know, we came into—I last served in the administration during the period where we had an extraordinary accomplished record of fiscal discipline, produced surpluses, helped bring down interest rates, helped lay the foundation for not just a strong dollar but an incredibly long period of private investment growth, productivity growth. So, I am a deep believer in and have deep conviction in the central importance of fiscal responsibility for this country.

Now, we started this year in the worst financial crisis in decades and, because of that crisis and the damage done by the financial system, we had to do, with the Congress, extraordinary things. And those, by necessity, produced a short-term temporary increase in our deficits. There was no path through this crisis that did not involve some temporary short-term increase in borrowing. But at the time that we proposed and, again, the President proposed and he acknowledged that we were going to have to bring this deficit down over time and that's what we're going to do with the Congress, it is going to be difficult to do, and it is going to be important to do, because, again, we are going to find that recovery will be weaker, private investment will be weaker, interest rates will be higher unless we are able to convince people that we're going to have the will and ability to do that.

FINANCIAL REGULATORY REFORM

Senator TESTER. Okay. Too-big-to-fail. It can't be an option in any industry and I think we may be there in energy and we may be there in food systems. We are absolutely there in the banking industry. How do we fix it? Do we fix it with regulation? How do we fix it?

Secretary GEITHNER. I think there are, I would just mention a few things and they will be the core of what the President lays out soon.

First, you have to have better design, tougher constraints on leverage, on risk taking in the core parts of the system. You have to have better oversight of the central markets like derivatives, because those are the markets that sort of effect whether failure is going to risk wrecking the system or whether failure can be absorbed and accommodated. So you need thicker shock absorbers in those central market, too.

You need resolution authority, as I said in response to Senator Bond's comments, that allows us to deal with the perspective failure of a large complex institution like AIG. Those are some of the things you need.

And I would just make one observation, Senator, just to show how hard and complex this is. It's not just the size. And in some

ways size is not the most important factor. It is the role the firm plays in the system, how connected it is, what impact its failure has. And you've had, in this crisis, what are not the largest institution in the world, present the risk of catastrophic damage because of how interconnected they are.

So, better capital applied across the system to limit scale of leverage, much better oversight and shock absorbers in the central infrastructure to limit the risk of damage caused by failure and better resolution tools.

Senator TESTER. Okay. I want to step back, step back for just a second. Neel Kashkari said that that the big guys had an advantage over the community banks in particular, because of their access to credit due mainly to TARP, I would imagine. Do you think that they have an unfair advantage and——

Secretary GEITHNER. I don't, I don't—you know, we have 9,000 banks in this country. I expect that, 10 years from now, we will still have a financial system, and it is very important that we have a financial system, that has thousands and thousands of small community banks operating across the country. I think that makes our system more resilient and stronger and I think this crisis would have been worse without that. And one of the importance of the reforms that we are going to layout is to make sure that large institutions have constraints on leverage that are appropriate, given their scale and risk. And that will help offset some of the potential concerns you raised about a level playing field for community banks.

Senator TESTER. Thank you very much.

FINANCIAL PRODUCT SAFETY COMMISSION PROPOSAL

Senator DURBIN. Mr. Secretary, I was glad the President announced the support for the concept of a Financial Product Safety Commission. I first introduced that bill in March and I think that to have an agency charged with protecting consumers from predatory tricks and traps is a good idea and could have spared us some of the problems we are currently going through with prepayment penalties on mortgages, for example.

But, in a way that is the easy part of my question. The tougher part gets to the heart of the issue and the heart of the issue would be an interest rate charge. Is there too much, is there an interest rate that is too high in America? Do we have an obligation as a country to say that certain levels of interest rates are unconscionable, intolerable, illegal, unacceptable?

I put in a bill to put the usury rates at 36 percent because I thought that was so high that we would be just fine. As I said, if you wanted to start a snake farm, you should put in a usury bill and watch what crawls under your door. The folks that came from title loans and payday loans could sit and say to me, with a straight face, Senator, you're going to put us out of business. Thirty-six percent will put you out of business? Yes. I asked them how much do you charge for loans? Oh, somewhere between 58 percent and 800 percent. People used to go to prison, they called it juice in the old days, when people were engaged in that sort of thing, you know, in the back alleys. Now it is acceptable, legal in this country.

Is there, should there be a consideration about limiting interest rates charged for certain products in America?

Secretary GEITHNER. Senator, I believe that we have to have a much stronger set of protections for consumers, particularly in the area of financial products that involve debt and credit. Those were where the failures were the most stark and I think it is going to require more than institutional and I agree with you, just establishing a commission doesn't, it just doesn't—it may be necessary but it is not sufficient.

So, I think you need to have stronger protections. I think the credit card reform bill is a good step, but it is a not a sufficient step. And we're going to propose what we believe and the President believes is a necessary set of much stronger protections.

Now, I understand your, the reason why you're supportive of a cap on interest rates. You have been exposed to a lot of the concerns on the other side of that, in terms of that would have unintended effects, in terms of denying people the rights to some forms of credit. I think you're right, it's sort of hard to make the case as to why some of those products are necessary or desirable, but I do not believe that those caps are a necessary part of a strong, credible consumer protection regime. And what I suggest is, I hope that when we lay out our proposals, we will have a chance to look at those and talk to you about whether those go far enough to meet your concerns.

USURY CAP

Senator DURBIN. Can I ask you to also consider the following? If we can't sell the notion of a usury cap, shouldn't we prevail upon institutions? I mean, credit unions have been coming to me for over two decades saying we're different, we're not greedy like banks, we're just trying to serve our little group of people that save there and we loan to them.

Shouldn't we be talking about making credit available to the poor people who are lured into these payday loans and title loans? Have credit available in lower amounts at reasonable interest rates so that these people are not exploited? I just don't think we can continue to look the other way. I have challenged the credit unions to do it, they haven't responded.

But perhaps the banks bear some responsibility here. If we are going to have credit available for people who are truly struggling in this economy, why do we throw them to the wolves with these payday loans and title loans?

Secretary GEITHNER. I agree. I think people who have spent their lives, like you, thinking about these issues believe that an important part of the solution is to make sure that all our citizens feel that they have the capacity to be part of the broader financial system that has these protections. And one step toward the objective you laid out is to make sure that they have bank accounts, have a relationship that allows them access credit which is going to be on forms where they are less vulnerable—I think that's an important thing.

The President's nominee for Assistant Secretary for Financial Institutions at the Treasury, his name is Michael Barr, has spent his life's work on these kinds of questions and he is one of the more

thoughtful people in the country thinking about to bring about reform in those areas.

Senator DURBIN. Thank you. Senator Collins.

REGULATORY REFORM

Senator COLLINS. Thank you, Mr. Chairman.

Mr. Secretary, another issue that keeps coming up is regulatory shopping. In other words, financial institutions will figure out which regulator gives them the most advantages. I saw this on the State level 20 years ago where we would have a financial institution come in and threaten to switch to a Federal charter because our audits were too tough or our consumer protections were too strong.

I don't think that it's a coincidence that AIG bought a small federally chartered thrift, or established a small federally chartered thrift, in order to get under the regulation of the Office of Thrift Supervision, OTS, which is generally viewed as being a weaker regulator than the Comptroller of the Currency.

Are you looking, as part of your reforms, on combining the OTS with the OCC? That's what my bill does. And needless to say, I think it's a brilliant idea and needs to be done.

Secretary GEITHNER. Senator, you're absolutely right that one of those things that helped produce this crisis was that, in our country, we allowed people to choose their regulator, to put risk in areas where they thought it was going to be least well-regulated, and that level of unevenness in the basic standards and protections in our system proved tragically damaging to the stability of our system. And fixing that will be critically important.

And, as part of that, we are looking at the areas in our system where we are most vulnerable to that kind of shopping for regulators and regulatory arbitrage. You pointed out one example, and I think it is one the more compelling examples, of that failure and weakness in our system. But just to say that we're looking beyond that. Of course, we're looking at that, but we know that this is something that we need to do globally, too. Because we need to make sure that we're not vulnerable in the future to risks if we get the standards better here, risks just moving offshore to other areas where there is still risk to our system. So, we want to have a level playing field, more conservatively set, more evenly enforced across the U.S. financial system. And we want to try to bring the world to those higher standards as well.

Senator COLLINS. You know, you also made an excellent point when you talked about the excessive leverage in the system. I think when Bear Stearns failed, its leverage ratio was an astonishing 30:1. That's something that never would have been allowed to happen under our regulatory process for a small community bank or a credit union.

So, I hope, as you look at this issue, that we're going to be establishing safety and soundness requirements regardless of the type of institution. It seems to me that Bear Stearns, the larger investment banks, all of which have either disappeared, have been acquired, or no longer exist, should have been required to meet the same kinds of capital requirements and leverage ratios that we would impose upon a community bank or a credit union.

Secretary GEITHNER. Senator, I have a lot of sympathy for that view and I think that, again, a centerpiece of what we need to do for this country is to make sure there are more conservative, better designed constraints on leverage applied more evenly across those institutions that play a critical role in how our markets function, both in normal times and in distress.

Now, it is true that, in the United States, we were fortunate to have, across the banking system, a very simple, easily enforceable, crude constraint on leverage. And for that reason, in many ways our financial troubles today are much less acute than they are for countries around the world where that kind of constraint did not exist.

So just an example, banking assets in our country today about one times gross domestic product (GDP). They are between two and eight times GDP across Europe. In part because they did not have in place that kind of simple, crude constraint on leverage. So, you are right. That is an important part of the reform. We want to have, as I say, thicker shock absorbers in the system, thicker cushions of capital against risk, that are more simple, more evenly enforced, and are less pro-cyclical, you know, that they dampen future crises rather than amplify them. And that would be a part of what we propose.

Now, I want to just say that these are things that—these are very complicated things. Of course, we want to get them right. And we are going to go through a very careful process to bring experts together and thinking about what the right mix of those constraints are so that we have them in place before we start to see the seeds of next boom.

Senator COLLINS. If you haven't already looked at them, I would encourage you to look at the Canadian and the Australian twin peaks system, which I think also have benefits to them.

Canada has not had the kind of financial crisis that we've had, and it is very interesting to look at the differences in their regulatory structure, their mortgage lending, and their tax deductions. It's fascinating to look at those differences and then look at the results.

My time has expired, so I am going to submit for the record, with the chairman's permission, some questions on our debt level because I wasn't able to get to that important issue today.

Thank you.

Senator DURBIN. Of course, Senator Collins, your questions will be submitted for the Secretary, along with others, for him to consider.

The last question will come from an organic farmer from Montana, Senator Tester.

STRESS TESTS AND ECONOMIC RECOVERY

Senator TESTER. Thanks, Mr. Chairman. The Congressional Oversight Board issued a report this morning stating that additional stress tests may be necessary due to uncertain economic conditions. What are your thoughts on that?

Secretary GEITHNER. Yeah. I haven't had a chance to look at the report, but of course I'll look at it and read it. But I did see some of the initial coverage of the report.

I think I should say that—just two things. The process was designed by the Federal Reserve, it was a very conservative test. And I want to cite one example. People are focused, like the Congressional Oversight Board did, on the unemployment assumptions in the initial scenarios. Those were not the binding constraint. The loss estimates that the Fed used for its estimate were more conservative than the worst 2 year period in the Great Depression, when unemployment was in the high 20s, 30s for a period of time. Those were the ones, those were the parts of that test where the—those were the ones that were most important.

I think it was a reasonably conservative and, in some ways, the best test of that was that, in the wake of that conclusion of those results, we've seen a very, very substantial amount of equity come back into the financial system because it provided a level of clarity and disclosure about balance sheets that did not exist before. And I think that's a good test.

Now, markets don't get everything right and, you know, we're still going through a deep recession and we are at the early stage of repair and recovery. Life is uncertain and there are risks ahead. But I think it was a very carefully designed conserve test and it has helped play an important role in improving confidence in the system.

REFORMING GOVERNMENT SPONSORED ENTERPRISES

Senator TESTER. Okay. The administration, you've referenced it several times, is going to be sending out a plan for Congress on modernization and regulation for financial markets. Will there be a recommendation for Freddie Mac and Fannie Mae?

Secretary GEITHNER. The future of the GSEs, including Fannie and Freddie, will be an important, is an important challenge for us, but we are not going to—I'm violating my rule of getting ahead of the President, we're not going to recommend, in our initial proposals for reform, precisely what we think the future of those issues should be.

We are going to begin the process of consulting with Congress and a broad section of housing experts on what we think the range of options are. But we are going to defer recommendations on those things for a bit longer.

Senator TESTER. Okay. Can you give me any kind of timeframe that you're looking at?

Secretary GEITHNER. I can't yet, but we probably will next week when we lay it out. But it's just a little early, just given the scale of the stuff that we are going to get to take on. We want to do this carefully.

Senator TESTER. No problem. Thank you.

Senator DURBIN. Mr. Secretary, thank you for your time here today. We are going to allow you to leave, of course, and go about your business of saving the American economy, or lunch. Whatever is on your schedule.

ADDITIONAL COMMITTEE QUESTIONS

But we thank you very much for being here. We'll send you some questions that you might consider and, while we're changing wit-

nesses here. Mr. Shulman is going to come up here, the IRS always has the last word. We will let him take the table.

Secretary GEITHNER. Thank you. He is doing a great job and I hope you will give him the support he needs.

[The following questions were not asked at the hearing, but were submitted to the Department for response subsequent to the hearing:]

QUESTIONS SUBMITTED BY SENATOR RICHARD J. DURBIN

DEPARTMENTAL OFFICES

Question. Secretary Geithner's testimony stated that the Treasury Department will be reducing costs by cutting the number of the Department's economic attachés from 20 to 16.

During this global economic crisis, why has the Department requested to eliminate staff tasked with communicating with our international economic partners?

Answer. The Department is working daily to address the current economic problems and ensure the quickest path to recovery. The fiscal year 2010 budget for the Departmental Offices will improve the analytical capabilities at the Department to address these challenges while also maintaining fiscal responsibility. We looked to offset some of the proposed increases in the Office of Domestic Finance and the Office of Tax Policy by identifying savings in the attaché program. The reallocation of resources will not negatively impact our long-term missions.

Treasury places great value on its international attaché presence, which helps advance Treasury priorities across a broad range of issues. Indeed, the attaché program has grown from 8 attachés in April 2007 to the 15 attachés currently in the field. Nonetheless, the five attaché posts in question are currently vacant. By extending the vacancies in the four posts in question, Treasury can help free up funding for programs focused on the domestic economic situation. We will continue to actively communicate with our international partners through our existing 15 attachés posted around the world, and we remain committed to working with our existing staff and other Executive Branch agencies to promote and support economic prosperity at home and abroad.

Question. The fiscal year 2009 omnibus provided $6.2 million for a new Operations Center to provide the Department with a 24/7 capability to monitor the global market.

What is the current status and timetable for full functionality of the Center?

Do you agree with the previous Administration that this 24/7 capability will enhance Treasury's responsiveness to global partners and to financial crises?

Answer. The Department does support the development of an Operations Center. Construction of the Operations Center is set to start at the end of September with phase 1 (24/7 call center ops).

Phase 2, which is ongoing, is to reassess the requirements for the Treasury Markets Room in light of the evolving mission of Treasury related to financial stability and economic recovery requirements. In this context, we are also refining the interaction between the Markets Room staff, the executive communications support team, and the emergency planning team. Since the original concept of the Treasury Operations Center was developed in 2007, prior to the 2008 financial crisis and the onset of the recession, Treasury leadership has been working to leverage investments in the Operations Center to full effect. To do so, we are refining the capabilities needed in the areas of financial markets and economic policy analysis as a result of financial stability and economic recovery initiatives. Results of this assessment will be completed this fall and will inform decisions related to staffing and organizational alignment of the Markets Room.

Phase 3 will reassess the coordination and interaction between the Treasury Operations Center and the Intelligence Operations Center. Phase 3 should not require additional resources.

COMMITTEE ON FOREIGN INVESTMENT (CFIUS)

Question. The Department has seen a significant increase in its CFIUS caseload over the last several years. The fiscal year 2009 omnibus provided additional funds for CIFIUS to address the growing backlog of cases.

To what extent have the additional funds allowed CFIUS to make progress in clearing out the backlog of cases?

Has the caseload dropped off significantly due to the economic crisis?

Answer. Treasury has utilized additional funding to increase critically needed staffing for CFIUS to handle the significant increase in caseload over the last several years. The number of covered transactions reviewed by CFIUS nearly tripled between 2005, when 64 notices were filed, and 2008, when 155 notices were received. Because of the statutory timelines for CFIUS reviews (30 days) and investigations (45 days), cases cannot accumulate in a backlog but must be reviewed within those required periods regardless of the transaction volume at any particular time. This is why adequate staffing to fully review each case for potential national security concerns is essential. Although there was a decline in the number of cases during the economic crisis of recent months, the number of anticipated cases in the pipeline has begun to rise. We expect that case volumes will return to levels of recent years when merger and acquisition activity picks up with economic growth.

OFFICE OF FOREIGN ASSETS CONTROL (OFAC)

Question. Building on the lifting of certain travel and trade restrictions included in the fiscal year 2009 omnibus, President Obama has committed to further opening trade and communication with Cuba.

What is the economic potential in agricultural trade between the United States and Cuba if all agriculture trade restrictions are lifted?

How does that compare to the level of agricultural trade today?

Answer. The Census Department reports that goods trade between the United States and Cuba since 2000 has been as follows:

U.S. GOODS TRADE WITH CUBA

[Millions of 2008 dollars]

	Exports	Imports
2000	8.8	0.4
2001	8.8	.....
2002	174.6	0.2
2003	303.2	0.4
2004	460.6	.....
2005	406.8	.....
2006	363.6	0.1
2007	464.3	0.3
2008	711.5	.....
1Q09	182.5	.....

Source: http://www.census.gov/foreign-trade/balance/c2390.html#2000.

The Trade Sanctions Reform and Export Enhancement Act of 2000 or TSRA allows sales of agricultural commodities to Cuba, while prohibiting U.S. government assistance, foreign assistance, export assistance, credits, or credit guarantees for purposes of financing such exports. TSRA also denies exporters access to U.S. private commercial financing or credit; all transactions must be conducted with cash in advance or with financing from third countries.

We do not have an estimate of the potential increase in agricultural trade with Cuba if remaining trade restrictions are lifted. A July 2007 report by the International Trade Commission estimated that the U.S. share of Cuban agricultural, fish and forest imports would increase if financing restrictions were lifted.

Question. In April of 2009, President Obama announced his intent to allow U.S. telecommunications network providers to provide phone and internet services in Cuba. However, the Cuban government would have to allow the presence of U.S. providers in Cuba for U.S. companies to enter the Cuban market, and it is unclear if or when that approval will occur.

How do you plan to pursue persuading the Cuban government to accept the operation of U.S. telecommunications companies in Cuba?

Answer. While Treasury is responsible for implementing and enforcing the Cuba Sanctions program, this question is more appropriately addressed to the Departments of State and Commerce. This would likely be part of a larger dialogue between the United States and Cuban governments over diplomatic and trade issues.

COMMUNITY DEVELOPMENT FINANCIAL INSTITUTIONS (CDFI) FUND

Question. Like a lot of individuals and businesses, CDFIs are having trouble finding financing in this economy. The budget proposes to continue a provision in the Recovery Act that temporarily waives the matching fund requirement for CDFIs.

How much of the requested budget increase will fill in the gaps left open by the decrease in private financing, and how much will actually go toward expanding the reach of CDFI funds?

Answer. Treasury estimates that private sector capital contributions to CDFIs will decline by at least $125 million in fiscal year 2010. The requested increase of $136.6 million, or a 127 percent increase in fiscal year 2010 for the CDFI Fund, which includes $80 million for the new Capital Magnet Fund and $113.6 million for the CDFI Program, will provide considerable support to CDFI industry. The request also includes additional funding to support a more robust research and evaluation program and the implementation of operational improvements.

Treasury believes that 100 percent of its CDFI Program award dollars allow CDFIs to expand their reach by: (i) introducing new financial product offerings; (ii) expanding their geographic service areas; and/or (iii) increasing the number of customers served.

Question. When does the Department project that CDFIs will be able to once again secure sufficient private funding so that Congress can reinstitute the matching funds requirement?

Answer. With the onset of the financial crisis in 2008, and resulting mergers among major banks, CDFIs have experienced severe reductions in capital contributions and investments by the major depository institutions in the CDFIs over the last 2 years, as well as significant reductions in philanthropic contributions. Declining capital contributions from depository institutions, corporations, and philanthropic institutions (amounting to a decrease of at least $125 million in private sector investments in 2010) necessitate a matching funds waiver for fiscal year 2010. Treasury is hopeful that conditions in the market will change significantly such that the matching fund requirements can be reinstated in full in fiscal year 2011. The 2010 budget requested a waiver only through 2010.

Question. Even without the matching funds requirement, CDFI grants generally only make up part of the financing package for projects such as housing units and community centers.

Considering the economic downturn, is there enough demand from high-quality CDFIs to spend the additional funds requested in fiscal year 2010?

Answer. CDFIs have seen a huge increase in loan applications since the current economic crisis began from both existing customers and customers who had been working with regulated financial institutions. Also, many CDFIs are developing neighborhood stabilization programs which entail housing and neighborhood rehabilitation, including community services. Finally, there is continuing demand for small business financing in neighborhoods that are heavily impacted by foreclosures and high vacancy rates.

Given this tremendous need for capital, Treasury believes that the $90 million in Recovery Act funding and $113.6 million requested in fiscal year 2010 will provide significant support to qualified CDFI Program applicants. Including the additional Recovery Act resources, the CDFI Fund will make approximately 90 awards totaling $145 million through the CDFI Program.

CAPITAL MAGNET FUND

Question. The fiscal year 2010 budget requests an $80 million appropriation to jump start the Capital Magnet Fund. The Capital Magnet Fund will be much like the CDFI program but will focus exclusively on the development of affordable housing. When the Capital Magnet Fund was created, Fannie Mae and Freddie Mac were required to provide revenues to the fund. However, the program has not been started because Fannie Mae and Freddie Mac are not currently in a financial position to allow them to make any contributions.

Considering the start-up time needed to administer a new program, how soon will Capital Magnet Fund grants be disbursed?

Answer. In March 2009, the CDFI Fund solicited public comments regarding the design and implementation of the Capital Magnet Fund (CMF). Over the next several months, the CDFI Fund will develop proposed regulations, the Notice of Funding Availability (NOFA) for a fiscal year 2010 funding round, a funding application, standard operating procedures for application review and awardee compliance/performance monitoring, and related automated systems. The CDFI Fund's goals are to publish the NOFA and solicit applications in the spring of 2010 and to make CMF award announcements in the summer of 2010.

Question. Please describe the major differences between the CDFI Fund and the Capital Magnet Fund.

Answer. The CMF is similar to the CDFI Program, and consistent with the CDFI Fund's core mission, in that it provides capital to organizations to support their fi-

nancing activities, rather than providing subsidies for specific projects or units, as is the case with most other Federal housing programs (e.g., Hope VI; Low-Income Housing Tax Credit; Section Eight). However, there are several differences between the CMF and the CDFI Program:

—The CMF targets a broader pool of applicants than the CDFI Program. CMF funding is available to CDFIs and to other nonprofits, whereas CDFI Program financial assistance is only available to CDFIs.

—The size of CMF awards is expected to be much larger than CDFI Program awards. CDFI Program award requests have been capped at $2 million per application, and award amounts have actually been lower (averaging $1 million per applicant in the fiscal year 2008 funding round). By contrast, with an $80 million appropriation, the CDFI Fund anticipates that it can make CMF awards in much larger amounts.

—CMF awards may only be used to attract private capital to finance the development, rehabilitation, preservation, and purchase of housing that is affordable to low-, very low, and extremely low-income households, and related economic development activities. Thus, the CMF fulfills a distinct need for flexible and innovative affordable housing financing such as: pre-development grants and loans; loan guarantees; loan loss reserves; project equity; subordinated gap financing and bridge loans. CDFI Program awards may be used for a broader range of activities including, among others: business and microenterprise lending; consumer lending; the provision of financial services; and CDFI capacity building.

Question. The Treasury Department is currently overseeing the management of Fannie Mae and Freddie Mac.

When does Treasury project that Fannie Mae and Freddie Mac will become healthy enough to begin the mandatory payments into the Capital Magnet Fund?

Answer. The Federal Housing Finance Agency (FHFA) placed Fannie Mae and Freddie Mac into conservatorship on September 7, 2008, and as conservator is responsible for overseeing the management of Fannie Mae and Freddie Mac. Consistent with its responsibilities as conservator, FHFA suspended the required Housing and Economic Recovery Act of 2008 contributions (which include the Capital Magnet Fund) by Fannie Mae and Freddie Mac in view of their losses and draws on the Treasury Department's Senior Preferred Stock Purchase facility. The ability of Fannie Mae and Freddie Mac to begin making these contributions will depend on an improvement in their overall financial condition, which is closely tied to overall conditions in the housing market.

FINANCIAL CRIMES ENFORCEMENT NETWORK (FINCEN)

Question. The fiscal year 2009 omnibus provided an $865,000 increase for FinCEN to strengthen its global efforts to combat terrorist financing and money laundering, including for addressing a large case backlog. FinCEN's work in this area is expanding as the global financial intelligence community grows. For example, in May of 2009, the Egmont group, the international organization of Financial Intelligence Units, added nine new members, including Saudi Arabia and Sri Lanka.

Why does the budget request decline to include additional funding to continue to enhance the capacity of FinCEN to communicate and coordinate with other Financial Intelligence Units around the globe?

Answer. FinCEN continues to work with FIUs around the world to expand and enhance global financial intelligence sharing initiatives aimed at combating transnational crime threats facing U.S. financial markets. FinCEN's information exchanges and case support workload to support the growing number of FIUs continues to grow.

This is very important work and continues to be a priority for the Department, however, we are operating in a tight fiscal environment with many competing priorities. The President's budget maintains the level of staff and other resources supporting FinCEN's work with international partners; it also invests in FinCEN's IT Modernization effort, which will improve data integrity and better equip FinCEN analysts to provide accurate, complete and timely responses to requests.

Question. The President's fiscal year 2010 budget requests $10 million to fund an upgrade to the information technology (IT) system used for financial reporting under the Bank Secrecy Act. In July 2006, FinCEN halted work on BSA Direct, the previous attempt to upgrade its IT systems. Treasury spent 2 years of planning and invested $14.4 million in that failed system.

What lessons were learned from the previous attempt to replace FinCEN's IT systems?

Answer. An independent review of the BSA Direct program identified several key factors that played a part in its failure. The most critical of these were: unclear

project scope and requirements; inadequate program governance; and a lack of demonstrated project management experience (both Government and Contractor).

FinCEN has been diligent in resolving all of these factors, as well as taking additional steps necessary to develop a solid foundational approach to assure the success of the new BSA IT Modernization initiative. Over the last 3 years, FinCEN has developed a comprehensive IT Modernization Vision and Strategy that identifies the scope of what is required to meet customer needs; an Enterprise Transition Strategy that outlines the high level plan for how we plan to accomplish the initiative; and employed a System Development Lifecycle, based on a model that has been successful within the IRS, to execute and monitor the program. FinCEN has committed to transparency and active engagement of internal/external stakeholders, working through the Bank Secrecy Act Advisory Group (BSAAG) and establishing an active partnership with the IRS at both an operational and strategic level. Further, we are currently working to establish a project plan that will allow the IT Modernization effort to be accomplished in the most cost-effective manner.

Finally, and to address the most critical lesson learned, Treasury has emphatically addressed the issue of program governance. FinCEN has collaborated with the Department and IRS to establish proper governance and oversight for the BSA IT Modernization initiative. In 2008, the Modernization Executive Group (MEG) was created and currently serves as the highest level, integrated governing body in support of BSA information management and is tri-chaired by the Treasury Chief Information Officer, the IRS Deputy Commissioner, and the FinCEN Director. The MEG established an Executive Steering Committee, comprised of senior Departmental, IRS and FinCEN business and technical representatives, to provide oversight and guidance to the Modernization program. FinCEN also has a new bureau-wide Project Management Office and an IT-specific Modernization Management Office to ensure the day-to-day project controls are in place for successful execution of its IT Strategy. Finally, this initiative was discussed and endorsed as a Departmental priority by the Treasury Department's Executive Investment Review Board, consisting of representatives of all Treasury components for the purpose of providing executive direction and review of significant Treasury IT projects.

Question. What improvements has FinCEN made to the planning and implementation process that will avoid problems that plagued the previous failed upgrade?

Answer. FinCEN has established the organization's first enterprise business transformation and IT modernization strategy (the BSA IT Modernization Vision & Strategy), which serves as the roadmap for aligning FinCEN's IT portfolio with business objectives and processes. The bureau has also leveraged the IRS Enterprise Life Cycle to develop a System Development Life Cycle (SDLC) to ensure a robust, repeatable process is in place to manage the projects and overall program efforts required to modernize its IT environment. As part of the SDLC, the Executive Steering Committee must approve the results of each phase of the life cycle before FinCEN can move to the next phase.

Since fiscal year 2007, FinCEN has hired six seasoned managers from industry, Department of Defense, and other Federal Agencies to oversee the Technology Solutions and Services Division (TSSD), establishing an entirely new senior management team supporting IT. The Chief Information Officer and new TSSD management team have extensive experience in managing large information technology programs and IT Modernization efforts, as well as years of hands-on experience in acquisition. Over the past 2 years, TSSD has elevated all critical Contracting Officers Technical Representatives (COTRs) responsibilities to the new senior staff, while also ensuring each COTR holds the requisite Federal Acquisition Certification for COTRs (FAC–COTR). The manager responsible for overall program control is a certified Project Management Professional from the Project Management Institute and is currently undergoing the necessary steps to obtain the Federal Acquisition Certification for PM's (FAC–PM) for FinCEN's major IT investment (BSA IT Modernization).

In addition to ensuring the appropriate planning and execution processes are in place, establishing appropriate governance and oversight, and incorporating an entirely new management team, we are continuously involving both our internal and external stakeholders to ensure successful project implementation.

Question. How does FinCEN plan to involve the wide variety of stakeholders in the planning for this IT overhaul—including banks, federal law enforcement, state and local law enforcement, and other federal intelligence agencies?

Answer. FinCEN has engaged its internal stakeholders by establishing a Cross-FinCEN Integrated Product Team (IPT) made up of representatives from each FinCEN Office (Regulatory/Policy, Analytics/Liaison, International, Office of Counsel, and Management Programs). The Data Management Program and Data Management Council (DMC), which is comprised of Federal law enforcement and regu-

latory members, were established to engage FinCEN's government stakeholders. These two entities have participated in the identification and validation of BSA capabilities and requirements. In addition, FinCEN plans to engage the IPT and DMC continuously through the modernization initiatives in such System Development Life Cycle activities as user acceptance testing, training, and communications. When appropriate, FinCEN will also leverage the BSA Advisory Group, comprised of Federal representatives as well as financial institutions, for feedback pertaining to the impacts of the Modernization on their respective user communities. Finally, these processes will ensure this investment is leveraged in the most efficient manner possible by incorporating the common needs of the over 300 agencies at the Federal, State, and local levels that depend upon the system.

TREASURY INSPECTOR GENERAL

Question. The recent increase in bank failures has forced the Treasury Inspector General to defer much of its routine but important audit and investigative work in order to meet its statutory responsibility to review certain bank failures. For fiscal year 2009, Congress provided $26.1 million for the Treasury Inspector General, a $7.6 million increase compared to the fiscal year 2008 level, so that staff could return focus on critical audit and investigative work. However, the budget proposes an increase of just $575,000 over the fiscal year 2009 enacted level.

Considering that analysts anticipate that a significant number of bank failures will occur in fiscal year 2010 and over the next several years, without a larger funding increase, how would the Treasury Inspector General's office be able to fully maintain its oversight work while conducting these critical bank reviews?

Answer. Based on the best information we have to date, we believe that the fiscal year 2010 budget request is sufficient for the OIG to meet its responsibilities, including material reviews. The fiscal year 2010 request allows the OIG to retain the larger workforce that was approved for fiscal year 2009, an increase of 39 FTEs, or nearly 34 percent, over the fiscal year 2008 level. We will continue to monitor OIG workload and seek additional resources if necessary.

ALCOHOL AND TOBACCO TAX AND TRADE BUREAU (TTB)

Question. The fiscal year 2010 budget proposes to charge producers, wholesalers, and retailers of beer, wine, and distilled spirits annual regulatory fees. These fees would offset the operating costs of TTB.

What impact would these new fees have on the industry?

Answer. Revenue from the proposed ongoing permanent "licensing and registration fee" starting in fiscal year 2010 would support the bureau's mission. Members of the alcohol industry (including retailers, wholesalers, breweries, wineries, distilleries, and industrial alcohol businesses) would pay fees ranging from $300 to $1,000, depending on the type and size of the business entity. Revenue in the first year, from annual estimated offsetting receipt collections would start out low, but grow in subsequent years to eventually offset the annual operating costs of TTB (currently around $100 million).

Annual fees are shown in the table below. A licensing and registration fee of $300 from over 350,000 retailers will generate an estimated 90 percent of the yearly revenue collected, while the remaining 10 percent would be collected from wholesalers and alcohol producers. TTB currently collects over $7 billion in federal excise taxes from alcohol producers.

The licensing/registration fee would shift the burden of paying for regulation of the alcohol industry from the general public to consumers, producers, wholesalers, and retailers of alcohol beverages.

Annual Fee Requirement

The annual fees to be charged under this program are as follows:

	Amount
Retailer Dealers in Liquors and Beer	$300
Wholesaler Dealers in Liquors and Beer	500
Alcohol Producers	1,000
Distilled Spirits Plant [1]	
Bonded Wine Cellar [1]	
Bonded Wine Warehouse [1]	
Tax paid Wine Bottling House [1]	
Every Brewer [1]	1,000
Denatured Spirits, Recovery and Tax Free Users (Industrial Alcohol)	300

	Amount
Non-beverage Domestic Drawback Claimants	500

[1] Reduced fees by substituting "$500" for "$1,000" if gross receipts are less than $500.
$500,000 for the most recent taxable year before the 1st day of the taxable period.
Certain exemptions and exceptions of the annual fee may apply to the certain business as outlined under the legislative proposal.

TROUBLED ASSET RELIEF PROGRAM (TARP)

Question. TARP places strict limitations on compensation for executives of companies receiving financial assistance from the federal government, and the Recovery Act strengthened those restrictions after weaknesses in the original TARP restrictions emerged. GAO reports that Treasury has been working to increase oversight and compliance with executive compensation restrictions, including the new provisions included in the Recovery Act.

Please provide an update on the steps Treasury is taking to institute a clear, robust process to monitor compliance with the executive compensation restrictions.

Answer. On June 15, 2009, Treasury published an Interim Final Rule ("IFR") entitled "TARP Standards for Compensation and Corporate Governance" that implements the executive compensation provisions of the Recovery Act. The IFR sets forth detailed restrictions on executive compensation applicable to TARP recipients, as well as periodic reporting and certification requirements and other procedures for monitoring compliance. The IFR also provides for the appointment of a Special Master, who has the responsibility to (i) review and approve the compensation of each of the 25 most highly compensated employees of each TARP recipient that has received exceptional assistance, (ii) review and approve the compensation plans applicable to the next 75 most highly compensated employees of each such TARP recipient, (iii) review prior compensation paid to Senior Executive Officers by TARP recipients and negotiate the return of any payments that are found to have been contrary to the public interest, and (iv) issue interpretive guidance under the rule. All TARP recipients will be required to submit detailed compensation information in order to facilitate the review process.

Question. In light of criticism that Treasury was not requiring institutions receiving TARP funds to provide detailed reports on their use of taxpayer dollars, Treasury has required that all participants in the Capital Purchase Program complete a monthly survey of lending activities. Treasury has declined to seek any further details on any TARP recipients' use of funds, with the exception of Citigroup and Bank of America, citing that such data would not be useful and would be difficult to gather.

However, the Special Inspector General for TARP sought more detailed data from over 350 TARP recipients and found that banks were, in fact, able to provide a reasonable level of detail on their use of funds. The IG reported: ". . . one thing is clear: Treasury's arguments that such an accounting was impractical, impossible, or a waste of time because of the inherent fungibility of money were unfounded."

Why has Treasury declined to require more detailed reporting from TARP beneficiaries?

Answer. It is important to distinguish between Treasury's capital-enhancement programs and its other programs. The Capital Purchase Program, Capital Assistance Program and institution-specific programs for AIG, Citigroup and Bank of America are designed to provide capital to cushion against losses and allow financial institutions to continue operating in the ordinary course of business, including lending to consumers and businesses. In order to serve its purpose, capital must be available for any legitimate business purpose. Although Treasury requires applicants for the Capital Assistance Program to specify how they intend to use the funds, accounting for actual use of particular dollars invested as capital is not a meaningful exercise and therefore not required. Because banks' double-entry bookkeeping systems do not trace the paths from creating liabilities (receiving capital) to investing in assets (making loans), we cannot precisely attribute the contribution of TARP capital to particular uses. The banks can, however, report trends in loans and other uses of funds, and we do require that they report such to Treasury.

On the other hand, Treasury's home ownership preservation program, small business lending initiative, auto industry programs, and the terms of Treasury's participation in the Term Asset Backed Securities Loan program impose specific limitations on the use of TARP funds, and require controls and periodic reports to insure that those limitations are respected.

Question. When Congress approved TARP, the expectation was that TARP funds would be used to purchase toxic assets—mainly, assets related to subprime and other troubled mortgages. Since then, TARP has evolved into 12 separate programs aimed at addressing different stress points in the market and at rebuilding a basic

lending capability for domestic markets. The complexity of this program has created a communications challenge. GAO reported in March 2009 that TARP is still very poorly understood by Congress and the public. GAO reports that Treasury has not yet developed an effective strategy for communicating with Congress, the public, and other stakeholders.

How can Treasury's actions support increasing confidence in the financial markets if the public does not have a basic understanding of the goals of TARP?

How can the Department better articulate and justify its strategy so that Americans and the markets can regain confidence in the economy?

What can Treasury do to educate concerned members of the public?

Answer. Treasury publishes a wealth of information about TARP investments and the activities of the Office of Financial Stability. In addition to transaction reports detailing every transaction, monthly financial reports, and tranche reports that review how each $50 billion of TARP funds have been spent, Treasury posts on its FinancialStability.gov website all program descriptions, guidelines, frequently asked questions and answers, contracts, press releases, and a variety of other information about TARP. Treasury also maintains a separate MakingHomeAffordable.gov website that sets forth extensive information about Treasury's homeownership preservation programs.

Nevertheless, Treasury recognizes that public perceptions of TARP could benefit from improved communications. To that end, Treasury is in the process of developing and implementing an overall communications strategy that will include regular proactive briefings for Congress and the press, clearer explanations of TARP programs and OFS activities, discussions of progress being made in achieving program objectives, and expanded efforts to communicate with and educate the public about the goals and achievements of TARP.

Question. Firms that repay preferred stock purchased under the TARP program will also have the option to repurchase warrants that Treasury holds at Fair Market Value.

How is Treasury ensuring that the valuation of the warrants is accurate so that taxpayers get a return at fair market value?

Answer. Treasury will ensure that taxpayers' interest are protected by conducting a process to determine whether to accept the bank's initial determination of the fair market value of the warrants. Treasury has developed a robust set of procedures for evaluating repurchase offers, based on three categories of input: market prices, financial modeling, and outside consultants/financial agents.

Question. Contracts for implementing TARP include the primary, large contract for the asset manager, Bank of New York Mellon, as well as smaller contracts for tasks such as legal and accounting services. These contracts have for the most part been priced on a "time and materials" basis. GAO has warned that such contracts are considered "High Risk" to the taxpayer dollar. This is because, unlike fixed-price contracts, the structure of the time-and-materials contracts provides no incentive for the contractor to control for cost or labor efficiency. In a recent TARP review, GAO reported that in response to GAO's warning, Treasury has converted two time-and-materials contracts into fixed-price arrangements and is closely assessing new contracts to identify those that may effectively utilize a fixed-price contract.

What do TARP officials consider when determining the appropriate compensation structure for new contracts?

Is Treasury conducting a thorough, comprehensive review of all of its existing contracts so that more can be converted to fixed-price, lower-risk arrangements?

Answer. Treasury considers the degree to which the contract requirements can be clearly defined to permit negotiation of a reasonable price. In the legal services contracts, the requirement to create novel, unprecedented financial structures for government investment in private corporations inhibits Treasury's ability to accurately predict the level of effort that will be required. Over time, as certain transactions are repeated, our ability to reasonably predict the level of effort increases. Treasury gathers data on the number of hours required to complete transactions and uses the data to negotiate fixed prices on a per transaction basis.

Opportunities have been limited thus far to convert significant number of contracts to fixed-price due to the difficulty in estimating with a reasonable degree of accuracy the extent or duration of the required services. Due to this high degree of uncertainty, fixed-price arrangements may not be appropriate for many TARP contracts. Treasury selects appropriate contract types based on the risk to successful performance and the capacity to negotiate a fair and reasonable price for the required services. Given the still-evolving nature of TARP, and the challenge of reasonably forecasting the level of effort required to design new financial structures and execute transactions, premature conversion to fixed price contracts would place Treasury at risk of agreeing to too high a price for services rendered. Treasury is

gathering cost data from all of its time and materials and labor hour contracts to identify areas where the level of effort can be reasonably predicted, and the costs associated with those efforts, to support the future negotiation of fixed pricing for follow-on work where appropriate.

QUESTIONS SUBMITTED BY SENATOR BEN NELSON

Question. While much of the focus up until recent weeks has been placed on the auto manufacturers, the dealerships also have much at stake. Considering that the Treasury has provided auto manufacturers with a significant amount of funding and has taken on significant ownership in these companies, how much of the assistance already provided is the Treasury prepared to allow to dealerships that have lost their franchise designations and have been left with few options?

Answer. Both General Motors (GM) and Chrysler and have committed to operating with transparency with regard to the dealership closings. The plans to consolidate dealer networks were developed by each company over a long period of time and were a part of their overall plans to restructure in order to achieve financial viability. Without the funds provided by the Treasury Department, GM and Chrysler's entire dealer network might have been eviscerated. Chrysler has worked to have the majority of its inventory off of the rejected dealership lots. GM has set up an appeals process for its rejected dealers and is providing them with 18 months of support to allow them to dispose of their inventory, which GM believes should be a sufficient amount of time given current inventory levels.

Question. No one disputes the importance of the domestic auto industry to our country and economy. Everyone understands we aren't only talking about the auto manufacturers. For instance in my state we are also talking about the dealerships, parts supplier, and a host of other industries that are either touched directly or indirectly by the auto industry.

However, I have great concerns about the United States government having an open-ended ownership stake in private companies because of the assistance that the federal government has provided.

What oversight is the Treasury Department prepared to take or conditions established so that domestic automakers are being good stewards of taxpayer money and can ensure the taxpayers of a return of their investment?

Answer. The government expects to protect the taxpayers' investment by managing its ownership stake in a hands-off commercial manner. Both companies now have new Boards of Directors comprised of distinguished business professionals who will help guide these companies through their ongoing restructurings. The Treasury Department will continue to monitor the taxpayer's investment under the TARP program and will seek to dispose of the ownership interest as soon as is practicable.

Question. While the federal government is a reluctant stakeholder in domestic companies, what should the American taxpayer expect when it comes to the divestment of funds they've provided to these auto companies? Are there benchmarks of solvency that are established or are planning on being established that will allow the taxpayers to be repaid of their investment in the auto companies? Will repayment of federal funds be on a continual basis?

Answer. The return will depend on the overall market, the economy, and the recovery of the auto sector. The decision to provide funds to the companies by the current Administration was based upon a determination that the companies have viable business plans. As a result, we will monitor GM and Chrysler's performance and seek the return of taxpayer funds as soon as is practicable.

Question. How can technology best be utilized to maximize transparency with regard to TARP transactions and the use of TARP funds by recipients? How can we ensure that this information is available as quickly, comprehensively and understandably as possible, for the benefit of both taxpayers and market participants?

Answer. Improving the ways in which the Office of Financial Stability (OFS) communicates its activities and shares relevant data with the public, market participants, and our oversight bodies is one of my highest priorities. Treasury has already improved its ability to share information through the development of our website, FinancialStability.gov, and I fully expect that the Internet will continue to play a central role in our efforts to operate in as transparent a fashion as possible.

We are working to add to the website's functionality, increase the resources available through the site, and develop additional features. I believe we need to expand the ability of people to interact with OFS, such as through a question and answer feature, and offer presentations of information tailored to the widest possible audience, including those people who do not regularly read the business page or follow the financial markets.

QUESTIONS SUBMITTED BY SENATOR SUSAN COLLINS

Question. An analysis of the Obama administration budget proposal by the Congressional Budget Office projects that the public debt ratio will double in 10 years, to 82 percent of GDP. This would be the highest debt level since World War II.

The CBO analysis also shows that the Obama budget will produce a deficit level averaging 5.3 percent of GDP across the 10-year budget window. Worse, the deficit level will be rising—not shrinking—toward the end of the 10-year period, reaching 5.7 percent in 2019.

Last month, you told Bloomberg Television that: "It's very important that this Congress and this president put in place policies that will bring those deficits down to a sustainable level over the medium term," and you added that the proper deficit target is 3 percent of GDP or smaller.

What policies do you believe should be put in place to reduce the deficit to 3 percent or less of GDP over the long term?

Answer. When we developed the fiscal year 2010 budget, we projected that the budget deficit would shrink to just above 3 percent of GDP on average during 2012–2019. The Administration's Mid-Session Review projections show a higher deficit outlook, with deficits averaging just above 4 percent of GDP over that period. This increase is primarily driven by changes in our economic assumptions, based on new data on the severity of the recession that weren't available when we developed the fiscal year 2010 budget.

Our first priority is to make sure that we do not choke off recovery in the near term by taking actions to reduce the deficit in the near term. As the recovery proceeds and the temporary surge in spending retreats, the deficit will fall. The process of developing the 2011 budget will include proposals for further deficit reduction to the extent that they are needed to put the nation back on a fiscally sustainable path.

Question. Thinking about our long-term debt situation for the moment, do you believe that it will be necessary to raise taxes to achieve a 3 percent deficit-to-GDP level?

Answer. We agree that it is important to keep the deficit at a sustainable level relative to GDP in the long term. The proposed fiscal year 2010 budget moved the budget deficit to about 3 percent of GDP, with a combination of some programs that raise revenue and put fiscal restraint on discretionary spending. The updated economic assumptions in the Mid-Session Review, which reflect a more severe recession than evident when the 2010 budget was developed, have raised projected deficits relative to GDP over the 10-year budget window. We would consider a wide range of approaches consistent with the President's commitment if we see the need to further lower the deficit after the economy recovers.

Question. In his testimony before the House Budget Committee last week, Federal Reserve Chairman Bernanke made the point that the debt cannot be sustained unless "debt and interest payments . . . are stable or declining," with "tax rates [that] are not so high as to impede economic growth." Do you agree with the Chairman that higher taxes can impede economic growth?

Answer. Most economists agree that high tax rates can hurt economic growth and that taxes should be as low as possible while still funding the needs of the United States. But large and rising deficits that become a permanent part of the economic landscape also pose a threat to economic growth. They destroy confidence in the economy and reduce business capital spending, which will lower productivity and the standard of living.

In the longer term, all policymakers will need to balance the goal of creating a sustainable fiscal path with the goal of keeping taxes low. It does the economy no good overall to have a large deficit that saps business and consumer confidence and crowds out business spending just to keep taxes low. And likewise, it does the economy no good if needed government programs are unfunded—with attendant consequences for productivity and quality of life—just to keep taxes low.

We look forward to working with the Congress to find a sustainable balance of policies in keeping with the President's commitments.

Question. The Treasury Department has an abysmal record for implementation of major capital IT investments. Some of these failures include FinCEN's Bank Secrecy Act (BSA) Direct System, IRS's web-based Electronic Fraud Detection System, and the abandoned Treasury Communication Environment.

As of last week, the Director of FinCEN was unable to explain to Appropriations Committee staff the anticipated total cost for the new BSA IT system. The FinCEn Director could also not explain how the fiscal year 2010 requested budget increase of $11 million would be used. Given that this is a complex, multi-year effort, we would like to have more details about the fiscal year 2010 request and the long-

term project costs. Secretary Geithner, can you tell us how the $11 million would be spent and what the long-term costs of this project will be?

Answer. The fiscal year 2010 President's budget request is part of a larger, multi-year initiative, that provides the ability to begin the integrated BSA IT Modernization Effort, including the full scope of BSA IT modernization capabilities. The fiscal year 2010 request of $10 million will be combined with base resources of $2.5 million to begin the project.

Specifically, the resources included in the fiscal year 2010 President's budget will be used to complete the planning, requirements, architecture and design (Lifecycle Milestone 3) activities for the following projects:

—Infrastructure
  —IT Modernization Development and Test Environment
  —Storage Area Network (SAN)
—Registered User Portal
  —User portals
  —Access Control
  —Identity Management
—E-Filing
  —E-Filing
  —E-Forms/Paper Filer Analysis
  —Shared Filing Services/Work in Progress Database
—System of Record (SOR)
  —SOR
  —Bulk Data Dissemination
  —Basic Query
  —Alerts
—Query Audit Log
—Advanced Analysis
  —Proactive Analysis
  —Analytic/Visualization Tool

In terms of long-term costs, initial estimates are for a 4-year project plan estimated at $120 million; however, in order to create the most cost-effective solution for the taxpayer's dollar, estimates will be refined and adjusted based on the results of the fiscal year 2009 requirements and alternatives analysis.

Question. The stimulus provided the CDFI Fund with $100 million for additional grants under its core and Native American programs and to cover associated administrative expenses. The stimulus also gave the Fund an additional $3 billion in new markets tax credits. These new resources coupled with the Administration's fiscal year 2010 request of $243.6 million represent a huge expansion of the Fund's programs from the fiscal year 2009 appropriation of $107 million.

The last two financial audits issued by the Treasury Office of Inspector General cited a "significant deficiency" in the CDFI's monitoring of grant recipients to determine if those recipients had complied with their grant agreements. The auditors reported that CDFI managers continued to have difficulty communicating with each other. The auditors called this situation a "significant deficiency." I understand that the Treasury moved the chief financial officer's function out of the CDFI to the Department even though CDFI is required to have a CFO. Taken together, it appears that this office has some serious management and operational problems.

Mr. Secretary, in light of the large increase for the CDFI in the budget request, could you please comment on these issues? Specifically I'd like to know what actions the Department has taken to ensure that CDFI is making grants and awarding tax credits in a speedy but responsible manner, and how CDFI will monitor those grants to determine the money is used for their intended purposes.

Answer. Although Treasury's Office of the Inspector General (OIG) did identify concerns with respect to compliance monitoring and management communication, no material weaknesses were identified in either the fiscal year 2007 or fiscal year 2008 audits, and the CDFI Fund received a clean opinion on its fiscal year 2008 balance sheet. Since fiscal year 2007, the Department, in conjunction with the CDFI Fund, has taken action to improve the efficiency and operations of the CDFI Fund, bolstering: (1) the awardee selection process, (2) compliance monitoring, (3) management communication; and (4) other areas to better meet the CDFI Fund's mission and provide better service to stakeholders and constituents. In addition to improving operational efficiency, these steps were taken to ensure that the CDFI Fund is in alignment with Treasury directives, orders, policies, procedures, and guidelines. Treasury is confident that the CDFI Fund has the necessary systems and processes in place to ensure the full integrity of its award programs.

Awardee Selection

The CDFI Fund has an extremely rigorous application selection process that ensures awards are made in an expeditious and responsible manner. Further, the Fund has developed compliance monitoring protocols and systems to ensure that award funds are used for their intended purposes.

In fiscal year 2008, the CDFI Fund began working with an outside consultant to evaluate and streamline the CDFI Program award review and selection process. The resultant new Standard Operating Procedures streamline the application process and strengthen internal controls and accountability. Among other benefits, through these new procedures, the CDFI Fund reduced fiscal year 2009 grant selection decisions by about 60 days and reduced the time from award selection to disbursements by 120 days. In fact, the CDFI Fund anticipates disbursing substantially all of the $98 million in Recovery Act award dollars within 60 days of award announcement.

With respect to its two largest programs, the CDFI Program and the New Markets Tax Credit (NMTC) Program, applicants are required to submit uniform application materials. Each funding application is rated and scored independently by three readers, followed by a Quality Assurance reviewer. Applications meeting previously established minimum aggregate scoring thresholds are considered eligible for an award. These eligible applicants are then reviewed again and an award determination is made.

There are several internal control safeguards that mitigate against any one person being able to exercise undue influence over the selection of awardees, including:

—Conflict of interest policies preclude a reader from reviewing an application of an applicant for which the reader has a previous, current, or potential relationship, financial or otherwise.

—Readers score applications independently and in remote locations. They do not discuss their reviews with other team members. Reviewers cannot communicate directly with one another regarding their applications without first making contact with the Quality Assurance reviewer.

—Review Forms provide instructions to readers with respect to how each element is to be scored, thus helping to limit reader variance.

—The relative weight ascribed to each scoring element is computer-generated and unalterable by the reader, thereby limiting the degree to which a reader can change the outcome of an overall application score.

—Each Review Form is reviewed by a Quality Assurance reviewer to ensure that (i) the reader followed the scoring guidelines and (ii) the scores are appropriate, given the reader's ratings and narrative.

—If a reader review results in a scoring anomaly, the application is re-scored by a fourth reviewer and the anomalous score will likely be disregarded.

—If the Selecting Official varies significantly from the recommendation of the review manager, a third person (the Reviewing Official) is engaged to make a final determination.

Compliance Monitoring

The significant deficiencies noted by the Treasury Inspector General for the compliance area focused on a lack of consistency in following established written policies and procedures to determine awardee compliance. The auditor's recommendation to address these significant deficiencies was to increase staff resources dedicated to compliance and monitoring. The CDFI Fund implemented these recommendations, hiring a compliance manager and additional staff, as well as providing additional training to the compliance staff. It also updated compliance monitoring policies and procedures related to awardee financial statements.

With respect to awardee compliance and performance monitoring, the CDFI Fund has developed automated on-line data collection tools, known as the Community Investment Impact System (CIIS) and the CDFI Compliance Monitoring System (CCMS), through which CDFI Program and NMTC Program awardees report institution- and transaction-level information and reports to the CDFI Fund annually, along with their audited financial statements. The CDFI Fund uses these reports to verify compliance with award agreements, and they are a valuable source of data for program evaluation and dissemination of information about the CDFI industry.

In addition to reviewing the annual financial statements and reports from all of its awardees, the CDFI Fund engages in "desk audits" and site visits each year to a small percentage of awardees. Desk audits are ordered when a potential issue of non-compliance is discovered through standard review of annual reports, and generally require the awardee to provide additional clarifying information and/or supporting documentation. Site visits may be conducted in response to a particular incidence of non-compliance, and are scheduled for a random sample of awardees.

Management Communication

The Department takes very seriously the Inspector General's findings with respect to the need to improve management communication within the Fund, and has instituted a number of initiatives to address this concern. In addition to weekly meetings with the management team, the CDFI Director has established quarterly all-hands meetings and monthly brown-bag lunches with the staff to ensure employees have an opportunity to raise concerns, receive recognition for exemplary work and discuss cross-cutting issues impacting all of the Fund's programs.

Recently, the Fund established the position of Chief Operating Officer to bring together core management and administration functions.

In addition, the Fund has encouraged program managers to conduct offsite planning retreats with their staff. Three out of seven managers have already held these sessions; the remaining four will be convened within the next 60 days.

Steps and Actions Taken to Improve CDFI Fund Operations

Numerous other steps and actions taken to improve CDFI Fund operations include:

—Comprehensive, third-party assessment of the CDFI Fund's financial management functions and capabilities, which resulted in the appointment of Treasury's Assistant Secretary for Management/Chief Financial Officer as the CDFI Fund's Chief Financial Officer. Through this action, the CDFI Fund benefits from standardized financial management and internal control processes, enhanced cost effectiveness, and improved risk management.

—Creation of new programmatic Standard Operating Procedures by Booz Allen Hamilton, which were implemented in late fiscal year 2008 and continue to be refined.

—Comprehensive skills assessment (conducted by Booz Allen Hamilton) of CDFI Fund program staff, to identify the resources necessary to carry out the new Standard Operating Procedures.

—Assessment of the CDFI Fund's human resource functions and the transfer of services to the Office of Human Resources, which allows CDFI Fund employees and managers to have consistent with the rest of the Department's employees, in addition to the establishment and implementation of human capital policies and procedures approved by the Office of Human Resources.

—Procurement of a minority-owned vendor to provide support in updating position descriptions of all employees, training in writing employee specific performance plans using Treasury's new performance management system, and tailoring Individual Development Plans for all CDFI Fund employees to reflect the new Standard Operating Procedures and defined roles and responsibilities.

—Implementation of "best practice" recruitment tools so as to recruit a diverse talent pool, including the use of multiple recruiting mechanisms and hiring authorities.

—Development and implementation of a new strategic plan for fiscal year 2009 with line staff involvement.

—Establishment of a performance-based awards program to encourage continued improvements of the CDFI Fund's programs and operations through motivation and reward of employees.

—Creation of a strong collaborative working relationship with union representatives to identify bargaining unit employee needs and concerns.

Question. Mr. Secretary, during your recent trip to China, I was troubled by the response you were given by some in China when you attempted to assure the Chinese that their investments in U.S. Treasuries are "very safe." As the Washington Post put it in an editorial on Friday, the fact that the Chinese question the trustworthiness of bonds backed by the full faith and credit of the United States should serve as a "wake up call" for all Americans.

China is currently the largest purchaser of U.S. Treasurys and many high level Chinese officials are worried about the safety of their assets and have begun to push for alternatives to the dollar as a reserve currency. Such a move would be disastrous for the United States and world economy. How do you intend to avoid such a move by the U.S. Government's largest creditor?

Answer. We are confident that the dollar will remain the major currency of use in international transactions and thus a major reserve currency. The attractiveness of the dollar to foreign investors is the unparalleled breadth, depth, and liquidity of U.S. financial markets and the confidence that foreign investors have in the long-term prospects of the American economy and American economic policy.

As Secretary of the Treasury, I am committed to ensuring that the U.S. economy and U.S. financial markets are vibrant, robust, and open to foreign investors. In ad-

dition to ensuring a growing economy, the President is committed to reducing the medium- and long-term federal budget deficit and securing fiscal sustainability.

Question. Treasury has pumped at least $70 billion into the failing multinational corporation, AIG. This insurance company nearly failed not because of its insurance business but because it had engaged in hundreds of Credit Default Swaps transaction which it could not cover when counterparties all came calling for payment at the same time. AIG used much of the TARP funds to pay these counterparties, not only Goldman Sachs, but many foreign banks, including Deutsche Bank and Societe Generale. The Special Inspector General has raised questions about whether Treasury could have used its contribution to AIG as leverage to monitor these payments and force these counterparties to accept a "haircut" on their payments. After all, without Treasury's injection of funds, AIG would have failed and they likely would have received nothing at all. Do you believe Treasury missed an opportunity to save taxpayer dollars?

Answer. When evaluating the costs to the taxpayer of Treasury's support of AIG, the benefits also should be taken into account.

The disorderly failure of AIG would have caused direct damage to the system as a whole and would likely have lowered overall risk appetite throughout the system due to the heightened uncertainty that such an event would have generated. As with all of our TARP programs, we have two goals—preserving the stability of the financial system as a whole and making sure that the taxpayers are protected and appropriately rewarded for the risk they are taking. The mitigation of systemic risk generates significant, but difficult to quantify, benefits for taxpayers.

Moreover, Treasury makes every effort to protect the taxpayer. Treasury works with AIG to maximize the chances that AIG can repay the government for its very significant financial support. In this way, the success of AIG as a business and the success of AIG's restructuring are very much in the taxpayer's medium- to long-term interest.

Treasury understands that, as a steward of taxpayer dollars, we must work hard to ensure that the financial support offered to AIG is not wasted or abused.

Treasury's ability to impose "haircuts" on AIG's derivatives counterparties is extremely limited due to the nature of derivatives contracts. Most derivatives trades are governed by standardized contracts (ISDAs) and many have so-called credit support annexes or CSAs, which govern the posting of collateral. The purpose of a CSA is to mitigate counterparty credit risk, thereby enabling the parties to focus on pricing and trading the underlying risk factors instead of worrying about whether their counterparty will be able to pay, should the trade swing in their favor. This feature facilitates liquidity, price discovery, risk transfer, and the functioning of markets generally.

Under a CSA, the failure to meet a collateral posting obligation in full generally constitutes an event of default and results effectively in the immediate termination of the underlying trades. Most of the governing contracts also contain a provision that a default on any other such contract (e.g., with another counterparty) constitutes a default on that particular one, which gives rise to so-called "cross-default risk." Put simply, if AIG were to unilaterally "haircut" one of its counterparties by posting less than the contractually obligated amount, that would constitute an event of default, trigger cross defaults, and result in mass trade terminations. In the fall of 2008, AIG had almost 50,000 derivative trades in a wide variety of asset classes with over 1,000 counterparties. Defaulting then would have destabilized an already fragile market.

This is why the Administration has proposed a special resolution regime to give the government the tools necessary for an orderly resolution of complex non-bank firms, in which creditors and counterparties may share in the losses.

QUESTIONS SUBMITTED BY SENATOR CHRISTOPHER S. BOND

TOXIC ASSETS

Question. The Administration seems to be still treating the symptoms but not the cause of the financial credit crisis. Throwing billions of taxpayer dollars at the banks without cleansing the toxic assets is simply throwing money down a rat hole. And it appears that your plan to address the toxic assets—the so-called PPIP program—may never get off the ground given FDIC Chairman Sheila Bair's recent announcement to postpone the program. Many people, including myself, are highly skeptical of the PPIP program, in the first place, since it is voluntary for the banks to participate. Without forcing the banks to clean up their balance sheets and ex-

pected losses mounting in the commercial and residential real estate markets and credit card markets, we are simply postponing their day of reckoning.

In your testimony, you seem to indicate that Treasury intends to still move forward with PPIP.

How do you intend to go forward with the PPIP program given the government's inability to attract bank participation since it is voluntary? Is there a Plan B?

Answer. Treasury is committed to the Legacy Securities PPIP, and we have been finalizing the details over the past several months. The Legacy Securities PPIP will address the market for commercial mortgage-backed securities (MBS) and non-agency residential MBS. Treasury announced in early July that it had selected nine prequalified fund managers that will receive up to $30 billion in investments from Treasury. As of October 5, 2009, Treasury announced three additional closings of Public-Private Investment Funds (PPIFs) established under the Legacy Securities Public-Private Investment Program (PPIP), bringing the total number of initial closings completed to five. As of October 5, total Treasury commitments to these five PPIFs amounts to $16.67 billion, of which $9.20 billion has been closed on. Including private capital, total PPIP closings to date amount to $12.27 billion. Fund managers have established relationships with small, minority- and women-owned businesses. Following an initial closing, each PPIF will have the opportunity for two more closings over the following 6 months to receive matching Treasury equity and debt financing, with a total Treasury equity and debt investment in all PPIFs equal to $30 billion ($40 billion including private investor capital).

Financial market conditions have improved since the early part of this year, and many financial institutions have raised substantial amounts of capital as a buffer against weaker than expected economic conditions. However, these legacy assets are still highly illiquid despite significant increases in the prices of many of these securities. The difficulty of obtaining private financing on reasonable terms to purchase these assets has limited the ability of investors to reduce liquidity discounts in legacy assets. The lack of clarity about the value of these legacy assets has also made it difficult for some financial institutions to raise new private capital and has continued to clog balance sheets.

One of the PPIP's primary objectives is to facilitate price discovery and reduce excessive liquidity discounts that have been embedded in legacy asset prices. As capital is freed up, U.S. financial institutions should engage in new credit formation. Furthermore, enhanced clarity regarding the value of legacy assets should increase investor confidence and enhance the ability of financial institutions to raise new capital from private investors. Finally, an inherent link exists between the new issue securitization market and the secondary market performance of legacy assets. As spreads compress in the legacy asset market, new securitization issuance should come to market at reasonable borrowing costs. The new issue securitization market is an absolutely critical component of lending in the economy.

REGULATORY REFORM

Question. Clearly, our financial regulatory system must be addressed since it played a role in the current credit crisis. One of the core issues is how to address "too big to fail" companies. Some argue that "too big to fail" is now "too big to exist."

Is anti-trust reform being considered as part of the Administration's regulatory reform proposal? How are you proposing to align the incentives properly to prevent future irresponsible behavior by financial institutions and future taxpayer-funded bailouts?

Answer. While effective enforcement of anti-trust laws is an important part of protecting consumers and competition in the financial sector, we have not proposed anti-trust reform as part of our regulatory reform proposals. We do not believe that the risks we propose to address are directly related to competition issues that can be addressed through an anti-trust framework.

In the past 2 years, we learned that the system was not resilient enough to bear the failure of a large, interconnected firm or contain the damage from such a failure on the broader economy. The problem was that such firms had not been required to maintain sufficient capital and liquidity cushions and were not supervised on a consolidated basis. In other words, they were not required to internalize the risks they presented to the financial system. Our plan fixes that.

Under our plan, firms that could present risks to the stability of the financial system if they failed will be subject to much higher standards so that the risk of failure will be lower. Moreover, our special resolution regime for nonbank financial firms gives the government an effective tool for an orderly resolution, in which creditors and counterparties may share in the losses rather than a bailout. In addition, we will reduce incentives for risk taking by reforming and raising capital standards for

financial firms and working to address misalignment of incentives in specific markets, like the securitization markets, through such steps as requiring originators or sponsors to maintain an economic interest in the performance of a securitization.

Finally, we have proposed steps to align the compensation of executives with the long-term interests of shareholders so that they do not have incentives for excessive risk-taking—both through regulation and supervision of financial firms and through corporate governance reform, such as "say on pay" legislation and legislation requiring independent compensation committees on corporate boards of directors.

SOCIAL AND ECONOMIC MISSIONS

Question. There is growing concern about asking weakened financial institutions to carry out the government's economic and social policies. While I understand the pressure to have bailed-out banks more engaged in efforts such as foreclosure mitigation, the danger is more financial losses that will be covered with more taxpayer funds. Further, this leads to more government involvement in dictating private business practices.

What is the Administration's exit strategy when it comes to those financial institutions—such as Fannie and Freddie, Citi—who are being required by the government to carry out various social policy programs? How will you avoid the negative consequences of forcing these entities to fulfill the inherent conflicting goals of serving shareholders and meeting the needs of the public good?

Answer. Given the important role that Fannie Mae and Freddie Mac play in the mortgage market, their participation in efforts to reduce preventable foreclosures is vital to speeding the housing recovery. The future of Fannie Mae and Freddie Mac will require careful consideration of the appropriate role of the Federal government in the mortgage market. The Administration has committed to undertaking a wide-ranging initiative to develop recommendations by early next year on the future of Fannie Mae and Freddie Mac. There are a number of options for the reform of the GSEs, including: (i) returning them to their previous status as GSEs with the paired interests of maximizing returns for private shareholders and pursuing public policy home ownership goals; (ii) gradually winding-down their operations and liquidating of their assets; (iii) incorporating the GSEs' functions into a federal agency; (iv) introducing a public utility model, in which the government regulates the GSEs' profit margin, sets guarantee fees, and provides explicit backing for GSE commitments; (v) instituting a conversion to providing insurance for covered bonds; or (vi) dissolving Fannie Mae and Freddie Mac into many smaller companies.

The 2008 Housing and Economic Recovery Act (HERA) reformed and strengthened the regulation of Fannie Mae and Freddie Mac by establishing a Federal Housing Finance Agency (FHFA) as a new independent regulator. In addition to the establishment of FHFA, HERA also provided FHFA with enhanced authority to develop regulations regarding the safety, soundness, and the mission activities of Fannie Mae and Freddie Mac.

STRESS TESTS

Question. Many experts question the reliability of the stress tests that were conducted on the large banks. Some believe that the results are too optimistic because the tests were too lenient and banks bargained with the government to reduce their capital needs. Further, to meet the capital levels required by the stress test results, it was reported that banks are relying on preferred-stock conversions for 22 percent of their fundraising. One financial expert stated that "Conversions from preferred to common don't do anything; you can just ignore them."

Do you stand by these tests? If so, can you assure the American taxpayer that they will not be asked to fund additional rounds of bailouts for these large banks? Will you conduct more stress tests? If so, under what circumstances would you conduct more stress tests?

Answer. The Supervisory Capital Assessment Process (SCAP) or "stress test" was a carefully designed, stringent test. The test was designed to account for the highly uncertain financial and economic conditions by identifying the extent to which our largest banks are currently vulnerable to a weaker than expected economy in the future.

Supervisors applied a historically high set of loss estimates on securities and loans, as well as a conservative view towards potential earnings that could act as a buffer against those losses. For instance, the 2-year, loan-loss rate assumed under the "more adverse" scenario exceeds the observed 2-year loss rates for U.S. commercial banks from 1920 to present.

Since the stress test results were announced more than $80 billion of total private capital has been raised by the 19 participating institutions. This additional private

capital reduces the likelihood that the U.S. government will need to inject additional public capital into the banking system. Treasury must balance the desire to exit its investments in private sector entities as quickly as is practicable with the need to ensure that such a withdrawal does not put the progress that the Obama Administration has made in restoring financial stability at risk. To that end, Treasury will continue to provide support where it is necessary to sustain confidence in the financial system and to support critical channels of credit to households and businesses. The SCAP focused not only on the amount of capital but also on the composition of capital held by the largest banks. That is, SCAP focused on the proportion of capital that is common equity. The SCAP's emphasis on common equity reflects the fact that common equity is the first element of the capital structure to absorb losses, offering protection to more senior parts of the capital structure and lowering the risk of insolvency. All else equal, more common equity gives a bank greater permanent loss absorption capacity and a greater ability to conserve resources. Therefore, while we were particularly pleased with the record amounts of new common equity that was raised following the SCAP, we also believe that exchanges of preferred stock for common stock have enhanced the ability of some of our largest institutions to withstand a weaker than expected economic scenario.

Currently there are no plans to conduct another stress test of the largest banks.

PROTECTIONISM

Question. Despite history's lessons on how protectionism contributed to the Great Depression, there continues to be active efforts from some in Congress to push trade protectionism, which will clearly endanger our economic recovery. There are reports that the "Buy American" provision in the stimulus has slowed down some projects and has contributed to some job losses. Now, there is an effort on the House side that is pushing protectionism further on climate change legislation by tying federal aid to companies that only develop and produce plug-in cars in the United States.

What is the Administration's official policy on protectionism and free trade? What is the Administration doing to prevent the growth of protectionism? Will it work to stop these types of protectionist measures?

Answer. President Obama has clearly stated that trade is a key engine for U.S. economic growth and job creation. The President has also emphasized the importance of avoiding protectionism in responding to the financial and economic crisis.

As part of the commitment made by G–20 Leaders to avoid protectionist trade measures, the World Trade Organization (WTO) was tasked to monitor and report on trade and trade policy-related reactions to the financial and economic crisis, a process in which the United States actively participates. While continued vigilance is important, thus far the process appears to be working—in large part due to the presence of WTO rules and the effect of very visible individual and collective monitoring. Moreover, where protectionist measures are identified, the United States will engage our trading partners in both bilateral and multilateral settings. Enforcement of WTO rules is a top priority.

With respect to the American Recovery and Reinvestment Act of 2009, we appreciate that Congress responded to the President's call to avoid protectionism in responding to the financial crisis and included a provision in the Recovery Act that ensures that the "buy American" requirement is applied in accordance with U.S. international agreements on government procurement. Public comments have been solicited on an interim Federal procurement rule and interim OMB guidance implementing the "buy American" requirement in the Recovery Act. After a thorough review of the public comments, a final rule and final OMB guidance will be prepared with the aim of ensuring that the law is implemented effectively and consistently with the objective of promoting economic recovery and job creation.

As the Congress prepares legislation, the Administration will continue to review proposed bills with a view to ensuring that they avoid protectionism and that they are fully consistent with our international trade obligations.

REPAYMENT OF TARP FUNDS

Question. The Administration has begun some banks to repay funds from the Troubled Asset Relief Program (TARP).

For these cases—especially those who are still considered "too big to fail"—how can you assure the taxpayer that they will not return to the government trough for more bailout funds? Can you definitely say that they will not be back for more taxpayer-funded bailouts?

Answer. The government's Supervisory Capital Assessment Program (SCAP), the so-called "stress test", estimated the capital needs for major banks under an adverse economic scenario. In particular, the SCAP estimated losses that those banks are

likely to incur through 2010 and the appropriate level of loan loss reserves at the end of that period. The estimated losses and the required level of reserves took into account the potential for significant additional declines in housing prices and further increases in mortgage defaults resulting from, among other things, interest rate resets. We believe that the SCAP captured the likely capital needs of the major banks under an economic scenario that is more adverse than what we, and private forecasters, expect. Since the stress test results were announced, many major banks have raised a substantial amount of new private capital. This additional private capital reduces the likelihood that the U.S. government will need to inject additional public capital into the banking system. Treasury must balance the desire to exit its investments in private sector entities as quickly as is practicable with the need to ensure that such a withdrawal does not put the progress that the Obama Administration has made in restoring financial stability at risk. To that end, Treasury will continue to provide support where it is necessary to sustain confidence in the financial system and to support critical channels of credit to households and businesses.

AUTO RESCUE

Question. The Administration has orchestrated and forced the car companies into bankruptcy but seems to be reluctant to force failed large financial institutions like Citi into restructuring.

Why are you treating failed financial institutions differently from GM and Chrysler? If Citi is not forced into a FDIC-like restructuring, how can you assure the taxpayer that they will not return for additional bailouts?

Answer. In acting to help financial institutions such as Citigroup and the automotive industry, the overarching goals of the Administration have been the same: promote the liquidity and stability of the financial system and protect the taxpayer. The actions taken have depended on the particular circumstances facing the different institutions.

The Administration took action to help the automotive industry in order to prevent a significant disruption to the industry, as conditions in the industry posed a risk of creating significant disruptions to financial market stability and negative effects on the real economy of the United States. One of the conditions on which the Administration initially provided loans to these companies was that they develop viability plans. As a result of development and consideration of these plans, it became clear that the best way to achieve viability was for GM and Chrysler to substantially restructure their businesses. Due to a variety of factors, Chapter 11 bankruptcy proved to be the most effective means of accomplishing this important goal.

Last fall, the Administration and Congress believed quick, forceful action was necessary to stabilize the financial system and certain financial firms. With Congressional authorization, these actions were taken to meet the specific needs of the time and to address the distinct difficulties faced by financial firms as a result of the crisis. The Treasury initially provided support to Citigroup on the same terms as over 650 institutions received funding pursuant to the Capital Purchase Program. The Treasury subsequently determined that additional assistance was needed to Citigroup pursuant to the Targeted Investment Program. This program is used when an institution is sufficiently important to the nation's financial and economic system that a loss of confidence in the firm's financial position could potentially cause major disruptions to credit markets or payments and settlement systems, destabilize asset prices, significantly increase uncertainty, or lead to similar losses of confidence or financial market stability that could materially weaken overall economic performance. This assistance is provided on terms that are more restrictive than those under the CPP program. These include more stringent restrictions related to executive compensation, dividend payments, share repurchases, corporate expenses, internal controls and other matters.

Citigroup was also one of the banks examined as part of the government's Supervisory Capital Assessment Program (SCAP), the so-called "stress test", which estimated the capital needs for major banks under an adverse economic scenario. In particular, the SCAP estimated losses that those banks are likely to incur through 2010 and the appropriate level of loan loss reserves at the end of that period. The estimated losses and the required level of reserves took into account the potential for significant additional declines in housing prices and further increases in mortgage defaults resulting from, among other things, interest rate resets. We believe that the SCAP captured the likely capital needs of the major banks, including Citigroup, under an economic scenario that is more adverse than what we, and private forecasters, expect. Since the stress test results were announced, many major banks have raised a substantial amount of new private capital. This additional private capital reduces the likelihood that the U.S. government will need to inject addi-

tional public capital into the banking system. Treasury must balance the desire to exit its investments in private sector entities as quickly as is practicable with the need to ensure that such a withdrawal does not put the progress that the Obama Administration has made in restoring financial stability at risk. To that end, Treasury will continue to provide support where it is necessary to sustain confidence in the financial system and to support critical channels of credit to households and businesses.

INTERNAL REVENUE SERVICE

STATEMENT OF DOUGLAS H. SHULMAN, COMMISSIONER

Senator DURBIN. I am pleased to welcome Douglas Shulman, now well-immersed in his second year of a 5 year term as the 47th Commissioner of the Internal Revenue Service. Thank you for your service and your pledge to lead the IRS from good to great.

Each year, IRS employees make hundreds of millions of contacts with American taxpayers and businesses and represent the face of our Government to more U.S. citizens than any other agency. With approximately 93,000 employees, the IRS is effectively the accounts receivable department of the United States.

In fiscal year 2008, the IRS collected $2.7 trillion, 96 percent of total Federal receipts. Simply stated, the more revenue the IRS collects, the more revenue Congress has available to deal with some of the challenges facing our Nation and the more revenue we have available to ease the tax burden on those citizens we believe to be deserving of that. Conversely, the less revenue, the less revenue Congress has for tax cuts or for worthy expenditures.

The President's proposed budget of $12.126 billion for the IRS is an overall increase of 5.2 percent above the fiscal year 2009 enacted level, which supports 95,081 full-time equivalents (FTEs) and an additional 2,376 above the current fiscal year 2009 base.

Mr. Commissioner, thank you for your patience. Thank you for joining us. Senator Collins and others may have some questions along with mine after you've given your presentation. The floor is yours.

OPENING STATEMENT OF COMMISSIONER SHULMAN

Commissioner SHULMAN. Thank you Chairman Durbin and Ranking Member Collins. I appreciate the opportunity to testify about the IRS's fiscal year 2010 budget.

Over the past year, I think the agency has shown that it can improve performance and be agile and respond to changing situations. I often say that we need to excel at both service and enforcement. It's not an either/or proposition. And I believe this budget will allow us to make continuous improvements in both our service and our enforcement, as well as in technology and the workforce.

As the Secretary mentioned, the President's budget requests $332 million in additional enforcement initiatives. This set includes a robust set of international enforcement initiatives that the President, the Secretary, and I unveiled on May 4.

Increased resources for IRS compliance initiatives have direct measurable results through a return on investment, and this $332 million will yield about $2 billion a year once it becomes fully operational in 2012.

In addition, we've asked for money so we can continue to improve our service, including face-to-face, telephone, web-based, and self-

service service models. I believe it is incredibly important and fundamental to keeping honest taxpayers in the system that we have world-class service. And it's a key part of bringing in the $2.5 trillion it takes to run the Government every year.

And as you mentioned, Mr. Chairman, we are the face of the American Government to more people than any other agency. In this regard, I also want to point out to the subcommittee that I plan to deliver recommendations to the President and the Treasury Secretary by the end of this year on how we, the IRS, can better leverage the tax return preparer community to increase compliance and ensure high ethical standards of conduct for paid preparers.

Over 80 percent of the American people use either tax software or a paid preparer to prepare their return each year. This has been a transformational shift in the way taxes are prepared. And because paying taxes is one of the largest financial transactions that individual Americans have each year, we need to make sure that the professionals who serve them are ethical and that they ensure the right amount of taxes are paid.

I'm also pleased to report that we've moved, for the second year in a row, to enact stimulus legislation. This year we implemented major provisions of the American Recovery and Reinvestment Act, getting money into the hands of individuals, as well as small businesses.

Let me turn briefly to our ongoing effort to modernize our core taxpayer account database. We have consistently delivered on commitments over the last several years. This year I have adopted a much more focused strategy, which will allow the IRS to complete the taxpayer database conversion on an accelerated timeframe. We're doing this by gradually shifting course from simultaneously developing the database and the associated applications, to a more streamlined focus on completing the modernized database. This is going to be key to our future success, to future on-line services, and to new compliance and enforcement systems.

This budget also reflects our long-term commitment to efficiency savings and productivity. With e-filing going up, I'll just note we've consolidated processing centers into 5 sites instead of 10, and we project 5 year savings to be over $100 million.

And finally, let me just point out three important legislative changes in the President's budget. There are many on which we worked and I support them all. Three very important ones are: one, the robust set of international legislative proposals which will be essential to us curbing offshore tax abuse; two, the proposal to require tax preparers that have a certain volume of tax filings to file electronically; and three, the proposal that we eliminate the 20 percent downpayment for a taxpayer who comes in trying to enter a offer in compromise with us. Those are often taxpayers in financial distress and right now they have to put 20 percent down. There's been some decrease in the program and we want to get the program back up and so we are recommending getting rid of that 20 percent payment.

PREPARED STATEMENT

Mr. Chairman and Ranking Member Collins, thank you again for the opportunity to testify. I am happy to answer any questions.

[The statement follows:]

PREPARED STATEMENT OF DOUGLAS H. SHULMAN

INTRODUCTION

Chairman Durbin, Ranking Member Collins, and Members of the Subcommittee, thank you for the opportunity to appear today to discuss the President's fiscal year 2010 budget request for the Internal Revenue Service. The President's budget represents a strategic and wise investment in the Nation's tax system and will help the IRS stay on a path of continuous improvement in such critical areas as service, enforcement, technology, and human capital.

Through its service delivery, the IRS is often the face of government to the American people. The IRS is the only agency that interacts with every business, every taxpaying individual, and every non-profit organization each year. We have that rare opportunity to influence how people think about their government.

In terms of service, I believe that taxpayers want to come to the IRS, get their questions answered and issues resolved quickly, and be on their way. It sounds simple, but in a time of increasing complexity of the tax law, and challenging economic circumstances, achieving this goal will require discipline, focus, and resources. Our service operations must be designed with the taxpayer experience as the ultimate measure of our success.

We also need a vigorous and effective enforcement program. In today's tough economic environment, it is more important than ever that every citizen feels confident that individuals and corporations are paying the taxes they owe.

The American people who play by the rules every day expect the IRS to pursue those taxpayers who do not pay their taxes, and we are vigorously enforcing the tax law. We are focusing on current enforcement initiatives, such as in the international arena, while seeking to evolve and innovate. We can also hone our enforcement techniques by adding new tools, such as more information reporting, soft notices, and self-correction.

Of course, all of our efforts depend upon the people of the IRS. We must ensure that we have talented and capable leaders and employees for the foreseeable future at the IRS, and that they have the tools and resources they need to succeed.

We also need to continue moving our technology to the next level. The tax system, America's taxpayers, and the approximately $2.5 trillion of revenue depend on it.

Finally, as I announced last week, I plan to make recommendations by the end of the year to Secretary Geithner and the President on how to better leverage the tax preparer community to increase taxpayer compliance and ensure uniform and high ethical standards of conduct for preparers. Today, over 80 percent of taxpayers use either a tax return preparer or third-party software to complete their returns. This is nothing less than a transformational shift in tax administration. The first part of the review I plan to undertake will involve fact finding and receiving input from a large and diverse constituent community. Paying taxes is one of the largest financial transactions individual Americans have each year, and we need to make sure that professionals who serve them are ethical and ensure the right amount of tax is paid.

A FIRM FOUNDATION UPON WHICH TO BUILD

The IRS has a firm foundation upon which to build. Let me briefly highlight some key trends that demonstrate both across-the-board performance improvements and the IRS' ability to be agile and respond quickly to changing situations.

Service

As of May 9th, for the 2009 filing season, the IRS has received 133.2 million total individual returns and has issued 102.3 million refunds, for a total of $278.5 billion. A record 91.6 million tax returns were electronically filed this year—a major milestone for the IRS and testament to our commitment to a robust electronic tax administration program. So far this filing season, the e-filing rate is almost 70 percent for individuals, as compared to 61 percent for the same time period last year.

This year, there was also a surge in e-file from home computers. More than 31 million people prepared their own e-file return, representing more than a 19 percent increase from the previous year. And there were almost 200 million visits to IRS.gov, comparable to last year.

Taxpayers could also find on the IRS Web site the latest information about the American Recovery and Reinvestment Act (ARRA), including details on extending health insurance for people who lost their jobs and tax breaks for first-time home-

buyers. In addition, the IRS has developed "What If" scenarios and the possible tax implications for people who may be facing financially difficult times.

American Recovery and Reinvestment Act

The IRS is proud of the role it has played, and will continue to play in helping to implement, provide guidance, and publicize many of the provisions of the ARRA that will assist both individuals and businesses in economic distress and is getting the Nation back on the road to economic recovery.

For example, a mere 4 days after President Barack Obama signed ARRA into law, the Treasury Department and the IRS swung into action in record time, developing new withholding tables to ensure money would get into American's pockets through the Make Work Pay Credit.

In March, the IRS announced that businesses with deductions exceeding their income in 2008 can use a new net operating loss tax provision to get an expedited refund of taxes paid in prior years. This provision could throw a lifeline to struggling businesses, providing them with a quick infusion of cash. We are also making it as easy as possible for businesses large and small to take advantage of these benefits.

We have shifted resources to deal with the expected growth of bankruptcies and business workouts. Moreover, we worked with the Treasury Department on a number of regulations that clarified rules to unclog the credit markets.

On the individual front, we have taken a broad approach. Through a series of massive, nation-wide outreach efforts, such as "Super Saturday," we wanted to make sure that even more taxpayers are aware of every credit, deduction, and exclusion for which they qualify, including several new benefits this year.

Our message to taxpayers was that we are going the extra mile to help those in economic distress. We want to get them their refunds as quickly as possible. And if they think they can't pay, we ask them to come in and talk about it. There are steps we can take to help.

The bottom line is that we need to be flexible yet principled and to empower our employees to use their judgment when dealing with these taxpayers in areas such as missed payments and postponing collection actions.

This year there are also a variety of new benefits and tax credits the IRS is administering that can also help energize the economy and generate much needed jobs. We are working with the media and other stakeholder groups to get out the message about their availability.

Enforcement

In fiscal year 2008, both the levels of individual returns examined and coverage rates rose substantially. We conducted nearly 1.4 million examinations of individual tax returns in fiscal year 2008, an 8 percent increase over fiscal year 2006. This reflects a steady and sustained growth over the past 3 years. Similarly, the audit coverage rate has risen from 0.58 percent in fiscal year 2001 to 1.01 percent in fiscal year 2008.

While the growth in examinations of individual returns is visible in all income categories, it is most apparent in examinations of individuals with incomes over $200,000. Audits of these individuals increased from 105,549 in fiscal year 2007 to 130,751 during fiscal year 2008, an increase of 24 percent. Their coverage rate has risen from 2.68 percent in fiscal year 2007 to 2.94 percent in fiscal year 2008.

In the business arena, audit coverage rates for small corporation returns (assets under $10 million) increased slightly over fiscal year 2007 by .03 percent. Of note, coverage rates for three classes of large corporations with assets between $50 million and $250 million and higher all increased. Coverage rates for partnership returns stayed even as compared to fiscal year 2007, while Subchapter S returns reflected a small .05 percent drop due largely to the increase in number of S-corporations. The coverage rate for tax-exempt organizations increased slightly.

IRS Criminal Investigation has also been vigorously attacking egregious tax avoidance, money laundering, and other financial crimes that have a corrosive effect on our tax system. For example, overall number of individuals charged in an information or indictment rose from 2,323 in fiscal year 2007 to 2,547 in fiscal year 2008.

Over the same period of time, prosecution recommendations for employment tax evasion more than doubled. The incarceration rate in these investigations was 81 percent and the average sentence was 29 months.

In fiscal year 2008, IRS-developed cases related to foreign and offshore issues also resulted in 61 criminal convictions, and the average term for those going to jail was 32 months. For the first 4 months of fiscal year 2009, there were 20 convictions, and the average sentence was 84 months.

IRS Workforce

In late fiscal year 2008, the IRS established the Workforce of Tomorrow task force to address recruitment and retention issues so that the IRS has the necessary leadership and workforce in place to address future challenges.

The IRS considers employee engagement fundamental to the overall success of the organization and believes that employee engagement is an ongoing process. The IRS conducts an annual survey to assess the level of engagement of employees. Overall satisfaction showed steady improvement from a score of 3.48 in 2002 to a score of 3.79 in 2008, on a scale of 1 to 5, with 5 being the most satisfied.

IRS job satisfaction is higher than most other Federal agencies, according to the Office of Personnel Management's Federal Human Capital Survey.

THE ADMINISTRATION'S FISCAL YEAR 2010 BUDGET REQUEST FUNDS KEY PRIORITIES

Total resources to support IRS activities for fiscal year 2010 are $12,440,801,000. This amount includes $12,126,000,000 from direct appropriations, an estimated $147,101,000 from reimbursable programs, and an estimated $167,700,000 from user fees. The direct appropriation is a $603,402,000 increase, or a 5.2 percent increase over the fiscal year 2009 enacted level of $11,522,598,000. This amount excludes funding to implement the ARRA.

The IRS continues to achieve efficiency savings in its operations. Because of the increase in e-filing, the IRS has effectively revised base operations and continues to implement savings resulting from the consolidation of an additional two of the paper processing sites. This consolidation has already resulted in significant savings and will continue to do so.

The IRS Strategic Plan 2009–2013 guides program and budget decisions and supports the Department of the Treasury Strategic Plan. The IRS Strategic Plan builds on past successes while being innovative and adapting to new situations, such as the increasing complexity of tax laws, changing business models, expanding use of electronic data and related security risks, accelerating growth in international tax activities, and growing human capital challenges. I am a firm believer that organizations must always be evolving, changing, and improving and the strategic plan reflects that philosophy.

The IRS Strategic Plan has two overarching goals: (1) improve service to make voluntary compliance easier; and (2) enforce the law to ensure everyone meets their obligation to pay taxes. The IRS must excel at both service and enforcement to meet its mission; it is not an either-or proposition.

To improve service and make voluntary compliance easier, the fiscal year 2010 President's budget request for IRS provides the necessary funding to implement the following key strategic priorities.

Enforcement Program

The fiscal year 2010 President's budget request includes program increases of $332.2 million for investments in strong compliance programs, including a robust portfolio of international enforcement initiatives that the President and Treasury Secretary Geithner and I unveiled on May 4, 2009.

The international initiatives include reforming business tax deferral rules so that—with the exception of research and experimentation expenses that have significant spillover benefits to the United States—companies cannot receive deductions on their U.S. tax returns supporting their offshore investments until they pay U.S. taxes on their offshore profits. The Administration also seeks to prevent abuse of the foreign tax credit.

In addition, getting tough on overseas tax havens is an integral part of the Administration's plan. It would reform the so-called "check-the-box" rules to require certain foreign subsidiaries to be considered as separate corporations for U.S. tax purposes. It would also crack down on the abuse of tax havens by wealthy Americans. For example, the Administration proposes withholding taxes from U.S. customer accounts at foreign institutions doing business with the United States but which don't share information with the IRS through the "Qualified Intermediary" program. To further combat abuse, the Administration proposes extending the statute of limitations for international tax enforcement to 6 years.

The Administration's full budget describes additional international tax reform proposals. Other legislative proposals to improve compliance and strengthen tax administration can be found later in this testimony. A key focus of our strategy is to shift enforcement resources so we can expand programs targeted at non-compliance among large corporations, U.S. business with international operations, high net-worth individuals, flow-through entities and partnerships.

Increased resources for the IRS compliance programs yield direct measurable results through high return-on-investment activities. The new enforcement personnel funded in the fiscal year 2010 President's budget are expected to generate $2.0 billion in additional annual enforcement revenue once the new hires reach full potential in fiscal year 2012. This estimate does not account for the deterrent effect of IRS enforcement programs, which are conservatively estimated to be at least three times larger than the direct revenue impact.

The tax law is complex, and even sophisticated taxpayers make honest mistakes on their tax returns. Accordingly, helping taxpayers understand their obligations under the tax law is critical to improving compliance. To this end, the IRS remains committed to a balanced program of assisting taxpayers in both understanding the tax law and paying the proper amount of tax.

Taxpayer Service Program

The fiscal year 2010 President's budget request continues improvements to both the quality and efficiency of taxpayer service, using a variety of person-to-person, telephone, and web-based and self-serve methods to help taxpayers understand their tax obligations and pay what they owe. The IRS taxpayer service program is funded in the Taxpayer Services and Operations Support appropriations. It should be noted that service investments and strategy are guided by the Taxpayer Assistance Blueprint—a 5-year plan that outlines the steps the IRS should take to improve taxpayer service and the IRS strategic plan.

Providing quality taxpayer service is fundamental to keeping honest taxpayers in the tax system and compliant. It also helps them avoid making unintentional errors before returns are filed, which, in turn, reduces the need for follow-up correspondence from the IRS.

The IRS provides year-round assistance to millions of taxpayers, including outreach and education programs, issuance of tax forms and publications, rulings and regulations, toll-free call centers, the IRS.gov web site, Taxpayer Assistance Centers (TACs), Volunteer Income Tax Assistance (VITA) sites, and Tax Counseling for the Elderly (TCE) sites.

For example, in the Small Business arena alone, in fiscal year 2008, the IRS participated in over 2,600 meetings, symposiums, and seminars attended by over 162,000 small business owners and tax professionals. The IRS also holds national and local Small Business Forums which provide an open avenue of communication between IRS and trade and industry groups. We held 135 Small Business Forums and facilitated 410 Small Business Tax Workshops in fiscal year 2008.

American Recovery and Reinvestment Act

As noted in the introduction, the IRS is now implementing a number of ARRA tax provisions, including individual tax credits, such as the Make Work Pay credit; energy credits for certain appliances, education credits, and child credits; tax incentives for business; bond incentives; and a tax credit to provide discounted health benefits to certain workers who have lost their jobs. The IRS will be able to continue to implement and administer these critical tax programs within the levels contained in this budget request.

EXPLANATION OF BUDGET ACTIVITIES

Enforcement

The fiscal year 2010 President's budget request is $5,504,000,000 in direct appropriations and an estimated $60,797,000 from reimbursable programs, plus an estimated $7,800,000 from user fees[1], for a total operating level of $5,572,597,000. The direct appropriations level is an increase of 7.6 percent from the fiscal year 2009 enacted level and includes $600,000,000 to support tax enforcement activities funded by an allocation adjustment. This appropriation funds the following budget activities.

Investigations ($637,694,000 from direct appropriations and an estimated $51,553,000 from reimbursable programs).—This budget activity funds the criminal investigations programs that explore potential criminal violations of the internal revenue tax laws, enforce criminal statutes relating to these violations, and recommend prosecution as warranted. These programs identify and document the movement of both legal and illegal sources of income to identify and document cases of suspected intent to defraud. It also includes investigation and prosecution of tax and money laundering violations associated with narcotics organizations.

[1] Note that user fees are available to supplement appropriations contingent on demand for user fee services and receipt of fees. These amounts are subject to change.

Exam and Collections ($4,706,350,000 from direct appropriations, an estimated $8,783,000 from reimbursable programs, and an estimated $7,800,000 from user fees).—This budget activity funds programs that enforce the tax laws and compliance through examination and collection programs that ensure proper payment and tax reporting. The budget activity also supports appeals and litigation activities associated with exam and collection.

Regulatory ($159,956,000 from direct appropriations and an estimated $461,000 from reimbursable programs).—This budget activity funds the development and printing of published IRS guidance materials; interpretation of tax laws; advice on general legal servicing, ruling and agreements; enforcement of regulatory rules, laws, and approved business practices; and supporting taxpayers in the areas of pre-filing agreements, determination letters, and advance pricing agreements.

The Office of Professional Responsibility is funded within this budget activity and is responsible for identifying, communicating, and enforcing the Treasury Circular 230 standards of competence, integrity, and conduct of professionals representing taxpayers before the IRS.

Taxpayer Services

The fiscal year 2010 President's budget request is $2,269,830,000 in direct appropriations, an estimated $39,000,000 from reimbursable programs, and an estimated $127,000,000 from user fees, for a total operating level of $2,435,830,000. The direct appropriations level is a reduction of 1.0 percent from the fiscal year 2009 enacted level, though it does not represent a program reduction due to non-recurrent activities and savings. This appropriation funds the following budget activities.

Pre-Filing Taxpayer Assistance and Education ($676,063,000 from direct appropriations, an estimated $819,000 from reimbursable programs, and an estimated $18,700,000 from user fees).—This budget activity funds services to assist with tax return preparation, including tax law interpretation, publication production, and advocate services. In addition, funding for these programs continues to emphasize taxpayer education, outreach, increased volunteer support time and locations, and enhancing pre-filing taxpayer support through electronic media.

Filing and Account Services ($1,593,767,000 from direct appropriations, an estimated $38,181,000 from reimbursable programs, and an estimated $108,300,000 from user fees).—This budget activity funds programs that provide filing and account services to taxpayers, process paper and electronically submitted tax returns, issue refunds, and maintain taxpayer accounts. The IRS continues to make progress in decreasing paper returns and increasing the use of electronic filing and payment methods. As previously noted, a record 90 million tax returns were filed electronically this year.

Operations Support

The fiscal year 2010 President's budget request is $4,082,984,000 in direct appropriations, an estimated $47,304,000 from reimbursable programs, and an estimated $32,900,000 from user fees, for a total operating level of $4,163,188,000. The direct appropriation level is an increase of 5.6 percent from the fiscal year 2009 enacted level and includes $290,000,000 of support funding for enhanced enforcement activities. This appropriation funds the following budget activities.

Infrastructure ($900,852,000 from direct appropriations, an estimated $155,000 from reimbursable programs, and an estimated $16,100,000 from user fees).—This budget activity funds administrative services related to space and housing, rent and space alterations, building services, maintenance, guard services, and non-Automated Data Processing (ADP) equipment.

Shared Services and Support ($1,296,629,000 from direct appropriations and an estimated $32,228,000 from reimbursable programs).—This budget activity funds policy management, IRS-wide support for research, strategic planning, communications and liaison, finance, human resources, and equal employment opportunity and diversity services and programs. It also funds printing and postage, business systems planning, security, corporate training, legal services, procurement, and specific employee benefits programs.

Information Services ($1,885,503,000 from direct appropriations, an estimated $14,921,000 from reimbursable programs, and an estimated $16,800,000 from user fees).—This budget activity funds staffing, equipment, and related costs to manage, maintain, and operate the information systems critical to the support of tax administration programs. The IRS business programs rely on these systems to process tax and information returns, account for tax revenues collected, send notices for taxes owed, issue refunds, assist in the selection of tax returns for audit, and provide telecommunications services for all business activities including the public's toll-free telephone access to tax information.

Business Systems Modernization (BSM)

The fiscal year 2010 President's budget request is $253,674,000 in direct appropriations. This amount is an increase of 10.3 percent from the fiscal year 2009 enacted level. This appropriation funds the planning and capital asset acquisition of information technology (IT) to continued modernization of the core taxpayer account database.

This effort is a critical underpinning of the next generation of IRS service and enforcement initiatives. The integration strategy includes a particular focus on enhanced information technology security practices and robust accounting and financial management controls. This activity also funds the ongoing development of the Modernized e-File platform for filing tax returns electronically. The account also funds BSM labor (salaries and expense dollars) and related contract costs.

Health Insurance Tax Credit Administration (HITCA)

The fiscal year 2010 President's budget request is $15,512,000 in direct appropriations. This amount is an increase of 0.7 percent from the fiscal year 2009 enacted level. This appropriation funds costs to administer a refundable tax credit for health insurance to qualified individuals, which was enacted as part of the Trade Adjustment Assistance Reform Act of 2002 (Public Law 107–210).

FISCAL YEAR 2010 BUDGET ADJUSTMENTS

The IRS funding increase for fiscal year 2010 is $603,402,000, which includes $256,329,000 for maintaining current levels; a net decrease of $115,794,000 from efficiencies, savings and reinvestments; and a program increase of $462,867,000 to strengthen enforcement, address IT security needs and deploy information technology systems. These investments also fund increased front-line enforcement efforts. By fiscal year 2012, these investments are projected to increase annual enforcement revenue by $2.0 billion.

The budget request supports these activities by proposing:

—$332,160,000 to target the tax gap by addressing underreporting of tax associated with complex international activities; expanding enforcement efforts on noncompliance among business and high-income taxpayers; and minimizing revenue loss by increasing document matching efforts;

—$108,100,000 to address critical IT operational and security infrastructure needs; and

—$22,607,000 to accelerate efforts to modernize the core taxpayer account database.

Fiscal Year 2009 Enacted Level

The fiscal year 2009 enacted level for the IRS is $11,522,598,000, supporting an estimated 94,209 FTE.

Maintaining Current Levels

Adjustments Necessary To Maintain Current Levels +$260,061,000/0 FTE.—Funds are requested for: fiscal year 2010 cost of the January 2009 pay increase of $80,054,000, the proposed January 2010 pay raise of $148,894,000, and non-labor related items such as contracts, travel, supplies, equipment, and GSA rent adjustments of $31,113,000.

Government-wide Reduction for Productivity Improvements −$13,732,000/0 FTE.—The IRS continues to focus on improving the efficiency of its operations through a disciplined process of productivity improvement. Additional efficiency savings are outlined in the next section.

GAO Audit Reimbursement Pursuant to Public Law 110–323 +$10,000,000/0 FTE.—This estimated adjustment will provide funds to reimburse the Government Accountability Office (GAO) for the audit of the IRS annual financial statements. The IRS must pay this cost pursuant to Public Law 110–323. In prior years, GAO conducted the financial statement audit for which it did not receive reimbursement.

Efficiency Savings

Increase e-File Savings −$8,360,000/−182 FTE.—This decrease is a result of savings from increased electronic filing (e-File), which is projected to lead to 4.6 million fewer returns filed on paper (2.9 million individual and 1.7 million business) in fiscal year 2010. This is projected to result in a savings of 182 FTE in submission processing.

Non-Recur Savings −$27,074,000/0 FTE.—This decrease is the net reduction of one-time costs associated with the IRS fiscal year 2009 enforcement initiatives.

Non-Recur Stimulus Savings −$67,900,000/−1,322 FTE.—One-time resources were provided in fiscal year 2009 to meet the requirements of the Economic Stimulus Act of 2008 (Public Law 110–185).

Non-Recur Fiscal Year 2009 Reduction Adjustment/Correspondence Inventory −$13,439,000/0 FTE.—One-time resources were provided in fiscal year 2009 to handle the increased adjustment/correspondence workload that resulted from diverting staff from paper correspondence to telephone service to meet the requirements of the Economic Stimulus Act of 2008 (Public Law 110–185).

Non-Recur Pension Plan Form Processing −$1,352,000/0 FTE.—This decrease results from the funding of the one-time cost in fiscal year 2009 to test the IRS ERISA (Employee Retirement Income Security Act of 1974) Residual Solution (IERS) system. This system will process the electronic Form 5500, Annual Return/Report of Employee Benefit Plan from the new Department of Labor ERISA Filing Acceptance system and the paper Form 5500EZ, Annual Return of One-Participant (Owners and Their Spouses) Retirement.

Reinvestment

Submission Processing Consolidation (Andover) +$2,331,000/0 FTE.—Increased use of electronic filing options has led to consolidation of the individual return processing sites. Increased e-File savings will be reinvested to fund one-time severance pay costs for the ramp-down of the Andover submissions processing site. As the Andover consolidation approaches, the IRS will continue to assist employees in finding employment either in or outside the IRS.

Program Increases

Reduce the Tax Gap Attributable to International Activities +$128,064,000/+784 FTE.—The IRS plans a multi-year investment, beginning in fiscal year 2010, to deal more effectively with increasing international tax activities of individual and business taxpayers.

This multi-year investment will improve the identification and coverage of international issues and increase issue specialization to address increasingly complex international transactions by both business and individual taxpayers. It will bring an unprecedented increase in international resources with the specialized skills to identify and examine international non-compliance.

The resources will improve the use of data we receive from non-U.S. entities and foreign governments, provide the needed legal resources, and address aggressive profit allocation activities of multinational entities doing business in the United States.

This effort will also focus on increasing reporting compliance of domestic taxpayers with offshore activity. The additional resources will allow the IRS to implement a stronger presence in offshore activities that will be able to uncover the use of offshore credit cards, disguised corporate ownership, brokering activities, and non-U.S. financial institutions providing banking services to U.S. and non-U.S. persons. This initiative will also fund the anticipated growth of collection activities resulting from increases in small and large business examination assessments, foreign investment transactions, and withholding compliance for nonresident aliens.

Finally, this initiative will allow the IRS to increase its overseas presence by adding attachés in key countries to continue our efforts to aggressively combat abusive foreign tax schemes and other tax evasion schemes. These resources are also a key component in supporting the Department of Treasury's objective of "Pre-empted and neutralized threats to the international financial system and enhanced U.S. national security."

This multi-pronged approach will aggressively target the many areas of offshore tax abuse with the goal of identifying more of these abuses and curbing this activity.

Improve Reporting Compliance of Small Business and High Income Taxpayers +$94,215,000/+755 FTE.—This initiative will improve reporting compliance by increasing examinations of business and high-income returns and exams involving flow-through entities by 47,400; audits targeting employment, excise, and estate and gift taxes by 6,350; and investigations of business non-filers by 183,000. This request will generate $567.2 million in additional enforcement revenue once new hires reach full potential in fiscal year 2012.

Expand Document Matching for Business Taxpayers +$26,237,000/+300 FTE.—This initiative will increase the coverage of the document matching program to reduce the number of business taxpayers who misreport their income. This request will generate $386.5 million in additional revenue once new hires reach full potential in fiscal year 2012.

Address Nonfiling/Underpayment and Collection Coverage +$83,644,000/+491 FTE.—With expanded enforcement efforts in recent years, the IRS must invest in

improving its collection operations to ensure appropriate overall balance and coverage. This initiative will generate $359.4 million in additional revenue once new hires reach full potential in fiscal year 2012. In addition, this initiative will fund the rent, furniture, telecommunication, and IT costs to build two new Automated Collection System (ACS) sites.

Address IT Security and Material Weakness +$90,000,000/+36 FTE.—Improving IT security is necessary to ensure the integrity of the tax system and maintain taxpayer confidence. This initiative will allow the IRS to enhance enterprise security risk management; harden software applications and network infrastructure security; improve security compliance monitoring and reporting; and provide an enterprise solution to deploy end-to-end audit log collection.

Implement Return Review Program (RRP) +$18,100,000/+10 FTE.—In fiscal year 2008, the Electronic Fraud Detection (EFDS) System stopped $1.4 billion in erroneous refunds. This initiative will complete modernization of the IRS fraudulent refund detection systems. It will deliver an integrated and unified RRP system that will enhance IRS capabilities to detect, resolve, and prevent criminal and civil tax refund and abuse.

Business System Modernization (BSM) +$22,607,000/0 FTE.—This initiative will provide funding for the continued modernization of the core taxpayer account database. This effort is a critical underpinning of the next generation of IRS service and enforcement initiatives. The integration strategy includes a particular focus on enhanced information technology security practices and robust accounting and financial management controls.

Legislative Proposals

The fiscal year 2010 President's budget includes a number of legislative proposals intended to improve tax compliance with minimum taxpayer burden. These proposals will specifically target the tax gap and generate nearly $10 billion over the next 10 years. The Obama Administration proposes to expand information reporting, improve compliance by businesses, strengthen tax administration, and expand penalties.

Modify Electronic Filing Requirements.—Electronic filing benefits taxpayers and promotes effective tax administration because it decreases processing errors, expedites processing and payment of refunds, and allows the IRS to efficiently maintain up-to-date records. This proposal would require electronic filing by tax return preparers (initially defined by a set threshold amount).

Expand Information Reporting.—Compliance with the tax laws is highest when payments are subject to information reporting to the IRS. Specific information reporting proposals would:

—Require information reporting on payments to corporations;
—Require a certified taxpayer identification number (TIN) from contractors;
—Require increased information reporting on certain government payments; and
—Increase information return penalties.

Improve Compliance by Businesses.—Improving compliance by businesses of all sizes is as important. Specific proposals to improve compliance by businesses would:

—Require electronic filing by certain large organizations; and
—Implement standards clarifying when employee leasing companies can be held liable for their clients' Federal employment taxes.

Strengthen Tax Administration.—The IRS has taken a number of steps under existing law to improve compliance. These efforts would be enhanced by specific tax administration proposals that would:

—Expand IRS access to information in the National Directory of New Hires for tax administration purposes;
—Make repeated willful failure to file a tax return a felony;
—Facilitate tax compliance with local jurisdictions;
—Extend statutes of limitations where State tax adjustments affect Federal tax liability;
—Improve the investigative disclosure statute;
—Repeal the requirement of a partial payment with an application for an offer-in-compromise; and
—Allow assessment of criminal restitution as tax.

Expand Penalties.—Penalties play an important role in discouraging intentional non-compliance. Specific proposals to expand penalties would:

—Impose a penalty on failure to comply with electronic filing requirements; and
—Clarify that the bad check penalty applies to electronic checks and other forms of payment.

IMPROVE TAX ADMINISTRATION AND OTHER MISCELLANEOUS PROPOSALS

The Administration has put forward additional proposals relating to IRS administrative reforms. These proposals would:

—Require information reporting on expense payments relating to rental property;
—Improve the foreign trust reporting penalty;
—Apply the Federal Payment Levy Program to contractors before providing Collection Due Process; and
—Clarify that vendor levy on "goods and services" would not exclude "property."

CONCLUSION

Mr. Chairman, thank you again for this opportunity to testify on the President's fiscal year 2010 budget for the Internal Revenue Service. We urge its passage. It provides the IRS with the much needed resources to provide taxpayers with high quality customer service, and bolster IRS enforcement in critical areas, such as unlawful offshore tax evasion. It also makes wise investments for the next generation of technology and the IRS workforce.

I also urge this Subcommittee to support the enactment of the legislative proposals included in the budget to improve compliance. Collectively, they will generate more $10 billion over the next 10 years if enacted.

I look forward to working with you and the Subcommittee on this important budget request and I will be happy to respond to any questions.

REGULATION OF PREPARERS

Senator DURBIN. Thank you, Mr. Shulman. Three States that I know of here, the staff has found, Oregon, California, and Alabama, already regulate tax preparers. Can you find, in their State regulation, evidence that the tax preparers in those States are doing a better job?

Commissioner SHULMAN. Some of this regulation is pretty recent and it is a relatively small subset. The Government Accountability Office (GAO) has actually done some studies of State regulation and what is effective. It kind of is across the board, everything from registration, to registration and licensing, to actual continuing education.

What I announced last week is that I'm going to have a wide-open discussion about this. We're going to invite the industry in; we're going to invite taxpayers in; we're going to invite consumer advocates in. I would love to work with the subcommittee on this and look and say, "what's the most effective way for us to work with that community to make sure there's good compliance?" And that could include service and education. It clearly will include ramped up enforcement of the bad preparers, and then regulation is on the table. And we will closely look at those States——

MISTAKES ON RETURNS

Senator DURBIN. Are there some parts of the 1040 or schedules and such where you most often find mistakes being made?

Commissioner SHULMAN. The most common mistakes occur where there's complexity. Refundable credits are one place there's quite a bit of mistakes, including the earned income tax credit. Another common mistake is math error, like not putting your Social Security number right. One of the reasons we encourage electronic filing is it often catches math errors. You can't submit it until the form is complete.

Senator DURBIN. Years ago, my bookkeeper in Springfield, Illinois passed away and I said, listen, I'm a lawyer. I took a tax course, I'll do my own tax return. I think every Member of Con-

gress should be required to do their own tax return. I think we'd have tax simplification in a hurry in this country.

And, as you might guess, the IRS sent back my tax return and said, you did a math error here, Mr. Durbin, which was a humbling experience and disqualifies me from service in the President's Cabinet. But, having said that, it was an eye opener.

REFUND ANTICIPATION LOANS

May I ask you about refund anticipation loans (RAL). I don't know if you are familiar with these. I have co-sponsored legislation to require companies operating as refund loan facilitators that offer loans to register with the Federal Government. The National Consumer Law Center found that the effective annualized rate, interest rate, for a refund anticipation loan can range from 50 percent to 500 percent.

Is the IRS doing anything at this point to address concerns about refund anticipation loans?

Commissioner SHULMAN. A couple of things. One of the most important things we do is continue to get our technology in order, so that we can get refunds out quickly to people, so they can get money in their pockets without having to take a RAL. Now, if you electronically file and choose a direct deposit, you may get your refund back in under 10 days. Anecdotally, it may come back in even fewer days.

If we can finish our modernized taxpayer database, every taxpayer will have the opportunity to get a refund back quicker. So, one key to addressing RALs is to get rid of the need. I personally think that it's incredibly unfortunate that people's financials are in a state, many times often not their own doing, that they need to take a high-interest loan and that they can't wait the 10 days to get this refund. As we look at the whole preparer issue, refund anticipation loans are clearly an associated service that some preparers provide, and we will take a look at this.

The focus is on preparer conduct, but clearly all the related industries will be part of the preparer review.

PERFORMANCE ON TOLL-FREE PHONE LINES

Senator DURBIN. What about answering the phone at the IRS? You reduced your performance goal from providing telephone assistance from 82 percent last year to 77 percent this year. I wonder why you did that. And what steps are you taking to improve the IRS's telephone performance for next year?

Commissioner SHULMAN. Phones have been stressed after sending checks out to all the American people last year, this year doing the Recovery Act, and the truing up the checks. Just to give you a sense, in 2007, we had 48 million calls between January and May. In 2008, we actually had 64 million and in 2009 we had 74 million.

And so one thing we have done as a result is redone our call routing to make it quicker for people to get in the right queue and answer important questions quickly for people, filing-dependent questions.

Second is, we're trying to push more taxpayers to the Web. So, for instance, one of the reasons for the decline this year is about

5 million people called and said, "what is my adjusted gross income?" Next year, we will have a Web service to get your adjusted gross income.

And then third, we've actually added an estimated wait time. So, if you call and it says it is going to be 15 minutes before we get to you, you can hang up and call back when it's not as busy.

So, we're doing a lot of refinements. I think the reality is lots of Government services are competing for money. We are trying to figure out the right number for level of service. I think the 77 percent doesn't mean 23 percent are unhappy. Only 7 percent got a busy signal or disconnected; it's a much smaller number. And so we're trying to get better at the Web and figure out the right level of service.

PHISHING AND DATA PROTECTION

Senator DURBIN. Two weeks ago, I got the best e-mail that I could possibly imagine. It was from the IRS! And they told me that I had a refund coming. I was elated, $600. It's terrific. I'll think of something to do with that.

Of course you know as I know, right off the bat, there's something wrong with this. Can you tell me what it is?

Commissioner SHULMAN. We don't send e-mails to people soliciting things.

Senator DURBIN. And so there are lots of scams like that out there. This person wanted me to send back some information so they could send me a refund check, nominally in the name of the IRS.

Do you go after these folks? Do you try to initiate prosecution?

Commissioner SHULMAN. We're very troubled. We would like to get the message out that you are not going to get an unsolicited phone call or an e-mail from the IRS telling you that you have some special deal with the IRS. So people should just delete that. We shut down about 2,000 sites this year. It is called phishing, sending out e-mail pretending like they are the IRS. We work with law enforcement authorities when we see these. We have hot lines. We have lots of people reporting to us. Two thousand Internet sites have been shut down just this filing season. We are very aggressive about it.

Some of these are originating from overseas and it's hard for——

Senator DURBIN. My friends from Nigeria have an ongoing correspondence with me.

Thank you. Senator Collins.

Senator COLLINS. Thank you, Mr. Chairman. I just want to associate myself with the chairman's last question to express concern about the need for more enforcement and education to deal with these scams. They are pervasive. I've talked with the Federal Trade Commission (FTC), but the IRS can certainly play an important role as well in alerting consumers.

Consumers are particularly confused because, 2 years ago, they received rebate checks from the Federal Government. So when they get an e-mail message supposedly from the IRS saying that "your stimulus check is now available," they equate it to the rebate checks.

So I just want to second Senator Durbin's concern in that area. I think we need to do more both to educate consumers and go after the people who are perpetrating these scams, which is difficult to do in an Internet world.

TAX GAP

Let me switch to some other issues. The IRS Oversight Board, in its statement to this subcommittee, identified two serious weaknesses of our tax administration system. The first is the $290 billion tax gap, and the second is what the Board referred to as the archaic nature of IRS information systems. And I am well aware of that second issue because year after year after year, the GAO puts the IRS informations systems on its high risk list.

I'd like to start with the tax gap issue and ask you what you think should be done to address the tax gap, in addition to better enforcement.

Commissioner SHULMAN. I would say that tax gap numbers are imperfect and a lot of them are extrapolated numbers from 1980 data. The only way to really get good tax gap numbers is to do random audits. We like to do our audits in a more focused, risk-based way, so random audits would be a burden on people.

With that said, we take the tax gap very seriously. I think there are three important things that can be done with tax gap. One is simplification. As long as the Tax Code is this complex, people are going to make mistakes and people are going to have opportunities to use the complexity of the system for evasion.

Second is information reporting. All our statistics show that if we get a W–2 from an employer and tax is withheld at the source, we have 99 percent compliance. When people operate a cash business, and there's no information reported to us and it is all voluntary, the compliance rate is much lower. The Congress passed a couple of very important information reporting provisions last year, such as credit card reporting for small businesses, as well as basis reporting. They will be helpful.

The President's budget this year has very important information reporting proposals, especially in the international context. So we would get more information about across-border wire transfers, and that is going to be important.

And so, the first step is simplification and the second step is information reporting. We also are taking a look at this whole issue of how to leverage preparers to be part of the system. If you think about the image of someone sitting down with the 1040 form and a pencil, the chairman notwithstanding, not that many people do that anymore. People are using a third party, someone as an intermediate. And those people need to be part of the solution to getting people to pay the right amount of taxes. Because when they don't, it is actually a huge disservice to the American people. You know, if you end up paying penalties and interest and having trouble with the IRS, your preparer hasn't done you any favors. So, I think that the whole issue of leveraging preparers is going to be part of our tax gap strategy.

REGULATION OF PREPARERS

Senator COLLINS. Let me follow-up on the issue of so-called bad preparers. Do you make referrals to State licensing boards when you identify a "bad preparer" who is a CPA? Because they're the ones who have the ability to impose sanctions.

Commissioner SHULMAN. Under Circular 230, we have the ability to impose sanctions on anyone who represents a person before the IRS. We can also give preparer penalties and then we coordinate with States. And so we do all of the above. It is such a transformational shift, with so many people using a third party, standing between them and the IRS, that we need to have this overall strategy. It includes the punitive aspect of enforcement, but also includes making sure that we are getting the right education, the right services, to preparers so that they can serve the American people well.

INTERNATIONAL ACTIVITY AND THE TAX GAP

Senator COLLINS. Does the IRS have an estimate of the tax gap attributable to international activities? The reason I ask this is you mentioned in your opening statement offshore tax abuses, and it seems that that is the focus of your fiscal year 2010 enforcement initiative.

Commissioner SHULMAN. The short answer is no. We don't have a good international tax gap estimate. The reason for that is, to get good estimates that we are willing to put out, we actually need to do random audits. To do them internationally, we have to coordinate with other law enforcement agencies. By its nature, the reason that people evade paying taxes by going overseas is its hard for the U.S. Government to get to them.

There are some wildly high estimates that are based on total deposits and how many are overseas, and assuming that no one is paying taxes on them. There are some numbers that get bandied about as part of the debate.

For me, when I think about tax gap and I think about enforcement, I think not only about the dollars that we're going to bring in directly, but also about the deterrent effect and how we project fairness to all American people.

And so the international issues that are very important to me are to go get the money that is being hidden offshore. And I also think ordinary Americans need to know that, if they are wealthy and have a lot of assets and are playing the international capital markets, they are not going to get a free pass while firemen and teachers are paying their fair share of taxes. And so it's a long way of saying it's part of collecting the $2.5 trillion you need to run the Government. This is a matter of fundamental fairness and the deterrent effect, and people need to know that the U.S. Government is on the job.

BUSINESS SYSTEMS MODERNIZATION

Senator DURBIN. I would like to ask one follow-up question here. It is on CADE, customer account data engine. I am kind of noticing, I worked with Senator Collins on this issue after 9/11 on technology in the Federal Government. And I have to tell you, after fol-

lowing it for years, it has been a source of frustration of how many bad starts we've had different with different agencies, trying to bring modern technology. Maybe the private sector has the same problem, but it seems to be endemic at the Federal Government.

Your CADE system, a core component of BSM, Business Systems Modernization, was intended to replace the original master file. It has now cost over $400 million since work began almost 5 years ago. But it has only delivered only about 15 percent of the full capability intended. The fiscal year 2010 budget request proposes a 10 percent increase for BSM, or about $24 million of the $229.9 million enacted last year.

Has the IRS taken actions to address GAO's recommendations to fully revisit the division's strategy for Business System Modernization, including developing long-term plans for completing the program?

Commissioner SHULMAN. I'm aware of the GAO report that came out yesterday and have a couple of thoughts.

The first thing I did when I came in is I talked to lots of stakeholders. I talked to GAO and our auditor and I said, you know, tell me about CADE. To put it into perspective, CADE is a $50 million or so project each year within a $1.5 billion technology portfolio. And so while it's important because it is our core database, it is not everything we do on technology.

CUSTOMER ACCOUNT DATA ENGINE

What I was told by overseers is we've made great progress, we've proven that we can do systems development, but they don't see a path to finishing CADE. And the internal projections for finishing were 2015, 2017, 2020. I believe the key to technology projects, the way get them done, is you have leaders—not just technology leaders, but the people who run agencies— focus on them and drive toward those results.

And so what we've done is refocus the effort and split apart all the application work from the database work. If we get the database done, we will get refunds out quicker, we will address material weaknesses, and we will be able to use data for enforcement purposes. So the real business value of CADE comes out of the database; we are focused on getting that done now. And we are slowing down the application development and just focusing on conversion of the database.

The other thing that I think is important from that report that came out is that the vast majority of that $400 million is being put to good use. The key is getting a data model with consistent definitions used in all of our systems. That was under that umbrella. We put out faster refunds to millions of taxpayers using the money that's been spent. Especially in these difficult economic times, that has been really important. And we are using a huge amount of the software and hardware.

So, this is a gradual shifting of focus. It is what you do with any big technology project, you learn as you go along. I certainly would hope it is not put in a category of failure; I don't believe it has failed at all. I think it's a step in what we can get done during my 5-year tenure. And that is what we are trying to get done.

Senator DURBIN. Thank you. Senator Collins.

INFORMATION TECHNOLOGY SECURITY

Senator COLLINS. Thank you, Mr. Chairman. Just one final question and the rest I will submit for the record.

I appreciate the chairman bringing about the CADE strategy because that has been of concern to me. The other issue that concerns me has to do with IT security weaknesses. How much improvement in data protection do you believe the IRS will be able to make with the $90 million that you are requesting for IT security? Give us your assessment of the vulnerabilities and whether that is, in fact, a sufficient amount to address the problem.

Commissioner SHULMAN. Senator, when I came in, all everyone talked about was modernization. And I actually believe that if you have a big technology portfolio, you need to worry about the current systems, updating those, so that your workers have tools along the way, making sure that there's the right balance between security and infrastructure. You need to worry about data security, especially when you hold the taxpayer records of the United States. And you need to worry about your new systems.

So, one of the things this budget reflects is rebalancing the portfolio so we are not myopically focused on modernization; we care a lot about security and data. There's $90 million in the budget request to upgrade our security posture and infrastructure. It is incredibly important. I think, knock on wood, we haven't had any major data breaches. There is always going to be a spectrum of weaknesses that overseers are going to point out, and you have to do risk-reward evaluations. You're never going to get every single piece of potential weakness but you have to figure out what is important.

I pay a lot of attention to GAO procedure reports. All development is now new development. We're seeing a lot of laws which are incredibly important for internal threats. We are consolidating our access points into our networks so that we have perimeter security.

A lot of data security is cultural. You want people who have access to data to wake up every day and feel it's their responsibility to lock down the data. So, we had something called Operation Red last year where we stood down every employee of the IRS for 2 hours to talk about what data is under their sphere and what can they do to better protect it, everything from file cabinets to safes to technology.

I would say we are in a better security posture now than when I started. The people who are interested in breaching the security are always going to be innovating, and so we are going to need to stay ahead of the curve. But I think the money requested in this budget will allow us to keep improving in that vein.

Senator COLLINS. Thank you. Thank you, Mr. Chairman.

Senator DURBIN. I'd like to say that the IRS Oversight Board has submitted for inclusion in the record and preliminary recommendations on the fiscal year 2010 IRS budget proposal. The GAO office, at my request, is evaluating the budget proposal and will submit its analysis and recommendations.

Colleen Kelly, president of the National Treasury and Employer's Union on behalf of employers has submitted a written statement. Without objection, these will all be made part of record.

[The statements follow:]

PREPARED STATEMENT OF THE IRS OVERSIGHT BOARD

The Internal Revenue Service (IRS) Oversight Board thanks Chairman Durbin, Ranking Member Collins, and members of the Subcommittee for the opportunity to present the Oversight Board's views on the administration's fiscal year 2010 IRS budget request.

This statement presents the Board's recommendations for the IRS' fiscal year 2010 budget and why the Board believes this level of funding is needed to meet the needs of the country and of taxpayers. Created as part of the IRS Restructuring and Reform Act of 1998 (RRA 98), the Oversight Board's responsibilities include overseeing the IRS in its administration, management, conduct, direction and supervision of the execution and application of the internal revenue laws. The Board is also responsible for ensuring that the IRS' organization and operations allow the agency to carry out its mission. To this end, the Board was given specific responsibilities for reviewing and approving annual budgets and strategic plans.

The Board has a responsibility to ensure that the IRS' budget and the related performance expectations contained in the performance budget support the recently published IRS Strategic Plan 2009–2013. In addition to this statement, the Board develops a formal report in which it explains in detail why it has recommended this budget for the IRS. Because of the late budget cycle caused by the change in administrations, this report is still under development. The Board requests that this report be entered into the meeting record when it is sent to the Subcommittee later this month.

FISCAL YEAR 2010 IRS BUDGET RECOMMENDATIONS

The IRS Oversight Board recommends an fiscal year 2010 IRS budget of $12.489 billion, an increase of $966 million over the enacted fiscal year 2009 amount of $11.523 billion. This recommendation is $363 million above the President's request of $12.126 billion.

Tables 1 and 2 at the end of this statement show more information on the Board's budget recommendations. Table 1 shows the program initiatives or increases the Board is recommending, and Table 2 shows the Board's recommended budget by account.

As the Board stated in its 2008 Annual Report to Congress, our tax administration system has two serious weaknesses, the $290 billion tax gap and the archaic nature of IRS information systems. As a result, the Board recommends that strengthening the system be a national priority.

Addressing those weaknesses is critical and urgent. The Board is fully supportive of the administration's boost in enforcement funding. However, the Board recommends greater funding in the areas of Business Systems Modernization (BSM) and Operations Support than the President's budget requests. While the Oversight Board and the administration's budgets agree in many ways, the Board feels that these key additional investments are needed sooner—not later—to strengthen our tax administration system.

The effort required to correct the two weaknesses identified above is not to be taken lightly. Although the tax gap can never realistically be eliminated, it is equally as foolish to suggest that nothing can be done to reduce it. As the Board has opined on numerous occasions, there is not a single solution to reducing the tax gap. Rather, a comprehensive, multi-faceted, multi-year, approach is needed that provides for excellent taxpayer service combined with vigorous enforcement, along with a long-term investment in IRS information technology and infrastructure. It is generally recognized that the IRS "cannot audit its way out of the tax gap." Balance between immediate expansion of personnel combined with long term investments in information technology and infrastructure is needed.

The second weakness, modernizing the IRS' archaic information technology systems, is equally daunting—yet it must be done. As noted in the Board's 2008 Annual Report to Congress, the IRS' systems modernization program has been on the Government Accountability Office's (GAO's) high risk list since 1995. The GAO placed this program on its high risk list because it believed that the IRS relied on obsolete automated systems for key operational and financial management functions. The Board believes that it is unacceptable for this program to remain on the high risk list for so long is unacceptable.

The Board believes strongly that the IRS' BSM program must be in a position to move forward in fiscal year 2010 and fiscal year 2011 so that program milestones scheduled for 2011 can be achieved. Because the President's budget provides little additional funding for the Customer Account Data Engine in fiscal year 2010, it

puts the fiscal year 2011 milestones at great risk. In addition, the Board believes additional funding is needed to refresh and update the IRS' aging infrastructure. In total, of the $363 million difference in the two budgets, about $332 million is for investments in critical information technology and infrastructure.

The Board would also increase funding for several key initiatives to improve taxpayer service. These initiatives are all designed to help the IRS plan and implement better taxpayer service in the future.

Board Fully Supports Increased Enforcement Funding

The Board's recommendation for the enforcement account, which at $5.5 billion is close to half of the IRS total budget, is identical to the President's budgets. Both the President's and Oversight Board's budgets add $332 million for additional enforcement. This increase constitutes a 7.6 percent boost in enforcement funding, and includes additional funding to strengthen criminal investigations programs, increase examinations and collections, and support a variety of regulatory matters.

This increase in enforcement resources pays for itself; in some cases many times over—a consideration that should not be ignored in the budget process. In addition, it helps to reduce the tax gap, which deprives the nation, and hence its citizens, of $290 billion it is legally owed. The tax gap is an affront to honest taxpayers and efforts must be made to reduce it.

The President's request for enforcement funding includes a multi-year investment of $128 million, starting in fiscal year 2010, to deal more effectively with increasing international tax activities of individual and business taxpayers. The Board is pleased with this, as the effects of globalization on tax administration are significant and must be addressed.

The Board also strongly supports additional funding to improve compliance among "high-risk" taxpayer segments. Estimates shows that much of the tax gap is due to underreporting of income by businesses, mostly run by individuals. It is imperative that the IRS not only ensure that all individuals understand their tax obligations, but that they report their income and pay their taxes.

Taxpayer Service Increase Recommended

For the taxpayer service account, the Oversight Board's and President's budgets are within 0.2 percent of one another. The President's budget request for taxpayer service benefits from congressional action taken during consideration of the fiscal year 2009 budget. By adding additional funding to the IRS taxpayer service budget in fiscal year 2009, Congress raised the base amount for taxpayer service in fiscal year 2010, giving the IRS additional resources to serve taxpayers in an increasingly more complex economic environment.

The need for taxpayer service is especially acute during periods of economic hardship, as taxpayers may find themselves facing challenging financial situations. In addition, taxpayers need additional help to understand new tax provisions and programs designed to help them during difficult times. Every change in the tax code causes the tax administration system to become more complex, with more taxpayers in need of help to understand and meet their obligations. It is especially important during this recession that the IRS be able to follow through on its strategic goal to "make voluntary compliance easier."

Despite a higher funding base for taxpayer service, there are several areas where the Board recommends additional funding. In 2005, Congress asked the IRS, National Taxpayer Advocate, and the IRS Oversight Board to develop a 5-year plan to improve taxpayer service. The result was the Taxpayer Assistance Blueprint (TAB), which was completed in April 2007. In the Board's opinion, the IRS needs additional resources to more fully carry out the TAB by expanding its on-line capabilities. Additional funding is also needed to optimize the use of Taxpayer Assistance Centers, also known as walk-in sites, which traditionally serve lower income taxpayers who depend more on walk-in services. Overall, the Board recommends an additional $31.6 million be appropriated for taxpayer service, all of which will be focused on improving taxpayer service in the future.

Strategic Funding Needed for Business Systems Modernization

The IRS' archaic computer systems are a serious challenge facing the IRS. The Board is dismayed by the long-term under-funding of the BSM program, forcing the IRS to stretch out its efforts at a painfully slow pace, to the detriment of taxpayers.

The Board is pleased that the IRS has revised its BSM approach to put more focus on completing the program, and considers it a critical foundation of service and enforcement in the future.

However, the Board questions whether the President's budget will allow for substantive progress in the coming years. The Board has opined in past years that the BSM account is fundamentally under-funded, and despite the additional $7.3 million

added by Congress in fiscal year 2009 and the President's fiscal year 2010 requested increase of $22.6 million, the fiscal year 2010 request for BSM continues to be far too low. Progress will come slowly should that trend continue. The Customer Account Data Engine project, in particular, has funding needs that go far beyond what was requested in fiscal year 2010, and those needs will only grow in fiscal year 2011.

The Board's recommended BSM budget of $400 million is 58 percent higher than the President's BSM budget of $253.7 million. At $253.7 million, the President's BSM budget consumes 2.1 percent of the IRS total budget of $12.126 billion. This compares to the Board's recommendation of a $400 million BSM budget, which consumes 3.2 percent of its total $12.489 billion budget. Although the difference is quite small when viewed as a portion of the total budget, the vision presented by these two BSM budgets is quite different. The Board believes that funding decisions for the IRS must look beyond consideration of short term benefits and immediate return on investment. Serious consideration must also be given to the long term benefits to taxpayers and the tax administration system that will result from a modernized information technology system. These investments will result in fundamental changes to tax administration that will benefit both taxpayers and tax administrators alike.

The Board recommends that a total of $400 million be appropriated for the BSM program so that the pace of progress is increased, allowing the IRS to achieve key milestones in fiscal year 2011, such as the deployment of a daily Individual Master File capability and a Customer Account Data Engine relational database.

More Funding for Operations Support

Another important aspect of the IRS' performance is the state of its legacy infrastructure: the technology and tools used by IRS employees to do their work. IRS laptops, software, the telecommunications systems, and the buildings themselves are aging and must be updated and maintained. In addition, the IRS must protect its hardware and data infrastructure from threat, whether it comes from bad weather or cyber-attack.

The administration's fiscal year 2010 budget calls for $108.1 million in program increases to address information technology security and material weaknesses and to strengthen the Electronic Fraud Detection System. The Board supports this funding, as both can help ensure the integrity of the tax system and maintain taxpayer confidence that its returns remain private and safe from security risks.

However, more needs to be done. The Board recommends a total of $292 million in infrastructure program initiatives, compared to the $108 million requested by the President's IRS budget. The Board recommends an additional $164 million in technology initiatives and a $20 million initiative related to workforce development. This funding is needed to refresh and maintain the IRS' infrastructure, strengthen its ability to protect the personal information of taxpayers, increase the productivity of its workforce by leveraging information technology, and upgrade its financial services accounting system that uses a software application product that is so old the vendor will no longer support the program in 2013.

In addition, workforce development cannot be ignored, especially during a period when the IRS is losing experienced employees to retirement and is hiring a significant number of new employees. Frontline supervision plays a key role in employee satisfaction, quality, and productivity, and the IRS lacks funding to properly train frontline managers in a timely fashion. Approximately $15 million of the workforce initiative is for frontline management training, with the remaining $5 million for succession planning and executive development.

Long-Term Investment Key to IRS Strength

Although the magnitude of the Board's budget recommendations for the IRS are not vastly different from the President's budget request in amount, they do focus more on the IRS' strategic goals and call for investments that are needed today for a stronger tax administration system in the future. The Oversight Board believes that its approach represents a meaningful long-term investment to benefit our Nation in the decades to come.

TABLE 1.—IRS OVERSIGHT BOARD RECOMMENDED FISCAL YEAR 2010 IRS BUDGET BY PROGRAM INITIATIVE

[In thousands of dollars]

Fiscal Year 2009 Enacted	11,522,598

TABLE 1.—IRS OVERSIGHT BOARD RECOMMENDED FISCAL YEAR 2010 IRS BUDGET BY PROGRAM INITIATIVE—Continued

[In thousands of dollars]

Changes to Base:	
Maintaining Current Levels	256,329
Efficiencies/Savings	(118,125)
Reinvestment	2,331
Subtotal Changes to Base	140,535
Total Fiscal Year 2010 Base—Current Services	11,663,133
Program Increases	
Taxpayer Service Initiatives:	
TAB Technology Enhancements	6,000
Optimize TAC Footprint	17,880
Research and Analysis to Improve Taxpayer Service	7,750
Subtotal, Taxpayer Service Initiatives	31,630
Program Increases	
Enforcement Initiatives:	
Reduce the Tax Gap Attributable to International Activities	128,064
Improve Reporting Compliance of SB/SE Taxpayers	94,215
Expand Document Matching for Business Taxpayers	26,237
Address Nonfiling/Underpayment and Collection Coverage	83,644
Subtotal, Enforcement Initiatives	332,160
Infrastructure Initiatives:	
Address IT Security and Material Weakness	90,000
Implement Return Review Program	18,100
Refresh/Sustain Infrastructure	75,000
Training and Certifying Project Managers	5,000
Enhance Privacy, Information Protection and Data Security	9,154
Technology Investments to Enhance Operations	35,000
Upgrade Integrated Financial System (IFS)	40,700
Leadership Training and Development	20,000
Subtotal, Infrastructure Initiatives	292,954
BSM Initiative:	
Fund BSM to Accelerate Taxpayer Benefits	168,933
Subtotal, BSM	168,933
Subtotal Fiscal Year 2010 Program Initiatives	825,677
Total Fiscal Year 2010 Request	12,488,810
Fiscal Year 2010 President's Request for IRS	12,126,000
Increase Over President's Request	362,810

TABLE 2.—SUMMARY OF OVERSIGHT BOARD RECOMMENDED IRS FISCAL YEAR 2010 BUDGET BY ACCOUNT

[Dollars in thousands]

	Taxpayer Service	Enforcement	Ops Support	BSM	HITCA	Total
Fiscal Year 2009 Enacted Budget	$2,293,000	$5,117,267	$3,867,011	$229,914	$15,406	$11,522,598
Changes to Base:						
Maintaining Current Levels Adjustment	$60,195	$133,815	$61,060	$1,153	$106	$256,329
Efficiencies/Savings	($90,918)	.....	($27,207)	.....	.....	($118,125)
Reinvestment	$2,025	.....	$306	.....	.....	$2,331
Subtotal Changes to Base	($28,698)	$133,815	$34,159	$1,153	$106	$140,535
Total Fiscal Year 2010 Base—Current Services	$2,264,302	$5,251,082	$3,901,170	$231,067	$15,512	$11,663,133
Program Increases						
Taxpayer Service Initiatives:						
TAB Technology Enhancements	$592	.....	$5,408	.....	.....	$6,000
Optimize TAC Footprint	$4,238	.....	$13,642	.....	.....	$17,880
Research and Analysis to Improve Service	.....	.....	$7,750	.....	.....	$7,750
Subtotal, Taxpayer Service Initiatives	$4,830	.....	$26,800	.....	.....	$31,630
Enforcement Initiatives:	.....	.....	.....	.....	.....	.....
Reduce the Tax Gap Attributable to International Activities	$3,124	$104,113	$20,827	.....	.....	$128,064
Improve Reporting Compliance of SB/SE Taxpayers	$267	$75,114	$18,834	.....	.....	$94,215
Expand Document Matching for Business Taxpayers	$1,425	$17,955	$6,857	.....	.....	$26,237
Address Nonfiling/Underpayment and Collection Coverage	$712	$55,736	$27,196	.....	.....	$83,644
Subtotal, Enforcement Initiatives	$5,528	$252,918	$73,714	.....	.....	$332,160
Infrastructure Initiatives:						
Address IT Security and Material Weakness	.....	.....	$90,000	.....	.....	$90,000
Implement Return Review Program (RRP)	.....	.....	$18,100	.....	.....	$18,100
Refresh/Sustain Infrastructure	.....	.....	$75,000	.....	.....	$75,000
Training and Certifying Project Managers	.....	.....	$5,000	.....	.....	$5,000
Enhance Privacy, Information Protection and Data Security	.....	.....	$9,154	.....	.....	$9,154
Technology Investments to Enhance Operations	.....	.....	$35,000	.....	.....	$35,000
Upgrade Integrated Financial System (IFS)	.....	.....	$40,700	.....	.....	$40,700

Leadership Training and Development	.....	.....	$20,000	.....	.....	$20,000
Subtotal, Infrastructure Initiatives	.....	.....	$292,954	.....	.....	$292,954
Business Systems Modernization Initiative:	.....	.....	.....	.....	.....	.....
Fund BSM to Accelerate Taxpayer Benefits	.....	.....	.....	$119,133	.....	$119,133
Subtotal, Business Systems Modernization	.....	.....	.....	$168,933	.....	$168,933
Subtotal Fiscal Year 2010 Program Changes	$10,358	$252,918	$393,468	$168,933	.....	$825,677
Total Fiscal Year 2010 Board Recommendation	$2,274,660	$5,504,000	$4,294,638	$400,000	$15,512	$12,488,810
Fiscal Year 2009 Enacted	$2,293,000	$5,117,267	$3,867,011	$229,914	$15,406	$11,522,598
Fiscal Year 2010 President's Request for IRS	$2,269,830	$5,504,000	$4,082,984	$253,674	$15,512	$12,126,000
Increase Over President's Request	$4,830	.....	$211,654	$146,326	.....	$362,810
Percent Increase Over President's Request (Percent)	0.2	.....	5.2	57.7	.....	3.0

PREPARED STATEMENT OF COLLEEN M. KELLEY, NATIONAL PRESIDENT, NATIONAL TREASURY EMPLOYEES UNION

Chairman Durbin, Ranking Member Collins, and distinguished members of the Subcommittee, I would like to thank you for allowing me to provide comments on the administration's fiscal year 2010 budget request for the Internal Revenue Service (IRS). As President of the National Treasury Employees Union (NTEU), I have the honor of representing over 150,000 federal workers in 31 agencies, including the men and women at the IRS.

IRS FISCAL YEAR 2010 BUDGET REQUEST

Mr. Chairman, NTEU strongly supports the administration's fiscal year 2010 budget request of $12.1 billion for the IRS, a roughly $600 million increase over fiscal year 2009 levels. We believe that the President's request will allow the IRS to continue providing taxpayers with top quality service and will assist efforts to enhance taxpayer compliance and close the tax gap.

We are particularly pleased the administration's budget request would provide $5.5 billion for IRS tax enforcement, including additional resources made available through a program integrity allocation adjustment. According to the administration, IRS enforcement efforts recoup $5 for every $1 dollar invested and the program integrity savings from increased investment for IRS enforcement efforts will be more than $13 billion between 2010–2014.

We are also pleased to see the recently passed budget resolution fully funds the President's budget request for the IRS and includes the President's request for additional resources for IRS tax-law enforcement.

I would also note that in previous years, NTEU has supported the budget recommendations proposed by the IRS Oversight Board which have generally called for additional resources above that requested by the administration. For fiscal year 2010, the Oversight Board has recommended $12.961 billion in funding for the IRS. While we have not seen the specific details of the Board's updated proposal, we would be inclined to support providing additional funding for the IRS above the administration's request and look forward to reviewing the Board's final recommendation.

MAJOR CHALLENGES

Mr. Chairman, NTEU believes the President's request will allow the IRS to meet its customer service and enforcement challenges while also addressing some of the most immediate challenges it will face in the coming years, including the growing human capital crisis, increasing complexity of tax administration, and a burgeoning tax gap.

HUMAN CAPITAL CRISIS

NTEU believes that IRS employees are the most valuable asset in effective tax administration. We are glad to see that the IRS Strategic Plan for 2009–2013 recognizes this fact and stresses the importance of investing in the workforce in order to achieve its service and enforcement goals. But as the IRS notes, they face several major challenges such as large numbers of retirements and competition with both the public and private sectors for critical talent. According to the IRS, more than half of IRS employees and managers are age 50 or older. The expected large scale retirements of thousands of Service personnel over the next several years will only further deplete the decimated IRS workforce that is down by more than 23,000 since 1995. According to a report by the IRS Oversight Board, an independent body charged with providing IRS with long-term guidance and direction, roughly 4,000 IRS employees a year for the next four years are expected to retire, taking with them years of experience and valuable skills. The dramatic decline in staffing levels coupled with the pending retirement wave has caused the Oversight Board to identify human capital issues as one the most important strategic challenges facing the IRS.

In the face of an aging workforce and looming wave of retirements, Commissioner Shulman created the Workforce of Tomorrow task force to ensure that in five years the IRS has the leadership and workforce ready for the next 15 years and to help make the IRS the best place to work in government.

NTEU was happy to see that the President's budget request acknowledges the human capital crisis at the Service and provides for major increases in Service staffing, particularly in the area of enforcement. According to the administration, the new enforcement personnel funded in the President's budget will generate $2.0 bil-

lion in additional annual enforcement revenue once the new hires reach full potential in fiscal year 2012.

INCREASING COMPLEXITY OF TAX ADMINISTRATION

Under the President's budget request, the IRS will also be better equipped to handle the challenges associated with the increasingly complexity of tax administration. For example, one of the biggest challenges the IRS confronts each year is identifying new tax law and administrative changes as well as expiring tax provisions. According to the IRS, in 2007 alone, 41 tax provisions expired affecting a wide range of taxpayers.

During the 2009 Filing Season, the IRS was presented with additional challenges due to the enactment of two significant new tax laws, the "Housing and Economic Recovery Act of 2008," which includes a refundable homebuyer credit as well as an additional standard deduction for real property taxes, as well as the "Emergency Economic Stabilization Act of 2008," which included 116 different tax provisions.

In the future, the IRS will also be confronted with the challenges presented by the increasing globalization of individual taxpayers and businesses. As more and more U.S. taxpayers and businesses expand into global markets, it will be important that the IRS has the technical expertise to identify and understand the proliferation of complex international activities and the emerging global nature of tax administration.

TAX GAP

Recent and projected large Federal budget deficits have generated congressional and executive branch interest in raising revenue by reducing the tax gap, that is, the difference between what taxpayers should have paid and what they actually paid on a timely basis. For tax year 2001, the IRS estimated a gross tax gap of $345 billion, equal to a noncompliance rate of 16.3 percent.

NTEU believes that efforts to close the tax gap must focus on improving compliance activities and enhancing taxpayer service. By improving document matching, examination, and collection activities, the IRS will be better able to prevent, detect, and remedy noncompliance. And providing taxpayers with assistance and clear and accurate information before they file their tax returns will help reduce unnecessary contacts afterwards, allowing IRS to focus enforcement resources on taxpayers who are intentionally evading their tax obligations.

In addition to generating additional revenue for the Federal Government, reducing the tax gap will help strengthen public trust in the fairness of the tax system which will positively impact voluntary compliance with tax laws.

That is why NTEU supports the President's request for an additional $332 million to help close the tax gap by strengthening compliance and allowing the IRS to better address the main components of the tax gap including, underreporting, non-filing and underpayment.

ENFORCEMENT

Mr. Chairman, as you know enforcement of the tax laws is an integral component of IRS' effort to enhance voluntary compliance and close the tax gap. IRS enforcement activities, such as examination and collection, target elements of the tax gap and are a high priority for the Service. In fiscal year 2008, the IRS initiated additional information reporting requirements for large partnerships and foreign corporations, soft notices and self-correction to improve compliance.

These efforts helped the IRS bring in $56.4 billion in enforcement revenue in 2008, a 65 percent increase over fiscal year 2002. The $56.4 billion in collections in 2008 represents a 5 to 1 return on investment for all IRS activities. In addition, the IRS showed consistent improvement in its enforcement results meeting or exceeding 78 percent (14 of 18) of its program targets.

Most impressively, the IRS continues to bring in record amounts of enforcement revenue despite severe cuts to enforcement staffing over the past 13 years. In particular, the number of revenue officers and revenue agents—two groups critical to closing the tax gap and thereby reducing the Federal budget deficit—have shrunk by 33 and 20 percent respectively. Revenue officers went from 8,139 to 5,481 and revenue agents fell from 16,078 to 12,951. As noted previously, these drastic cuts have come at a time when the IRS workload has increased dramatically due to the increasing complexity of tax administration.

NTEU believes it is essential that the IRS continue to direct resources toward enforcement activities that have the greatest overall impact on compliance and can best aid the Service's efforts to close the tax gap. One such activity is the IRS Automated Underreporter (AUR) program which has evolved as an important Service

compliance initiative using third-party information returns to identify income and deductions that were not reported on tax returns. NTEU believes the program is an effective way to detect taxpayer underreporting which accounts for roughly 82 percent of the gross tax gap.

In fiscal year 2008, increased AUR contact closures increased by almost 4 percent from the previous year and dollars collected through AUR and information return processing increased by 22 percent.

The administration's budget request acknowledges the import role the AUR program can have in closing the tax gap by reducing the number of taxpayers who underreport their income and proposes an increase of $26.2 million and 300 FTE to increase coverage of the AUR document matching program. According to the administration, this request will generate $386.5 million in additional revenue once new hires reach full potential in fiscal year 2012 resulting in a return on investment (ROI) of 17 to 1.

TAXPAYER SERVICE

Mr. Chairman, NTEU strongly believes that providing quality customer service to the taxpayer is an important part of IRS efforts to help the taxpaying public understand their tax obligations while making it easier to participate in the tax system. Through many sources, the IRS provides year-round assistance to millions of taxpayers, including outreach and education programs, issuance of tax forms and publications, rulings and regulations, toll-free call centers, the IRS.gov web site, Taxpayer Assistance Centers (TACs), Volunteer Income Tax Assistance (VITA) sites, and Tax Counseling for the Elderly (TCE) sites. These efforts have helped the IRS raise their standard of service to America's taxpayers and assisted in efforts to improve voluntary compliance. The IRS has continued to make great strides in recent years in the quality of the service it provides despite relatively flat budgets, that when adjusted for inflation, have provided the IRS with fewer resources over the past several years compared to fiscal year 2002.

But despite receiving fewer resources and continued reductions in the number of customer service representatives at the Service, the IRS was able to deliver a successful 2008 filing season. As you know, the 2008 filing season was particularly challenging due to late enactment of the AMT legislation and implementation of the Economic Stimulus Payment program. Despite these challenges, the IRS carried out another successful filing season during which IRS employees processed more than 155 million individual returns including returns filed solely to claim an economic stimulus payment, an increase of 11 percent over last year and issued 107.6 million refunds, totaling $369 billion; answered over 40.4 million calls, an increase of 21 percent due to a large increase in taxpayer inquiries about the economic stimulus checks; completed 52 million automated calls, an increase of over 123 percent; maintained account and tax law accuracy rates of over 90 percent and expanded return preparation at IRS Taxpayer Assistance Centers (TACs) preparing over 575,000 returns, a 42 percent increase over last year.

Mr. Chairman, while IRS employees were able to continue providing quality service to taxpayers in fiscal year 2008, we do have concerns about the potential negative effect on IRS' ability to continue doing so should the "efficiency savings" assumed in the administration's budget request not materialize. For fiscal year 2010, the budget request identifies "efficiency savings" of more than $118 million at the cost of 1,504 FTE's. If, as sometimes been the case in previous years, IRS fails to realize all expected savings then the funds available for critical Service personnel, such as those working at the 401 TACs located nationwide, would be further reduced.

As stated previously, NTEU strongly believes providing quality service to taxpayers is critical to ensuring taxpayers understand their tax obligations while making it easier for them to participate in the tax system. And in the current economic climate, we believe it is more important than ever that taxpayers be able to deal with the IRS directly to work through any financial difficulties they may encounter. IRS employees have a wide range of tools and information at their disposal, which allow them to work with taxpayers to address their financial hardships and to become compliant.

Above all else, the IRS employee's interest is in assisting struggling taxpayers to meet their tax obligations in a way that will not exacerbate their financial distress. When an IRS employee works with a taxpayer, the employee has access to all of the taxpayer's information and can answer questions and offer advice. For example, they can see whether a taxpayer has not filed a return and explain that the sooner the taxpayer makes arrangements to address filing and balance due issues the less penalty and interest they will owe. They can look at the taxpayer's records and an-

swer questions about why they owe a balance and what they can do about it. They can also tell the taxpayer that they are not having enough taxes withheld by their employer and need to address that or that if an ex-spouse is claiming a child as a dependent they will not also be able to receive an exemption. If a simple mistake, like a math error, has occurred, they can fix it. They can provide an extension of the time period for payment. They can make a determination that the taxpayer meets the currently not collectible requirements or whether the taxpayer may be eligible for an Offer in Compromise, in which part of the balance due is foregone.

NTEU believes providing quality services to taxpayers is an important part of any overall strategy to improve compliance and that the President's request for taxpayer services will enable the IRS to deliver another successful filing season, improve the responsiveness and accuracy of taxpayer service, and support Service efforts to enhance taxpayer compliance.

SECTION 1203

Mr. Chairman, while meaningful funding for the IRS is important to operations, NTEU also believes that in order to maximize efficiencies at the IRS, Congress must act to modify Section 1203 of the IRS Restructuring and Reform Act of 1988 (RRA 98). Commonly known as the "Ten Deadly Sins," Section 1203 outlines ten infractions for which IRS employees must be fired, including the untimely filing of Federal income taxes even when a refund is due. No other Federal or congressional employee is subject to similar mandatory termination.

Without question, Section 1203 has had a negative impact on the morale of the IRS workforce and is impeding the ability of the IRS to perform its mission. According to numerous GAO reports, IRS employees greatly fear the threat of being fired under Section 1203. This in turn has had a chilling effect on the ability of IRS employees to do their jobs. In particular, employees specifically attribute the decrease in recommending a seizure of taxpayer's assets to Section 1203. Clearly, Section 1203 impedes IRS' enforcement mission and is unfair to the IRS employees who must work under the constant threat of losing their jobs.

NTEU believes mandatory termination for Section 1203 violations is unduly harsh and should not be the only disciplinary action available. We advocate amending RRA 98 to allow for appropriate penalties other than mandatory termination for Section 1203 violations and to allow for independent review of determinations.

To be clear, NTEU does not condone any violation of law or rules of conduct by its members at the IRS or in any other government agency. Violations of some rules clearly warrant termination of employment. However, one group of Federal employees should not be singled out and required to be fired for offenses that do not subject other executive, judicial, or legislative branch employees to the same penalty.

Mr. Chairman, the large majority of IRS employees work hard, follow the rules and pay their taxes on time. It is patently unfair to hold those who are charged with enforcing the tax laws to a higher standard than those who write them. NTEU asks for your support for changes to section 1203 of the IRS Reform and Restructuring Act, so that tax fairness applies to all Americans, even those who work at the IRS.

CONCLUSION

Mr. Chairman, thank you for the opportunity to provide NTEU's thoughts on the administration's fiscal year 2010 budget request for the IRS. We believe that by investing in the IRS workforce and demonstrably effective enforcement and taxpayer service programs, the administration's request will ensure the IRS continues to meet its mission of providing America's taxpayers top quality service by helping them understand and meet their tax responsibilities and by applying the tax law with integrity and fairness to all.

ADDITIONAL COMMITTEE QUESTIONS

Senator DURBIN. The record will remain open, Mr. Commissioner, until Wednesday, June 17, for subcommittee members to submit statements and questions to be submitted to you for consideration.

[The following questions were not asked at the hearing, but were submitted to the Service for response subsequent to the hearing:]

QUESTIONS SUBMITTED BY SENATOR RICHARD J. DURBIN

MEASURING RETURN ON INVESTMENT: NEW INITIATIVES

Question. In your fiscal year 2010 budget request, the IRS seeks $332 million for new enforcement initiatives projected to yield direct measurable results through high return-on-investment. The proposed investments in enforcement personnel in fiscal year 2010 are expected to yield $2 billion in additional annual enforcement revenue once new hires reach their fully trained potential in fiscal year 2012.

GAO's review and written assessment of the proposed budget observes, with concern, that the IRS has no plans to compare the actual performance to the projections.

Would it not be prudent and beneficial to determine the extent to which your revenue forecasts were accurate and the yield was realized?

Answer. The IRS maintains a historical record of enforcement revenue produced by its enforcement programs at an aggregate level, and the IRS uses this historical revenue information to estimate future revenue produced from proposed enforcement initiatives in budget requests and to compare its estimated revenue projections with actual revenue. Actual annual enforcement revenue is analyzed to determine factors causing variance from expected results. For example, analysis of fiscal year 2007 enforcement revenue indicated that the increase from $48.7 billion in fiscal year 2006 to $59.2 billion was primarily the result of two large settlements.

While the IRS does compare the actual performance to the projections at the aggregate revenue level, specific examination and collection activities are fungible, and therefore, it is difficult to isolate the revenue attributable to a specific initiative. The IRS uses its existing suite of performance measures as a tool for managing its activities. IRS performance measure results, including examination and collection coverage, are a better gauge of the efficiency and effectiveness of existing programs.

Question. Assuming that Congress is able to provide these funds as requested and the IRS proceeds with the initiatives planned, how will we know whether this was a wise investment?

Answer. At full performance levels in fiscal year 2012, the additional enforcement personnel will produce additional revenue and increases in performance measures in examination and collection as presented in the fiscal year 2010 budget request. For example, the number of audits in targeted categories is projected to increase, and the number of collection accounts resolved is expected to increase, both resulting in increased revenue. The IRS expects these initiatives to yield a return-on-investment (ROI) of 7.8 to 1 once they reach full potential.

Question. Do you agree that knowing what actually happens as a result of these targeted investments would be a helpful indicator of success and useful in making future spending decisions and resource allocation plans?

Answer. The IRS will continue to collect actual cost and revenue data associated with high-level enforcement programs, and will continue to analyze actual enforcement revenue results to refine future projections for budget initiatives, as needed.

The IRS uses actual enforcement revenue from prior years to calculate its Return on Investment figures (ROIs) for proposed enforcement initiatives. The ROIs are based on rolling, 10-year averages of enforcement revenue produced by specific enforcement functions with greater weight placed on the most recent year revenue. The IRS bases revenue estimates on historical yield per FTE, which it evaluates and updates annually.

Question. Will IRS collect data to determine the actual costs, revenues, and ROI to determine whether the investment produced the anticipated results? If "NO"—what is the IRS's rationale for not keeping track of the actual return on investment of these new initiatives?

Answer. As stated above, the IRS does collect actual cost and revenue data associated with high-level enforcement programs and uses the cost and revenue data to develop its proposed budget initiatives. Tracking the revenue produced by each initiative hire is not possible. For example, each new international examiner will work on a mix of cases which could include audits that are not associated with the initiative because of shifting work priorities or the emergence of new international issues. Additionally, the new international examiner will work on cases as part of an audit team. Apportioning actual revenue resulting from a team audit to various audit team members, who may or may not be an initiative hire, is not feasible. Initiative hires work on a variety of tasks and on group audits, and as a result, tracking the revenue derived from a specific initiative hire is not possible, but the revenue is tracked and analyzed for high-level enforcement programs.

DETERRENT EFFECT OF ENFORCEMENT INITIATIVES

Question. In addition to the direct revenue impact of such an investment, isn't there a deterrent effect?

Answer. Yes. Several empirical studies have indicated that the "deterrent" effect from enhanced enforcement efforts could be larger (perhaps much larger) than the direct revenue effect.

Question. How does IRS measure deterrent effect? What is the estimate?

Answer. By the "deterrent" effect of an IRS activity, we mean the change in voluntary compliance—both subsequent compliance by a person directly contacted as a part of that activity and changed compliance behavior by the population in general—that is prompted by an expansion or intensification of that IRS activity. More generally, the IRS refers to this phenomenon as the "indirect" effect since deterrence may not always be the mechanism at work. For example, the general population may demonstrate improved voluntary compliance in response to expanded prosecutions of tax criminals, but not because they fear being caught committing tax crimes; rather, the expanded prosecutions may reassure the average taxpayer that criminals are receiving justice, which makes the average taxpayer more likely to pay his or her taxes in full. Likewise, IRS's services to taxpayers may have a positive effect on the voluntary compliance of those who do not receive those services, but who hear positive reports from those who do.

We can observe the compliance behavior of each taxpayer, but that behavior is driven by a complex set of factors (including things outside of IRS control, such as economic, demographic, and socio-political factors) that vary widely across the population. We cannot observe how many dollars are paid as a result of each of those factors separately; we can only attempt to estimate that. Several academic studies have attempted to estimate the indirect effect of audits, and a few have also estimated the effect of criminal investigations and other IRS activities, but since all of these statistical studies have limitations and weaknesses, there has not yet formed a consensus as to the true indirect effect of these or other IRS activities. The estimates that exist for the indirect effects range from approximately zero to over 10 times the magnitude of the direct effect.

Question. Are there particular remedial actions or collection interventions that IRS uses that you have found to be more conducive or effective than others when it comes to deterrent effect?

Answer. There is some limited statistical evidence that audits of individuals are quite cost-effective in generating an indirect effect (partly because they are less costly to complete than activities such as criminal investigations or complicated corporate audits). The IRS is continuing to research the indirect effects of both enforcement and service activities in an effort to allocate resources optimally.

ELECTRONIC FILING—STAFFING SHIFTS

Question. The IRS budget for fiscal year 2010 reflects that due to increased e-filing options there will be an expected decline of 4.6 million in the number of paper returns filed, resulting in a savings in submission processing of 187 FTE. The IRS is also consolidating its individual return processing centers to achieve efficiency as the paper return volume drops. The IRS is slated to ramp-down its processing center in Andover, Massachusetts and plans to reinvest $2.3 million to fund a one-time severance payment for employees.

How is the IRS transforming its workforce to adapt to 21st century?

As the volume of e-filing grows, what is the IRS doing to facilitate retraining of processing staff to perform different activities and functions?

Answer. One of the IRS' top priorities is to support the Submission Processing employees whose jobs are affected by site consolidation. Though some of the information included below is specific to the Andover, MA site that is scheduled to close in September 2009, the actions taken are representative of the efforts that have been made with each consolidation and demonstrate the IRS' strong commitment to provide all employees with a wide range of options.

Mitigation Strategies to Minimize Employee Impact

A number of mitigating strategies are used to assist employees in minimizing the impact of consolidation. These strategies are generally broken down into two distinct groups:

Formal strategies—outlined in Article 19 (Reduction in Force and Mitigation Strategies) of the 2006 National Agreement between IRS and NTEU, these strategies are available to employees 1 year prior to the projected Reduction in Force date.

Other strategies—undertaken outside of Article 19 to focus on preparing employees for the consolidation. Many of these strategies begin prior to the onset of the required Article 19 strategies.

Formal strategies include:

—Reassignment Preference Notice (RPN)—entitles directly affected employees to priority selection for vacant positions for which they apply and qualify, either at their same or lower grade Servicewide, i.e. both within and outside the employee's commuting area.

—Voluntary Early Retirement Authority/Voluntary Separation Incentive Payment (VERA/VSIP)—provides an opportunity for eligible employees to separate from the Service early and receive a buyout.

—Severance Pay—received by those employees who are separated via a RIF and are not eligible to retire.

—Job Swaps—per Article 19, directly affected employees may swap jobs into other occupied positions, either inside or outside the commuting area.

—Outplacement Services—employees are granted administrative time to participate in outplacement and career services.

—Relocation to "Follow Your Work"—allows directly affected employees who occupy positions to be abolished to voluntarily relocate and be realigned to a vacant position in a continuing site to perform the work that the employee is currently performing.

—Career Transition Assistance Program (CTAP)—grants the affected employee selection priority for any internal vacancy for which s/he applies and is determined to be well-qualified.

—Inter-Agency Career Transition Assistance Program (ICTAP)—grants affected employees selection priority for any external Federal Government vacancy for which s/he applies and is determined to be well-qualified.

—Grade and Pay Retention—provided to affected employees who are selected for a position not more than three grades below their current grade.

Other Strategies include:

—Identifying work that can be consolidated or redirected into continuing sites. The following summarizes the positions created through these efforts:

	Positions
Brookhaven:	
Centralized Offer in Compromise	325
Campus Support Department	140
Memphis:	
Centralized Offer in Compromise	350
Case Processing	325
Campus Support Department	90
Philadelphia:	
Centralized Insolvency	280
Case Processing	230
Campus Support Department	180
Andover:	
Automated Underreporter	[1] 200
Campus Support Department	89

[1] Wth plans to grow to about 300–400 total.

—Communications—numerous vehicles are used to keep employees updated on the consolidation plan and to assist employees in minimizing the impact of consolidation, including:

—Newsletters—the Andover campus developed and distributed a publication titled "Changing Times" to employees on a regular basis beginning in February 2008. The issues have addressed various consolidation issues and include employee Q&A's.

—Webpage—info included on Andover SP webpage includes newsletters, FAQ's, and information on Article 19.

—Employee Meetings—management holds routine meetings with employees to provide consolidation updates and ensure employees are aware of the effect consolidation will have on their current and future positions.

—Flyers and handouts—will cover topics such as buyouts, early outs, and job swaps.

—Info to employees in non-work status—pertinent information is mailed to seasonal employees in non-work status.

—Training—provided on various topics to assist employees in continuing with or finding new employment, including:
  —How to apply for positions on USAJobs, the official job site of the federal government.
  —How to a prepare a résumé.
  —How to interview for a job.
  —How to apply for a job swap (will be conducted in Andover at a later date).
—Term Hiring—In an effort to minimize the employee affect from consolidation, sites scheduled to consolidate began hiring Term employees at least 2 years prior to consolidation. The Andover site initiated this practice in 2003, 6 years prior to consolidation. This hiring practice has helped to mitigate the effect of consolidation on our career and career conditional employees by limiting the number of potential applicants for continuing positions on the campus. Andover is the first consolidating site where the number of Term employees exceeds the number of career conditional employees.
—Job Fairs—job fairs include employers from the private sector and IRS Business Units that will remain at the campus after consolidation.
—Tuition Assistance—program offered to all IRS employees to assist them in gaining the skills needed for continued employment.
—Mock Interview Cadre—established to assist Andover employees with upcoming interviews.
—Link Line—a phone number established for Andover employees in non-work status to receive information on W&I job openings in Andover Posts of Duty.
—Career Link—Andover IRS is partnering with local Department of Labor to establish an office within Andover IRS office to provide career guidance, employment workshops, and reemployment assistance.
—Computer Kiosks—set up in Andover Posts of Duty for employees without access to a computer to look for job vacancies or update their Merit Promotion Questionnaire's (MPQs).
—Employee Meetings—One-on-One meetings have been held with every employee in Andover SP to determine future plans (i.e. continued employment, retirement, etc.) and provide information related to MPQ assistance, Mock Interviews, etc.
—Job Vacancies—Weekly Career Opportunity Listing (COL) and USAJobs vacancy announcements distributed to SP Operations for dissemination to all employees, in order to keep them informed of potential jobs, both internally and throughout the government.
—Employee Assistance Program (EAP) representatives are in attendance at each RIF briefing and have committed to provide extended services to SP employees during this transition.

QUESTION SUBMITTED BY SENATOR FRANK R. LAUTENBERG

Question. Federal receipts at the U.S. Treasury have declined nearly 19 percent for the first 7 months of fiscal year 2009 as compared to the same period in fiscal year 2008. A significant portion of this revenue loss is due to a decrease in tax receipts as a result of the current economic recession. To what extent do you expect tax revenues to increase as a result of federal efforts to create jobs and spur economic recovery?

FEDERAL RECEIPTS, FISCAL YEAR TO DATE (APRIL 2009)

	Year to date, fiscal year 2009	Comparable period in fiscal year 2008	Percent change
Total	$1,256,066	$1,549,720	−18.9
Individual Income Tax	$566,369	$747,558	−24.2
Corporation Income Taxes	$70,781	$171,142	−58.6

Answer. The IRS does not predict the effect legislation will have on tax revenues. The Joint Committee on Taxation and the Department of the Treasury under certain circumstances will provide estimates of the revenue effects of proposed but unenacted tax legislation.

QUESTION SUBMITTED BY SENATOR BEN NELSON

Question. In a Ways and Means Subcommittee hearing on June 4, 2009, you said you would like to work with Congress to provide the Internal Revenue Service with more discretion regarding imposition of the 6707A penalty for failure to include reportable transaction information with a taxpayer's return. Can you elaborate on what kind of discretion would be appropriate, especially in cases where taxpayers acting in good faith unknowingly failed to file—or, worse, were mislead into believing they did not need to file information about such transactions?

Answer. As we have stated before, the IRS is concerned there are taxpayers who have been caught in a penalty regime that was not intended by the legislation. Many taxpayers are subject to this penalty and the amount due significantly exceeds the tax benefit resulting from the transaction. Furthermore, the statutory language does not allow for any adjustment to the penalty based on the tax benefit to the taxpayer. We may be open to changes that allow sufficient flexibility for a 6707A penalty to be proportional to the tax benefit associated with the reportable transaction giving rise to the penalty. This change could improve the fairness of the penalty, provide some measure of relief for virtually all taxpayers, and simplify tax administration.

QUESTIONS SUBMITTED BY SENATOR SUSAN COLLINS

Question. The IRS is in the midst of a significant hiring initiative for enforcement staff as a result of its fiscal year 2009 budget. What enforcement areas will the new staff be focused on and what do you anticipate the resulting increased revenues to be?

Answer. The enforcement staff hired in fiscal year 2010 will be focused on the activities listed below and will generate over $2 billion in additional revenue once they reach full potential in fiscal year 2012.

RETURN ON INVESTMENT ENFORCEMENT INITIATIVES

[Dollars in millions]

Fiscal year 2010 enforcement investment	First year (fiscal year 2010)				Full performance (fiscal year 2012)		
	FTE [1]	Cost	Revenue	ROI	Cost	Revenue	ROI
Direct Revenue Producing Initiatives	2,330	$332.1	$611.1	1.8	$262.8	$2,049.7	7.8
Reduce the Tax Gap Attributable to International Activities. This initiative funds a multi-year investment to deal more effectively with increasing international tax activities of individual and business taxpayers. This effort addresses the underreporting of tax associated with international transactions as well as domestic taxpayers involved in offshore activities. It expands the IRS presence in the tax-exempt and governmental sectors and confronts international tax evasion schemes	784	128.1	93.8	0.7	103.4	736.6	7.1
Improve Reporting Compliance of SB/SE Taxpayers. This initiative improves reporting compliance among Small Business/Self Employed (SB/SE) taxpayers by increasing examinations of business and high-income returns, exams involving flow-through entities, audits targeting employment, excise, and estate and gift taxes, and investigations of business non-filers	755	94.2	159.6	1.7	72.6	567.2	7.8
Expand Document Matching for Business Taxpayers. This initiative increases coverage of the document matching program to reduce the number of taxpayers who misreport their income. Matching third party information such as W–2s and 1099s against tax returns is critical to ensure compliance	300	26.2	191.8	7.3	22.8	386.5	17.0
Address Nonfiling/Underpayment and Collection Coverage. This initiative improves voluntary compliance and decreases nonfiling by broadening collection coverage with a focus on repeat non-filers and non-filers with high income. Additional collection staff will increase the number of collection actions against unpaid assessments and allow the IRS to close more collection cases	491	83.6	165.9	2.0	64.0	359.4	5.6

[1] Total includes revenue and non-revenue generating FTE.

Question. Commissioner Shulman, how can we address the tax gap?

Answer. The Internal Revenue Service and Treasury issued an update of the 2007 Tax Gap Strategy report in early July. That report addressed this question in detail.

Question. Does IRS have an estimate of the tax gap attributable to international activities?

Answer. No. The data on which we base our tax gap estimates do not generally allow us to separate international and domestic issues. Moreover, some forms of noncompliance do not lend themselves to a clear characterization based on geography.

Question. If there is not an estimate of the effect of international activities on the tax gap, why is that the focus of the fiscal year 10 enforcement initiative?

Answer. Globalization has led to an increase in international tax activity, which has historically been an area of significant concern to the IRS. For example, foreign tax credits claimed by U.S. corporations increased by 71 percent between Tax Years 2000 and 2007, while foreign tax credits claimed by U.S. individuals increased by 133 percent during that time period. Likewise, between 2001 and 2006, foreign-source gross income of individuals grew 86.6 percent in real percentage terms, whereas worldwide income reported on all individual U.S. tax returns grew only 14.8 percent during that period.

Question. Please describe any plans the Service may have to develop an international tax gap estimate.

Answer. We are conducting a pilot study, beginning with Tax Year 2006, to extend our National Research Program (NRP) reporting compliance studies of individual returns to include a small sample of returns with international addresses. We hope to determine from this pilot how best to compile representative compliance data for this population. If successful, this approach may allow us to estimate this portion of the international tax gap. Future studies of corporation income tax reporting compliance will need to address this concern, as well.

Question. IRS reduced its performance goal for providing telephone assistance from 82 percent last year to 77 percent this year. Commissioner Shulman, why was the goal reduced and what does it mean for taxpayers? In your opinion, does this lower level allow for sufficient access for taxpayers to speak directly with an IRS assistor?

Answer. The IRS is dedicated to providing the best possible service regardless of the channel the customer chooses. Although the goal and actual CSR LOS was lower this year than in prior years, the IRS funded the Toll-free program in 2009 at higher levels than in prior years by allocating more staffing (full time equivalents (FTEs)) during filing season than in 2007 and 2008. The actual toll-free FTEs for 2007, 2008, and 2009 filing seasons were 3,067, 3,100 and 3,344, respectively. However, increased customer demand, the introduction of new programs such as the Identity Protection Specialized Unit, and increased complexity of the calls handled by assistors resulted in lower service levels, despite increased resources. From January 1st through April 18, 2009, the IRS serviced over 39 million taxpayers through both assistor and automated telephone service during the 2009 filing season. This level compares to just over 35 million taxpayers serviced during the same time period during the 2008 filing season and 32 million serviced in 2007. On most days, taxpayers were able to get to an assistor if they chose to wait. We provided an estimated wait time to the vast majority of callers, so they could make an informed decision about whether to wait or call back at a later time.

Question. This year, IRS's average actual telephone performance has been well below its goal. Next year, IRS can expect another year with high call demand given the Recovery Act tax law changes. What specific steps are you taking now to improve IRS's telephone performance for next year should call volume could remain high?

Answer. We are taking numerous steps to prepare for the coming year. During the 2009 filing season, there were 4.8 million calls from taxpayers asking for their prior year Adjusted Gross Income (AGI) or Personal Identification Number (PIN), which is required by online filers to submit their returns electronically. For 2010, we are developing both a web and automated telephone application to provide this information to taxpayers without requiring interaction with an assistor. This enhancement will free up assistors to handle more complex taxpayer questions. We will be implementing improvements in our Toll-free menus, which will get customers to the right resource faster. We will be expanding the use of estimated wait time announcements to more applications and customers. Lastly, we are planning to increase the number of staff on-rolls at times of peak customer demand during the filing season, through seasonal hiring.

Question. IRS has spent $2.6 billion on its business systems modernization effort since 1999. Its Customer Account Data Engine (CADE), a part of BSM intended to

replace the Individual Master File, has cost over $400 million since work on it began almost 5 years ago, but CADE has only delivered about 15 percent of the full capability intended. Please explain this small return on investment?

Answer. The IRS has received approximately $309.3 million in funding for CADE over the past 5 years. With that funding, the IRS has delivered a complete tax return processing system for approximately 40 million taxpayers who are enjoying the benefits of substantially faster refunds. In addition, the CADE project has proved the IRS is capable of delivering a modern database with significant functionality, including improved financial accounting capabilities, which have allowed the IRS to make progress against addressing its material weakness in this area.

CADE also already includes capabilities to process Forms 1040, Schedules A, B, C, D, E, F, R, SE and Form 1040A, Schedules 1 and 3 for single and married filers and filers with certain dependents; extension Forms 4868; decedent and surviving spouse returns; certain math error notices; online address changes; returns with disaster area designations; receipt processing; and last name changes. In addition, CADE has supported legislative tax refund programs, such as Telephone Excise Tax Refunds and the recent Economic Stimulus payments.

The IRS created the statistic referenced in your question for different purposes during a very specific engineering analysis, and we never intended to reflect a holistic assessment of the status of the effort. It understates nearly half the percentage of taxpayers that are in the new system, and it also does not reflect that a substantial portion of the overall effort is expended in setting up infrastructure to process the very first tax return.

Finally, any discussion of return on investment should recognize the public's return on IRS IT investments. Because of the IRS's progress on CADE, approximately $58 billion in refunds went out on average 5 days faster that they would under legacy systems. This improvement has real economic value to taxpayers, particularly those in difficult economic situations.

Question. Of the vast extent of IT security weaknesses that exist in IRS current and modernized systems, how much improvement in data protection can the IRS make with the requested $90 million for IT Security and what data and systems are still vulnerable?

Answer. The way IRS business is transacted, the way the Service operates, and the way core tax administration is conducted have changed. These activities now rely on an interdependent network of information technology infrastructures. At the same time, threats from cyberspace have risen dramatically and are growing increasingly more complex, harder to detect and prevent. In order for the Service to keep abreast of the latest security threats from cyberspace and elsewhere, more strategic and tactical investments will have to be made to protect against the debilitating disruption of the operation of the IRS' information systems or breaches of the sensitive personally identifiable information entrusted to us by the American taxpaying public.

This initiative requests an increase of $90.0 million and 36 FTE to improve IT security and address specific components of the Computer Security Material Weakness. At the more strategic level, this budget initiative will:

—Better ensure the integrity of the tax system and maintain taxpayer confidence;
—Allow the IRS to improve the privacy and security of taxpayer information;
—Segregate securely the development, testing, and production environments for IT systems, and;
—Implement the Federal Information Security Management Act (FISMA) security compliance controls on all enterprise-wide Windows and UNIX computing assets.

At the more tactical levels, specific activities that will be included in this initiative are:

—Implementation of Network Access Control to better manage what devices are permitted to connect to the internal network. This change will specifically strengthen controls over many of the 700+ remote places of duty.
—Bolsters the disaster recovery capabilities for the enterprise.
—Improve the replication of our production environment in our test and development environments. This improvement will enable more complete testing of security controls and their impact before moving new applications into production.
—Improving the real-time ability for the IRS to monitor and report on the security posture of all devices on the IRS network. This enhancement will allow the IRS to better understand how new and developing threats could potentially affect core business systems.
—Implementing data leakage protection tools to monitor and control the movement of sensitive information in and out of the IRS network.

—Providing an enterprise solution to deploy end-to-end audit log collection, storage, and reporting to directly address a major component of the Computer Security Material Weakness.

QUESTIONS SUBMITTED BY SENATOR CHRISTOPHER S. BOND

ENFORCEMENT

Question. In the 1998 IRS Restructuring Act, Congress directed the IRS to refocus its mission not only to enforcement of the tax laws, but also serve the public and meet the needs of taxpayers. With the emphasis that you and the Administration has placed on enforcement, it appears that the pendulum is swinging further back to the "bad old days" of heavy handed IRS enforcement that led to the restructuring legislation in the first place.

Are the enforcement initiatives that the IRS has announced this year coming at the cost of taxpayer service? What steps are you taking to ensure that taxpayer service remains an equal part of the IRS' mission?

Answer. The IRS remains committed to a balanced program of assisting taxpayers in both understanding the tax law and paying the proper amount of tax.

The fiscal year 2010 President budget request of $2.27 billion for taxpayer service will allow the IRS to continue improvements for both the quality and efficiency of taxpayer service, using a variety steps including, person-to-person, telephone, and web-based and self-serve methods to help taxpayers understand their tax obligations and pay what they owe.

The IRS provides year-round assistance to millions of taxpayers including: Outreach and education programs; issuance of tax form and publications; rulings and regulations; toll-free call centers; IRS.gov web site; Taxpayer Assistance Centers (TACs); Volunteer Income tax Assistance (VITA) sites; and Tax Counseling for the Elderly (TCE).

The IRS will continue to implement and administer these critical programs within the levels contained in the budget request.

BUSINESS SYSTEMS MODERNIZATION

Question. For many years, the IRS has struggled to update its computer systems to improve processing, enhance collections, and strengthen customer service. To address IRS' computer system problems, the Business Systems Modernization (BSM) was created. The center-piece of BSM is the Customer Account Data Engine (CADE) project.

What is the status of BSM?

Answer. The BSM program is a critically important component of the IRS's overall technology portfolio. In recent years, the IRS has consistently delivered on its commitments and is providing systems that deliver concrete benefits to taxpayers. Some of these benefits include:

—*CADE*.—Issuing refunds for nearly 40 million taxpayers on average 5 days faster than existing legacy systems;

—*Modernized e-File*.—Dramatically reduced processing error rates, which eliminates rework for taxpayers and the IRS;

—*E-Services*.—Delivering value-added, web-based services for taxpayers and the tax practitioners who serve them;

—*Account Management Services*.—Providing IRS customer service representatives (CSRs) with faster and improved access to taxpayer account data with real-time data entry, validation and update of taxpayer addresses; and

—*Filing and Payment Compliance*.—Placed more than 203,800 taxpayers with Private Collection Agencies since September 2006, facilitating the collection of more than $90 million on cases formerly unassigned for active collection.

The Modernized e-File project is on track to begin delivery of Form 1040 and certain schedules in 2010, which will extend the benefits of this program to individual taxpayers.

The CADE project has delivered a modern database with significantly more functionality than the Individual Master File, including improved financial accounting capabilities, which have allowed the IRS to make progress against addressing its material weakness in this area. In 2008, the IRS refined the program focus to target an accelerated integration of the legacy and modernized databases to get all 140 million taxpayers into a common relational database, and into a faster processing cycle. That database will serve as a strategic foundation for the IRS's next generation taxpayer service and compliance programs.

Finally, as the IRS proceeds with its modernization efforts, we are mindful of maintaining a holistic, overall portfolio approach to our technology programs. In particular, we are focused on balancing our work on modernization with appropriate investments in core IT operations, and in particular, IT security.

Question. When will the CADE system be able to handle all individual and business tax returns?

Answer. The Commissioner has set a goal of completing the development of the taxpayer account database for all individuals, and moving to a faster processing cycle within 5 years. The team has developed and delivered a long-range plan, and is in the process of developing the BSM expenditure plan for fiscal year 2010, each of which provide further details on the interim deliverables for 2010 and 2011.

In the interests of prioritization and focus, the IRS plans to deliver on the individual account database before upgrading the business tax account database.

PRIVATE DEBT COLLECTION

Question. With the start of the new Administration, the IRS abandoned its private debt collection program.

What is your justification from a purely business case perspective for abandoning this program for collecting small-dollar, non-complex collection cases? Are we to assume that these tax debts will now just go uncollected, since IRS officials have previously testified that the agency does not have the staff to work these cases? Or, do you plan to pull staff off of more complex, higher-dollar cases to work the ones that were handled by the private debt collection program?

Answer. In early 2009, the IRS completed a cost effectiveness study of the Private Debt Collection (PDC) program, supported by an independent review, which showed that it is reasonable to conclude that when working similar inventory, collection efforts are more cost-effective using IRS employees rather than outside contractors. In addition, from 2002 to 2008, the percentage of potentially collectible inventory in active IRS collection status increased from 62.2 percent to 71.4 percent, and the dollar amount of potentially collectible inventory shelved due to lack of IRS resources declined from $7.6 billion to $3.6 billion. These elements contributed to the March 2009 decision not to renew contracts with the private collection agencies (PCAs).

The IRS plans to work the types of cases that were assigned to PCAs as part of its overall collection strategy, which includes notice, telephone, and in-person contact. A part of this strategy is supported by a fiscal year 2010 IRS budget initiative which requests funding for two new Automated Collection System sites.

TAX GAP

Question. The Administration's budget includes a number of proposals aimed at closing the so-called "tax gap," many of which originated in the last couple of budgets submitted by the previous Administration. Yet, the last estimate that the IRS undertook to quantify the tax gap was in 2001.

When is the IRS going to update its tax gap estimates so we can measure accurately the success of these initiatives?

Answer. We do not have plans to update estimates of all components of the tax gap simultaneously for a common year since new data will not be available for all components at the same time. Furthermore, any post-initiative tax gap estimates will require compliance data to be compiled and analyzed for a tax year in which the initiatives are fully implemented. Since the tax gap estimates are, of necessity, very approximate, it would probably be more effective to estimate the effect of the initiatives by analyzing trends of observable tax data, such as tax revenue or enforcement revenue, accounting for other factors that have caused the trends to vary over time.

Question. Does the IRS plan to estimate the extent to which the current tax gap is associated with taxpayers' intentional efforts to evade the tax law as opposed to honest mistakes due to the incredible complexity of our tax code today?

Answer. The IRS seeks to be able to distinguish intentional noncompliance from unintentional mistakes. Several of our reporting compliance studies have tried to address this question. However, we have found that it is virtually impossible for auditors to know for sure what motivated an error. It is relatively easy for a taxpayer to claim that an error was an unintentional mistake (e.g., "I lost my receipts," or "I forgot about that income."), whether that is true or merely an attempt to avoid penalties and more detailed scrutiny. Moreover, even if IRS employees could distinguish between intentional and unintentional errors, the unintentional errors among all returns would likely include both overstatements and understatements of tax in roughly equal amounts. Since the tax gap is defined as the aggregate amount of un-

derstatements net of overstatements, those unintentional overstatements and understatements are likely to cancel each other when added to the tax gap. If so, the tax gap likely includes very little net unintentional noncompliance. Having said that, though, the IRS seeks to minimize unintentional noncompliance since it represents unnecessary burden on both taxpayers and the IRS. It is also important to point out that, in addition to spawning unintentional errors, the complexity of the tax code undoubtedly creates opportunities for willful noncompliance.

Question. Does the IRS plan to produce an estimate of how much of the tax gap is associated with international transactions, since the Administration has placed so much emphasis on this compliance area?

Answer. We are conducting a pilot study, beginning with Tax Year 2006, to extend our NRP reporting compliance studies of individual returns to include a small sample of returns with international addresses. We hope to determine from this pilot how best to compile representative compliance data for this population. If successful, this approach may allow us to estimate this portion of the international tax gap. Future studies of corporation income tax reporting compliance will need to address this concern, as well.

IMPLEMENTATION OF TAX GAP STRATEGY

Question. In 2006, the Treasury Department and the IRS prepared a strategy for addressing the tax gap, and in 2007, the IRS released a progress report on the implementation of that strategy.

Please provide me an update on the implementation of the tax gap strategy, including new initiatives that the IRS plans to implement over the next 5 years to close the tax gap.

Answer. The Internal Revenue Service and Treasury issued an update of the 2007 Tax Gap Strategy report in early July. That report addressed this question in detail.

SUBCOMMITTEE RECESS

Senator DURBIN. We thank you for your appearance today and thank Senator Collins.

This subcommittee stands recessed.

[Whereupon, at 12:33 p.m., Tuesday, June 9, the subcommittee was recessed, to reconvene subject to the call of the Chair.]

FINANCIAL SERVICES AND GENERAL GOVERNMENT APPROPRIATIONS FOR FISCAL YEAR 2010

TUESDAY, JUNE 16, 2009

U.S. SENATE,
SUBCOMMITTEE OF THE COMMITTEE ON APPROPRIATIONS,
Washington, DC.

The subcommittee met at 3:30 p.m., in room SD–138, Dirksen Senate Office Building, Hon. Richard J. Durbin (chairman) presiding.

Present: Senators Durbin, Nelson, and Collins.

Also present: Senator Bennett.

SMALL BUSINESS ADMINISTRATION

STATEMENT OF HON. KAREN G. MILLS, ADMINISTRATOR

OPENING STATEMENT OF SENATOR RICHARD J. DURBIN

Senator DURBIN. Good afternoon. I am pleased to convene this hearing to consider the fiscal year 2010 funding request of two agencies within the jurisdiction of the Appropriations Subcommittee on Financial Services and General Government—the Small Business Administration (SBA) and the General Services Administration (GSA).

My distinguished ranking member, Senator Collins, will be here shortly, along with others.

SBA and GSA are both playing key roles in the Federal Government's efforts to stimulate the economy. The Recovery Act provided SBA with $730 million to expand access to capital for small business. As the lifeblood of the American economy, small businesses must be the main driver of our Nation's economic recovery. The Recovery Act also provided $5.5 billion for GSA to initiate new Federal building projects.

These projects employ architects, engineers, electricians, plumbers, carpenters, and many others. They provide an indirect benefit to local economies by spurring increased economic opportunity. Capital construction projects led by GSA are important investments, not only for the Government, but also for the communities in which the projects take place, including many small businesses.

Small businesses are at the heart of many sectors of the economy, including information technology, retail, and green jobs. In fact, in fiscal year 2008 alone, small businesses were awarded over $1 billion in GSA contracts. In addition to Recovery Act initiatives

and implementation, we are also going to discuss the fiscal year 2010 funding requests for SBA and GSA.

Joining us for our first panel is Karen Mills, the new Administrator of the Small Business Administration. I welcome you to the subcommittee.

Ms. MILLS. Thank you, Senator.

Senator DURBIN. The budget request for fiscal year 2010 for SBA is $779 million, which will provide funding for a wide array of programs supporting small business lending and entrepreneurial development. SBA has been on the front lines of the economic crisis, working to help small business owners as they face difficulty gaining access to capital. SBA oversees a loan portfolio of $85 billion and in a typical year makes or guarantees loans to $20 billion for small businesses.

We will discuss the good news regarding the performance of new programs, as well as an array of entrepreneurial development programs that can help small businesses stay on their feet and even grow in this tough environment.

Administrator Mills, I look forward to hearing your testimony on your fiscal year 2010 budget request and on SBA's progress on implementing new Recovery Act programs, and I give you the floor.

SUMMARY STATEMENT OF HON. KAREN G. MILLS

Ms. MILLS. Well, thank you very much, Senator Durbin.

Chairman Durbin and Ranking Member Collins, who I know is going to be here, and members of the subcommittee, it is an honor to testify here before you. And I am very pleased to be here to support the President's 2010 budget for the Small Business Administration.

First, though, I would like to briefly update you on the progress that we have made with the Recovery Act.

With the launch yesterday of the ARC loans, that is America's recovery capital, the SBA has implemented more than $645 million of the $730 million in our Recovery Act funding. So, on March 19, we announced that we were going to raise the guarantees—that we'd raise the guarantees on most of the 7(a) loans—and that we also would reduce or eliminate the fees on 7(a) and 504 loans.

The results actually are quite encouraging. The problem we are trying to address is that we had an environment of very, very tight credit for small business, and small businesses were suffering because they couldn't get any liquidity and any credit. And we were able to, with these two programs, increase our loan volume by more than 30 percent compared to the weeks before the Recovery Act.

And just as importantly, we have been able to bring back over 500 banks who had not been lending, some of them since 2007, and who are now lending through the SBA programs. So, at this pace, the funding for the 90 percent guarantee and the fee reductions will last through December 2009.

As I said, on Monday, we began the ARC loans, and actually, 30 were approved yesterday. We actually expect there to be 10,000, but we are off to quite a lot of demand. These are loans that are going to provide relief for some viable small businesses that are struggling.

They are 100 percent guaranteed by the SBA. They are $35,000, or up to $35,000. They have no interest for borrowers. And they have over 12 months before any repayment begins, and then the repayment is over 5 years.

Overall, the SBA is here to ensure that small businesses will continue to drive the American recovery and also to be able to build a strong foundation for America's competitiveness and for the creation of what we call 21st century well-paying jobs.

The 2010 SBA budget request is $779 million, and it is in support of these objectives. There are four basic functions of the SBA, and they are included, each one, in this budget.

First is our disaster assistance programs, and they are to ensure that communities will recover from a disaster and begin to again contribute to the economy. We actually have more than 1,200 trained standby employees, and they go from the ice storms in Maine to the wildfires in California, and then they go to the tornadoes in the Midwest and the floods. And now they are ready to go down to the gulf coast or the eastern seaboard for hurricane season.

And they help communities. They are deployed to communities who are affected by disaster, and they process and give out both homeowner and business loans. And I am pleased to say that they are ready to go for this season and that our processing times in this disaster center, which we have worked very hard to bring quite lower, are on target, and that is 14 to 18 days.

Our 2010 request in this area is $101 million for administration of the direct loan program.

The second area is our Capital Access Division, and that oversees our business loans. And I heard Senator Durbin mention—I was going to say more than $80 billion—you actually said $85 billion. Thank you. That actually is right where we are.

We are requesting the same authorization levels that were enacted in 2009 to support more than $28 billion in small business financing. This is through our 7(a), 504, our SBIC investments, and our microloan programs. The total subsidy request for this is $83 million in fiscal year 2010.

Our third division is our Government Contracting Division, and that helps small businesses that have the opportunity—helps them have the opportunity to participate in Government contracting and subcontracting. This budget requests an additional $2 million. We are going to revise the certification process for our HUBZone and 8(a) business development programs, and we are going to make sure that only eligible businesses participate, and we are going to be able to determine when our site visits and our oversight is necessary.

Our fourth division is our Entrepreneurial Development Division, and that is really the backbone of the agency. We have over 900 small business development centers, SBDCs. We have more than 100 women-owned business centers. And we have more than 350 chapters of SCORE, which is our retired executive program.

Overall, we have 14,000 affiliated counselors. And one of the partner organizations said to me the other day that he thinks that we are within 45 minutes to an hour of most small businesses with counseling assistance.

The performance of these operations is quite strong. We have seen 34,000 clients since October, and that is a 5 percent increase, as you can imagine in these times, compared to last fiscal year.

So, as you can see, we are a small agency with a big mission, especially in today's economic climate. Already, Federal agencies throughout the administration are turning to the SBA. They are looking for ways to tap into our network of staff and our partners who are already on the ground and working with small business owners.

One recent visible example of our work has been with the auto task force and where we have helped devise dealer floor plans, the financing for dealer floor plans. This budget is going to allow us the flexibility to build more of these partnerships in response to these challenging times. Specifically, $20 million in the 2010 budget allows us to create three important collaborations.

The first initiative is on veterans. We are going to provide an additional $5 million to focus throughout our agency on serving veterans. We have 12,000 troops returning this summer. We have tens of thousands over the next coming year, and we have to be ready to serve these veterans who are or who want to become small business owners.

So already we have eight specialized veterans centers, but we actually need to be serving veterans in all of our other partners. There are 2 million women veterans. We need to be ready to serve them in our women-owned business centers. We are already in conversations with the Secretary at Veterans Affairs on how to coordinate our efforts, and this is part of an overall objective at the SBA and across the administration to collaborate, to break down sacred turf in order to make Federal dollars work more efficiently for those who need our help.

The second initiative is $10 million, which is requested to form a ready reserve, or SWAT team. This is an interagency collaboration with SBA. At the request of a community, these teams will go into areas that have been disproportionately impacted by the economy and help them plan for jobs and growth. The focus is going to be on the manufacturing sector, on the automotive industry, on communities that are reinventing their economy from the ground up.

I went to Kokomo, Indiana, which is one of the highest concentrations of Chrysler employment, 2 weeks ago, and the mayor, Greg Goodnight, asked me for just this kind of help. Could we send this kind of team in?

The ready reserve teams are going to work closely with this network, this bone structure of SBA partners to help leverage the local assets, create jobs, grow small businesses.

The third initiative in this budget is $5 million to support small businesses through regional economic clusters. An example that I like to talk about is the Maine boat builders, and the Maine boat builders have formed a cluster with the University of Maine, working on new composite technology. This is a 400-year-old industry now competing across the globe.

Maine's small boat builders are one example, and I know that Senator Collins has actually been working with this group for a long time, even longer, much longer than I have.

So clusters like this are forming in every State. They are going to be fueled by efforts in the Department of Commerce. The Department of Commerce has $50 million in their budget for these cluster activities. The SBA resources on the ground will coordinate with Commerce's manufacturing and export centers, with Labor's trade assistance programs, and a number of other programs to assist the clusters' needs.

In the coming year, my personal commitment with all our efforts at the SBA is that we will measure our progress on an agency-wide basis and transparently report our activities to Congress and to taxpayers.

PREPARED STATEMENT

Already, we are tracking our progress in a systematic and integrated way. We have a dashboard of data on a weekly basis and on a monthly basis. And we are going to continue to use these metrics in our objectives of implementing the Recovery Act, reinvigorating the agency, and serving as the strongest possible voice for small business.

Thank you very much. I would be happy to——

Senator DURBIN. Thank you, Administrator Mills.

[The statement follows:]

PREPARED STATEMENT OF KAREN MILLS

Chairman Durbin, Ranking Member Collins and Members of the Committee, it is an honor to testify before you. I am pleased to be here to support the President's 2010 Budget for the SBA, but first I would like to briefly update you on the SBA's progress with the Recovery Act.

With the launch of the America's Recovery Capital (ARC) loan program yesterday, the SBA has implemented more than $645 million of the $730 million in total SBA Recovery Act funding. On March 19, we announced that we would raise guarantees on most 7(a) loans to 90 percent and reduce or eliminate fees on both of our flagship loan programs. The results are encouraging. In this environment of tight credit, we were able to increase our loan volume by more than 30 percent compared to the weeks before the Act was passed. Just as importantly, we have brought nearly 500 banks and credit unions back to the program who had not participated since 2007.

By and large, the stimulus money is out in the marketplace—in the hands of entrepreneurs and small business owners—and it is working. At this pace, funding for the 90 percent guarantee and the fee reductions will last through December of this year.

Yesterday, we opened up applications in our ARC loans program. These will provide the relief that many viable but struggling small businesses need. The ARC loans are up to $35,000 with no interest for borrowers and no repayments for 12 months. We expect these loans to be in high demand. We have taken steps to ensure that smaller lenders and community banks have access to these loans before the supply runs out. Specifically, we have limited the number of loans a lender can give to 50 a week, with a total from any lending institution of no more than 1,000. And if a bank doesn't use all of the loans one week, they can roll them over to the next week.

The SBA is here to ensure that small business will continue to drive America's economic recovery and build a stronger foundation of American competitiveness while creating well-paying jobs in the 21st century.

The 2010 SBA Budget request of $779 million is key to moving forward with that overarching goal in mind. There are four basic functions of the Agency that are supported by this budget.

First, our disaster assistance programs ensure that businesses and communities can recover quickly from disaster and once again contribute to the local economy. We have a direct loan volume of more than $1 billion for this area and the processing times for our disaster loans are on target. We also have more than 1,200 trained standby employees who can be deployed to communities affected by disaster, and we continue to find ways to improve operations and planning in this area.

The total fiscal year 2010 request in this SBA function is $101 million for administration of the direct disaster loan program. Disaster loan subsidy funding is available through unobligated balances.

The budget request also includes $1.3 million in administration expenses for the disaster assistance programs and $1.7 million in credit subsidy funding to conduct two pilots of guaranteed disaster loan programs authorized in the 2008 Farm Bill.

Second, our capital access division oversees our business loan programs which now support a portfolio of more than $80 billion in loan guarantees. We have requested the same authorization levels as enacted in fiscal year 2009 to support more than $28 billion in small business financing through our 7(a), 504, Small Business Investment Company and Microloan programs.[1]

The total subsidy request for this is $83 million for 2010, of which $80 million supports $17.5 billion in 7(a) volume and $3 million supports $25 million in Microloan volume.

Also, we continue our multi-year investment in the SBA's Loan Management Accounting System, an effort to replace our outdated computer system. The budget requests $5 million in additional funds for this effort.

Finally, $3 million is requested for Capital Access to conduct a study on the next generation of equity capital programs to help stimulate innovation and job creation.

Third, the SBA's Government Contracting Division helps small businesses receive opportunities to participate in Government contracting and subcontracting, with a goal of delivering 23 percent of all Federal prime contracts to small firms. These contracts serve as stepping stones for small business growth while allowing Federal agencies access to quality products and services with high levels of innovation, service, and responsiveness.

This budget requests an additional $2 million to revise the certification process for the HUBZone and 8(a) Business Development programs, so that only eligible businesses participate in these programs. The money will also improve training programs which target both small businesses and procuring agencies to ensure that small businesses have the opportunity to compete.

Fourth, our entrepreneurial development division is the backbone of the agency, harnessing the entrepreneurial spirit of entrepreneurs and small business owners across the country. We manage this effort through nearly 900 Small Business Development Centers and more than 100 Women's Business Centers, 350 chapters of SCORE, our mentoring program that matches experienced executives with small businesses, and other programs which comprise about 14,000 affiliated counselors in total. Entrepreneurial Development also includes major initiatives to reach small business owned by veterans, Native Americans, minorities and other populations, such as those in rural areas. Our role is to be there for those who need help accessing capital and advice to pursue small business opportunities.

I should note that the performance of our counseling operations is strong, with our Small Business Development Centers serving nearly 34,000 clients since October, a 5 percent increase compared to last fiscal year.

The major focus of this division in fiscal year 2010 will be not only to maximize the impact of the linkages the SBA has with our extensive network of partners, but also to improve the coordination between our partners. In addition, we will take advantage of the collaborative opportunities we are seeing with Federal agencies as well as state, local and private sector players who can help us serve entrepreneurs and small businesses.

The SBA is also engaged in new collaborations with the Departments of Veterans Affairs, Commerce, and others that I will describe further shortly.

As a foundation to support each of these four areas, the SBA is renewing its focus on investing in its people, technology, and other core agency investments that are critical to the agency's future.

With technology, the Recovery Act provides $20 million to move forward with efforts such as automating old paper-based systems, boosting data transfer speeds and a new web portal and a customer relationship management system.

The fiscal year 2010 budget request includes $3 million for additional IT improvements related to technical training, off-site data storage, a better SBA Internet presence, and more email storage capabilities for employees.

Our people, of course, are our strongest asset.

This budget request includes $13.6 million in additional funds for salaries and benefits, $10 million of which will go to hire about 80 additional employees, bringing total salary expenditures to $268 million with 2,203 employees. These new hires will be largely focused on loan purchases and processing.

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[1] $17.5 billion, $7.5 billion, $3 billion and $25 million, respectively. In addition, $12 billion in authority is requested for the Secondary Market Guaranty program.

This budget also requests an additional $2 million to help the agency address much needed efforts in this training, mentoring and our succession planning efforts. Our hope is that these investments in SBA staff will allow us to build on our recent Most Improved Agency award related to job satisfaction in the Federal Government. We rose from 30th to 26th, but there is still much room for improvement.

As you can see, we are a small agency with a big mission, especially in today's economic climate.

Already, Federal agencies throughout the Administration are turning to the SBA, looking for ways to tap into our vast network of staff and partners who are already "on the ground" interacting with small business owners across the country.

The most visible recent example of this has been our work with the Auto Task Force. We are moving rapidly to implement a new program to finance dealer floor plans. We have also been engaged more recently in the health care discussion to ensure that the needs of small business employees will be met in the future.

This budget allows us the flexibility to build more of these partnerships to adapt to the needs of these challenging times. Specifically, $20 million is allocated in the 2010 budget to allow the SBA to create truly powerful collaborations through three major initiatives.

The first initiative provides an additional $5 million to focus on veterans business issues. We have 12,000 troops coming home from Iraq this summer and tens of thousands more in the coming year. We must be ready to serve these veterans who are, or who want to become, small business owners.

Already, we have 8 specialized veterans resource centers, but we need to be serving veterans throughout our 900 Small Business Development Centers, our 350 SCORE chapters and our other partners. Also, there are nearly 2 million women veterans, and we need to ensure that our Women's Business Centers are well-equipped to serve all of them.

The $5 million requested in the 2010 budget will leverage our existing networks to serve veterans. We are already in conversations with the Secretary at Veterans Affairs on how to coordinate our efforts. This is the part of an overall objective at the SBA and across the Administration to collaborate and break down "sacred turf" in order to make our dollars work more efficiently for those who need our help.

Secondly, a $10 million initiative is requested to create a program of ready reserve teams or SWAT teams. This will be an interagency collaboration with SBA experts and experts at other Federal agencies. At the request of the community, this team will go into areas that have been disproportionately impacted by the economy and help them plan for growth.

This will include regions that have been hit in the manufacturing sector, the automotive industry, and other communities that are reinventing their local economy from the ground up.

I recently went to Kokomo, Indiana, a town with 25 percent unemployment. The mayor, Greg Goodnight, asked me for exactly this kind of help as they work to grow new companies in electronics and engineering.

The ready reserve teams will work closely with our existing partners to leverage the local assets in communities like Kokomo and uncover possible new opportunities. They will find ways to grow a broader knowledge base, to learn new skill sets, and to create 21st century jobs.

Third, the Budget contains a $5 million initiative is to support small businesses who participate in Regional Economic Clusters.

An example is the Maine boatbuilders who are working with new composite technology to create lighter, faster boats that are competitive in global markets. Senator Collins has been working with this group for some time. Maine's small boatbuilders have clustered together to be a new driver of the State's economy.

Clusters are forming in every State and will be fueled by efforts in the departments of Commerce and Energy. The SBA's resources on the ground will coordinate with Commerce's manufacturing and export centers, Labor's trade assistance programs, and others to serve each cluster's particular needs.

This budget will allow us $5 million for this effort to identify, grow and expand the partnerships that will allow us to maximize the national economic impact of regional clusters.

In sum, this $20 million budget request will allow the SBA to be a strong voice for small business across the Administration while reaching out to underserved populations such as veterans . . . emphasizing innovation in areas hard-hit by the recession . . . and building on the strengths that already exist in small business communities.

As you can see, we are a small agency with a big mission, especially in today's economic climate.

In the coming fiscal year, my personal commitment with all of our efforts—both new and existing—is that the SBA will measure our progress on an agency wide-basis and transparently report our activities to taxpayers. Already, we are tracking our overall progress in a systematic and integrated way, reviewing a dashboard of data on a weekly and monthly basis. We will use these metrics to continue implementing the Recovery Act, reinvigorating our agency and serving as the strongest possible voice for small business.

Provided with the resources, the SBA can continue to be a true catalyst for the growth and innovation—helping entrepreneurs and small business owners lead us out of this recession, stimulate the economy, strengthen U.S. competitiveness, and create new, well-paying 21st century jobs.

Thank you and now I'm pleased to take your questions.

SMALL BUSINESS DEVELOPMENT CENTERS

Senator DURBIN. I welcome my colleague Senator Collins.

I would like to ask a question or two. First, you have requested some $20 million for new entrepreneurial development initiatives, and your testimony says this money will be used in part for increased focus on veterans, SBA SWAT teams, and small business clusters. I like the idea of innovative thought and new approaches. However, there is something that I find I can't resolve.

Also in this budget is a proposed $13 million decrease in the small business development centers. They have an established network of connections across the country, and they are already on the street, ready to address the challenges that you have identified. I could give you the list of accomplishments of these SBDC associations, but I think you would know them.

So here is what I am trying to struggle with. Why would you cut back on an established network that has proven that it can help businesses and then start a new function to go after three specific business needs? It would seem to me that we wouldn't want to sacrifice the SBDCs to create a new experimental program, and also will there be SWAT uniforms for the SBA employees?

Ms. MILLS. Well, yes, on the SWAT uniforms, of course.

Well, you are absolutely right to point out this anomaly in the data. And let me be very clear, it is not our intention to cut the SBDC programs. So here is how the anomaly appeared.

When we proposed our 2010 budget, proposed $97 million for SBDCs, that was level funding for this absolutely critical program. So 2009 was $97 million. We proposed in our 2010 budget the same amount.

This is a critical program, and it is what we call the bone structure, the foundation stone, as you have pointed out, of how we are executing, how we are on the ground. The numbers, the metrics on this are very, very good. Not only are they up 5 percent, but we have—or we document how—when they serve clients on a long-term basis, the performance of these clients increases versus the control group who are not served. So these are really critical elements of our plan.

The reason that you see $110 million in 2009 is that Congress passed the actual 2009 after we had submitted the 2010, and there was an increase for the SBDCs, which we are very grateful for.

Senator DURBIN. So you are saying that the $97 million is flat funding from the previous fiscal year?

Ms. MILLS. Yes, and our intention was never to cut this program. We rely on this program. It is a backbone program. So there was no replacement contemplated.

Senator DURBIN. It would seem that flat funding would not anticipate just ordinary increase in cost of living and the like?

Ms. MILLS. Well, as I said, we are very, very happy to talk about supporting this program because this program is a foundation stone of everything that we want to do.

EMPLOYEE TRAINING

Senator DURBIN. Let me ask you about one of the—since you are brand new to the agency, I will just ask you what your thought is about this particular issue.

OPM did a survey in 2008 of the best places to work in the Federal Government. The Small Business Administration in 2008 ranked 26th out of 30 agencies. That is low, but an improvement over the previous year, where it ranked 30th out of 30 agencies, dead last.

So when it comes to this issue of morale and the like, I would like to know what your thoughts are on how you are going to change that particular—or at least address that particular challenge. One of the things that has been suggested is more money into employee training so that there is a notion that if they do train and improve their skills, that there is a chance for advancement within the organization.

However, the report states the agency has not yet documented a comprehensive plan for training that links core competency to your goals. So can you tell us if you are aware of this problem, what you are doing to address it, whether it involves any training component or things like student loan forgiveness?

Ms. MILLS. Senator, I am very happy to talk about this. When we talk about the priorities, when I talk about my priorities for the agency, one of the most important ones is reinvigorating the agency, and there are two components of this—investing in our people and investing in information technology. And what you have just described is at the core of our plan to invest in our people.

It is unacceptable to be 30th out of 30. We won an award last month for most improved agency, and we are only at 26. This is not good enough.

So we have embarked on a revision of our training program, and this is a priority for me as the Administrator and for our whole team because we have terrific people. And we ask them, as I said, to do a lot of jobs, to carry a big load. And we need to prepare them and invest in them in order for them to be great managers, in order for them to be great counselors. And we actually have some excellent programs in the planning process that we plan to begin to implement in the next month.

So we are also looking at student loan forgiveness, and I am pleased to tell you that we are going to do that as well, and that is going to be implemented within the next 30 days.

Senator DURBIN. Do you have the legal authority to do that?

Ms. MILLS. Yes, I believe we do.

Senator DURBIN. Good.

Senator Collins.

Senator COLLINS. Thank you. Thank you, Mr. Chairman.

I would ask unanimous consent that my opening statement be entered into the record.

Senator DURBIN. Without objection.

[The statement follows:]

PREPARED STATEMENT OF SENATOR SUSAN COLLINS

Thank you, Mr. Chairman.

Administrator Mills, welcome and thank you for being here today. Before I discuss your new role as head of the Small Business Administration, I want to thank you for your service to our State of Maine. Your efforts to promote economic development and investment in small businesses in our State have helped retain and create jobs, and have helped small manufacturers increase efficiency and competitiveness.

I am sure that you will bring the same leadership and vision to the SBA as you brought to our home State.

As we all know, small businesses are the backbone of our economy. Our economic strength and future are tied to the strength of small businesses.

During the last decade, America's small businesses have created about 70 percent of all new jobs. Small businesses employ about half of U.S. workers and create more than half of nonfarm private GDP.

In Maine alone, we have 154,000 small businesses. About 112,000 are self-employed individuals, and another 42,000 of these small businesses have employees. These Maine entrepreneurs created nearly 5,000 new jobs in 2007 alone.

Administrator Mills, I look forward to working with you to give small businesses the support and assistance they need to emerge from this recession strong and nimble. I am eager to hear about the progress you are making in implementing the SBA's portion of the Recovery Act, which contained many provisions aimed at helping small businesses recover, grow and expand. I also look forward to hearing your fiscal year 2010 proposals and how they will continue SBA's core services of entrepreneurial assistance and access to capital for small businesses.

Mr. Prouty, the Recovery Act provided $5.5 billion to GSA for construction of new facilities, and for renovation and modernization of old ones to create more energy efficient Federal buildings. There are plans to spend these funds in all 50 States and 2 U.S. territories—creating jobs, constructing buildings the Nation needs, and reducing the energy consumption of the Federal Government. The Recovery Act also included $300 million for the purchase of energy efficient motor vehicles for the Federal fleet. These funds were intended to help stimulate the economy and maximize economic benefit for the ailing auto industry. I look forward to hearing from you about the progress GSA is making in executing this enormous investment.

The President's fiscal year 2010 budget provides funds for construction projects in many States, including my own. However, I am concerned that the President's request does not follow the Judicial Conference's Five-Year Courthouse Construction Plan. In fact, the fiscal year 2010 request does not fund a single courthouse on the Judicial Conference plan. Mr. Chairman, I am pleased that we have invited Judge Bataillon to testify about the selection process for courthouse construction. As Chair of the Space and Facilities Committee for the Judicial Conference, Judge Bataillon will be able to discuss how the fiscal year 2010 Budget request will affect the design, construction, and completion of our Nation's courthouses.

Mr. Chairman, before I conclude, I would like to submit for the Record a letter that Mr. James Duff, Secretary of the Judicial Conference, sent to you and me on June 9, 2009. (Pause for Senator Durbin to accept the letter into the Record.)

This letter expresses the Judicial Conference's concerns about the President's budget request. It states, in part, that "if these projects are not funded in fiscal year 2010, we are concerned that all projects in 2010 and subsequent years will be delayed at least another year-seriously impacting the judicial process where courthouses are already out of space, and critical security deficiencies currently exist."

Mr. Chairman, thank you for calling this hearing. I look forward to working with you as we consider the fiscal year 2010 budget requests of SBA and GSA, as well as the other agencies within our subcommittee's jurisdiction.

Senator COLLINS. Thank you.

I want to apologize to you, Mr. Chairman, and to our witness for my late arrival. Since the witness is from the State of Maine, she can appreciate that I was at the Seapower Subcommittee of Armed Services, which is also a very high priority for our State.

SMALL BUSINESS DEVELOPMENT CENTERS

Administrator Mills, let me first associate myself with the remarks made by the chairman about the small business development centers. As a former regional administrator of the SBA, I know personally how valuable those centers can be in providing advice and guidance, which can be at least as important—well, maybe not as important, but almost as important as money to a new business or a business that is thinking of expanding. So I, too, hope we are not seeing a cutback in those valuable centers.

AMERICAN REINVESTMENT AND RECOVERY ACT

I would like to ask you for an update on the implementation of the Recovery Act. This subcommittee gave the SBA some $730 million to help get small business lending going again through a variety of means, including increasing the amount of a loan that the SBA could guarantee, cutting fees, a variety of programs.

What is the status of the SBA's efforts to implement the Recovery Act?

Ms. MILLS. Thank you, Senator Collins.

The status of the Recovery Act is that as of yesterday, with the implementation of the ARC loans, we have implemented $345 million of the $730 million of Recovery Act money now available for funding. The first stage went out on March 19, which was the increase of guarantees to 90 percent and the reduction of fees. And the reaction—we really have to thank you for putting this money forward because the reaction was immediate.

When small businesses had been having difficulty getting credit, we were able to see our loan volume go up by 30 percent. And actually, I am told as of yesterday, it is now 35 percent over the weeks before the Recovery Act.

In addition, we were able to attract 500 new banks into the program who had not made a loan since—some of them since 2007. So the formula in that Recovery Act is exactly right, and we are seeing the loan volumes increase and increase. We are not back yet to pre-October, pre-2008 levels. But money is in the hands of small businesses, and the Recovery Act is working to keep those jobs.

Senator COLLINS. That is great to hear.

Ms. MILLS. It is good.

SMALL BUSINESS ACCESS TO CREDIT

Senator COLLINS. I will tell you, and I know you hear it back in Maine as well, that there is still a lot of small businesses that are having their lines of credit terminated, that are having loans called, and this infuriates me because a lot of times the financial institutions that are cutting off lending to small businesses are those that have received billions of dollars in TARP money.

So it is just infuriating to me that they are cutting off credit to small businesses that, in many cases or in most cases, are paying on time. They have not violated the terms of their loan agreements, but it is just a matter of the bank trying to build up its capital or reduce its exposure.

When I was the regional administrator in New England in 1992 or 1993—I can't remember which year—banks were failing

throughout New England, and we initiated a New England lending and recovery project, which I have discussed briefly with you. And what this project did is go into failed banks and take out the creditworthy loans and place them with a new lender with an SBA guarantee. And the result was that we were able to intervene in cases where, through no fault of its own, a small business was losing its credit.

Is SBA looking at some sort of proactive program like that, where you would go in and offer to put a guarantee on a loan in order to keep it from being called or the credit line terminated?

Ms. MILLS. Well, yes. We absolutely have, and in fact, you had mentioned this a while ago. There are two programs that are really going to be helpful to this quite distressful problem of credit lines being cut to small businesses.

The first is actually the ARC loans. What is happening to many of these small businesses is that the credit lines that are being cut are actually credit card, business credit card lines. And the availability on those lines has been cut, and therefore, they have no liquidity to run their business.

The ARC loans, which went out yesterday and became available, are $35,000 lines of loans to businesses to pay down any loan they want, including credit card loans. And that would give them an additional $35,000 line of credit.

These are 100 percent guaranteed by the SBA. They have no interest to the borrower. The SBA pays the interest. And they have no repayment due for at least 18 months—6 months to give the loan, then 12 months after. So this will be very good for smaller borrowers who particularly have this issue of their lines of credit cut on credit card loans.

The second—and it will give them a much cheaper option—the second thing that we are implementing and have implemented is that you can refinance a bank loan into an SBA guaranteed 7(a) loan today. And in the next couple of weeks, you are going to be able to implement, to refinance into a 504 loan.

So if you meet the criteria for a 504 expansion loan, you, in the past, could not refinance existing debt into that guaranteed loan. But because of the provisions of the Recovery Act, we are going to be able to implement new rules. And so, those will be available for exactly the kind of great businesses that, for various reasons, the bank is not able to be the provider of enough liquidity and putting it with an SBA bank with a guarantee.

Senator COLLINS. Thank you, Mr. Chairman.

DEALER FLOOR PLAN FINANCING PROGRAM

Senator DURBIN. I understand, Administrator Mills, that on July 1, SBA will begin guaranteeing loans to dealerships to finance inventories of cars, trucks, RVs, boats, and even manufactured homes, that this is because of recent changes to old regulations that used to prohibit this kind of lending.

This is kind of a bold step for the SBA, and it clearly will be needed by some. But it is a stressed marketplace, and I am just wondering as the SBA considers these loans, what steps are you taking to mitigate the risks that are part of this new loan program?

Ms. MILLS. We worked very hard to do a number of things in response to the crisis in the automotive industry. The first was to provide some kinds of financing that the distressed dealers were looking for, and this goes to not just dealers at Chrysler and GM, but, of course, to all dealers, including used car dealers. And it goes to boat builders—boat dealers, RV dealers, as you said, and also motorcycle dealers, in fact.

And the steps that we have taken, what we needed to do was make sure we were taking no more risk with these loans than with our normal 7(a) portfolio. So we actually constructed credit criteria, including our guarantee on this, for instance, is 75 percent, not 90 percent. And the advance rates are of a certain level.

So we have been quite careful to balance the need to step up and provide liquidity to the sector and also to not take on additional—to manage our risk at the appropriate level.

SMALL BUSINESS CONTRACTING

Senator DURBIN. I would like to ask you about one issue that you are going to face and we have all faced in the Federal Government. Federal agencies reported a total of $78 billion in Federal prime contract dollars went to small businesses in 2006. Many of these were obtained using contracting preferences, such as sole-source awards and set-asides for small businesses.

The SBA's inspector general and others have reported flaws in this procurement system related to the contracts. There is evidence that large firms are awarded contracts reserved for small businesses. In addition, Federal agencies have inappropriately been counting contracts performed by large firms toward their small business procurement goals.

SBA introduced a scorecard to rate small business procurement practices at Federal agencies, including the accuracy of reporting, and issued regulations to require small businesses to regularly recertify. How is the SBA working with Federal agencies to ensure contracting personnel are properly trained to understand what is a small business, what is a masquerading large business, and how we meet our goals to actually do business with smaller entities?

Ms. MILLS. Well, Senator, our Government contracting program is designed to have the SBA help ensure that 23 percent of all Federal contracts throughout all of the agencies go to small businesses. And the purpose of this is—it should be—we believe it should be a win-win situation. These are very good for small businesses, particularly some of the high-growth, innovative businesses because it allows them to get to the next level of volume, and then after that, they can export and they graduate and they become job creators and sort of the mainstays of the growth in our economy.

From the Federal agency point of view, it is a win-win also because they get access to some of the most innovative companies and technologies. And when you contract with a small business, very often you get top management and you get the CEO at the table working on these issues.

However, as you point out, it is difficult sometimes for Federal agencies to know how to access great small businesses, and they worry: Will the small business that I am contracting with be there? Is it financially stable?

So one of the things that we are focusing on, in answer to your question, is increased training and activities that improve the reach and access and availability of small businesses to speak to these procurement agents and connect to these procurement agents.

The second issue you raise, though, is that we have had a series of issues relating to whether this is really reserved for small business. This program is for small businesses. It is not for big businesses masquerading as small businesses. There have been a series of findings on this, and we are engaged in addressing every single one that has come out of the report.

And in the budget you will find funding for our HUBZone program and our 8(a) certification programs so that we can re-look at a number of ways we do business, certifying that sometimes it is good for big business to be affiliated and mentor a small business, but it is not good if the small business is not actually the one engaged in the contract and in fulfilling the contract.

So we are working very hard on these issues that you have described and consider them one of our important priorities because we think, actually, this can be a win-win for small businesses and for the Federal Government.

Senator DURBIN. Thank you.

Senator Collins.

Senator COLLINS. Thank you, Mr. Chairman.

LENDER OVERSIGHT

I want to follow up on the questions that the chairman has just raised about the ability of your agency to guard against fraud. You have had an enormous budget increase as a result of the stimulus bill, and yet I am told that SBA's nondisaster staffing has decreased by about 28 percent since 2001. Your loan portfolio went up by 59 percent during that period. Information that you have given us today shows that it has gone up even further.

How is the SBA going to ensure, when you have over 5,000 lenders and 270 certified development companies that are making loans, how are you going to ensure the integrity of that process when your nondisaster staff is shrinking?

Ms. MILLS. Well, thank you, Senator Collins, for asking that.

In fact, this agency went from 3,000 people 8 years ago to 2,000 people now. The budget has gone down by 24 percent. But to answer your question, I said there are two areas that we were going to invest heavily in in reinvigorating the agency. And the first is our people. The second is information technology.

A large part of the information technology investment that we are making, and we got some money in the stimulus act—in the Recovery Act to look at this—is for lender oversight and risk assessment. We have formed a new committee on risk assessment, and we are beginning the process of understanding how we can use technology as well as people to identify risk, to collect better data on risk, and to be more proactive about our understanding of how we go after risk-based solutions.

And I think we do—at this moment, we have some very good components, but we are raising the level of this activity to really

my level, to the administrator level. So I am getting very involved in this myself.

Senator COLLINS. Speaking of human capital, I am told that the chief financial officer of the SBA as well as three senior staff who were involved in estimating credit subsidies all recently left the agency. That concerns me at a time when you are working so hard to expand your lending programs. What are you doing to fill that particular gap at a critical time?

Ms. MILLS. Well, thank you for that question because it gives me an opportunity to brag about our people a little bit.

Our financial staff did at the period of January–February largely go over to the Troubled Asset Relief Program (TARP). But we have been able to actually build inside a first-rate, crackerjack chief financial officer's office and staff who are doing just a terrific job.

So I am pleased to say that the staff has totally risen to the occasion, and we are very confident about our numbers. As you know, I am a metrics-oriented person. So that is a first priority for us.

SMALL BUSINESS CLUSTERS

Senator COLLINS. Thank you.

And finally, you and I share a common interest in helping to develop business clusters, particularly in rural areas of a State such as in our State of Maine. Does this budget have support for the development of small business clusters?

Ms. MILLS. Yes, Senator Collins.

There is $5 million in this budget, and Senator Collins put forth a bill last year which designed a program for clusters. And much of that is now incorporated in the Commerce Department's $50 million cluster program. This $5 million is designed to have the SBA resources, the footprint that we have on the ground, which is so substantial, be linked and leveraged and aligned with those cluster programs.

Senator COLLINS. Thank you.

Senator DURBIN. Thank you, Senator Collins.

And Administrator Mills, thank you for your testimony today. We certainly appreciate it. We will be working with you and your staff on your budget for the next fiscal year.

Ms. MILLS. Thank you.

ADDITIONAL COMMITTEE QUESTIONS

Senator DURBIN. We will probably submit written questions, and if you can take a look at them and send us some replies on a timely basis, it would help us to do our work.

Thank you for being here today.

Ms. MILLS. Yes, we will do that. Thank you very much.

Senator DURBIN. Appreciate it.

[The following questions were not asked at the hearing, but were submitted to the Administration for response subsequent to the hearing:]

QUESTIONS SUBMITTED BY SENATOR RICHARD J. DURBIN

RECOVERY ACT: IMPACT ON SMALL BUSINESS LENDING

Question. The American Recovery and Reinvestment Act of 2009 (Recovery Act) provided $375 million to stimulate lending in Small Business Administration (SBA)

loan programs, supporting, on a temporary basis, reduced-fee loans for borrowers and a higher federal guarantee under the 7(a) program. SBA's loan data shows that since the Recovery Act, the volume of weekly lending under these new programs has increased by 32 percent. In addition, private lenders who had stopped partnering with SBA to make small business loans are returning to the 7(a) program in large numbers.

How long will SBA be able to continue making these reduced-fee loans?

Answer. The $375 million in Recovery Act funds will support a program level of approximately $8.7 billion for the 7(a) program and approximately $3.6 billion for the 504 program with fee elimination and 90 percent guarantees for 7(a) loans. Initially, SBA projected that these funds would last until the end of calendar year 2009. Given the higher-than-expected increase in lending volume, we now believe those funds might run out in early December 2009 for the 7(a) program, and will last through the middle of December for the 504 program.

Question. To what extent does SBA estimate that lending volume will bounce back from the large drop-off that occurred early in fiscal year 2009?

Answer. Lending volumes are steadily increasing to more historic average levels. As the overall economy recovers, we believe the lending volume will recover as well. In July 2009, the combined 7(a) and 504 volume rose to $1.4 billion, which is approaching the 2008 monthly average of approximately $1.5 billion.

Question. What steps is SBA taking to ensure that lenders stay in the 7(a) program once the fees and guarantee level return to normal levels?

Answer. We have heard from lenders that the higher guarantee has helped them extend credit to small businesses in the current economic environment. SBA continues to work with lending partners to identify areas of improvement in SBA programs. At the same time, the Agency is working to continue to revise and streamline operating procedures and to provide good customer service to lenders, making the agency a better long-term partner. This includes development of a much more robust and modern customer relationship management system, allowing SBA to systematically track its interactions with lenders.

RECOVERY ACT: AMERICAN RECOVERY CAPITAL LOANS

Question. The Recovery Act provided $255 million for a bridge loan program to help distressed small businesses make it through the economic downturn. These American Recovery Capital loans—or "ARC" loans—are risky because they are intended for small businesses that are already experiencing financial trouble. SBA estimates that the total volume of ARC loans will be around $350 million.

In deciding which small businesses are eligible to borrow under the ARC loan program, how does SBA determine if a distressed small business is strong enough to weather the economy?

Answer. SBA's ARC loan program is uniquely designed to meet the needs of viable businesses facing immediate financial hardship. SBA asks businesses to demonstrate their viability by showing evidence of profitability or positive cash flow in at least one of the past 2 years. Future cash flow projections based on reasonable growth going out 2 years should show that the business will be able to meet current and future debt obligations, including future repayment of the ARC loan once the disbursement and deferred payment period end, and operating expenses. Also, the borrower must certify that they are currently no more than 60 days past due on any loan being paid with an ARC loan and they must have an acceptable business credit score as determined by SBA.

Question. How does this compare to SBA's estimated demand for the program?

Answer. Since it was launched last month, the ARC program has been steadily ramping up. Through August 4, SBA has approved over 1,000 loans totaling over $34.5 million. SBA estimates that the funding provided will support approximately 10,000 loan approvals through fiscal year 2010, and the agency believes the program is on track to meeting that projection.

Question. How is SBA ensuring that smaller lenders, like community banks, are able to participate in the program before funding is exhausted?

Answer. SBA trained over 3,300 lending officers at over 1,300 banks on how to make these loans and how to use SBA's electronic lending systems. So far, smaller, community based lenders have made most of the loans in the ARC program. In addition, we have limited lenders to no more than 25 loans per week on a cumulative basis and no more than 1,000 loans in total to help ensure access to the program.

LIQUIDITY OF SBA LOANS

Question. The secondary market for SBA's loans is showing initial signs of improvement due to Recovery Act programs and other changes in capital markets. In

May, sales into the secondary market reached the levels of months prior to the economic downturn. The Federal Reserve has, through May, made about $170 million in loans to investors to purchase pooled SBA loans, and Treasury expects to soon make $15 billion in TARP funds available for the federal government to directly purchase SBA loans.

How will the TARP purchases and the Federal Reserve's loan program complement or support the recent improvements in the marketplace?

Answer. The programs from Treasury and the Federal Reserve have been important in the fragile recovery of SBA's 7(a) secondary market. Treasury's announcement that it would serve as a backstop for the market has provided lenders, brokers and investors with confidence around the market's overall liquidity. Over the past 3 months, the average monthly loan volume settled from lenders to broker-dealers has been $335 million, moving the market closer to pre-recession averages. In July, $324 million settled. At the same time, prices for these loans have begun to recover. In July, 67 percent of the loans settled (50 percent of the dollar volume) were sold at or above premiums of 106.

Similarly, the Federal Reserve's TALF program has now supported over $419 million in SBA-backed securities. SBA continues to work with Treasury and the Federal Reserve to ensure long term health of its secondary markets.

SUBSIDIZING 7(A) LOANS IN FISCAL YEAR 2010

Question. In a typical year, the fees SBA collects on 7(a) loans fully offset the cost of payments the agency makes on defaults. However, SBA's budget request states that in fiscal year 2010, those fees will not be sufficient to keep the 7(a) program operational. SBA is requesting an appropriation of $80 million to keep 7(a) loans flowing to small businesses throughout fiscal year 2010.

What changes will occur between 2009 and 2010 that will cause the risk of 7(a) loans to increase?

Answer. In the current economic environment, SBA has seen an increased number of defaults in its loan portfolio, and this historical performance is factored into the model that estimates the fiscal year 2010 subsidy rate. This increasing default rate means that the risk of a subsequent SBA purchase of a 7(a) loan is more likely than it may have been in previous years. The risk of default in the 7(a) program is actually closely correlated to the unemployment rate in the macro economy. With unemployment on the rise, and projected to remain elevated for some time, we expect a higher default rate in fiscal year 2010.

Question. Does SBA expect that once the health of the economy improves, defaults in the program will return to a level fully supportable by fees?

Answer. The econometric subsidy model that is used to determine the subsidy rates in SBA loan programs uses historical loss rates and defaults in SBA's portfolio as well as macro economic estimates related to unemployment rates and interest rates. Unemployment rates are the most significant indicator of loan default in the SBA 7(a) program credit subsidy model. Once the overall economy improves, and unemployment decreases, SBA may be able to run a zero subsidy 7(a) program. However, this could take several years and depends on many other broad market and economic factors.

LENDER OVERSIGHT

Question. SBA's Inspector General has identified deficiencies in SBA's oversight of lenders. The President's request for SBA's lender oversight activities is $11.3 million, a 3.7 percent increase over the fiscal year 2009 enacted level of $10.9 million.

How will the budget request enhance SBA's efforts to ensure lenders are properly overseen?

Answer. The request will allow the SBA to continue expanding upon its goal of ensuring stewardship and accountability over taxpayer dollars through financial portfolio management and prudent oversight. The Agency will achieve this goal by: (1) continuing to perform on-site lender reviews with the objective of reviewing all large and mid-size lenders and community development companies generally on a bi-annual basis; (2) ensure that these lenders and CDCs whose portfolios comprise more than 80 percent of the Agency's guaranty dollars outstanding are accountable for managing their portfolios in a prudent manner, thus reducing the SBA's overall credit risk; and (3) continuing to monitor its smaller lenders and CDCs through its off-site monitoring process.

The SBA will expand its oversight efforts to the Microloan program by applying its off-site monitoring approach to microloan intermediaries.

The SBA also plans to issue guidance with regard to the use of loan agents by lenders to originate SBA guarantied loans. In addition, as the Loan and Lender

Monitoring System (L/LMS) continues to be leveraged for oversight and portfolio management purposes, more involved data analysis of performance trends will be conducted. The results of these analyses will be used for more effective management of SBA loan portfolios, as well as to assist in identifying irregularities that may be an indication of inappropriate lending activities.

Finally, the SBA will also apply its portfolio analysis capabilities, first developed through L/LMS, to the Agency's disaster loan portfolio. This portfolio analysis capability will be used to provide relevant information for senior management to use in decision making.

The SBA plans to issue further guidance to lenders regarding grounds for enforcement actions and the types of enforcement actions that may be taken by the Agency against lenders. This guidance will increase Agency transparency with its lending partners.

Question. What limitations does SBA face in following up on on-site and document reviews of lender activity?

Answer. As the IG has pointed out, substantial strides have been made in lender oversight, and SBA continues to make improvements in its oversight processes. SBA utilizes a combination of an offsite portfolio monitoring tool as well as periodic on-site examinations of its largest lenders in its risk based approach to lender oversight. SBA published the Lender Oversight Interim Final Rule in December 2008, which provides SBA with increased enforcement capabilities. SBA has a robust system for portfolio management and lender performance evaluation. We are working to make the benefits of this tracking technology infrastructure more accessible and user friendly. Additionally, staffing has been increased by seven positions in the Office of Credit Risk Management over the last 2 years.

Going forward, SBA recently re-procured its contract for off-site monitoring and is starting to make more information available to lenders and SBA staff for portfolio management, redeveloping risk rating metrics to enhance their predictiveness, integration of more dynamic, ongoing evaluation of lenders and loan portfolio—identification and investigation of trends and developments—into oversight activities, and development of procedural guidance related to the lender oversight regulation.

MICROLOAN PROGRAM: FISCAL YEAR 2010 REQUEST

Question. SBA's Microloan program was provided $22.5 million in fiscal year 2009 funding as well as an additional $30 million under the Recovery Act. Yet, the President requests only $13 million for fiscal year 2010. While the budget continues to support a robust level of lending—$25 million—it reduces funding for grants for borrower counseling.

Has there been a measurable increase in demand for Microloans since the Recovery Act became law?

Answer. The Recovery Act provided an additional $6 million in microloan loan subsidy, which supports approximately $50 million in additional microlending to intermediaries, and $24 million in microloan technical assistance grants. SBA was able to expedite expenditure of all 2009 non-Recovery Act microloan funds by mid-July, and now, Recovery Act funds are available for SBA microlending intermediaries to use through fiscal year 2010.

Question. How will Microlenders provide adequate technical assistance to borrowers in fiscal year 2010 if the grant funding is reduced per the budget request?

Answer. These funds, combined with the 2010 budget-requested funds will more than double the size of SBA's microloan program over 2009 and 2010. The microloan grant fund request is adequate to support the needs of current and future intermediaries.

MICROLOAN PROGRAM: EXPANDING MICROLOAN ACCESS

Question. The Microloan program can accommodate up to 300 lenders. However, there are currently only 165 SBA-approved Microlenders. Additional partners would provide small businesses better access to the Microloan program.

What steps is SBA taking to expand the number of Microlenders?

Answer. Since the Recovery Act funding was provided, SBA has received 15 new applications from intermediaries, 9 of which have already been approved. The Agency has reached out to microlending institutions and made presentations at industry conferences and workshops to reach out to potential participant organizations.

SBA is working to make improvements to its microlending program, including through a new electronic application. These program changes and new marketing efforts will help expand the number of intermediary partners that provide microloans to borrowers. SBA has done extensive work with intermediaries around best program practices and is reviewing applications for new intermediaries.

Question. How can SBA connect other federal partners to the Microloan program—for example, Community Development Financial Institutions?

Answer. SBA has reached out to Community Development Financial Institutions and continues to discuss this program opportunity with them.

ENTREPRENEURIAL DEVELOPMENT INITIATIVE: "SWAT" TEAMS

Question. The President's budget requests $20 million for a new entrepreneurial development initiative. Administrator Mills' testimony states that $10 million of this funding would be used to send SBA "SWAT" teams into distressed communities, including regions that have been impacted by the economic crisis.

What criteria is SBA contemplating to use in selecting communities for this assistance?

Answer. To evaluate where SBA's pilot program would be most effective, SBA will consider target criteria that show economic distress such as the following: Unemployment; industries in distress (loss of tax revenue); natural disaster impact; involvement with other federal, state and local agencies; and other economic factors, including Employment and Training Administration or Economic Development Administration referrals.

Individual businesses will be targeted to receive an in-depth assessment to identify steps for stabilization and growth.

ENTREPRENEURIAL DEVELOPMENT INITIATIVE: VETERANS' BUSINESSES

Question. SBA's proposed Entrepreneurial Development Initiative requests $5 million to increase SBA's focus on veterans' business issues.

How would the requested funding help SBA help returning veterans start and grow their small businesses?

Answer. Veterans constitute a special class of business owner. Currently SBA supports eight veterans' centers, but this outreach effort limits the number of veterans assisted to those located within one of these eight immediate geographic locations. To meet the unique needs of returning service men and women, SBA intends to leverage its Entrepreneurial Development networks to reach out to veterans who will need assistance to stabilize veteran-owned businesses and return them to prosperity. With this funding, SBA will: train all of SBA's current resource partners in the unique needs of veterans regarding business start-up or management; and will expand the outreach of existing services (business counseling, training and mentorship) to more veterans. SBA will leverage the knowledge and skills that reside in existing Veteran's Business Outreach Centers to more effectively target this training and outreach.

Question. To what extent is SBA coordinating and collaborating with the Department of Veterans Affairs and other organizations to conduct outreach and implement other initiatives to best address the needs of veterans?

Answer. SBA's Administrator Karen Mills will meet with the Secretary of Veterans Affairs to develop a strategy for greater collaboration, avoid duplication and fill gaps for services to veteran-owned businesses and veterans wishing to explore business ownership.

ENTREPRENEURIAL DEVELOPMENT INITIATIVE: BUSINESS CLUSTERS

Question. Administrator Mills' testimony states that under SBA's proposed Entrepreneurial Development Initiative, $5 million of the requested $20 million will be used to support small businesses that are part of "economic clusters".

How would this $5 million enhance the strength of regional cluster businesses?

Answer. SBA's clustering program will facilitate networking among like-minded businesses that face similar economic problems. The network will promote the development of wide-scale discussions on industry solutions and best practices. SBA's district offices will promote clustering by leveraging existing programs and training opportunities to bring businesses together to focus on common economic challenges and potential linkages between businesses to foster growth. Examples of current or planned industry clusters include: The resurgence of the boat-building industry in Maine; and the robotics initiative in Michigan and southern Virginia.

Question. How would SBA leverage these resources with the Department of Commerce's manufacturing and export programs, trade assistance programs at the Department of Labor, and state and local agencies?

Answer. To expand the Clustering Program's impact, SBA will partner with numerous Federal departments and agencies (Commerce, Defense, Energy, Labor, Agriculture, Export Import Bank, etc.) to leverage extensive industrial knowledge and expertise.

DISASTER LOANS

Question. As of June 2009, carryover balances in the disaster loan program were projected to support over $5.5 billion in new disaster lending. Due to these large balances, the budget does not request additional funds for new disaster loans.

How does the level of balances compare to the needs of the disaster loan program in previous years?

How does that compare to disaster lending after the largest recent disaster, Hurricane Katrina?

Answer. The following chart shows original loan approvals for fiscal year 2005 through fiscal year 2009 to date:

Fiscal Year	Homes		Business		Total	
	Number	Amount	Number	Amount	Number	Amount
2004	25,024	$627,425,200	3,486	$256,065,200	28,510	$883,490,400
2005	52,677	$1,388,084,700	9,398	$890,604,800	62,075	$2,278,689,500
2006	145,164	$8,399,440,708	24,819	$2,770,815,600	169,983	$11,170,256,308
2007	11,760	$457,311,500	2,254	$362,358,400	14,014	$819,669,900
2008	12,755	$536,303,400	2,373	$289,536,700	15,128	$825,840,100
June 2009	16,562	$698,964,200	3,020	$318,105,200	19,582	$1,057,334,500

FEDERAL CONTRACTING

Question. Federal agencies reported that a total of $78 billion in Federal prime contract dollars went to small businesses in 2006. SBA's Inspector General and media reports have highlighted flaws in the Federal procurement system related to these contracts. There is evidence that large firms are awarded contracts reserved for small businesses. Further, federal agencies have inappropriately been counting contracts performed by large firms towards their small business procurement goals. SBA introduced a "scorecard" to rate small business procurement practices at federal agencies, including the accuracy of reporting data, and issued regulations to require small businesses to regularly recertify that they meet certain standards to be considered a small business.

How is SBA working with other federal agencies to ensure contracting personnel are properly trained to understand how small business contracting preferences should be implemented?

Answer. The SBA employs professionals, known as Procurement Center Representatives or PCRs. PCRs are the SBA's "eyes and ears" at the buying offices they cover, ensuring that small businesses, including 8(a), HUBZone, SDVOSB and Women-owned small firms, are afforded the maximum, practicable opportunity to receive Federal prime contract awards. In addition to the informal training, which often occurs during the pre-award consideration stage "negotiations" between the PCR and contracting officers, our PCRs provide and participate in formal training events for buying office staff, including training on how small business contracting preferences should be implemented. Thus far in fiscal year 2009 (October 1, 2008-June 30, 2009), SBA's PCRs have provided training to more than 1,100 staff at Federal buying offices. Additionally, PCRs handle many requests for guidance/training from contracting officers on how small business preferences should be handled on a daily basis.

Also, SBA has worked with other agencies to develop a series of data checks to help ensure data quality. The checks have been used in to help improve the quality of the 2007 data and reduce instances of businesses being incorrectly coded.

Question. What recourses or remedies does SBA use when identifying an award to an ineligible entity?

Answer. SBA has a number of programs to identify potentially ineligible entities for its programs. SBA's primary program for identifying an award to an ineligible entity (i.e., a firm that may be other than small (a large business) is our size determination program. If a contracting officer, an other interested party, or the SBA itself believes that a bidder on a Federal contract may have misrepresented its size, the SBA (through our field network of Size Specialists) will investigate the allegations and make a formal determination as to the firm's size. Our determination is provided to the contracting officer, other interested party (i.e., the protestor) and the protested concern, which under certain circumstances can appeal the SBA's findings. First, size is determined at the time of offer, so firms that are large now may still be counted as small for the life of a contract if they were small at the time of offer. However, SBA's recertification rule requires procuring agencies to accurately reflect a firm's change in size status if there is an acquisition, or merger, or, for long-term

contracts, after 5 years and each option thereafter. Second, SBA performs formal size determination in response to protests that may be filed by unsuccessful offerors, the contracting officer or SBA, and these determinations apply to the procurement in question and are binding on the procuring agency. Third, if we determine that a firm willfully or recklessly misrepresented its size status, we may refer the matter to the SBA's Office of Inspector General or propose the firm for suspension or debarment.

The SBA also maintains a Service Disabled Veteran-Owned Small Business (SDVOSB) protest program (at its headquarters) that will investigate claims that an entity may have improperly self-certified its SDVOSB status. Our findings are set forth in a formal determination. If we determine that the firm is not entitled to SDVOSB status, we will issue a formal determination which sets forth the evidence we considered as well the basis for our findings which is provided to the cognizant contracting officer for the appropriate action.

Question. What other steps is SBA taking to oversee the accuracy of reporting on small business contracting?

Answer. SBA has increased its oversight of agency contracting officers who enter the award data into the Federal Procurement Data System, which is the official database for Federal procurement information. As briefly described before, we recently provided Federal agencies with "anomaly reports" identifying specific individual contract action reports which may be miscoded. SBA works closely with the headquarters of those agencies to investigate these apparent discrepancies and to correct the FPDS database, as necessary.

Additionally, the SBA is conducting 30 Surveillance Reviews at major Federal buying offices across the country. Part of these reviews involve an examination of contracts reported to have been made to a small business to determine if the awardee is indeed small and the level of due-diligence performed by the contracting officer when verifying the firm's size.

WOMEN-OWNED BUSINESS RULE

Question. Under the Bush Administration, SBA issued a proposed rule that would limit the use of sole-source contracts for women-owned small businesses to four industries. SBA is currently developing a revised rule related to sole-source contracts for women-owned small businesses.

When will the revised proposed regulation become public?

Answer. One of the Agency's highest priorities is implementation of the WOSB Program as quickly as possible and in a way that withstands legal scrutiny. In furtherance of this goal, the Agency has been working on a revised regulation and is preparing to submit a draft proposed rule for inter-agency clearance. Although I am unable to give you a precise timeline on the WOSB Program implementation because of the nature of the regulatory process, the proposed regulation will be published in the Federal Register for public notice and comment as soon as practical.

Question. What resources is SBA consulting to develop the new rule? How is SBA involving women business owners and other stakeholders?

Answer. SBA has already received approximately 1,700 comments on the previous proposed rule and SBA is considering these comments in drafting a proposed rule. Through the standard regulatory process, SBA will submit a draft proposed rule to OMB for approval and inter-agency clearance. Once cleared, SBA will then publish a proposed rule in the Federal Register which will provide the public notice of the proposed rule and give the public an opportunity to comment on any aspect of the proposed rule. Upon the close of the comment period, SBA will incorporate all of the comments into the rulemaking record and proceed with an evaluation of each comment. SBA will then draft a final rule for publication in the Federal Register which will provide an analysis of the comments received.

QUESTIONS SUBMITTED BY SENATOR MARY L. LANDRIEU

FEDERAL AND STATE TECHNOLOGY PROGRAM

Question. The Federal and State Technology Program—or FAST—and the Rural Outreach Program provide opportunities for businesses in underutilized areas to participate in the SBIR and STTR programs. By providing matching funds through competitive grants, the FAST program has been successful in increasing total SBIR dollars for small businesses in participating states. Through Louisiana's participation in the FAST program, the state jumped from 47th in the United States to 33rd in total SBIR dollars.

The program hasn't been funded since 2004. Given these programs' past successes, do you support funding this program again at the level of $5 million?

Answer. This program has not had enacted funding since 2004 and the 2010 President's budget does not request funding. However, SBA and the SBIR/STTR agencies work diligently to ensure that awards support high quality innovations through a competitive process. To ensure high-quality innovations, the program elicits applicants from across the country and outreach efforts by participating agencies attempt to elicit the widest range of applications possible to enhance the SBIR and STTR competitive processes.

WOMEN'S BUSINESS CENTERS

Question. For 20 years the Women's Business Center (WBC) program has successfully provided business counseling and assistance to women with an emphasis on those who are socially and economically disadvantaged. With the economic turmoil, this program, too, is seeing an increase in demand from entrepreneurs hoping to establish a small business, as well as requests from small business owners hoping for assistance as they attempt to survive through economic uncertainty. To demonstrate the negative impact on our local technical assistance providers, consider our Women's Business Center in New Orleans, which faced a $45,000 shortfall in funding in 2007—despite the increased demand for their services post-Katrina.

Additionally, much of the country is still not served by this program; with Arkansas, Idaho, Kentucky, Montana, Wyoming, Washington, DC, Guam, Northern Marianas Islands and the U.S. Virgin Islands remaining without centers.

Question. How much would it take to fund all of the present Women's Business Centers and fund a center for each of the states currently not served by one, at the full amount of $150,000?

Answer. The President's budget would assist at least 150,000 clients. Funding 9 additional WBCs within the program at $150,000 would cost $1,350,000.

Question. Why would the President not request the $16.9 million that it takes to fund the present centers at the full amount?

Answer. The current budget provides for a sustained level of performance for existing centers.

In addition, the entrepreneurial development initiative will also serve similar economically or otherwise distressed populations.

Question. Why not request at least what was enacted in 2009?

Answer. The request provides an amount roughly equal to the 2009 enacted amount.

7(A) LOAN GUARANTY PROGRAM

Question. The President requested $80 million for the SBA's 7(a) loan guaranty program for fiscal year 2010. Taking this program to zero subsidy in 2005, as the last Administration did, and shifting the cost to borrowers and lenders by raising the fees has been very controversial. We want this important source of long-term capital to be affordable for borrowers and attractive for lenders, and we want to build on the investment we made in this program from the Recovery Act. Nevertheless, $80 million is a big share of SBA's budget.

Please explain why this $80 million is necessary and what are the consequences if we don't provide the funding?

Answer. The 7(a) upfront borrower and ongoing lender fees are capped by statute in the Small Business Act. In fiscal year 2010, even with the historical (i.e., maximum) fees in place, the 7(a) program cannot execute at a zero-subsidy rate, due to higher defaults and economic assumptions. The Subsidy rate for fiscal year 2010 is 0.46 percent. Therefore, in order to maintain the fully authorized program level ($17.5 billion), the Administration requests $80 million in credit subsidy. If the full request is not provided, the SBA would need to reduce its anticipated program level that the lower appropriated amount would support.

DISASTER

Question. As I have mentioned, last year I worked closely with Ranking Member Snowe and former Chairman Kerry to enact significant SBA Disaster reforms as part of the 2008 Farm Bill. In particular, these reforms increased SBA disaster loan limits, improved disaster planning capabilities, and provided the Agency with new tools for future disasters.

It is my understanding that some of these provisions were immediately implemented, while others are still in the process of being tested. As we approach the 2009 Atlantic Hurricane season, I would like an update from the Agency on its implementation of these reforms.

Please provide us with a status on what has already been implemented and what is in the process of being tested or implemented.

Answer. SBA quickly began implementation of the 2008 Small Business Disaster Response and Loan Improvements Act of 2008 (a.k.a. the Farm Bill), immediately after enactment. Many of the provisions were in place for SBA Disaster Assistance operations during the very active 2008 Hurricane season.

As of June 2009 SBA has met 19 of the 26 requirements. SBA has existing authority to undertake four of the seven remaining requirements, and three are in development stages.

A spreadsheet with status of each provision is attached. This spreadsheet shows which provisions have been implemented or completed and which are still in process.

Section	Status
12061—Economic Injury Disaster Loans to Non-Profits	Implemented/Regulations in Process
12062—Coordination with FEMA	Ongoing/Regulations in Process
12063—Public Awareness of Disaster Declaration and Application Periods	Completed
12064—Consistency btwn. Admin. Regs & SOP's	Completed
12065—Would allow up to $14,000 of a disaster loan to be disbursed without any collateral.	Implemented/Regulations in Process
12066—Processing Disaster Loans	Implemented
12067—Information tracking and follow up system	Implemented
12068—Increased deferment period	Available if needed
12069—Disaster Processing Redundancy	Completed
12070—Net Earnings Clause	Implemented/Regulations in Process
12071—EIDL loans in Ice Storms and blizzards	Available w/Existing Authority
12072—Develop and implement a Major Disaster Response Plan	Completed
12073—Disaster Planning—Full-time Disaster Planning Staff	Completed
12074—Assignment of Employees to the Office of Disaster Assistance and Disaster Cadre.	Ongoing
12075—Comprehensive disaster response plan	Completed
12076—Office Space	Completed
12077—Applicants that have become an MSE	Implemented/Regulations in Process
12078—Disaster Loan Amounts/Mitigation	Implemented/Regulations in Process
12079—Small Business Bonding Threshold	Ongoing
12081—Eligibility for Additional Disaster Asst	Available if needed
12082—Additional EIDL Asst	Available if needed
12083—Private Disaster Loans	In development
12084—Immediate disaster assistance program	Developing pilot for 2010
12085—Business Expedited Disaster Assistance Loan	Developing pilot for 2010
12086—Gulf Coast Disaster Loan Refinancing Program	Available if needed
12091—Reports on Disaster Assistance	Monthly reports are being distributed/ Annual report pending

Question. The President's request for SBA calls for $1.7 million to fund the two Guaranteed Disaster Loan Program Pilot Programs that we enacted as part of disaster reform?

Answer. The President's budget request for 2010 calls for $1.7 million to fund two Guaranteed Disaster Loan Pilot Programs. SBA has developed an outline for these programs which will be vetted with banking industry representative in two planned focus groups. It is imperative that we develop a program that the industry accepts to ensure participation when disaster activity warrants.

Question. Will it be available for the 2009 Hurricane season? (Yes/No)

Answer. The guaranteed commercial lending programs will not be available for the 2009 Hurricane season.

PRESIDENT OBAMA'S SMALL BUSINESS RECOVERY PLAN

Question. President Obama's plan to assist small businesses in gaining access to the credit markets contains elements of proposals that have been pushed by this Committee from the beginning of this economic downturn.

Can you tell us how implementation of that plan is proceeding?

Answer. Through the programs and funding provided in the Recovery Act, SBA has helped small businesses access the capital they need to survive the economic conditions. Recovery Act programs have helped through increasing lending through the 7(a) and 504 guaranteed loan programs, expanding the base of SBA lending partners, providing targeted assistance to struggling businesses through the ARC loan program, and allowing small businesses with higher dollar contracts to obtain

SBA-backed surety bonds. All of the $675 million in SBA program funds are currently available to support small businesses.

Question. Are there any lessons from your business background that can be applied towards improving SBA lending programs?

Answer. Over the course of my career I've had the opportunity to gain valuable insight into the capital access challenges faced by entrepreneurs and small businesses. During the recession of the early 1990s, I was operating small manufacturing companies that supplied the auto industry and that experience gave me a deep understanding of what our small businesses need today to survive this current downturn and to prosper in the years ahead. I've also had valuable experience with the funding needs of high-growth, high-potential companies that I've worked with over the years. That understanding of the capital needs small businesses have—whether you're a Main Street business or a high-growth potential business—is something I bring to this job and something that is guiding our current efforts at SBA to assess the efficiency and effectiveness of our programs and the systems through which we deliver them.

OFFICE OF TECHNOLOGY

Question. The Office of Technology, which promotes and monitors the highly successful Small Business Innovation Research (SBIR) and Small Technology Transfer (STTR) programs, has seen its operating budget cut by more than half during the last 18 years. At the same time, the SBIR and STTR budgets have more than doubled, with participating SBIR and STTR Federal agencies allocating more than $2 billion to small high-technology firms across the country each year.

I find this trend very alarming, particularly when other agencies try to get out of complying with the SBIR and STTR laws, as happened with about $229 million in the Recovery Act, and I am interested in hearing your perspective on how the Office of Technology is handling its oversight responsibilities in light of its diminishing budget.

In your opinion, does the Office of Technology have the staff and funding to meet the program's demands? (Yes/No)

Answer. The budget provides $250,000 for the Office of Technology. Within this amount, the Office provides oversight of the SBIR and STTR programs. I also understand the value of rigorous oversight. That is why SBA has committed to developing comprehensive performance measures for the SBIR and STTR programs. Currently, no continuous or comprehensive measures exist for the programs. With performance measures in place, we can regularly evaluate the effectiveness of these programs. SBA is currently working to implement measures now.

Question. As I just noted, without adequate funding, the Office of Technology cannot function as it was intended and cannot support the SBIR and STTR programs. The Committee believes that in order to provide the Office with the resources it requires, there should be at least $1.5 million allocated for the Office to go toward additional staff, oversight, outreach, travel, and maintenance of its databases.

Would you disagree that at least $1.5 million would be an appropriate amount to meet with needs of the Office of Technology, as Senator Snowe and I have recommended?

Answer. The budget provides $250,000 for the Office of Technology. Within this amount, the Office will provide oversight for the SBIR and STTR programs and will pursue high-priority activities, such as the development of comprehensive performance measures to regularly evaluate the programs' effectiveness.

SBA CONTRACTING PROGRAMS

Question. One of the principle functions of the SBA is to ensure that the Federal government meets its 23 percent small business contracting goal, specifically by reviewing more than $400 billion in federal contracts awarded each year. Several issues have been raised in the past with respect to the SBA not playing its proper oversight role with respect to contracting.

First, do you intend to increase the contracting oversight staff at the SBA—Procurement Center Representatives (PCRs) and Commercial Marketing Representative (CMRs)? (Senator Snowe and I think we need 100 more PCRs and 50 CRMS, which would require $15 million over time.)

Answer. The SBA is in the process of reassessing our internal procedures regarding the criteria for placement of the PCRs and CMRs. As we add and/or replace PCRs and CMRs we want to ensure that they are placed in locations which can maximize their individual and group ability to assist the Government's small business contractor community. Specifically, we are working with the SBA's Office of the Chief Information Officer (OCIO) to move forward with the development and imple-

mentation of the electronic Procurement Center Representative (ePCR) program which will allow the Agency to further automate the PCR review process, making it possible for them to examine increased numbers of purchase requests while expanding the PCR's ability to cover Federal buying offices located outside their local commuting area. Implementation of the electronic Subcontracting Reporting System (eSRS) has enhanced the ability of our CMRs to more closely monitor the subcontracting programs in place at the large prime contractors within their portfolios by giving them access to "real time" data. Information entered into eSRS, available to the CMRs, provides for greater scrutiny of the prime's use of small businesses as subcontractors. As the CMRs have ready-access to the prime's reports they can respond more quickly to situations which require their attention. As information on Department of Defense large prime contractors is being entered into the eSRS, we believe that this additional availability of reporting data will only increase the effectiveness of the CMRs to effectively monitor the large primes.

Question. Second, what plans do you have to ensure that minority small businesses—whether through the 8(a) program or as Small and Disadvantaged Businesses—have full access to the Federal marketplace?

Answer. It is crucial that minority-owned small businesses are able to participate fully in the federal marketplace. One way to measure this participation is through the small disadvantaged business (SDB) procurement goal which has been established by statute at 5 percent. Over the past several years, the Federal government has consistently achieved and exceeded this goal.

Our PCRs continue to work closely with the contracting officers at their assigned buying offices to ensure that all small businesses, including 8(a) program participants and SDBs have maximum practicable access to Federal procurement opportunities. Just recently, our PCRs undertook a major initiative with regard to the small business "parity" issue in light of a recent GAO decision which seemed to give priority to HUBZone small business concerns over 8(a) firms in Federal contracting. The Office of Management and Budget released interim guidance that agencies should follow SBA's parity regulations, while the Executive branch undertakes a review of the GAO opinion. Our PCRs have undertaken substantial efforts to ensure that the parity rules are followed while the opinion is being reviewed. To this end, the PCRs have increased training for the contracting officers at the buying offices to ensure they understand the need to conduct adequate market research and have an awareness of their office's achievements relative to their goals when deciding which type of set-aside to use.

Additionally, our PCRs are conducting 30 Surveillance Reviews at major Federal buying offices in fiscal year 2009. As part of these reviews, our PCRs are examining the individual buying office's compliance with the 8(a) Partnership Agreement, in place between the SBA and the higher Headquarters of the buying office reviewed.

While access to federal contracts is one aspect of the business development offered through the 8(a) program, it is not the primary purpose of the program. Because the program is a business development initiative, the SBA is working diligently to better track assistance provided to 8(a) firms through the Business Development Management Information System (BDMIS) and the Business Development Assessment Tool (BDAT).

QUESTIONS SUBMITTED BY SENATOR SUSAN COLLINS

Question. What is the status of efforts to establish an economic stimulus lending program, a secondary market guarantee authority for pools of SBA 504 program first-lien mortgages, and SBA secondary market lending authority to make loans to important broker-dealers that operate in the SBA 7(a) secondary market?

What are you seeing in terms lending to small businesses? Has the stimulus bill been effective in unfreezing the credit market for small businesses?

Answer. To date, the Recovery Act efforts to eliminate fees and raise guarantees has helped restore access to capital for small businesses. Through reduced fee and higher guaranteed loans, the Agency has supported nearly $8 billion in lending to small businesses using $155 million in Recovery Act subsidy. Additionally, over 800 banks that had not made an SBA loan since October 2008 have made loans through the Recovery Act. At the same time, since March market activity and pricing in the 7(a) secondary market has rebounded from its severe contraction in 2008. Over the past 3 months, the average monthly loan volume settled from lenders to broker-dealers in the secondary market has risen to $335 million, moving closer to pre-recession averages.

On June 15, SBA announced its ARC loan program, aimed at helping viable small businesses weather immediate financial hardship through interest free, deferred

payment loans to help them make payments on existing, qualified debts. Since it was launched, the ARC program has been steadily ramping up. Through August 4, SBA has approved over 1,000 loans totaling over $34.5 million.

Two provisions in the Recovery Act were designed to address market disruptions in SBA's secondary markets for guaranteed loans. Both of these programs are entirely new and complex, requiring regulations, procedures, credit subsidy models and systems to implement. SBA is working diligently to develop and implement these programs.

Section 503 established a new secondary market guarantee authority to provide SBA guarantees on pools of 504 first mortgage loans—which have not historically been guaranteed or securitized by SBA. The Agency has drafted regulations, credit subsidy models, procedural guidance and legal forms and agreements for this program. These documents are under review by OMB and through the inter-agency process. SBA has also started developing contracts and systems to implement this program.

Section 509 established a new direct loan program to help broker dealers in the 7(a) secondary market finance their inventories of guaranteed loans. The Agency has drafted regulations, credit subsidy models, procedural guidance and legal forms and agreements for this program. These documents have been sent to OMB for inter-agency and Administrative review. SBA has also started developing contracts and systems to implement this program.

Question. The Recovery Act directed SBA to initiate four new loan programs, and mandated revisions to other programs such as increasing SBA's guaranty on loans to 90 percent and increasing the size of surety bond guarantees. The SBA Office of Inspector General issued a Recovery Oversight Framework document identifying various risks to taxpayer dollars that could result from these new and revised programs. In addition, the OIG recently issued a report on unimplemented recommendations from prior audits that could affect the risks and performance of these programs. This included outstanding audit recommendations regarding the microloan program, which has now received additional funding under the Recovery Act.

What resources is SBA planning to devote to other risk mitigation efforts to prevent or limit these risks?

Answer. Lender oversight regulations were issued in the fall of 2008 that established clear responsibilities and a supervisory and enforcement framework for lender oversight. Additionally, staffing has been increased by seven positions in the Office of Credit Risk Management over the past 2 years. Going forward, SBA recently re-procured its contract for off-site monitoring and is: (1) making more information available to lenders and SBA staff for portfolio management; (2) redeveloping risk rating metrics to enhance their predictiveness; (3) integrating more dynamic, ongoing evaluation of lenders and loan portfolios; and (4) ensuring that trends or developments are identified and investigated when oversight activities surface them.

In the case of the Recovery Act programs, SBA did a comprehensive risk assessment for each of the programs and developed a detailed risk mitigation plan for each program. Senior managers from Capital Access, Office of Credit Risk Management, Office of Chief Financial Officer, and the Office of General Counsel participated in the risk assessment and risk mitigation efforts. The Office of Inspector General reviewed the plans and provided detailed comments.

What resources and efforts is SBA devoting to implementing the outstanding audit recommendations to improve efficiencies in these programs?

Answer. The Agency has committed significant resources to improving lender oversight technology systems and has staffed up to meet the increased demands for new Recovery Act programs and for the processing, servicing and liquidation of Recovery loans.

During fiscal year 2009, the Agency closed 66 OIG audit recommendations out of a total of approximately 200 at the start of the year and addressed in writing the majority of the 50 open GAO recommendations. Over the past 2 years, SBA reduced the average number of OIG audit findings from around 300 to approximately 150–170. In addition, per the 2002 Consolidated Reports Act, SBA's OIG publishes annually its Major Management Challenges (8 this year), with a scorecard rating system from red to orange to yellow to green. "Reds" have gone from 22 to 1 and the number of recommended actions from the high 80s to 26. We continue to work with OIG to incorporate lessons learned from previous audits and to develop corrective actions to minimize waste, fraud and abuse. Additionally, SBA has put in each senior executives job requirements a goal to address and resolve major audit findings in his/her respective program area.

Question. Please describe the current Veterans' Assistance programs that SBA operates (1) by the SBA Vets Office, (2) by SBA Capital Access program, and (3) by

SBA Entrepreneurial Development Office with a detailed description of loan programs (average dollar loans and average business size, geographic breakdown, total dollar volume) and grant programs (average dollar grants, average business size, total dollar volume).

Also please describe SBA's staff efforts at outreach to other federal agencies (U.S. Department of Labor, especially its Veterans Employment and Training Services Office, and U.S. Veterans Administration, the U.S. Department of Defense), state and local governments, not-for-profit organizations and other stakeholders, and identify existing studies, programs, resources and all existing studies, programs, resources and all available federal funding to assist veterans in starting and/or growing a small business that conduct veterans' benefit programs.

Answer. The SBA Office of Veterans Business Development (OVBD) is the lead SBA office for Veterans' Entrepreneurship. OVBD conducts comprehensive outreach to veterans including Reserve component members, for the formulation, execution, and promotion of policies and programs of the Administration that provide assistance to small business concerns owned and controlled by veterans, service-disabled veterans and reservists. The AA/VBD also acts as an ombudsman for full consideration of veterans in all Administration programs. OVBD, working with the Office of Capital Access, was responsible for the Agency establishing the Patriot Express Pilot loan program, which has approved 3,828 loans for $324.2 million for an average loan amount of $84,702 in 2 years, as of June 30, 2009; we enhanced the surety bond guarantee program for veterans, we established a special outreach and web based program for veterans and reservists in the SBDC program, we established a focused veterans and reservists on line program in SCORE, we market the Small Business Training Network to the veterans community, we established, and recently improved the Military Reservist Economic Injury Disaster Loan program, we provide funding to and manage the Veteran Business Outreach Center program, and we have expanded the District Office-Veterans Outreach Initiative. In addition, we oversee the government wide Service-Disabled Veteran Owned Small Business goal program, and OVBD provides training too and e-based ombudsman guidance to in excess of 10,000 veterans and reservists each year. OVBD works with the independent SBA Office of Advocacy in developing critical Advocacy research into veteran's entrepreneurship.

To accomplish its primary responsibilities of outreach and to act as an ombudsman OVBD utilizes:

—*Veteran Business Outreach Centers (VBOC)*.—8 Veteran specific business centers, which operate from a fiscal year appropriation of $1.2 million or $150,000 each.

—*District Office-Veterans Outreach Initiatives (DO–VOI)*.—OVBD Funding and support for district office Veteran Business Development Officers.

—*E-Guidance and Ombudsman Assistance*.—Program guidance provided to agency customers via e-mail.

—*Service-Disabled Veteran Procurement*.—Providing training SD veterans and to contracting officials to improving SD Veteran procurement opportunity.

—*Entrepreneurial Tools Development and Distribution*.—Development and distribution thousands of Veteran and Reservist specific Program guides annually.

—*Policy and Program Development and Implementation*.—Enhanced OVBD, CA, ED, GCBD, ODA programs and policies for veterans and reservists.

—*Inter and Intra Agency Coordination*.—Coordination and cooperation across SBA and representation, liaison and program and policy development with DOD, DOL, DVA, State, local and private Veteran Serving Organizations, numerous public presentations each year, and representation of agency veteran program resources with national media.

Question. Though the Office of Government Contracting and Business Development, SBA's 7j program provides training to 8(a) firms (firms that are socially or economically disadvantaged). These firms are eligible for government contracts set-aside specifically for small businesses; however, because of a firm's status as a socially or economically disadvantaged firm, its employees need more than just financial opportunities to grow. These firms are also in need of technical assistance to help them meet the demands of these contracts. 7j training is a significant part of the 8(a) program effort to promote small business opportunities and growth. Please give a status update report reviewing the last 5 years of the 7(j) program, including number of clients trained, length of training program, cost per client per training program, follow-up actions, description and examples of curricula provided, and all other relevant information that would provide the Committee with insight into the performance of the 7(j) program.

Answer.

	Fiscal year—				
	2005	2006	2007	2008	2009
Number of 7(j) eligible firms assisted	2,107	2,317	2,486	2,021	2,289
Per firm cost	$1,479	$988	$1,344	$2,356	$2,119
Duration of Training	(1)	(1)	(2)	(2)	(2)

[1] 1 and 2 day workshops.
[2] 1 day workshops.

The U.S. Small Business Administration (SBA), Office of Government Contracting and Business Development, 8(a) Business Development Program (BD) is expanding its efforts to provide innovative training and business solutions to 8(a) Business Development Program Participants. Over the past 5 years SBA has funded projects to enhance the business savvy of 8(a) Participants by providing them with fundamental business development strategies as well as the tools to enhance their ability to successfully compete in federal markets.

SBA monitors contractor/service provider performance and analyzes customer feedback from the 8(a) Participant and 8(a) Business Development Field Office personnel to assess the effectiveness of each 7(j) funded project. In addition, periodic surveys of BDS staff in the field are conducted to fine tune and develop initiatives that will foster business growth and enhance performance and the long term viability of 8(a) firms in the federal and commercial sectors.

Fiscal Year 2009

In fiscal year 2009, 7(j) funds have been used to support nine new initiatives. The first project involves the establishment of an 8(a) Association for the Washington Metropolitan Area that supports members throughout Washington, Virginia and Maryland. The 8(a) Association will be established to assist 8(a) certified businesses with valuable educational, promotional, and federal contracting information needed to further advance their level of experience and achieve a higher degree of success.

Secondly, the SBA will continue Phase II of its initiative with the John H. Chafee Center for International Business at Bryant University to provide international business development to 8(a) Participant firms. Phase II of the SBA 8(a) 7 (j) Trade Data Matching Program will provide 7(j) eligible businesses with counseling and training in the areas of international business development that is designed to help small business start, grow and foster success in the international market place. The training will include one-on-one counseling, traditional and online training, feature business forums and traditional peer to peer networking opportunities, business modeling, conferences and access to a sophisticated trade data retrieval system.

Additionally, three face-to-face projects utilizing traditional classroom as well as Webinars are being funded to provide critical business solutions to 8(a) Participants to bolster their ability to compete for and manage federal contracts, develop business strategies, maximize E-Commerce business opportunities, recruit, manage and retain talented staff, and access the capital necessary to grow and sustain business functions. Fifteen workshops are planned which include the following: Marketing to the Federal Government; How to Qualify for the GSA Schedule; Government Contract Negotiations; Proposal Preparation Training; Construction Contracting; Federal Contracting and Government Contract Management; Strategic Alliances; Leadership Skills; One-On-One Business Coaching; Small Business 8(a) Co-Ops; Regional Conferences and Seminars E-Commerce and Internet Business Strategies; Human Capital Management; Participating on Contracting Teams; Obtaining Debt, Equity and Contract Financing; and Planning for and Managing 8(a) Program Transition.

The sixth initiative will permit SBA to develop a Webinars series that will provide an online resource to allow 8(a) and 7(j) eligible firms to obtain direct business development advice from key business development resources. The Technology to host the Webinars will also be provided.

Project seven involves the award of a contract that will be awarded to a vendor to provide a publication that will be given to approximately 4,000 7(j) eligible and 8(a) firms. This publication will increase their knowledge of how to do business with the government to optimize their contracting opportunities.

7(j) funding will also be used to provide enhancements to the Business Management Development Information System (BDMIS). The 8(a) Business Development Assessment Tool 8(a) BDAT) will provide a uniform mechanism to assess the individual management, technical, financial and procurement assistance needs of 8(a) participants. The 8(a) BDAT will also track individualized assistance provided to 8(a) program participants on an annual basis.

Finally, the SBA serves as a co-host with the Department of Commerce Minority Business Development Agency for the 27th Annual Minority Enterprise Develop-

ment Week Conference. The Office of 8(a) Business Development will provide networking, matchmaking and training opportunities to the 7(j) eligible participants during Minority Enterprise Development (MED) Week 2009.

Fiscal Year 2008

SBA funded six projects using 7(j) Program funds. The first initiative funded Phase I of the international business model developed by the John H. Chafee Center for International Business at Bryant University to provide international business development assistance to 100 8(a) firms. Projects two and three provided face-to-face training and included the following workshop titles, Business Development for Small Businesses Parts 1 and 2, Financial Management for Small Business, and Cost and Pricing Parts 1 and 2. These workshops were also delivered via the web.

In addition, SBA awarded a contract to purchase a technical resource for 8(a) firms entitled "Gems of Wisdom for Increasing 8(a) BD Competitiveness. This book was provided to increase the knowledge base and competitiveness of 8(a) BD firms through the vast network of shareholders such as Offices of Small and Disadvantaged Business Utilization, Procurement Center Representatives and Commercial Market Representatives, Acquisition Team Members including contract offices, program offices and mentors.

The fifth project was awarded in support of the SBA's Emerging 200 initiative. The purpose of this effort was to increase outreach to areas historically challenged by high levels of unemployment and poverty. The service provider was tasked with identifying 200-inner-city businesses across the country that showed a high potential for growth—and to provide them the network, resources and motivation required to build a sustainable business of size and scale within a designated inner-city geographic location. The sixth and final project funded training activities for the fiscal year 2008 MED Week Conference.

Fiscal Year 2007

During fiscal year 2007, the SBA supported two projects using 7(j) Program funds. The initial project financed face-to-face training provided management and technical assistance to 8(a) firms and other 7(j) eligible businesses through one day face-to-face training for the following workshop titles, Business Development for Small Businesses Parts 1 and 2, Financial Management for Small Business, and Cost and Pricing Parts 1 and 2. This initiative also included individualized business counseling.

The second project purchased a business development resource entitled "Gems of Wisdom for Succeeding in the 8(a) BD Program and Beyond." The purpose of the publication is to share "gems of wisdom" of successful 8(a) BD graduates about their success in the Program. This book guided and encouraged others 8(a) firms, and it demonstrated that the "hands on" provided throughout the program really matters.

Fiscal Year 2006

SBA funded a single award to provide workshops to 8(a) and other 7(j) eligible firms. Workshops titles included Business Development for Small Businesses Parts 1 and 2, Financial Management for Small Business, and Cost and Pricing Parts 1 and 2. This initiative also included individualized business counseling.

Fiscal Year 2005

SBA funded two awards to provide workshops to 8(a) and other 7(j) eligible firms. Workshop titles included Business Development for Small Businesses Parts 1 and 2, Financial Management for Small Business, and Cost and Pricing Parts 1 and 2. This initiative also included individualized business counseling.

The second project was designed to maximize the return on time invested by each participant. Participants explored different areas of their business and discussed the common elements that lead to success and what decisions and practices might lead a business to fail. Identification of these elements and how they relate to individual business environments prepared participants how to analyze specific strengths, weaknesses, opportunities and threats so that achievable action plans could be developed and implemented. A companion workbook and DVD were produced which enabled SBA Field Offices to provide additional training to 8(a) Participants who were unable to attend previously scheduled workshops.

GENERAL SERVICES ADMINISTRATION

STATEMENT OF HON. PAUL F. PROUTY, ACTING ADMINISTRATOR

ACCOMPANIED BY THE HONORABLE JOSEPH F. BATAILLON, CHIEF JUDGE, U.S. DISTRICT COURT FOR THE DISTRICT OF NEBRASKA; CHAIR, SPACE AND FACILITIES COMMITTEE, JUDICIAL CONFERENCE OF THE UNITED STATES

Senator DURBIN. Next panel is the General Services Administration, and I will give a little introduction here as the panelists are going to take the table.

GSA employs more than 12,000 staff in 11 regions throughout our country; oversees a vast and diverse portfolio of Federal assets; manages more than 8,600 buildings with a total value of $74 billion, including 1,500 Government-owned buildings. This may be one of them.

It is responsible for servicing the workspace requirements for 57 Federal agencies with approximately 354 million square feet of workspace for over 1 million Federal employees in 2,000 American communities. It is a big job. They are big landlords.

First, we will hear the testimony of Paul Prouty, Acting Administrator of the General Services Administration. We look forward to hearing about the GSA's plans to implement the Recovery Act by converting Federal buildings to high-performance green buildings, as well as discussing the 2010 budget.

Also joining us to discuss the budget request for GSA is the Honorable Joseph Bataillon, Chief Judge of the U.S. District Court for the District of Nebraska. He is Chair of the Space and Facilities Committee of the Judicial Conference, which prepares an annual 5-year plan detailing the needs and priorities of the judiciary for courthouse space. GSA and the administration use this project plan in selecting projects each fiscal year and preparing the budget request.

We thank you both for being here. Your statements will be made a part of the official record, and at this point, the floor will be available to each of you for 5 minutes.

Mr. PROUTY. Thank you very much.

Chairman Durbin, Ranking Member Collins, Senator Bennett—good to see you, sir—distinguished members of the subcommittee, I am honored to appear before you today in support of GSA's 2010 budget request. With your permission, I would also like to provide an update on our efforts to implement the American Recovery and Reinvestment Act of 2009.

GSA's fiscal year 2010 budget request supports the administration's commitments to build a transparent, participatory, and collaborative Government through the use of new technologies, as well as address significant shortfalls in our national infrastructure.

The fiscal year 2010 budget request, in conjunction with the Recovery Act, provides $6.4 billion for capital projects. These projects

will create new jobs for thousands of Americans and will stimulate industries that have been battered by the economic downturn. In addition, these projects will deliver lasting progress toward modernizing our Nation's infrastructure, reducing the Federal Government's consumption of energy and water, and increasing our reliance on clean and renewable sources of energy.

GSA's fiscal year 2010 budget requests $645 million in net budget authority. This amount is just 2.4 percent of our total planned obligations of $27 billion. The majority of our funds come in the form of customer reimbursements for goods purchased or rent paid for space under GSA's jurisdiction, custody, or control.

For the Public Buildings Service, GSA requests $8.5 billion in new obligational authority. Of these funds, $658 million are requested for the construction and acquisition of critical facility projects for the Food and Drug Administration, the Federal Bureau of Investigation, U.S. Customs and Border Protection, and the judiciary.

We also request new obligational authority of $496 million to address the backlog of repair and alteration projects. Although the Recovery Act funding provides GSA with some relief from our substantial backlog of repair and alteration needs, our inventory of aging Federal buildings requires continued reinvestment.

We also request $40 million for our energy and water retrofit and conservation program and our Federal high-performance green buildings program to help address Federal requirements for energy conservation and reduced energy consumption in Federal buildings.

The GSA Federal Acquisition Service (FAS) is a leading acquisition organization for the Federal Government. Last year, revenues increased by 4.6 percent, making fiscal year 2008 the first year since fiscal year 2004 that GSA has seen revenue growth across the combined programs of FAS. FAS also realized a 2 percent increase in cash collections from our multiple award schedules program. This business resurgence is the result of a concerted effort to reduce operating costs, standardize the fees we charge our customers, and restructure our service offerings.

Today, GSA and FAS are delivering value to our customers by offering products and services that meet or exceed their expectations. As a leader in green Government, GSA continues to encourage Federal agency customers to consider the environmental impact of their acquisition decisions.

The American Recovery and Reinvestment Act has provided GSA with an opportunity to contribute to our Nation's economic recovery by investing in green technologies and reinvesting in our public buildings. The Recovery Act provided GSA's Public Buildings Service with $5.55 billion, including $1.05 billion for Federal buildings, U.S. courthouses, and land ports of entry, and $4.5 billion to convert Federal buildings into high-performance green buildings.

We are moving forward with speed, tempered by careful consideration of our procurement responsibilities and our ultimate accountability to the taxpayer. On March 31, GSA delivered to Congress a list of 254 projects in all 50 States, the District of Columbia, and two U.S. territories to be completed with funds provided by the Recovery Act. GSA selected the best projects for accomplishing the goals of the Recovery Act based on a detailed analysis of a number

of factors. Our goals in developing this list were to both put people back to work quickly and increase the sustainability of our buildings.

As of June 5, PBS has awarded contracts totaling $244 million to begin the construction, modernization, or repair of 25 Federal buildings across the country. Of this, $213 million has been obligated to convert GSA facilities to high-performance green buildings. We have also obligated $30 million for the construction of new energy-efficient land ports of entry at Calais, Maine and the Peace Arch at Blaine, Washington.

The Recovery Act provided GSA's Federal Acquisition Service with $300 million to replace motor vehicles across the Federal fleet with those that are new and more efficient. GSA's strategy to improve the energy efficiency of the Federal fleet balances energy efficiency goals with the need to expedite procurement, in order to maximize economic benefit for the auto industry and the economy as a whole.

To date, GSA has obligated $287 million to order over 17,000 fuel-efficient vehicles, of which 3,100 are hybrids. In the final phase of this procurement, GSA will order $13 million of compressed natural gas and hybrid buses and electric vehicles by September 30, 2009.

Today, I have discussed our fiscal year 2010 budget request, the Recovery Act, and GSA's eagerness to undertake the new challenges that lie ahead. Your approval of GSA's budget request is a vital step in helping us achieve our mutual goals of economic recovery, energy efficiency, and increased citizen engagement in Government.

PREPARED STATEMENT

GSA is committed to delivering on these goals, contributing to the long-term objectives of the administration, and providing the best use of taxpayer funds. I look forward to continuing this discussion of our 2010 budget request with you and the members of the subcommittee.

Thank you.

Senator DURBIN. Thank you.

[The statement follows:]

PREPARED STATEMENT OF PAUL F. PROUTY

Chairman Durbin, Ranking Member Collins, and Distinguished Members of the Subcommittee: My name is Paul Prouty and I am the Acting Administrator of the General Services Administration (GSA). Thank you for inviting me to appear before you today to discuss GSA's fiscal year 2010 budget request. With your permission, I would also like to provide you with an update on our efforts to implement the American Recovery and Reinvestment Act of 2009 ("Recovery Act").

GSA's fiscal year 2010 budget request supports the Administration's commitments to build a transparent, participatory, and collaborative government through the use of new technologies as well as address significant shortfalls in our national infrastructure. The fiscal year 2010 budget request, in conjunction with the Recovery Act, provides $6.4 billion for capital projects involving the new construction, major modernization, and repair of Federal buildings. These projects will create new jobs for thousands of Americans and will stimulate industries that have been battered by the economic downturn. Our projects will provide jobs for constructions workers, carpenters, plumbers, electricians, architects, and engineers nationwide. Our demand for building materials will create or sustain jobs in those industries. And these projects will deliver lasting progress towards modernizing our Nation's infra-

structure, reducing the Federal Government's consumption of energy and water, and increasing our reliance on clean and renewable sources of energy.

The budget establishes an aggressive agenda for opening Government to the American people by rapidly expanding the use of technology across the Executive Branch. The President knows that new technology is crucial to delivering greater transparency, accountability, and public participation in government. The Recovery Act has been the staging ground for the Administration's new approach to open Government through the innovative use of new technology

The fiscal year 2010 President's Budget creates a vision of Federal IT that goes beyond increasing the public availability of Government data. Data transparency is a key goal of this Administration, but we are limited in our ability to deliver the broader goal of participatory government without substantial changes in the Federal technology infrastructure. Sound and measured investments are needed to increase collaboration across Federal agencies, to open government processes and operations—not just data—to the public, and to consolidate, standardize, and reduce common Federal IT services, and solutions.

Our fiscal year 2010 budget request is a foundational piece for moving forward with the President's vision of transforming Government by transforming Federal information technology. We have proposed nearly $40 million in technology investments, which will improve transparency, accountability, and public participation. The investments included in our request look to 21st Century technologies to accelerate rapidly efforts, which are often characterized as "electronic government".

Our request seeks funding to begin building the capacity in the Federal Government for a culture of openness and transparency. That culture is based on innovative tools by developing new means of delivering Government data, citizen services, and Federal IT infrastructure. GSA's fiscal year 2010 budget requests the resources necessary for GSA to support the President's vision of "leveraging the power of technology to transform the Federal Government". The requested investments will allow GSA to take a dramatic step forward towards expanding public participation in and access to Government data, which will help to deliver greater transparency, accountability, and public participation in Government. Adopting new technologies and new ways to harness existing technology will make the Federal Government more efficient, more effective, and more responsive to its citizens.

FISCAL YEAR 2010 BUDGET REQUEST

GSA's fiscal year 2010 budget requests $645 million in net budget authority for the Federal Buildings Fund and our operating appropriations. This amount is just 2.4 percent of our total planned obligations of $27 billion. The majority of our funding is provided through reimbursements from Federal customer agencies, for purchases of goods and services or as rent paid for space in Federally-owned and -leased buildings under GSA jurisdiction, custody or control. GSA requests appropriations to support capital investments in the Federal Buildings Fund, to provide for our Government-wide responsibilities, and for other activities that are not feasible or appropriate for a user fee arrangement.

PUBLIC BUILDINGS SERVICE

Our fiscal year 2010 budget requests $8.5 billion in New Obligational Authority (NOA) and an appropriation of $525 million for the Federal Buildings Fund. Our request proposes a capital investment program of $1.15 billion, for projects for the Food and Drug Administration (FDA), the Federal Bureau of Investigation (FBI), U.S. Customs and Border Protection (CBP), and the Judiciary.

We have requested $658 million in NOA for New Construction and Acquisition, including $453.5 million for two Agency consolidations and three infrastructure and development projects, $151 million for three land port of entry facilities, and $53 million for two U.S. Courthouse projects. Our request includes the following projects:

—FBI Field Office Consolidation in Miami, FL ($191 million);
—FDA Consolidation in Montgomery County, MD ($138 million);
—Acquisition of Columbia Plaza in Washington, DC ($100 million);
—Southeast Federal Center Remediation in Washington, DC ($15 million);
—Denver Federal Center Remediation in Lakewood, CO ($10 million);
—Land ports of entry in El Paso, TX; Calexico, CA; and Madawaska, ME; and
—U.S. Courthouses in Lancaster, PA and Yuma, AZ.

GSA also requests NOA of $496 million for Repairs and Alterations (R&A) to Federal buildings. Although the funding provided in the Recovery Act gives GSA some relief from our substantial backlog of R&A needs, our inventory of aging Federal buildings requires continued reinvestment. The R&A program will continue to be a

strategic priority for GSA, and our fiscal year 2010 request focuses on the highest priority projects in our real property portfolio.

The request includes $176 million in NOA for four major building modernizations, $260 million for non-prospectus level projects, and $60 million for Special Emphasis programs. Our proposed major modernization projects are:

—East Wing (White House) Infrastructure Systems Replacement in Washington, DC ($121 million);
—New Executive Office Building in Washington, DC ($30 million);
—EEOB (Courtyard Replacement) in Washington, DC ($10 million); and
—EEOB (Roof Replacement) in Washington, DC ($15 million).

Our Special Emphasis programs would provide:

—$20 million for Fire and Life Safety Program;
—$20 million for Energy and Water Retrofit and Conservation Measures; and
—$20 million for improvements necessary to transform existing Federal buildings into Federal High Performance Green Buildings.

GSA is dedicating $40 million to our Energy and Water Retrofit and Conservation program and our Federal High Performance Green Buildings program, to help address Federal requirements for energy conservation and reduced energy consumption in Federal buildings. These Special Emphasis programs will upgrade Heating, Ventilation and Air Conditioning (HVAC) and lighting systems, install advanced metering, increase water conservation, support new renewable energy projects, and many other items that will conserve energy in Federal buildings. These programs are in addition to the energy conservation measures that are already incorporated into our prospectus-level New Construction and Repairs and Alterations project requests.

In fact, the Public Buildings Service (PBS) already incorporates sustainable design principles and conservation measures into the design and construction of, and repair and alteration to, many GSA Federal buildings. For example, 100 percent of the new construction projects initiated in fiscal year 2008 were registered for the U.S. Green Buildings Council's Leadership in Energy and Environmental Design (LEED). These projects will be measured against objective standards for sustainable design and construction and will receive LEED certification upon substantial completion. PBS has established a commissioning program, to ensure all building systems are working efficiently, and in a coordinated manner, upon completion of a construction project. PBS performs energy audits and environmental risk assessments on a regular basis to determine where resources should be focused.

These initiatives are just a few of the environmental measures that GSA incorporates into New Construction and R&A projects, in addition to our Special Emphasis programs. Our many environmental initiatives compliment each other to build a comprehensive program to promote efficient use of energy and water, increased reliance on sustainable energy sources, and environmental stewardship in the Federal inventory. These programs not only benefit the environment but increase the value of our assets and reduce operating costs over the life of our buildings.

In addition to our capital program, GSA requests New Obligational Authority for our operating program, in the amount of:

—$4.9 billion for the Rental of Space program, which will provide for 194 million rentable square feet of leased space;
—$2.4 billion for the Building Operations program; and
—$141 million for the Installment Acquisition Payments program.

OPERATING APPROPRIATION REQUEST

While only $270 million of GSA's proposed budget is funded through GSA's operating appropriations, the activities they fund are critical. Our operating appropriations provide for GSA's Office of Governmentwide Policy and the Chief Acquisition Officer, the many Government-wide programs of the Operating Expenses account, the Electronic Government Fund, the pensions and office staffs of former Presidents, and the Federal Citizen Services Fund.

The largest increase in our request is for major new Government-wide E-Government initiatives, supported by the CIO Council and under the auspices of the new Federal CIO. The proposed increase of $33 million in this account would be used to address initiatives in the area of Open Government and Transparency, to move agencies to realize large potential savings through alternative approaches to IT infrastructure, to increase agency use of collaborative technologies, and to advance the adoption of new tools to support innovations in how the Federal Government relates to citizens, the private sector, and State and local governments.

Additional funds requested for GSA operating appropriations include increases for the Federal pay raise and inflation, along with proposed program increases to:

—develop high performance green building standards for all types of Federal facilities;
—develop and enhance multiple Government-wide databases to improve Federal reporting and transparency;
—provide additional training support for the Federal Acquisition Institute, supporting acquisition workforce of all civilian Executive agencies; and
—reflect the full-year cost of the pension and related benefits for former President George W. Bush.

FEDERAL ACQUISITION SERVICE

The Federal Acquisition Service (FAS) had a very successful year in fiscal year 2008. Revenues increased by 4.6 percent last year, making fiscal year 2008 the first year since fiscal year 2004 that GSA has seen revenue growth across the combined programs of FAS. FAS also realized a solid two percent increase in cash collections from our multiple award schedules program. Business with the Department of Defense, FAS' largest customer, increased by three percent in fiscal year 2008. This "business resurgence" is the result of a concerted effort to reduce operating costs, standardize the fees we charge our customers, and restructure our service offerings. Today, GSA and FAS are delivering value to our customers by offering products and services that meet or exceed their expectations.

After 3 years of cost cutting, a protracted hiring freeze, and a major realignment of staff out of the Assisted Acquisition Services portfolio, to other parts of FAS and GSA, we are beginning to realize benefits. FAS now has a workforce that is better aligned with its workload, strong cash balances in the Acquisition Services Fund (ASF), and a stable organizational structure to support a strong mix of programs, which deliver value to customers. However, many years of cost cutting and reorganization have created new challenges for FAS, as major IT investments have been deferred, and staffing levels were reduced across all organizations. GSA must now begin to strategically invest in the FAS infrastructure and workforce to ensure a successful future.

Our future depends on investments in technology and continued process improvements in FAS. Short term investments in information technology tools, such as business intelligence, will improve our ability to understand the buying patterns of FAS customers. Business intelligence will improve our ability to help customers make better procurement decisions, which will result in more efficient use of Federal funds and more effective Government. Additional technology investments must be made to FAS legacy systems, that are as much as 35 years old. FAS has also implemented a Lean Six Sigma program. Lean Six Sigma is a process improvement methodology focused on improving efficiency and quality while reducing costs. Private sector experience suggests that Lean Six Sigma initiatives can produce significant improvements. FAS has already launched several Lean Six Sigma initiatives, which we expect to begin generating efficiency gains in fiscal year 2010 and beyond.

FAS also supports the entire Federal community in promoting good-for-Government initiatives, such as strategic sourcing. Strategic sourcing uses business intelligence to analyze customer spending data and makes recommendations to increase the efficiency and effectiveness of acquisitions. GSA participates in the Government-wide Federal Strategic Sourcing Initiative (FSSI), and has established an FSSI Program Management Office in FAS. FAS manages three major FSSI commodity categories: Domestic Delivery Services, Wireless Telecommunications Expense Management Services, and Office Supplies.

In fiscal year 2008, the Domestic Delivery Services contract had 57 participating agencies, boards, and commissions, with a total estimated spend of $94.7 million and $33.8 million in estimated savings. Wireless Telecommunications Expense Management Services expects to save agencies 25 to 40 percent off their wireless cost of operations. And FSSI Office Supplies has grown to over 50 participating Federal agencies, boards, and commissions, with $10 million in spend. Eighty-nine percent of this work is conducted with small business.

GSA and FAS also actively encourage our Federal agency customers to consider the environmental impact of their acquisition decisions. FAS offers a specially designed page, within GSA Advantage, which allows customers to shop by "Environmental Specialty Category." This application enables customers to search for products and services that are environmentally friendly, contain recycled content, or are bio-based. Customers are able to save time and make informed procurement decisions, as GSA has brought a wide range of products into a common procurement tool. In addition to offering environmentally friendly products, GSA has also a Multiple Award Schedule (Environmental Services, GSA Schedule 899) that is dedicated to environmental services. This schedule provides access to services from environ-

mental clean up and remediation and waste management and recycling services, to consulting services.

The GSA Vehicle Leasing program (GSA Fleet) is another example of our leadership in "Green Government". GSA Fleet enables agencies to fulfill their missions and meet their environmental responsibilities, offering over 80,000 alternative fuel vehicles (AFVs) that are leased to customers to meet their transportation needs. The use of AFVs across the Federal Government helps to reduce petroleum consumption, introduces more efficient vehicles into the Federal fleet and reduces greenhouse gas emissions. This GSA program also helps agencies better meet the requirements of multiple environmental statutes and regulations, including the Energy Policy Act and the Energy Independence and Security Act of 2007.

FAS is well positioned to continue as a leading acquisition organization for the Federal Government and assist agencies in achieving their missions in support of the American taxpayer.

AMERICAN RECOVERY AND REINVESTMENT ACT

The American Recovery and Reinvestment Act ("Recovery Act") has provided GSA with an unprecedented and exciting opportunity to contribute to our Nation's economic recovery, by investing in green technologies and reinvesting in our public buildings.

The Recovery Act provided GSA's Public Buildings Service with $5.55 billion, including $1.05 billion for Federal buildings, U.S. courthouses, and land ports of entry, and $4.5 billion to convert Federal buildings into High Performance Green Buildings. In addition, the Recovery Act provided the GSA with $300 million to replace motor vehicles across the Federal fleet with those that are new and more efficient.

Today, I would like to provide you with an update on GSA's efforts to implement the Recovery Act.

FEDERAL BUILDINGS FUND—RECOVERY ACT

As of June 5, PBS had awarded contracts totaling $244 million, to begin the construction, modernization, or repair of 25 Federal buildings across the country. We have obligated $213 million towards measures to convert GSA facilities to High-Performance Green Buildings, including modernizations of the Thurgood Marshall U.S. Courthouse in New York, the Birch Bayh U.S. Courthouse and the Minton-Capehart Federal Building in Indianapolis, IN, and the Denver Federal Center in Lakewood, CO. We have also obligated $30 million for the construction of new, energy-efficient Land Ports of Entry at Calais, ME, and the Peace Arch at Blaine, WA.

The Recovery Act funds that were provided for investments in Federal buildings will provide many direct and meaningful benefits. First, the money will help the Federal Government reduce energy and water consumption and improve the environmental performance of the Federal inventory of real property assets. Second, much of the funding provided will be invested in the existing infrastructure, which will help reduce our backlog of repair and alteration needs. This will increase the value of our assets and extend their useful life. Third, the funds provided for New Construction will reduce our reliance on costly operating leases, by providing more Government-owned solutions to meet the space requirements of our customers. Finally, we will stimulate job growth in the construction and real estate sectors and drive long-term improvements in energy efficient technologies, alternative energy solutions, and green building technologies.

We know this is not business as usual and we are moving forward with speed, tempered by careful consideration of our procurement responsibilities and our ultimate accountability to the taxpayer. In order to streamline business processes and provide tools and resources to assist GSA's regional Recovery project delivery, the Public Buildings Service (PBS) has established a nationally managed, regionally executed Project Management Office (PMO). The PMO works closely with counterparts in the core PBS organization to leverage PBS resources and expertise. This national operation will be accountable for the following:

—Develop and maintain consistent processes, policies and guidelines;
—Manage customer requirements and expectations at the national level;
—Drive successful project oversight and management;
—Ensure accurate tracking and reporting of Recovery Act funds;
—Manage cross-agency resources; and
—Enable PBS to adopt leading practices in the PBS organization generally.

PBS and the PMO have moved forward quickly. On March 31st, GSA delivered to Congress a list of 254 projects in all 50 States, the District of Columbia, and two U.S. territories to be completed with funds provided by the Recovery Act. These

projects fall into the following categories: new Federal construction; full and partial building modernizations; and limited-scope, high-performance green building projects. In the new Federal construction category, we will invest $1 billion in 17 projects; in the building modernization category, we will invest $3.2 billion in 43 projects; and in the limited-scope green buildings category, we will invest $807 million in 194 projects. This totals over $5 billion. GSA selected the best projects for accomplishing the goals of the Recovery Act based on a detailed analysis of a number of factors. Our goals in developing this list were to both put people back to work quickly and increase the sustainability of our buildings.

Many of the projects in the new Federal construction and building modernization categories have previously received partial funding. We can start construction quickly on these projects, while also identifying ways that existing designs can be improved. These categories include projects such as the Bishop Henry Whipple Federal Building in Fort Snelling, Minnesota, a multi-tenant office building project where Heating, Ventilation and Air Conditioning (HVAC), plumbing, electrical and life safety improvements are expected to deliver 23.6 percent energy savings, once the project is completed. This is over and above the 20 percent in energy savings already achieved in this building in recent years.

An example of the innovative improvements we will be making in some of the construction and modernization projects is the Edith Green-Wendell Wyatt Federal Building in Portland, Oregon. As part of this project, GSA will install a new high-performance double glass enclosure over the entire building, which will dramatically enhance energy performance and blast resistance. On the west facade, vegetative "fins" will provide shade, reducing the load on the new high-efficiency HVAC system that will be installed. These are just some of the "green" improvements GSA will make as part of this project. We expect the building to attain a LEED Gold rating.

By using well-established contracting techniques we can start work quickly, and make simultaneous improvements to the existing designs.

In the limited scope category, we have identified a number of projects that can rapidly be deployed in many buildings at once—buildings as varied as the Oklahoma City Federal Building, the Burlington Federal Building U.S. Post Office and Courthouse, and the J. Caleb Boggs Courthouse and Federal Building in Wilmington, Delaware. Through these projects, we can make significant improvement to the energy performance of a building and also improve the working conditions for the people in them.

Greening our buildings will be an ongoing process. As the Subcommittee knows, the Energy Independence and Security Act of 2007 (EISA) and other laws require GSA, among other things, to reduce its energy consumption by 30 percent by 2015; reduce fossil fuel-generated energy consumption in our new buildings by increasing amounts—from 55 percent in 2010 to 100 percent in 2030; and "green" an even greater portion of our inventory. Although the Recovery Act will accelerate our progress in these areas, that alone will not enable us to meet these goals. Our fiscal year 2010 budget request provides the next steps in a long-term program to meet the aggressive goals of EISA and related legislation.

ENERGY-EFFICIENT FEDERAL MOTOR VEHICLE FLEET PROCUREMENT

GSA's strategy to improve the energy-efficiency of the Federal fleet balances energy-efficiency goals with the need to expedite procurement, in order to maximize economic benefit for the auto industry and the economy as a whole. GSA is focusing this procurement on vehicles that will provide long-term environmental benefits, and cost savings, by increasing the fuel efficiency of the Federal fleet. GSA will use newer and more fuel-efficient vehicles and advanced technologies, while at the same time spending funds quickly to provide immediate stimulus to the economy and the automotive industry.

GSA is procuring new motor vehicles only to replace, on a one-for-one basis, operational motor vehicles in the Federal inventory that currently meet replacement standards, so as to not increase the overall size of the Federal fleet. Each vehicle purchased will have a higher miles-per-gallon rating than the vehicle it replaces and the overall procurement will provide a minimum of a 10 percent increase in fuel efficiency over the replaced vehicles.

GSA will only acquire motor vehicles that comply with all Federal environmental mandates. These vehicles will be included in the alternative fuel vehicle-acquisition compliance calculations of the Energy Policy Act of 2005, as well as the petroleum reduction and alternative fuel use increase requirements of Executive Order 13423, "Strengthening Federal Environmental, Energy, and Transportation Management". Vehicles acquired under this procurement will meet, or exceed, standards for green-

house gas emissions which were established in the Energy Independence and Security Act of 2007.

On April 14, 2009, GSA obligated $77 million to order 3,100 hybrid vehicles for Federal agencies using Recovery Act funds. The vehicles in this initial order are a mix of Chevrolet Malibus, Saturn Vues, Ford Fusions and Ford Escapes. This purchase represents the largest one-time procurement of hybrid vehicles for the Federal fleet.

On June 1, 2009, GSA obligated an additional $210 million. To date, we have obligated $287 million, and ordered 17,200 motor vehicles with funds provided by the Recovery Act.

In the final phase of this procurement, GSA will order $13 million worth of Compressed Natural Gas (CNG) and hybrid buses and low-speed electric vehicles, by September 30, 2009. While this is the smallest segment of the plan, we are excited by the fact that the vehicles purchased will replace some of the highest-emission vehicles in the Federal fleet with much lower-emission vehicles, which will reduce fuel consumption and further the Federal Government's exploration of the use of alternative fuels.

SUMMARY STATEMENT

Today, I have discussed our fiscal year 2010 budget request, the Recovery Act, and GSA's eagerness to undertake the new challenges that lie ahead. We at GSA are strongly committed to ensuring that the responsibilities entrusted to us are exercised in a manner that is effective, efficient, and transparent. My task, and the task of everyone at GSA, is to keep building on our recent successes and to fulfill GSA's mission to acquire the best value for taxpayers and our Federal customers, while exercising responsible asset management.

We look forward to carrying out our role in the Recovery Act, to responsibly deliver modernized and energy-efficient Federal buildings and motor vehicles, and to stimulate the economy by creating jobs and outlaying Federal funds to industries in crisis. Your approval of GSA' budget request for fiscal year 2010 is a vital step in helping us achieve our mutual goals of economic recovery, energy efficiency, and increased citizen engagement in Government. GSA is committed to delivering on these goals, contributing to the long-term objectives of the Administration, and providing the best use of taxpayer funds.

CLOSING STATEMENT

Mr. Chairman, this concludes my formal statement. I look forward to continuing this discussion of our fiscal year 2010 budget request with you and the Members of the Subcommittee.

Senator DURBIN. Judge Bataillon.

STATEMENT OF HON. JOSEPH F. BATAILLON

Judge BATAILLON. Good afternoon, Mr. Chairman, Senator Collins, Senator Bennett, members——

Senator DURBIN. Would you check and make sure that your microphone switch is on?

Judge BATAILLON. Now it is on. Thank you very much.

That is what I say to the lawyers all the time. You have to speak into the microphone, gentlemen.

But at any rate, thank you for inviting us here today. I appreciate the opportunity to appear before the subcommittee today to discuss the judiciary's courthouse construction needs, the process for identifying and prioritizing these needs for Federal construction projects, as well as lease construct projects, which are an alternate approach for acquiring smaller courthouse facilities.

Before addressing those issues, however, I want to convey the judiciary's gratitude to this subcommittee for supporting and furthering the administration of justice through appropriating monies from GSA Federal Buildings Fund for the construction of new courthouses and for the renovation of existing courthouses.

We understand that there are many Federal needs competing for scarce capital resources in Government, and we deeply appreciate the subcommittee's willingness to champion the needs of the judiciary in terms of the real estate infrastructure necessary to conduct the work of the courts and administer justice. We are particularly grateful for the subcommittee's appropriation of additional funds for the San Diego courthouse in 2009 and for its support of courthouse construction with the American Recovery and Reinvestment Act funds.

On April 1 of this year, James Duff, Director of the Administrative Office of the United States Courts, on behalf of the Judicial Conference, transmitted to this subcommittee, other cognizant congressional committees, the White House, the Office of Management and Budget, and the General Services Administration, the 5-year plan for courthouse construction projects as approved by the Judicial Conference of the United States in March 2009.

An advance copy of the plan was provided to GSA earlier this year for use in developing the 2010 Federal Buildings Fund budget request. We are disappointed that none of these projects listed on the 2000 plan—on the 2010 plan appear on the President's 2010 budget.

The projects that were included, however, were Yuma, Arizona, and Lancaster, Pennsylvania, which were initially determined by GSA and by the courts as lease construction projects as opposed to Federal building projects. They now appear on the budget as Federal building projects.

The distinction between these two execution strategies for acquisition of new construction has never been in place before, and it has never been part of the 5-year plan for the courts. Federally constructed projects have to be ranked and prioritized because Federal construction dollars are scarce, and at any given year, only so much money is available to be appropriated for these projects.

Lease construct projects, on the other hand, do not compete with each other for funding from a limited pool of Government construction capital but are privately financed. Consequently, there has been no need for the judiciary to rank or prioritize lease construction projects as long as they fit within our budget requirements.

Moreover, Federal construction has been and remains the primary means by which GSA provides new space for the courts. Lease construction has only played a small role in one or two courthouse construction projects in low-density population areas where a large court presence is not necessarily needed.

In addition, lease construction courthouse projects are delivered in a fraction of the time that it takes the Government to construct a Federal courthouse. This expedited delivery feature is a key benefit to the lease construction alternative.

While the use of the lease construction method has been very modest with the judiciary, it has been critical to the judiciary and GSA to deliver small projects on an expedited basis. We now understand that the Office of Management and Budget (OMB) has raised objections to the lease construction courthouse process, even for modest projects like the ones in Yuma and Lancaster.

If the lease construct execution strategy will no longer be accorded to GSA as an alternative to Federal construction methods

for delivery of new courthouses, and the administration seeks funding for these projects from the Federal Buildings Fund, the projects on the judiciary's 5-year plan will suffer, and the President's budget this year is an example of that. None of the 5-year construction projects are included in the President's budget request, only what would otherwise be considered as lease constructions.

If that continues to be the case, lease construction projects would have to compete for scarce Federal building dollars, along with long-term judicial space requirements, and Yuma is a prime example. Yuma was on the verge of a lease construct contract award and scheduled for completion in June 2011. A Federal construction execution will likely delay the project by at least another year or 2 years.

Yuma, to date, has handled over 2,000 defendants, and it is anticipated that they will handle at least 5,000 defendants this calendar year. The security requirements are so limited in this leased facility that ICE has required the court only to process 40 defendants a day because we don't have the capacity to do any more than that, and it becomes a bottleneck for the prosecution of these individuals.

The judiciary was not consulted prior to this change in execution strategy. We are disappointed that the Yuma and Lancaster projects, which we believe are appropriate for the lease construct path, have now been redirected to the Federal construction path, apparently at the expense of the 5-year plan.

With regard to the fiscal year 2010 projects, if they are not funded in this budget year, then they will be pushed back yet again another year, and it has been our experience that every time we push back a project, the costs for the project increase substantially. The judiciary urges the subcommittee to support remaining lease construction as necessary and appropriate and as an alternative to Federal construction, especially in locales where the court space is modest, acute, and of possible intermediate duration.

PREPARED STATEMENT

The judiciary believes that GSA has the authority to use this procurement method, which is a widely accepted method of delivering buildings in the private sector. Again, the judiciary is grateful for the past and continuing support shown by this subcommittee for its facilities and space needs.

Thank you very much.

[The statement follows:]

PREPARED STATEMENT OF JOSEPH F. BATAILLON

INTRODUCTION

Good afternoon, Mr. Chairman, Senator Collins, and members of the Subcommittee. I am Joseph F. Bataillon, Chief Judge of the United States District Court in Nebraska and Chair of the Judicial Conference Committee on Space and Facilities. I appreciate the opportunity to appear before this subcommittee today to discuss the Judiciary's courthouse construction needs, the process for identifying and prioritizing these needs for Federal construction projects, as well as lease-construction projects which are an alternative approach for acquiring smaller courthouse facilities.

Before addressing those issues, however, I want to convey the judiciary's gratitude to this subcommittee for supporting and furthering the administration of justice through appropriating monies from GSA's Federal Buildings Fund for the construc-

tion of new courthouses and for the renovation of existing courthouses. We understand that there are many Federal needs competing for scarce capital resources in Government, and we deeply appreciate the subcommittee's willingness to champion the needs of the judiciary in terms of the real estate infrastructure necessary to conduct the work of the courts and administer justice. We are particularly grateful for the subcommittee's appropriation of additional funds for the San Diego Courthouse in the 2009 appropriations bill, and for its support of courthouse construction with American Recovery and Reinvestment Act (ARRA) funds.

FIVE-YEAR COURTHOUSE PROJECT PLAN PROCESS

I would like to begin by describing the process and criteria used to develop the Judiciary's Five-Year Courthouse Project Plan. On April 1, 2009, James Duff, Director of the Administrative Office of the U.S. Courts, on behalf of the Judicial Conference, transmitted to this subcommittee, other cognizant congressional committees, the White House, the Office of Management and Budget, and the General Services Administration, the Five-Year Plan for Courthouse Projects as approved by the Judicial Conference of the United States on March 17, 2009. An advance copy of the Plan was provided to GSA earlier in the year for its use in developing the 2010 Federal Buildings Fund Budget request. The Five-Year Plan is a key output of the Judiciary's Long-Range Facilities Planning process. The Plan consists of an ordinally-ranked list of new courthouse construction projects for which the Judiciary is requesting authorization, funding and execution from the Executive and Legislative Branches. With one minor exception, all of the Federal-construct courthouse projects on the Judiciary's current Five-Year Courthouse Project Plan are projects that were not affected by the moratorium on new construction described below, because they all had received either authorization or funding from the Congress. These projects were evaluated by the Judicial Conference and its Space and Facilities Committee, and placed on the Plan on the basis of the following four weighted criteria: (1) year out of space (weighted 30 percent); (2) security concerns (30 percent); (3) operational concerns (25 percent); and (4) judges without courtrooms (15 percent).

In terms of the courthouse projects that populate the Five-Year Plan, it is important to note that a project is removed from the Plan once it receives the requested construction funding. Should a previously funded construction project require additional funds due to a budget shortfall (e.g., cost overrun), it is not placed back on the list. Thus, the Plan no longer lists the Los Angeles courthouse project, even though this remains the Judiciary's top priority among new courthouse projects. In 2005, Congress appropriated the full construction amount requested by GSA for the Los Angeles courthouse; but when the time came to put the project out for bid, GSA determined that it could not be delivered for the appropriated amount. Several years later, even with a substantial reduction in scope, GSA awaits sufficient funding for this much needed court project.

As part of its cost-containment effort which I will discuss later in my statement, the Judicial Conference has recently adopted changes to its long-range facilities planning process. I will briefly describe these changes, because they include revisions to the way new projects not previously authorized or funded will be scored for placement on future Five-Year Plans. Again, none of the projects on the current Plan were placed there under the new, revised scoring methodology. Under the new methodology, however, courthouse locations will be ranked in order of urgency of need, based on four criteria: (1) judges without chambers (30 percent); (2) judges without courtrooms (20 percent); (3) facility assessment (40 percent); and (4) caseload growth (10 percent). Building security issues are included in the facility assessment criteria. We are in the process of completing plans for approximately 30 districts, representing nearly a third of our courthouse inventory. The Long-Range Facilities Plan includes short- and long-term statistical projections of caseload and personnel in order to estimate future facilities needs, a comprehensive assessment of each courthouse building to see how it meets the needs of the court, and a set of strategies, some involving real estate and some operational solutions, to address current and projected space deficiencies. Security remains an important factor in the determination of urgency of need, but it is now part of the facility assessment criterion, rather than a stand-alone criterion.

COST CONTAINMENT

In 2004, the Federal Judiciary looked into the future and saw that its "must pay" requirements, such as GSA rent, would increase at a pace that would exceed projected appropriations within a few years. Budget projections indicated that rental costs for existing and new facilities would increase 6 to 8 percent annually, out-

pacing budget growth. The Judicial Conference recognized that controlling rent costs was absolutely critical to avoiding personnel reductions. As part of that effort, a national moratorium on courthouse construction was imposed from 2004 to 2006. The moratorium lasted 24 months and gave the Judiciary time to re-evaluate its space planning policies and practices and to enhance budgetary controls.

The long-range facilities planning methodology for the Judiciary was re-evaluated resulting in a greater emphasis on the ability of a facility to accommodate additional space requirements rather than the physical attributes of a facility in determining whether or not to recommend a new courthouse construction project. If a building has sufficient space, functional issues such as security concerns would then be addressed through repair and alterations and technology strategies. An emphasis on cost, which was the key driver in the development of the new rating methodology, has resulted in a realignment of the criteria for ranking projects, giving greater weight to when a building is out of space and less weight to security and operational concerns.

While the Judicial Conference undertook many other initiatives to reduce rent costs, which I will not enumerate at this time, the moratorium and changes to space planning policies and practices affect the Five-Year Plan process most directly.

LEASE-CONSTRUCTION PROJECTS

While GSA has utilized two execution strategies for the acquisition of new courthouses—Federal construction and lease-construction—the Judiciary has never placed lease-construct projects on the Five-Year Plan. Federally constructed courthouse projects have to be ranked and prioritized because Federal construction dollars are scarce, and in any given year, only so much money is available to be appropriated for these projects. Lease-construct projects, on the other hand, do not compete with each other for funding from a limited pool of Government construction capital, because they are privately financed. Hence, there has been no need for the Judiciary to rank or prioritize lease-construct projects. Moreover, Federal construction has been and remains, the principal means by which the GSA provides new space for the courts; lease-construction has only ever played a minor role, for small (one or two courtroom) courthouse projects in low population density areas where a large court presence is not needed. Use of the lease-construct method has been very modest.

I do want to note, however, that lease-construction is clearly a secondary means of new courthouse execution, running far behind Federal construction in terms of overall capital value. Nonetheless, the Judiciary is mindful that these projects add to the overall rent burden of the courts. Accordingly, it is Judicial Conference policy that each lease-construct project be subject to approval by both the Space and Facilities Committee and the Judicial Conference, and if the project is approved, it is with a specific dollar rent cap.

We now understand that the Office of Management and Budget has raised objections to lease-construct courthouses, even for modest project scopes. If the lease-construct execution strategy will no longer be accorded to GSA as an alternative to the Federal construct method for the delivery of new courthouses, then the Judiciary will need to revisit its courthouse prioritization method. However, the Judiciary urges the subcommittee to support retaining lease-construction as a legitimate, valuable and appropriate alternative strategy to Federal construction, especially in locales where the court space need is modest, acute and of possible indeterminate duration. GSA has the authority to use this procurement method, which is a widely accepted practice in the private sector. Furthermore, lease construct courthouse projects are delivered in a fraction of the time that it takes the Government to construct a Federal courthouse. This expedited delivery feature is a key benefit of the lease-construct alternative. From Judiciary project approval to completed construction, the lease-construct alternative takes approximately 3 years; the Federal construction alternative takes over 10 years, which includes time waiting to place the project on the Plan, and then time expended waiting for funding once it is on the Plan.

GSA FEDERAL BUILDINGS FUND 2010 BUDGET REQUEST

The President's fiscal year 2010 Budget Request for the Federal Buildings Fund does not include any projects from the Judicial Conference-approved Five-Year Courthouse Project Plan. Instead, funding is included for Federal construction of projects in Yuma, AZ, and Lancaster, PA, which GSA and the Judiciary had previously determined should proceed as lease-construction projects. In the case of Yuma, AZ, a critically needed facility in a very busy southwest border location, GSA had already begun the procurement process of preparing solicitations for offers.

The Judiciary was not consulted prior to this change in execution strategy. We are disappointed that these projects, which we believe were appropriate for the lease-construct path, have now been re-directed to the Federal construct path, apparently at the expense of projects on our Five-Year Plan, since no Plan projects were included in the President's fiscal year 2010 budget request. With regard to the projects on the Five-Year Plan for 2010, if they are not funded in 2010, these projects and all projects in subsequent years would be delayed at least a year.

CONCLUSION

Again, the Judiciary is grateful for the past and continuing support shown by this Committee for the facilities needs of the Federal courts. It is clear that while many projects have been successfully executed, much additional work remains to be done. I will be glad to take any questions you have at this time.

Senator DURBIN. Well, thank you both very much.

And first, let me get it straight "Prow-ty" or "Pru-ty"?

Mr. PROUTY. "Prow-ty."

Senator DURBIN. Prouty. Thank you. I'm sorry I mispronounced your name to start with.

DIFFERING CONSTRUCTION PRIORITIES

This really is a classic constitutional confrontation here, the building of courthouses, where we literally have three branches of Government involved in it and obviously going in different directions.

It reminds me when I was in the House, and then Appropriations chairman Jamie Whitten allowed me to come in as a new member, and I said I would like to also serve on the Budget Committee, which was permissible. You could be on Appropriations and Budget. And he said, "You can do it if you want to do it. But just remember, the Budget Committee deals in hallucinations, and the Appropriations Committee deals in facts."

So I went on and took on the Budget assignment. Turned out he was right.

So here, let me show you some charts here just to give you an idea of some things that we have noticed about construction.

This one is interesting, and I think that Senator Bennett will like it a lot. And it shows on the left-hand side what the judiciary lists as priorities in fiscal year 2010, and Salt Lake City is on there.

Senator BENNETT. Why do you think I am here?

Senator DURBIN. I know.

Your timely arrival. And you will notice the President's budget zeroed it out, and then you will notice what the history has been in the past. We have, I guess, appropriated some $40 million for a $211 million project.

I won't go into detail here other than just to show you that the three branches of Government all have different priorities when it comes to this construction. I am going to mention in a moment much of the last chart, the bar chart there, that shows the increased cost, which was a point that was made by Judge Bataillon.

Salt Lake City, off on the right, has been delayed for 9 years, and the estimated cost of construction has gone up from somewhere in the range of $50 million to over $200 million. And we have all been very cognizant of that.

So it appears that the judicial branch picks its priorities. The President then picks his priorities, and then Congress decides what

to fund, which may be a different priority. And that has been the way this has worked back and forth or has failed to work back and forth. And I don't know if we will be able to resolve that at this moment, Judge. But we will try to at least discuss it here.

SAN DIEGO COURTHOUSE

If I can ask about two specific courthouses, and I believe one or both have been mentioned. The San Diego courthouse, in the fiscal year 2009 appropriation, we provided an additional $100 million to cover cost overruns necessary to complete the project. The law was enacted in March, but a contract has yet to be awarded. It appears it is stalled once again.

The GSA didn't inform us of a delay. Would you like to tell us, Mr. Prouty, what is going on in San Diego?

Mr. PROUTY. We are currently, at the request of the House staff, reviewing the San Diego housing plan. It appears that there may be some space that is in the building which we, like you, would like to award that is not currently designated for the courts.

So we are putting a plan together. We think that there is some space that we can give to another Federal agency until such time as the courts need that space. So it is just a space requirements issue.

Senator DURBIN. So what is going to happen to the $110 million?

Mr. PROUTY. It is going to be spent and, hopefully, soon.

Senator DURBIN. Okay, and the contracts will be awarded soon?

Mr. PROUTY. I certainly believe that to be true.

LOS ANGELES COURTHOUSE

Senator DURBIN. Let us take a look at a downtown photograph of the home of the National Basketball Association (NBA) champion Los Angeles Lakers.

We appropriated $300 million for the construction of a Federal courthouse in fiscal year 2005, and you will notice that empty lot in the corner there. There is no indication that construction will begin anytime in the foreseeable future. Costs have obviously escalated dramatically in 4 or 5 years, making the initial project prohibitively expensive. As a result, GSA and judiciary have been exploring less costly alternatives.

Can you tell us, when we are so short on money and we do appropriate the money and nothing happens for 4 or 5 years, you can understand why that gives us a fair degree of angst. Would you like to comment on that?

Mr. PROUTY. I think it is safe to say that we are at a total impasse. For the amount of money that we have, we can't build what the courts want. So we currently have a project that—the original project, as you indicated, is with the scope, even the reduced scope, is beyond the money that we have got. We proposed a project, which included a smaller building and a renovation of an existing Federal building, and the discussions continue.

Judge BATAILLON. It has been very problematic for us, and that is a tremendous understatement. I have been on the Space and Facilities Committee for 9 years. The Los Angeles courthouse showed up on the 5-year plan in 1999, and it was scheduled for site and

design, number one on our list in 1999 and number one on our list for construction in 2000.

And frankly, the extraordinary increases in construction costs in the Los Angeles area have presented tremendous problems for both the courts and GSA. And we have tried to work together to solve these problems.

The latest scenario would be to split the courts even more than they are already, and Los Angeles is one of the largest courts, if not the largest court in the country that has not had a comprehensive housing plan. And it is important for the courts in order to maintain the way we operate to get this problem solved. And unfortunately, we haven't been able to overcome that.

And part of the problem, I believe, is that any further authorization from the House side for this project has pretty much been blocked.

Senator DURBIN. One last quick question, Mr. Prouty. This morning on National Public Radio (NPR) local broadcast, there was an indication that D.C. charter schools are having a tough time finding space to open new schools. I assume there is some excess GSA property in the District of Columbia. Is it possible that we could open up a dialogue between you and the District of Columbia government and see if there are any opportunities there that could be utilized?

Mr. PROUTY. The answer is absolutely yes, although I don't know the authorities and I don't know the vacant inventory.

Senator DURBIN. Okay. Well, let me try to work with you on that.

Mr. PROUTY. Great. Thank you.

Senator DURBIN. Senator Collins.

Senator COLLINS. Thank you. Thank you, Mr. Chairman.

JUDICIARY'S 5-YEAR COURTHOUSE PLAN

Judge, as Senator Durbin has pointed out, the administration did not follow the priorities set forth in the judiciary's 5-year courthouse project plan. Had the budget reflected your plan, Salt Lake City would have been first on the list. Could you give us more insight into the process? Is there a back-and-forth discussion of the priorities with GSA, with OMB, or did the budget proposal come as a surprise to you?

Judge BATAILLON. Well, the budget proposal came as a surprise to us. We submit the 5-year plan every year to GSA, and then it is up to the President to decide how the President wants to fund our building requirements. The stimulus bill included two courthouses, one in Bakersfield and one in Billings, Montana. And those were both originally slated as lease construct buildings.

When that occurred last year, we received some signals that OMB was changing the way it was interpreting the A–11 circular. And when that happened, then when the President's budget came out this year, I suppose it was somewhat of a surprise, but not too much of a surprise. Because apparently, we have changed the way we have decided to score these courthouses, and it does create problems as far as the 5-year construction plan is concerned.

We have always done a 5-year construction plan. That plan is based on the priorities set by the judiciary. We score these courthouses, and we have rescored these courthouses, and now we even

have a new method of scoring courthouses to make sure that the needs of the judiciary, in order to administer justice appropriately, are met. And that is why they give the 5-year plan.

By taking these two projects off of the lease construction line, if you will, or execution plan, it creates a problem about how we prioritize our courthouses. And it really puts these two projects in jeopardy because we have already set the 5-year plan, and the conference won't meet again until September to determine whether we can incorporate these. So it is very problematic for us.

Senator COLLINS. Mr. Prouty, this doesn't make much sense to me. I would understand if the GSA or OMB said we have *x* amount to spend, and we are going to go down the list until that is spent. But it doesn't make sense to me that the priorities are different than those established by the Judicial Conference.

MIAMI FBI OFFICE

Let me ask you about another line item in the construction budget, which is almost as much as it would cost to build the courthouse that is so high on the Judicial Conference list. The budget request includes almost $191 million for Federal construction of a new Federal Bureau of Investigation (FBI) field office in Miami. Prior to this request, the project was originally planned as a lease construct project, which is obviously far lower cost.

What criteria, what objective criteria led GSA to decide to request this funding for the Miami FBI field office at a time—at this time as opposed to other projects that are urgently needed?

Mr. PROUTY. The only—first of all, I want to mention that in the recovery funding, we did fund the top priority, which was Austin. But there are competing challenges here. Both OMB and the Government Accountability Office (GAO) are concerned about the lease construction program. It has been our goal for a very long time to have few, if any, courts in leased properties because it is problematic.

So the challenges have been to find a way to deal with those issues. If you look at the payback on the FBI project in Miami, over the 15 years of that initial lease period that it is beneficial to do a Government construction to the tune of $130 million.

Senator COLLINS. But initially, the upfront cost is more to do construction. Correct?

Mr. PROUTY. The payback, it is $190 million up front. You are right.

Senator COLLINS. And could the FBI's needs be met, should the building proceed as was originally planned as a lease construct project?

Mr. PROUTY. It certainly could have been.

Senator COLLINS. Thank you, Mr. Chairman.

Senator DURBIN. Senator Nelson.

Senator NELSON. Thank you, Mr. Chairman.

Welcome, Judge Bataillon. Mr. Prouty.

Judge BATAILLON. Senator, it is always good to see you.

Senator NELSON. Good to see you.

My colleagues may not know that when I was Governor, I was pleased and proud to recommend you for the judgeship, and I have been proud ever since.

Judge BATAILLON. Thank you very much, Senator.

CONSTRUCTION PRIORITIES

Senator NELSON. One of the challenges that is obvious before us is that the three branches of Government have not come together with any common understanding or common agreement as to where to proceed or how to proceed. Is it possible or is it naive to assume that it is even possible to work with OMB to sit down and go through the priorities? Do we know what their priority list, what criteria they use to establish their priority list that is different than what you do?

I guess first, Judge, I will ask you and then Mr. Prouty.

Judge BATAILLON. Well, OMB communicates directly with GSA on these issues, and GSA, of course, has to, I assume, follow what OMB tells them to do as far as their scoring method under the A–11 circular.

Previously, they have on small projects that the courts have been presenting, that scoring criteria was such that they believed that courthouse buildings were not special use. In other words, that there was no other private market for it. It wasn't uniquely governmental.

A courthouse has courtrooms. You could use that for a banquet hall. You could use that for a gathering hall. And it has office space, just like any other office might have, a bank or any kind of business.

And so, these smaller projects generally were scored so that they could be a lease construct. The part that was scored as uniquely governmental was the marshals' money for the holding cells. And so, we would always bring the money—or the marshals would bring the money up front for the holding cells.

Now OMB, as we understand it, has changed their interpretation of the scoring and has decided that this is a special purpose building, and it ought not to be built as a lease construct. So I am sure the administrator can elaborate on that.

Mr. PROUTY. There certainly is a discussion about the benefit to the Government and about the nature of these properties, and I am certainly not in the position to speak on behalf of OMB. But we, at GSA, would very much like to have a discussion which would preclude these types of discussions in the future.

Judge BATAILLON. So would we.

Senator NELSON. Well, it does seem that that would be part of the answer, to come to some sort of an agreement on whether it is a special use or not a special use to resolve the question about lease construct. And just because they have taken that position that it is special use doesn't make it so.

And hopefully—I don't know how to facilitate that, but I wish you would think about what we could do to help facilitate that because I think we are as frustrated as you are when you see the lack of construction on a project that has been appropriated, and then you see the cost of construction go up. It is as frustrating in some ways as seeing cost overruns. It just takes more Treasury dollars to be able to complete at some point.

If you are putting together another 5-year courthouse project plan, do you have any idea how long it might take for the Judicial

Conference to come up with another 5-year plan? And if you do come up with it, can you come up with it assuming the lease construct under one assumption and then no lease construct under another assumption?

Judge BATAILLON. We can come up with another 5-year construction plan, and the 5-year plan is a priority on how to spend the Federal Buildings Fund money. If it is a lease construct, then it doesn't come out of that pot of money and is just like leasing any other office space, except that GSA makes a contract with a developer. And so, we haven't put those buildings on the 5-year plan for a number of reasons.

One is because we have acute court needs, administration needs like in Yuma, and we want to get the building built as quickly as we can, and it is a small project and so we can deliver it.

But as far as the 5-year plan, we have a particularly difficult problem. In 2004, through 2004 and 2006, we had a moratorium on any construction because of the budget problems that we encountered in 2004 and had to lay off people, as a matter of fact, in order to meet our budget constraints. So we did a moratorium.

And when we did the moratorium, there were 15 courts that had some appropriation from Congress, and so we left those on the 5-year plan. And the 35 that didn't have some appropriation we pushed off of the 5-year plan, and now we are reevaluating all of those courts in what we call an asset management process.

So we have frozen the 13 to 15 courts that were on the original 5-year plan, and now we are trying to bring on other courts on the 5-year plan, and meshing those two groups of folks is getting to be very problematic.

And then if we throw Yuma into the mix or Lancaster into the mix or some other lease construct projects that we are talking into the mix, we have just created a quagmire for the judiciary. But to answer your question, we are smart folks, and if you tell us that we have to do 5-year—put these programs on the 5-year plan, we will do the best we can to do it.

Senator NELSON. Well, I am not telling to you to. I am just asking if you can. It is perhaps over my head to try to require that. But it seemed to me that it might be one of the ways to proceed.

Judge BATAILLON. Well, it is not that you would require it. I think it is basically OMB saying that they won't accept the lease construct process, and GSA communicating that to us, and so then we will have to take a different approach.

But it is a Gordian knot. And I go off the committee in October, and I will be happy to do it then.

Senator NELSON. Well, on the way out, will you rule them in contempt?

Judge BATAILLON. I will try.

Senator NELSON. Thank you. Thanks to both of you.

Senator DURBIN. Senator Bennett.

Senator BENNETT. Thank you very much, Mr. Chairman. I appreciate the opportunity to be here with the subcommittee.

Judge Bataillon, I couldn't have written your testimony better than you wrote it.

Judge BATAILLON. Thank you very much.

SALT LAKE CITY COURTHOUSE

Senator BENNETT. And the chairman, of course, has highlighted the fact Salt Lake City first went on the list in 1998. Is that correct?

Judge BATAILLON. Right.

Senator BENNETT. So it is even older than——

Judge BATAILLON. It has been on the list for 9 years.

Senator BENNETT. Yes. And I would like to—I can't appropriately give you the full letter because the last paragraph of the letter says, "The specific weaknesses in building security highlighted by this inspection should be treated as sensitive information and should not be released to the public."

But this is a letter from the senior inspector of the U.S. Marshals Service just this month, having gone through the Salt Lake City courthouse and looked at the various security problems that are there.

Judge BATAILLON. Right.

Senator BENNETT. Is it your understanding that this project is, to take a term that has been vastly overused here in the Congress in the last 6 months, shovel ready?

Judge BATAILLON. It is absolutely shovel ready. We have a site, and I am sure you have been to the site and seen the chain-link fence that is around it. We moved the Masonic Temple and a local pub in order to get this place, and now we have vacant property in Salt Lake, and it is ready to go.

We have designs. In fact, I have talked to Members of the House and the Senate, and it is a model of appropriateness and efficiency for the judiciary, and it needs to be built.

Senator BENNETT. As I say, I couldn't do this any better than you have done for me.

Judge BATAILLON. Thank you very much.

Senator BENNETT. Mr. Prouty, I would be ungrateful if I didn't acknowledge how helpful you have been over the years, as we have wrestled with this problem. And your office has always been available to mine, and you have always been very helpful.

Now we have been in touch with Alan Camp, who is the project manager in your Denver office, and he has informed my staff that the building prices are at their lowest point in 3 years. And if funding is not received in the 2010 budget, there is the possibility that costs will escalate, and the Salt Lake courthouse currently is projected to come in right under budget. Is that your understanding as well?

Mr. PROUTY. We are seeing—we are testing the market. We are obviously—we do a lot of research in the market. And now with all of the recovery funds, we think we are seeing and we anticipate the projects will come in less than they were. So I think the markets are decreasing. The extent of that we are not sure.

But you are right. The Salt Lake City project, if it were bid today, would certainly come in within budget.

Senator BENNETT. Thank you very much.

Mr. Chairman, I have laid out my case, and I have had a lot of help from your two witnesses, and I am now completely at your mercy.

Senator DURBIN. I have been waiting for this for so long.

Senator BENNETT. Thank you very much for allowing me to participate.

Senator DURBIN. Well, I am glad that you came by, Senator Bennett. You are always welcome here.

Senator Collins, do you have any additional questions?

Senator COLLINS. Mr. Chairman, I would just like to submit for the record, with your consent, a follow-up letter from the chief judge.

Actually, I take it back. It is from the Judicial Conference of the United States. It is a letter from James Duff that expresses disappointment that the budget does not fund any of the projects on the 5-year plan and talks about the impact on the judicial process where courthouses are out of space, as well as the critical security deficiencies.

I think it strengthens the case that our witness has made today on behalf of the judiciary and strengthens the case that Senator Bennett has made as well.

Thank you, Mr. Chairman.

Senator DURBIN. Without objection, it will be made part of the record if you would like it to be. Would you?

Senator COLLINS. Yes, please.

Senator DURBIN. Okay.

[The information follows:]

JUDICIAL CONFERENCE OF THE UNITED STATES,
Washington, DC, June 9, 2009.

Honorable RICHARD J. DURBIN,
Chairman, Subcommittee on Financial Services and General Government, Committee on Appropriations, United States Senate, Washington, DC 20510.

Honorable SUSAN COLLINS,
Ranking Member, Subcommittee on Financial Services and General Government, Committee on Appropriations, United States Senate, Washington, DC 20510.

DEAR CHAIRMAN DURBIN AND SENATOR COLLINS: On April 1, 2009, I sent a letter on behalf of the Judicial Conference of the United States, transmitting the Judicial Conference-approved Five-Year Courthouse Construction Plan for Fiscal Years 2010–2014 to this Subcommittee, the Office of Management and Budget, and the General Services Administration (GSA). An advance copy of the Plan was also provided to GSA earlier in the year for its use in developing the fiscal year 2010 Federal Buildings Fund budget request.

At the time of my letter, we did not know which, if any, projects would be included in the President's 2010 Budget Request. We were disappointed to learn that funding was not requested for any of the projects on the Five-Year Plan. If these projects are not funded in fiscal year 2010, we are concerned that all projects in 2010 and subsequent years will be delayed at least another year—seriously impacting the judicial process where courthouses are already out of space, and critical security deficiencies currently exist. These projects are ranked in priority order, and several are "shovel-ready" with contractors in place and construction ready to begin.

I have enclosed another copy of our Five-Year Courthouse Construction Plan for Fiscal Year 2010–2014 and appreciate any consideration you can give to our courthouse construction needs. If you have any questions, please do not hesitate to contact me.

Sincerely,

JAMES C. DUFF,
Secretary.

Enclosure

FIVE-YEAR COURTHOUSE PROJECT PLAN FOR FISCAL YEARS 2010–2014 APPROVED BY THE JUDICIAL CONFERENCE OF THE UNITED STATES—MARCH 17, 2009

[Estimated dollars in millions]

		Cost	Score	Est. Net Annual Rent
FISCAL YEAR 2010				
Austin, TX	Add'l. S&D/C	$116.1	82.0	$6.5
Salt Lake City, UT	Add'l D/C	$211.0	67.9	$11.4
Savannah, GA	Add'l. D	$7.9	61.3	$3.5
San Antonio, TX	Add'l. D	$4.0	61.3	$9.2
Mobile, AL	Add'l. S&D/C	$190.3	59.8	$4.7
Total		$529.3		$35.4
FISCAL YEAR 2011				
Nashville, TN	Add'l. S&D/C	$183.9	67.3	$7.0
Savannah, GA	C	$95.5	61.3	$3.5
San Jose, CA	Add'l. S	$38.6	54.5	$9.4
Greenbelt, MD	S&D	$14.0	53.8	$1.6
Total		$332.0		$21.5
FISCAL YEAR 2012				
San Antonio, TX	C	$142.2	61.3	$9.2
Charlotte, NC	C	$126.4	58.5	$7.1
Greenville, SC	C	$79.1	58.1	$4.1
Harrisburg, PA	C	$57.3	56.8	$5.4
San Jose, CA	D	$17.2	54.5	$9.4
Total		$422.2		$35.2
FISCAL YEAR 2013				
Norfolk, VA	C	$104.7	57.4	$5.1
Anniston, AL	C	$20.4	57.1	$1.1
Toledo, OH	C	$109.3	54.4	$5.9
Greenbelt, MD	C	$170.0	53.8	$1.6
Total		$404.4		$13.8
FISCAL YEAR 2014				
San Jose, CA	C	$223.9	54.5	$9.4

S=Site; D=Design; C=Construction; Addl.=Additional.

All cost estimates subject to final verification with GSA.

ENERGY EFFICIENCY IN BUILDINGS

Senator DURBIN. Can I switch off courthouses for a very quick observation and question, Administrator Prouty?

I recently was invited to tour what was formerly known as Sears Tower in Chicago. It is now known as Willis Tower. And it was built 35 years ago and I think still is the tallest building in the United States. And maybe it has been eclipsed overseas by some other building, but it is certainly a dominant feature on the Chicago skyline.

And the management company brought me in to show me what their plans were. And their plans involve about a $300 million investment in making this 35-year-old building energy efficient. It turns out when it was built 35 years ago, no one paid any attention

to the basics. They have 16,000 single-pane windows in the Sears Tower, for example.

And if you can imagine a heating and air-conditioning system that is ancient by today's modern standards, and it costs a fortune, 125 elevators and all of these things. They have decided that it is economical for them to invest $300 million in energy savings and that it will be paid back rather promptly.

And that, of course, means replacing the windows, maybe even repainting the building, putting wind turbines on every roof, adding solar panels, creating new heating and air-conditioning unit, actually creating a co-generation opportunity with 125 elevators, which with the friction they create can be generating electricity.

They think that this building can become an energy producer to the point where they can build a hotel next door and use the energy off the old Sears Tower to sustain a building next to it.

I think of that in terms of your responsibility with a lot of buildings even older, and pollution coming off of them every day. Someone estimates 60 percent of our pollution comes off of our structures as opposed to what we drive. And I am wondering, as you get into this decisionmaking about the future of GSA buildings, what calculations are you making that may parallel what I found at the Sears Tower?

Mr. PROUTY. I think we are in the same category. I was just going to say that we wished we had buildings so young as 35 years old. Our buildings are a lot older, a lot more inefficient.

There are a lot of really good things that are happening right now. The technology is improving to the point that you are getting a payback that causes these all to pay out in reasonable amounts of time.

Also what we are seeing is green buildings in the market perform better. We also know with the $4.5 billion that we have been given, that we are going to drive that industry. So we absolutely agree. We are looking for every innovative approach we possibly can. We are using solar. We are using wind. We are doing windows. We are doing insulation. We are doing improved technology in all the systems. So we agree we are learning more every day.

I am not an expert. We happen to have an expert with us.

Senator DURBIN. How do you stay in front of it on the technology? For example, it appeared at first blush the window replacement would be some at least double-paned insulated windows, and then it turns out there are other windows coming on the scene with film that allows in the sunlight at certain times of the year—the winter, when you want it—and shields the building, inside the building parts of the year when you don't want it.

And this really just seems to be coming so quickly. How do you evaluate these technologies when you are about to make massive investments?

Mr. PROUTY. Yes, we are tied to the industry. We have a green building program. Kevin Kampschroer leads that program. He is—he meets with them all the time. In many cases, we are leading that industry. So, as you say, it is a very dynamic world. It is changing every day. But the good news is we have $4.5 billion, which causes us to be able to test out some of these new technologies.

Senator DURBIN. At the risk of a commercial announcement, I have discovered a company that just bought a facility in Chicago called Serious Materials. It is out of California. And they have production facilities in several different places, and they are doing the window replacement on the Empire State Building with these new filmed windows. And so, I am going to promote them in the hopes it means more jobs in Chicago, a place that I am proud to represent.

Thank you very much.

Do you have anything further?

Well, thanks a lot for your testimony, Mr. Prouty.

Mr. PROUTY. Thank you very much.

Senator DURBIN. And Judge Bataillon, thank you for coming and giving us an insight into this constitutional clash that we have over the construction of courthouses. Thanks a lot.

Judge BATAILLON. Thank you very much. Thank you.

ADDITIONAL COMMITTEE QUESTIONS

Senator DURBIN. At this point, we are going to recess the subcommittee and tell you that there will be some written questions coming your way. Hope that you can respond to them on a timely basis and maybe by—we will leave the record open until Wednesday, June 24 at noon.

[The following questions were not asked at the hearing, but were submitted to the Administration for response subsequent to the hearing:]

QUESTIONS SUBMITTED TO PAUL F. PROUTY

QUESTIONS SUBMITTED BY SENATOR RICHARD J. DURBIN

RECOVERY ACT IMPLEMENTATION

Question. As part of the Recovery Act, GSA received $5.5 billion, of which $4.5 billion was designated for converting GSA facilities to High-Performance Green Buildings. The Act states that not less than $5 billion of Recovery Act funds must be obligated by the end of fiscal year 2010. GSA has identified 43 buildings for "full and partial building modernizations" at an estimated total cost of approximately $3.1 billion. GSA has also identified 194 buildings for "Limited Scope projects" at a cost of approximately $800,000,000. In addition, the Recovery Act funds an additional $1 billion in construction projects. This is a significant increase in workload as compared with previous years, and recent press reports suggest that there may be as many as 150 vacancies for contracting officers at GSA and shortages in other critical personnel areas.

Given the volume of projects to be undertaken by GSA and the amount of funds to be obligated in fiscal year 2010, how can you assure the subcommittee that GSA will be able to responsibly obligate $5 billion or more by the end of fiscal year 2010?

Answer. To ensure that we responsibly obligate $5 billion or more by fiscal year 2010, GSA has established a centralized program management office (PMO) within the Public Buildings Service (PBS) to oversee and manage recovery activities. The PMO is a small, cohesive, National Office staffed with high performing project managers and subject matter experts who are supported by contract/consultant resources.

The PMO will: manage Recovery Act tracking and reporting efforts; support regional offices by providing contracts, subject matter experts, legal expertise, audit functions, workload/staff modeling, tools, and troubleshooting of program and project challenges; interface with stakeholders, including Congress and tenant Federal agencies; ensure that cost, schedule, and scope are completed as promised; identify resource needs and shift resources to accommodate changing program requirements; and establish a quality review plan to define and assess the key GSA information systems that may contain information required for full Recovery reporting and con-

tinually monitor and review the information required for compliance with Recovery Act reporting requirements.

GSA's PBS has enhanced the reporting capabilities of its project tracking database to incorporate additional project milestones into the Variance Tracking Report, a management tool for monitoring and tracking project progress. This report also serves as an early warning tool so management can identify projects that are starting to deviate from the plan and promptly implement corrective activities.

The PMO is undertaking regular and ongoing activities with the Office of Inspector General to ensure effective and efficient program execution, including pre-award audits and ongoing dialogue.

GSA has implemented additional management controls and oversight mechanisms to ensure effective and efficient execution of recovery activities. For guidance, we are drawing on Agency-wide existing management controls, which are based on OMB Circular A–123, Management's Responsibility for Internal Control; the Federal Managers' Financial Integrity Act (FMFIA); OMB Circular A–127 Financial Management Systems; and the Federal Financial Management Improvement Act (FFMIA). GSA's internal control reviews are conducted for Agency program components to ensure that all significant risks are identified, tested, evaluated, and mitigated in a timely and effective manner.

Question. Does GSA currently have sufficient staff to handle these projects?

Answer. GSA is currently using several approaches to ensure there are sufficient resources to manage Recovery Act projects. Our approaches include deploying our experienced personnel to Recovery Act projects and backfilling with temporary hires as well as "industry hires" whose limited terms sunset with the expiration of the Recovery initiative. This solution fulfills our short-term need for a larger workforce without encumbering our long-term personnel goals. These industry hires are recruited from the ailing design, construction, and construction management industries.

GSA is also hiring contractors to support GSA in such areas as data tracking and reporting, reviews of scopes, schedules and budgets, energy performance reviews, design services, construction contracting, technical expertise, and project management.

GSA will continue to evaluate our resource needs on an ongoing basis, to determine where we have gaps and the best means to fill those gaps, including recruitment, contract staff, and redeployment of current staff. We are addressing resource requirements for accomplishing Recovery Act projects as well as our existing workload. We have sought approval from OPM to utilize various hiring authorities and are establishing national contract vehicles to supplement the workforce.

Question. What is the optimal number of FTEs (GSA contracting officers, project managers, and support staff) needed to ensure that GSA will be able to award contracts for the 237 green building "modernization or limited scope" projects and the $1 billion worth of new Recovery Act construction projects in a timely manner?

Answer. GSA has conducted a series of workforce analyses to determine the resources needed to deliver Recovery projects. It was estimated that approximately 232 Government FTE and contractor positions are required in procurement, realty, architecture, engineering, project management, and program analysis to expeditiously and fully support the projects and programs tied to the Recovery Act. GSA will be re-directing existing resources, as well as hiring temporary resources, to meet this workload demand.

Question. How does the optimal number compare to the actual staffing level?

Answer. The optimal number of combined Government FTE and contractor positions is approximately 232 positions. To achieve this staffing level, PBS has redeployed current staff, recruited new hires, and procured contractor support to address resource requirements for accomplishing Recovery Act projects as well as our existing ongoing workload. We are on track to achieve this goal.

Question. With respect to contract oversight, what is the optimal number of FTEs needed to ensure that these projects are appropriately monitored and contractors are delivering the products and services on time and at the proper cost?

Answer. The optimal number of positions estimated above includes contract oversight resource needs. The 232 positions include managers and analysts who are dedicated to monitoring contractor performance and ensuring that projects are delivered in compliance with Recovery Act funding and GSA requirements, on-time and at the proper cost.

Question. How does GSA plan to measure the environmental benefits of the Green Building projects in a quantifiable way?

Answer. We are improving energy performance on a large scale with our full and partial building modernization projects and in specific ways with our limited scope projects. In both types of projects, we expect energy savings from new building controls and adjustments; lighting replacements; new roofs and windows: and building

mechanical system upgrades. We are performing detailed surveys of each building to quantify the potential for energy savings. Once the surveys have been completed and the baselines identified, we will be able to estimate the energy consumption reductions for the building specific projects.

Question. How does GSA plan to measure the number of jobs created by the projects?

Answer. GSA will not prepare independent estimates of jobs created by our Recovery Act projects. Instead, we will support the Administration's efforts to collect job data directly from recipients of Federal contract awards and their sub-recipients.

GSA has included provisions in our Recovery Act contracts consistent with interim Federal Acquisition Regulation (FAR) clause 52.204–11. This FAR clause requires recipients of Federal contract awards to submit information required by Section 1512 of the Recovery Act through the www.FederalReporting.gov website.

Question. What the basic distinction between a "partial building modernization" and a "limited scope project?

Answer. Generally, full and partial building modernizations adopt a "whole building approach" and include repairs and renovations to multiple building systems in order to improve energy- and water-efficiency of the entire facility. Building systems, in this case, include Heating, Ventilation, and Air Conditioning (HVAC), building envelope, or lighting. Limited scope projects focus on installing a specific green technology (such as intelligent lighting, or ENERGY STAR roofs) or addressing a single building system.

Examples of repairs and renovations included in full and partial modernization projects include:

—Adding thicker insulation than required by the newest energy codes in climates where it makes sense;
—Installing variable frequency drives to reduce energy and extend the life of mechanical equipment;
—Converting parking structure lighting to LED (light-emitting diode), which dramatically lowers energy consumption, improves safety and visibility and reduces maintenance as LEDs can last two to three times as long as typical parking lot lights;
—Retrofitting or replacing less efficient windows; and
—Specifying dual flush toilets and waterless or low water urinals to save water and reduce demand on aging city sewer systems.

Examples of limited scope improvements include:

—Installing intelligent lighting systems that provide daylight and provide controls for occupants to adjust for ambient light versus task light;
—Replacing flat roofs with ENERGY STAR membranes; integrated photovoltaic panels bonded to the membrane; or planted roofs. These options offer benefits ranging from increasing the life of the roof, to producing energy and to reducing the "heat island" effect of a black roof; and
—Accelerating the installation of advanced meters—required under the Energy Policy Act to be completed by 2012. Advanced meters enable us to better manage buildings by instantaneously providing information on a building's energy use and encouraging immediate operational changes.

Question. What will be GSA's approach to prioritizing among the 43 "full and Partial Modernization Projects" for implementation? Among the 194 "limited scope" projects?

Answer. GSA's priorities for "Full and Partial Modernization" and green "limited scope" projects are based on the purpose of the Recovery Act: (1) Stimulate the American economy by spending money quickly; and (2) Improve the environmental performance of Federal assets, particularly reducing our dependence on carbon-based fuels.

Within these broad objectives, each class of project is prioritized based on the following criteria:

Full and Partial Building Modernization projects:

—High-performance features concentrating on energy conservation and renewable energy generation.
—Speed of construction start (job creation).
—Execution Risk (ensuring that the projects will not fail due to unforeseen conditions).
—Facility Condition. The Facility Condition Index is a standard real estate industry index that reflects the cost of the repair and alteration backlog of a particular building relative to the building's replacement value.
—Improving Asset Utilization.
—Return on Investment.
—Avoiding Lease Costs.

—Historic Significance.

Limited Scope projects are prioritized based on energy performance (beginning with the worst performing buildings) and informed by existing physical condition surveys:

—Projects are initially prioritized based on Energy Use Intensity: Btus/Gross Square Foot.

—This list is refined, based on input from Regions on specific building conditions and operations.

—Preference is given to projects in descending order of: energy conservation, return, or high-performance improvement.

No project is on our list if it does not deliver a positive return on investment.

UNDERUTILIZED OR EXCESS FEDERAL PROPERTY

Question. Underutilized or excess federal property is a significant problem that puts the government at significant risk for lost dollars and missed opportunities. GAO reported in May 2007 that GSA reported 258 buildings, with 13.8 million rentable square feet, as excess property. In order to help other agencies better serve the public by meeting—at best value—their needs for real property such as federal buildings and to meet its goal of exemplary management of buildings, GSA should reduce its excess and underutilized property.

What strategy will GSA employ to help the federal government reduce its excess and underutilized property?

Answer. GSA is responsible for managing the utilization and disposal of Federal excess and surplus real property government-wide, and we have a comprehensive strategy for promoting the effective use of Federal real property assets.

GSA Properties.—GSA has over 1,000 properties in our portfolio, making the disposal of underutilized real property a considerable task. GSA works together with partner Federal agencies, State and local governments, nonprofit organizations, business groups, and citizens, to ensure that we create a lasting, positive impact on communities by making valuable government real estate available for numerous public purposes. Properties that are not conveyed to eligible recipients for a public purpose are sold by competitive bid to private individuals.

In fiscal year 2008, GSA disposed of 13 of our own properties, valued at approximately $58.5 million. These disposals provided revenues of $56 million for the Federal Buildings Fund (FBF).

Other Federal Agencies.—GSA supports the Administration's goals of disposing of unneeded real property and reducing Federal spending by providing a variety of asset management and disposal services to other landholding Federal agencies. GSA assists those agencies in developing asset management plans and strategies, in accordance with Executive Order 13327, "Federal Real Property Asset Management", and provides a variety of asset utilization and disposal services, including: Understanding the role of each asset in supporting agency mission objectives; examining current and future utilization alternatives; collecting and organizing title, environmental, historical and cultural information; and identifying real estate and community issues affecting the property.

In fiscal year 2008, GSA disposed of 235 properties valued at approximately $192.2 million for other Federal agencies. GSA also conducted 26 targeted asset reviews to help agencies identify underutilized real property assets and improve their compliance with E.O. 13327.

PROJECTS REQUESTED FOR FISCAL YEAR 2010

Question. The 2009 Omnibus Appropriations Act required the fiscal year 2010 budget submission to include 5-year plans for Federal Building and Land port-of-entry projects. However, these plans have not been furnished to the Subcommittee.

Why were these plans not included in the Budget submission? When will they be provided?

Answer The 5-year capital plans required by the fiscal year 2009 Omnibus cannot be completed without input from many different customer Federal agencies. Our customers' long-term requirements and GSA's needs have changed as a result of the substantial new funds provided in the Recovery Act. The complexities created by the Recovery funding—as well as the increased workload that it placed on Federal capital planning staff—made it difficult to prepare a 5-year forecast of capital investment needs in time to include it in the fiscal year 2010 budget submission.

The required plans will be submitted as soon as they are coordinated. GSA will include the plans in future budget requests.

REPAIR BACKLOGS

Question. Restoration, repair, and maintenance backlogs in federal facilities are significant and reflect the federal government's ineffective stewardship over its valuable and historic portfolio of real property assets. As part of its 2008 financial statement, GSA reported about $7.3 billion in capital repair and alteration work items that had not been addressed by ongoing projects.

To what extent, if any, will the funding provided by the American Recovery and Reinvestment Act address these needs?

Answer. GSA expects Recovery Act funds to reduce the backlog of traditional Repairs and Alterations (R&A) needs by $1 to $1.5 billion. Of the $4.5 billion of ARRA funds directed towards High-Performance Green Buildings, almost two-thirds has been dedicated to energy improvements and greening initiatives, and the remainder will directly address the R&A backlog. The $1.05 billion provided for Federal buildings and LPOE projects will be used for New Construction, and will not have a direct impact on our repair and alterations liabilities.

Question. What action is GSA taking to ensure that recently constructed and recently renovated properties are maintained so the situation of allowing facilities to deteriorate does not continue?

Answer. GSA strives to maintain a portfolio of assets that are in "Good" condition, meaning needed repairs are less than 10 percent of the asset's functional replacement cost. GSA maintains the condition of these core assets through strategic reinvestment throughout the life of the asset. Asset condition is evaluated and monitored annually, through a series of asset management diagnostic tests. When repair and alteration needs are identified, such repairs are addressed through the minor repairs and alterations program. Recently constructed and recently renovated properties have few, if any, repair and alteration needs.

GSA has made progress in improving the condition of its portfolio of assets through strategic management of existing assets, and Recovery Act funding provided for repair, modernization, and green initiatives. For example, 50 U.N. Plaza in San Francisco, CA, had been mostly vacant, and Recovery Act funding will allow this historic asset to be fully utilized again. However, despite the investments of the Recovery Act, GSA continues to face challenges from maintaining an aging building portfolio. The Recovery Act is expected to reduce GSA's R&A backlog by approximately $1 to $1.5 billion.

QUESTION SUBMITTED BY SENATOR MARY L. LANDRIEU

CUSTOMS HOUSE

Question. The New Orleans Customs House is a magnificent historic structure located on the edge of the French Quarter that dates back to 1848. During Katrina, its roof failed, and the building suffered significant water damage. Since that time, GSA and Customs have dedicated funding to repair the building, and it is scheduled for re-occupancy in the spring of 2010. The Customs House is the only National Historic Landmark building in GSA's Southwest Region, which is based in Fort Worth, Texas. This subcommittee included language in the previous year's appropriations report that mentioned the building by name and underscored its significance to the local community. Section 307 of the Stafford Act and GSA Policy Number 2851.5 both require that preference for reconstruction work following a major disaster be given to locally-based firms. However, there are no Louisiana firms under contract to perform work on the Customs House.

Will you and the Chief Architect of GSA work with my office to ensure that the agency complies with the Stafford Act and follows its own policy on Gulf Coast reconstruction projects, by allowing locally-based Louisiana firms to participate in the restoration of the Customs House?

Answer. Yes, GSA will work with Senator Landrieu's office to address any questions on the restoration of the New Orleans Customs House.

Phase I of the New Orleans Customs House repair and alteration is for Hurricane Katrina reconstruction, and as such is governed by the Stafford Act. The design-build contract has been awarded to a local business: Carl E. Woodward, LLC, a New Orleans-based firm. The Phase I design firm is Waggonner & Ball Architects, also of New Orleans. As of July 2009, $36 million has been awarded. 95 percent of that amount, or approximately $34 million, has been awarded to Louisiana-based subcontractors.

Phase II of the Customs House restoration does not involve any work covered by the Stafford Act, such as debris clearance, supply distribution, or reconstruction work. Nevertheless, GSA has awarded 35 percent of the design contract to

Waggonner & Ball Architects of New Orleans. The remainder of the Phase II design contract was awarded to a design firm that, while not locally-based, had extensive prior experience working on the Customs House, and was able to present a fair and reasonable price for the remaining design work. The construction contract for Phase II repair and alteration is anticipated to be awarded during or near January 2010. GSA is encouraging organizations, firms, and individuals residing or doing business primarily in New Orleans to submit proposals for the final portion of the Customs House restoration work, and is considering holding a local business workshop on the subject during autumn 2009.

Re-occupancy of the Customs House is scheduled for Summer 2011.

QUESTIONS SUBMITTED BY SENATOR SUSAN COLLINS

Question. It seems like the $4.5 billion provided for converting GSA facilities to High-Performance Green Buildings will create a great deal of demand for "green" building products and technologies, such as LED lighting and solar roofing materials.

Is the domestic market for these materials strong enough to meet these needs?

Answer. GSA is investigating the capacity of American manufactures to provide products, particularly in the energy efficiency sector, to be installed and used in GSA's Recovery projects. GSA is using the services of a major construction management firm with close ties to the construction industry to analyze product requirements and project schedules. We are also using information already collected by the Department of Energy in this analysis. As part of this effort, GSA plans to manage project schedules and by extension, product orders, to level demand for specific manufactured products and materials.

Question. Will all of these materials come from American manufacturers?

Answer. The Recovery Act generally requires Federal agencies to utilize iron, steel, and manufactured goods produced in the United States for Recovery projects. GSA is asking the American manufacturing community to help meet its goal of "on time, on budget, on green." Although specific requirements vary by product type and project, GSA strives to use American-made goods to the greatest extent possible on all Recovery Act projects.

Question. Will GSA take any additional or extra steps to ensure that local, small businesses can compete to provide "green" products or services?

Answer. GSA's Recovery Act projects provide many opportunities for small businesses:

—GSA has planned over 200 high-performance green building limited scope projects, which range in size from $114,000 to $107,000,000, and together total just over $800 million.

—Other opportunities include an additional $296 million for small projects across the country.

—Opportunities also exist in support service contracts, such as acquisition and project management support.

GSA will support small businesses through the use of new small business set-asides where adequate competition and competitive pricing can be achieved.

GSA is also preparing a list of Indefinite Delivery, Indefinite Quantity (IDIQ) contract holders: This list will be made publicly available to assist small businesses in obtaining sub-contracts with existing GSA contractors. All bid opportunities will be advertising on www.FedBizOpps.gov.

GSA is hosting partnering events that provide opportunities for small vendors to present qualifications and form relationships with prime contractors. We have also developed a communication network through small business associations, to provide information to vendors across the nation.

GSA remains committed to negotiating aggressive small business subcontracting plans with our prime contractors for large design and construction contracts. As appropriate, GSA will publish prime contractor contact information online

Question. GSA's lack of responsiveness to this Committee and to the Committee on Homeland Security and Governmental Affairs is very problematic. As you know, both Committees have oversight over GSA's policies and activities, and are responsible for ensuring that GSA is using Federal funds effectively. Inquiries to GSA—particularly questions relating to the Public Buildings Service and construction projects—take a very long time to generate responses, and sometimes are never answered.

GSA frequently takes months to prepare responses to formal letters. Are you aware that this is a problem for GSA? Can you identify steps that you will take to improve this situation and ensure that GSA responds to Congressional inquir-

ies—formal and informal—in a timely manner? If not, will you agree that this is a problem and will you commit to taking immediate steps to improve this situation?

Answer. GSA is aware of the problem and we are currently analyzing our organizational structure and internal processes to correct this issue. The Public Buildings Service (PBS) has merged its legislative and correspondence offices into one office that reports directly to the PBS Chief of Staff. We have analyzed the correspondence process within PBS and are testing a new process starting July 30, 2009. We believe the new procedures will streamline the correspondence process within PBS and reduce the overall time it takes to return letters. In fact, PBS is aiming to reduce response time within PBS from months to 7 business days. This would include receiving the letter, vetting the request, researching the answer, drafting a response, and obtaining proper internal clearance for the draft response, to ensure we have properly answered the letter.

Question. The Fiscal Year 2009 Omnibus Appropriations Act includes separate provisions directing GSA to provide both a 5-year plan for Federal buildings and a 5-year plan for land ports of entry in fiscal year 2010 Congressional Budget Justification materials. GSA did not provide these plans in their budget justification materials and has yet to provide them to the Committee.

If these plans are not available, what is the basis for GSA's fiscal year 2010 request for Federal building construction and land ports of entry? How can this Committee be certain that the projects included in your request are the best or most pressing needs for Federal construction?

Answer. GSA's fiscal year 2010 request for New Construction projects concentrates on space consolidation efforts, for the Food and Drug Administration and the Federal Bureau of Investigation, and for mission-critical requirements that cannot be easily met in leased space.

Our customers' long-term requirements and GSA's needs have changed as a result of the substantial new funds provided in the Recovery Act. However, the Recovery Act plan was based on shovel-ready projects, and a large number of high-priority needs remain that were not "shovel-ready" at the time the Recovery Act plan was prepared.

The required plans will be submitted as soon as they are coordinated. GSA will include the plans, as required, in future budget submissions.

Question. Although GSA has not provided 5-year plans for Federal buildings or Land Ports of Entry, this Committee does have the 5-year courthouse plan of the Judiciary. But neither of the courthouses in GSA's request are on that list. The projects on the Judiciary's list are scored and ranked by fiscal year.

In developing the fiscal year 2010 budget request, why did GSA not follow the priorities set out in the Judiciary's Five-Year Courthouse Plan?

Answer. The funding provided by the Recovery Act allowed GSA to fund a large program of Courthouse requirements in fiscal year 2009 and fiscal year 2010; this freed up funds to meet the needs in Lancaster and Yuma with Federal construction.

Our Recovery Act project plan includes 6 Courthouse New Construction projects, including the Austin Courthouse ($116 million), which is the highest priority Courthouse to be identified by Judiciary in their Five-Year Plan. The Recovery Act project plan also includes funds for repair and alteration work on more than 110 Courthouses.

Question. What objective criteria led GSA to select Lancaster, Pennsylvania, and Yuma, Arizona, over the projects on the Judiciary's list?

Answer. These projects were originally identified as potential lease construction projects. Both OMB and GAO have been closely reviewing lease construction scenarios and have determined that it is often not in the best interest of the Federal Government and the taxpayer. In this case, GSA performed a 30-year present value life cycle cost comparison between Federal construction and leasing. The analysis considered both the government's equity and its capital and operating costs in each alternative to determine the lowest net costs expressed in present value terms for a given amount of space. The inherently governmental nature and long term requirement of these courthouses make Federal construction a financially responsible solution. A lease construction project would involve annual above-market rent outlays from the government over the life of the lease without any benefit of residual value at the end of the lease. The life-cycle cost analysis supports Federal construction as the best value to the taxpayer.

The Courthouse project in Yuma, AZ was originally proposed as a lease construction project because funding was not expected to be available to meet the Judiciary's requirements with Federal construction. GSA was also working with the Courts to develop a potential lease construction project in Lancaster, Pennsylvania. If funding were provided through the 2010 Appropriations, both projects would be converted

to Federal construction, which would allow for a government-owned solution and save taxpayer money.

Question. GSA seems to have an inability or unwillingness to appropriately address the needs of local communities when planning and executing Federal construction projects. For example, this is apparent in GSA's dealings with the Madawaska, Maine community.

Does GSA have a formal process for collecting public input on construction projects?

Answer. At GSA, we take pride in our work with communities when planning and executing Federal construction projects. Large or complex development projects often engender competing views on community impacts. GSA conducts formal and informal communications with local communities throughout all stages of the design and construction process for new construction projects.

During the planning stage of a project, GSA utilizes the process set forth by the National Environmental Policy Act (NEPA) to solicit public involvement and input from residents, business owners, local and state officials, and affected agencies. GSA typically hosts a public meeting to hear local concerns and provide contact information for those who want to comment directly to the agency. GSA takes into consideration issues raised by the public at these meetings or in writing to determine and update the scope of the prospectus development study. NEPA documentation is made available to local communities as it is developed. GSA then evaluates and responds to those comments as a part of our NEPA process.

Additionally, GSA holds community open house meetings and hosts stakeholder meetings at key stages during project design. For example, GSA held a stakeholders' meeting for the Madawaska Land Port of Entry on March 31 of this year. Nearby businesses (Fraser Paper and Montreal, Maine, and Atlantic Railway, Inc.), Town of Madawaska officials, Congressional delegation representatives, and the facility's future tenant, the Department of Homeland Security's U.S. Customs and Border Protection, were invited to attend. The GSA design team presented an electronic building information model (BIM) showing the new port and incorporating a 4 dimensional (time visualization) demonstration of how traffic will flow through the new port.

Question. Does GSA perform an objective review of citizen concerns, and notify the community of GSA's decision in a timely manner?

Answer. GSA performs an objective review of citizen concerns for Federal construction projects. GSA immediately responds to oral questions received during open houses and stakeholder meetings, and addresses written comments submitted through the Agency's NEPA review. In the case of Madewaska, GSA thoroughly reviewed and responded to community concerns, questions and comments. Once substantive comments were addressed, GSA notified the community of how it evaluated and responded to comments in its final EIS.

The timeliness of the GSA's responses can be best demonstrated by example. For the Madawaska Land Port of Entry, the Draft EIS was made available to the public on August 8, 2006. The public comment period started on August 3, 2006 and ended on September 22, 2006. GSA also hosted an open house on August 17, 2006, where 14 attendees offered oral comments and GSA received ten written comments. GSA received a total of 75 pages of public concerns and comments regarding its Draft EIS, including verbal and written comments. GSA objectively reviewed these comments and then responded accordingly in the final EIS, which was published in December 2006.

Question. Approximately how many data centers does the Federal Government own? Approximately how many square feet of data center space does the federal government occupy in government owned facilities and contractor owned facilities?

Answer. The Office of Management and Budget is currently gathering Government-wide information on data centers. Once we receive the updated information, we will be in a better position to answer these questions. We expect to provide the Committee with the answers by October 15, 2009.

Question. What risk does the continued proliferation of federal data centers present to the federal budget and our nation's energy consumption?

Answer. The proliferation of Federal data centers will increase energy consumption in order to support the facilities' environment control systems and information technology systems. Additional data centers, as historically constructed, would increase overall costs to the Federal government for construction and operation and maintenance, and not take advantage of modern concepts such as cloud computing and virtualization that can reduce IT cost, energy consumption and lower the cost of government operations. Future data centers should be built with a well-coordinated strategy that increases capacity and utilizes modern concepts such as green building, and other efficiencies that would otherwise not be realized.

Question. Is GSA actively exploring how it can be a singular provider of data processing and storage capability to a large portion of the rest of the Federal Government?

Answer. Yes, GSA is currently preparing a business case analysis to determine the viability of providing multi-tenant government-owned data centers that offer a fully acceptable risk mitigated data survivability solution to all Federal entities.

To date, this analysis has focused on ensuring that Federal data centers provide adequate protection for our nation's most critical information and network infrastructures.

Question. What role can intra-data center and inter-data center virtualization play in facilitating federal data center consolidation?

Answer. These activities will reduce the footprint of information technology tremendously, through the provisioning of technology resources, and will assist in the reduction of Federal energy consumption. Data center virtualization will be one vehicle to realizing the cost savings and efficiencies proposed in this area by this Administration.

Question. What challenges exist to GSA and other agencies on the statutory and regulatory levels to achieving a more consolidated federal IT infrastructure?

Answer. We are currently gathering Government-wide information on data centers. Once we receive the updated information, we will be in a better position to answer these questions. We expect to provide the Committee with the answers by October 15, 2009.

Question. What are some examples of excellence within the federal government with regard to pushing the consolidation agenda forward?

Answer. We are currently gathering Government-wide information on data centers. Once we receive the updated information, we will be in a better position to answer these questions. We expect to provide the Committee with the answers by October 15, 2009.

QUESTION SUBMITTED TO JOSEPH F. BATAILLON

QUESTION SUBMITTED BY SENATOR SUSAN COLLINS

Question. GSA will be spending $1.5 billion of American Recovery and Reinvestment Act (Stimulus) funds on facilities in which the Judiciary is a tenant. Do you believe the projects that have been identified reflect the Judiciary's highest priority needs?

Answer. The Judiciary's top space priority is the additional money needed to build the Los Angeles project. We were hopeful that stimulus funding was going to be provided to fund the estimated shortfall for the Los Angeles project that was authorized by the House and Senate. Thereafter, the Judiciary's space priorities are set forth in the attached Five-Year Courthouse Project Plan for Fiscal Years 2010–2014 (Five-Year Plan). Only one courthouse that was on the Five-Year Plan, Austin, Texas, was included in the stimulus legislation ($116 million). The Judiciary recognizes and is appreciative of the fact that of the $4.5 billion appropriated for green buildings, we will receive almost $1.3 billion of that money for repair and alteration projects in 132 buildings where the Judiciary is a tenant. In addition, two projects (Billings, Montana and Bakersfield, California) which the Judiciary and GSA had initially determined could best be provided through lease-construct are now funded as federal construction projects through the stimulus legislation. The Judiciary's highest priority space needs, however, are reflected in the Five-Year Plan.

FIVE-YEAR COURTHOUSE PROJECT PLAN FOR FISCAL YEARS 2010–2014 APPROVED BY THE JUDICIAL CONFERENCE OF THE UNITED STATES—MARCH 17, 2009

[Estimated dollars in millions]

		Cost	Score	Est. Net Annual Rent
FISCAL YEAR 2010				
Austin, TX	Add'l. S&D/C	$116.1	82.0	$6.5
Salt Lake City, UT	Add'l D/C	$211.0	67.9	$11.4
Savannah, GA	Add'l. D	$7.9	61.3	$3.5
San Antonio, TX	Add'l. D	$4.0	61.3	$9.2
Mobile, AL	Add'l. S&D/C	$190.3	59.8	$4.7

FIVE-YEAR COURTHOUSE PROJECT PLAN FOR FISCAL YEARS 2010–2014 APPROVED BY THE JUDICIAL CONFERENCE OF THE UNITED STATES—MARCH 17, 2009—Continued

[Estimated dollars in millions]

		Cost	Score	Est. Net Annual Rent
Total		$529.3		$35.4
FISCAL YEAR 2011				
Nashville, TN	Add'l. S&D/C	$183.9	67.3	$7.0
Savannah, GA	C	$95.5	61.3	$3.5
San Jose, CA	Add'l. S	$38.6	54.5	$9.4
Greenbelt, MD	S&D	$14.0	53.8	$1.6
Total		$332.0		$21.5
FISCAL YEAR 2012				
San Antonio, TX	C	$142.2	61.3	$9.2
Charlotte, NC	C	$126.4	58.5	$7.1
Greenville, SC	C	$79.1	58.1	$4.1
Harrisburg, PA	C	$57.3	56.8	$5.4
San Jose, CA	D	$17.2	54.5	$9.4
Total		$422.2		$35.2
FISCAL YEAR 2013				
Norfolk, VA	C	$104.7	57.4	$5.1
Anniston, AL	C	$20.4	57.1	$1.1
Toledo, OH	C	$109.3	54.4	$5.9
Greenbelt, MD	C	$170.0	53.8	$1.6
Total		$404.4		$13.8
FISCAL YEAR 2014				
San Jose, CA	C	$223.9	54.5	$9.4

S=Site; D=Design; C=Construction; Addl.=Additional.

All cost estimates subject to final verification with GSA.

CONCLUSION OF HEARINGS

Senator DURBIN. So that is about it for today, and the subcommittee is going to stand recessed.

Thank you very much.

[Whereupon, at 4:53 p.m., Tuesday, June 16, the hearings were concluded, and the subcommittee was recessed, to reconvene subject to the call of the Chair.]

MATERIAL SUBMITTED SUBSEQUENT TO THE HEARINGS

[CLERK'S NOTE.—The following testimony was received by the Subcommittee on Financial Services and General Government for inclusion in the record.]

PREPARED STATEMENT OF THE NATIONAL COALITION FOR HISTORY

The National Coalition for History (NCH) is a consortium of over 60 organizations that advocates and educates on federal legislative and regulatory issues affecting historians, archivists, political scientists, teachers, and other stakeholders. As researchers and conservators of American history and culture we care deeply about the programs and activities of the National Archives and Records Administration (NARA) and the National Historical Publications and Records Commission (NHPRC). Thank you for the opportunity to submit our views on the agency's proposed fiscal year 2010 budget.

We want to thank you Mr. Chairman, and all of the members of the subcommittee, for their strong support of NARA's budget in fiscal year 2009. Despite tight budget constraints, you were able to provide NARA with increased funding. We especially want to express our appreciation for the additional funding that was included for the second consecutive fiscal year to hire additional archival staff.

Congress continues to face enormous fiscal challenges in crafting the federal budget for fiscal year 2010. However, we are encouraged that NARA would see a $7.6 million increase in funding under President's Obama's proposed fiscal year 2010 budget. The overall funding level of $466 million reflects the Administration's strong commitment to NARA's mission as steward of our Nation's documentary heritage. However, there are specific priorities that we feel must be addressed at NARA.

National Historical Publications and Records Commission (NHPRC)

We appreciate the Subcommittee's strong support for the NHPRC in the fiscal year 2009 budget. Your actions not only saved the NHPRC from elimination, but also provided $9.25 million for grants, a $1.75 million increase from fiscal year 2008. This is the closest the NHPRC has come since fiscal year 2004 to receiving its fully authorized amount of $10 million.

While we are grateful that the Obama Administration has recommended funding the NHPRC grants programs at the $10 million level, this macro number does not tell the whole story.

NARA's "2010 Performance Budget—Congressional Justification" recommends apportioning the $10 million in funding amongst three program areas. The Founding Fathers Online initiative would receive $4.5 million. The traditional core programs of the NHPRC of publishing historical records of key individuals and movements in documentary editions would receive $2 million. In addition, the archives preservation, access, and digitization grants that go mainly to assist states in their archival programs would receive $3.5 million.

In 2008, Congress enacted the "Presidential Historical Records Preservation Act of 2008" (Public Law 110–404). In addition to authorizing the Archivist to enter into contractual agreements to put the Founding Fathers Papers projects online, the law creates two new grant programs that could potentially compete for already scarce NHPRC funds.

The law authorized "Grants for Presidential Centers of Historical Excellence" to facilitate the preservation of historical records related to any former president who does not have an archival depository administered by NARA under the Presidential Libraries Act. The law also authorizes the creation of a national database for records of servitude, emancipation, and post-Civil War Reconstruction and allows the NHPRC to make grants to preserve these records.

Given all of these additional responsibilities placed on the NHPRC, we feel that the priorities put forth by the Administration amount to nothing more than per-

forming triage on a grossly overburdened agency. It is certainly within the prerogative of the Administration to suggest how the $10 million be spent. However, the final decision rests with the Congress which appropriates the funds and makes its priorities known through bill language and committee reports.

The NHPRC is a 15-member body chaired by the Archivist of the United States that is comprised of representatives of the three branches of the Federal Government. In addition, the NHPRC includes six members representing professional associations of archivists, historians, documentary editors, and records administrators who are chosen based on their extensive expertise in their respective fields.

Congress created the NHPRC, and its predecessor the National Historical Publications Commission, in 1934 to make precisely the kind of resource allocation decisions the Administration proposes in its fiscal year 2010 budget request. Congress should leave these funding decisions to those with the professional expertise to determine priorities, not to bureaucrats at the Office of Management and Budget who sought throughout the Bush administration to eliminate the program altogether.

The NHPRC's $10 million annual authorization is expiring this fiscal year, and this amount has not been increased since fiscal year 1997. Even with an authorization, the NHPRC has constantly been threatened and inflation has seriously eroded its funding level in constant dollars. We urge the Administration and the Congress to support the passage of legislation to reauthorize the NHPRC at an annual level of $20 million for fiscal years 2010–2014.

Operating Expenses (OE)

The President's fiscal year 2010 request includes $339.8 million for NARA's operating expenses budget. This reflects a $12.5 million increase over fiscal year 2009.

The fiscal year 2010 budget operating expenses program budget includes $1 million to hire an additional 12 Full-Time Equivalent (FTE) archival staff. We are happy to see that the President's request continues the initiative your subcommittee began 2 fiscal years ago to provide NARA with additional funding to hire new staff and to ensure that research hours at NARA facilities are maintained.

For fiscal year 2010, the budget requests $4.2 million and 27 FTE to implement two new mandates assigned to NARA's portfolio.

The budget requests $1.4 million and 6 FTE to staff and operate NARA's Office of Government Information Services (OGIS). The OGIS will serve as the Freedom of Information Act (FOIA) ombudsman for the federal government as authorized by the OPEN Government Act of 2007 (Public Law 110–175). We are happy to see that the battles that were fought with the Bush administration over funding the office and locating it within NARA are finally over.

The OE budget also includes $1.9 million and 9 FTE to staff and operate the Controlled Unclassified Information (CUI) Office. We hope that the Archivist will play a key role within the administration in the development of the forthcoming government-wide CUI policy. The addition of the Office of Government Information Services (OGIS) and the CUI offices at NARA, as provided for in the President's fiscal year 2010 budget, will strengthen the Archivist's authority in ensuring appropriate open access to public information.

Electronic Records Archives (ERA)

The long-delayed Electronic Records Archives (ERA) is an essential tool for the NARA of today and tomorrow. Mandatory use of the ERA by all federal agencies is currently scheduled to begin in January 2011. Without this system NARA will be unable to manage the exponentially expanding volume of electronic records. Effective management of federal records will improve the performance of our government, save tax dollars, and ensure current and future generations will have access to our nation's history.

We believe that the Electronic Records Archive program merits the $18.5 million in increased funding proposed by the President in his fiscal year 2010 budget. However, we continue to share the concerns that members of this Subcommittee and the Government Accountability Office have expressed about the ERA program remaining on schedule and budget. This program is vital not just to NARA but also to the entire federal government and the historical and archival communities. We are confident that this Subcommittee will continue its vigorous oversight of the ERA program. One of the major challenges facing a new Archivist of the United States will be to ensure that the ERA comes fully online as currently scheduled in January 2011, when use of the system will be mandatory for all agencies.

We are concerned that, despite NARA's past assurances to the contrary, the Bush administration's electronic records will not be fully ingested until this autumn. Along with many in Congress, NCH expressed concerns throughout 2008 that the hastily-constructed Executive Office of the President (EOP) system that NARA had

built parallel to the ERA might not be capable of rapidly ingesting all of the Bush electronic records beginning on January 20, 2009. We hope that Congress will continue to monitor this situation and hold NARA accountable for completing this project expeditiously.

Repairs and Restoration

The bill provides $27.5 million for repairs and restoration. This amount includes $17.5 million for necessary expenses related to the repair and renovation of the Franklin D. Roosevelt Presidential Library in Hyde Park, NY, which NARA has listed as its top capital improvement priority. The remaining $10 million will be used to fund repairs and restorations to 16 NARA-owned facilities. NCH is pleased that the President's budget request continues to fund the much needed repairs at the FDR Library, the oldest in the presidential library system.

Congress last year made a strong statement that the costs associated with the construction and maintenance of presidential libraries have been spiraling out of control. Congress enacted a law (Public Law 110–404) increasing the endowment percentage requirement for presidential library foundations for the cost of land, construction, and installing equipment at these facilities from 40 percent to 60 percent. Unfortunately, we have seen earmarks for the maintenance of specific presidential libraries tacked on to NARA's annual appropriation at the expense of NARA's core mission. NARA must now provide Congress annually with a 10-year capital improvement plan for the Presidential Library System. NARA should ensure this plan is based on demonstrated needs, not outside political pressure.

Thank you again for the opportunity to present our views on these issues of vital concern to the historical and archival communities.

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