Department of the Treasury

PRESS RELEASES

Press Release number HP-89 was not used.

PRESS ROOM

August 2, 2006
HP-37

Assistant Secretary For Financial Institutions
Emil W. Henry, Jr.
August 2006 Quarterly Refunding Statement

We are offering $44.0 billion of Treasury securities to refund approximately $22.4 billion of privately held securities maturing on August 15 and to raise approximately $21.6 billion. The securities are:

- A new 3-year note in the amount of $21.0 billion, maturing August 15, 2009;
- A new 10-year note in the amount of $13.0 billion, maturing August 15, 2016;
- A reopening of the 30-year bond in the amount of $10.0 billion, maturing February 15, 2036.

These securities will be auctioned on a yield basis at 1:00 PM EDT on Monday, August 7; Wednesday, August 9; and Thursday, August 10; respectively. All of these auctions will settle on Tuesday, August 15. The balance of our financing requirements will be met with weekly bills, monthly 2-year and 5-year notes, the September 10-year note reopening, and the October 10-year and 5-year TIPS reopenings. Treasury also is likely to issue cash management bills in early September.

Current Thirty-Year Bond Reopening

The 30-year bond auction in August 2006 will be a reopening regardless of price movements in the bond. The IRS original issue discount (OID) rules provide that additional Treasury securities have the same terms as the original Treasury securities if they are issued not more than one year after the original Treasury securities were first issued to the public.

New Thirty-Year Bonds

Treasury will issue 30-year bonds on a quarterly basis beginning in February 2007. Total bond issuance in 2007 is likely to rise slightly to ensure liquidity in the new issue.

Quarterly issuance will be comprised of two distinct 30-year bond securities. Treasury will auction a 30-year bond in February 2007 and reopen that security in May 2007. A new 29 ¾ - year bond will be auctioned with accrued interest in August 2007 and reopened in November 2007. Moving to a quarterly issuance pattern will benefit the STRIPS market by creating interest payments for February, May, August and November.

Treasury Securities Lender of Last Resort (SLLR) Facility White Paper

On April 26, we released a white paper, "Consideration of a Proposed Securities Lending Facility," (available on the Treasury website at http://www.treas.gov/offices/domestic-finance/debt-management/securities-lending-facility_04262006.pdf) that identified some important policy considerations and outlined one of many possible structures for such a facility. We remind all interested parties that the deadline for submitting comments on this proposal is August 11, 2006. Following a full review of all submitted responses to this proposal, Treasury will make a determination as to whether or not to proceed with establishing such a facility.

Changes to Restrictions and Reporting on Bidding Procedures

Beginning on December 31, 2006, Treasury will raise the customer confirmation reporting requirement threshold amount from $500 million or more to $750 million or more.

With the release of our new auction software, anticipated to occur in the spring of 2007, we will report to the public the amount of noncompetitive auction awards 15 minutes prior to the close of competitive bidding.

Other Policy Matters Under Consideration

We are still considering allowing competitive and non-competitive bids in uniform price auctions (while maintaining the $5 million limit for non-competitive bids). Please send comments and suggestions on these subjects or others relating to Treasury debt management to debt.management@do.treas.gov.

The next quarterly refunding announcement will take place on Wednesday, November 1, 2006.

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PRESS ROOM

August 2, 2006
HP-38

Report To The Secretary Of The Treasury
From The
Treasury Borrowing Advisory Committee
Of The
Bond Market Association

August 1, 2006

Dear Mr. Secretary:

Since the Committee's previous meeting in May, the economic expansion has cooled from its brisk pace at the start of the year. Growth slowed to a 2½% annual rate in the second quarter, reflecting the drag from higher energy costs, diminishing strength in housing and the fading influence of special factors that boosted activity over the winter. Although monetary policy has become less accommodative, financial conditions are providing a reasonably supportive backdrop for growth near its sustainable trend over coming quarters.

The softening in housing may continue to temper overall growth near term. Sales of homes are down 9% from their peaks, leaving a large overhang of supply that is curbing construction and dampening home prices. The latter could reinforce a slowing in consumer spending. After contributing a half percentage point to growth in 2004 and 2005, residential investment declined at a 6.3% annual rate in the second quarter and is likely to remain at low ebb for a time.

Nonetheless, consumer confidence remains cautiously optimistic in part on signs that job availability is holding up during this latest energy crunch. Business profits and balance sheets remain buoyant. As of July 27, with about 65% of S&P 500 companies reporting, 81% had met or exceeded expectations for the second quarter as profits continued to rise at a double digit pace.

Inflation pressures have accelerated this year, characterized by further increases in energy prices and evidence that higher costs for fuel and materials are boosting underlying inflation. Core measures have risen at 2½-3% rates in the first half. Nonetheless, with monetary policy closing off lingering upside risks, inflation expectations have been well behaved and the prospect of cooling demand suggest price pressures could abate somewhat, particularly if energy and commodity prices plateau.

Yields on U.S. Treasury securities have backed down from recent cyclical highs as earlier concerns about overheating have eased. Forward rates reflect a much-reduced prospect of any additional Fed rate hikes this year and anticipate some slight retracement in 2007.

The improving trend in the Federal budget deficit continues with both official and private estimates for FY2006 coalescing near the $300 billion mark. A strong cyclical recovery has provided outsized strength to tax receipts, but public spending, especially on health care, also is rising.

Against this economic and financial backdrop, the Committee considered its charge.

In the first section of the charge, the Treasury provided the Committee with a brief update on its efforts to create a quantitative framework or model for evaluating its portfolio of marketable debt securities.

The Debt Management Model has progressed from a conceptual framework to a beta test version--albeit a model that is still very preliminary. The Treasury provided the Committee with an expanded summary of the model--its key inputs and potential outputs and solicited suggestions on the types of model outputs that would be useful in guiding future policy making.

With respect to specific outputs of the model, a number of members suggested that average maturity of the debt be included even while other proposed outputs such as the interest cost of the debt and its variability already capture some of the attributes of this measure.

Several members pointed out that for the model to be successful that certain constraints would need to be articulated. An example of such a constraint might be to keep the issuance amount of specific maturity securities within a defined range.

Other members pointed out the need to identify specific forecast horizons and to develop reasonable variances of inputs around a baseline level.

Finally, one member highlighted the need for Treasury to devote resources to better project the level and variability of tax receipts which have varied widely and may make the value of any model, no matter how robust, ineffective.

In the second part of the charge, the Treasury solicited the views of the Committee with respect to a shift to a quarterly 30-year bond auction cycle beginning in February 2007. A bar chart was presented to members highlighting the variability of interest rate risk offered at Treasury refundings since February 1985 as well as its average level over that period. Another chart showed the projected average maturity of issuance and average maturity of outstanding debt assuming quarterly 30-year bond issuance through 2011.

Committee members' opinions varied with regard to the necessity of and the timing of transitioning to a quarterly auction cycle. Members generally agreed that for liquidity purposes an adequate supply per auction would need to be maintained by Treasury. Some members quantified minimum size constraints per cusip at $10-12 billion in the current environment. One member suggested that insufficient demand and/or trading volume had been demonstrated to warrant any increased supply. Others, however, mentioned that liability based investing trends in the long end by pension plans was increasing at a reasonable pace and would likely continue. One member pointed out that traditional measures of liquidity, such as average daily trading volume, might be less important for the long end of the market due to the nature of the buyers being primarily buy and hold investors looking to hedge long-duration liabilities. While some members found the proposition of shifting to a quarterly auction frequency with larger notional supply unnecessary or ill-timed, most felt that it was appropriate, would augment liquidity in long-dated strips and be well received by the market.

In the third part of the charge, Treasury asked for the Committee's views on the appropriate role of Treasury as a regulator in the Treasury market when liquidity in specific securities is reduced artificially by market participants.

There was a widely held opinion on the Committee that the Treasury already has several powerful and effective tools to regulate the Treasury market and that no additional tools were necessary. It was further widely held that the Treasury should focus its attention on utilizing these tools in the avoidance of systemic settlement fails where market liquidity is severely and artificially reduced by certain market participants and not used simply to ensure that financing costs on specific issues remain stable.

Several members pointed out that the Treasury's use of "suasion" and large position reporting in the past has been very effective in both resolving systemic fails and ensuring that they rarely occur.

Other members pointed out that the Treasury's ability to "tap" the issuance of specific securities also provides the regulator with a powerful tool and helps to ensure a liquid trading and financing market for Treasuries.

Finally, several members pointed out that the Treasury market is the most liquid and best functioning market in the world and that increased regulation might come at a cost and is not needed nor warranted.

In the final section of the charge, the Committee considered the composition of marketable financing for the July-September quarter to refund approximately $22.4 billion of privately held notes and bonds maturing or called on August 15, 2006 as well as the composition of Treasury marketable financing for the remainder of the July-September quarter, including cash management bills, as well as the composition of Treasury marketable financing for the October-December quarter. To refund $22.4 billion of privately held notes and bonds maturing August 15, 2006, the Committee recommended a $21 billion 3-year note due August 15, 2009, and a $13 billion 10-year note due August 15, 2016, and a $12 billion reopening of the 30-year bond due February 15, 2036. For the remainder of the quarter, the Committee recommended a $22 billion 2-year note in August and September, a $14 billion 5-year note in August and September, and an $8 billion reopening of the 10-year note in September. The Committee also recommended a $25 billion 14-day cash management bill issued September 1, 2006 and maturing September 15, 2006 as well as a $12 billion 8-day cash management bill issued September 7, 2006 and maturing September 15, 2006. For the October-December quarter the Committee recommended financing as found in the attached table. Relevant features include three 2-year note issuances monthly, three 5-year note issuances monthly, one 3-year note issuance in November, a 10-year note issuance in November with a reopening in December, as well as a 5-year TIPs reopening in October and a 10-year TIPs reopening in October.

Respectfully submitted,

Thomas G. Maheras
Chairman
Keith T. Anderson
Vice Chairman

Attachments (2)

REPORTS

- Table Q3
- Table Q4

US TREASURY FINANCING SCHEDULE FOR 3rd QUARTER 2006
BILLIONS OF DOLLARS

SSUE	ANNOUNCEMENT DATE	AUCTION DATE	SETTLEMENT DATE	OFFERED AMOUNT 4-WK	OFFERED AMOUNT 3-MO	OFFERED AMOUNT 6-MO	MATURING AMOUNT	NEW MONEY
4-WEEK AND	6/29	7/3	7/6	15.00	15.00	14.00	46.00	-2.00
3&6 MONTH BILLS	7/6	7/10	7/13	15.00	15.00	14.00	38.00	6.00
	7/13	7/17	7/20	15.00	16.00	14.00	41.00	4.00
	7/20	7/24	7/27	23.00	16.00	15.00	46.00	8.00
	7/27	7/31	8/3	27.00	17.00	15.00	47.00	12.00
	8/3	8/7	8/10	*27.00*	*17.00*	*15.00*	*47.00*	*12.00*
	8/10	8/14	8/17	*27.00*	*17.00*	*16.00*	*47.00*	*13.00*
	8/17	8/21	8/24	*20.00*	*18.00*	*16.00*	*56.00*	*-2.00*
	8/24	8/28	8/31	*18.00*	*18.00*	*16.00*	*61.00*	*-9.00*
	8/31	9/5	9/7	*15.00*	*18.00*	*16.00*	*61.00*	*-12.00*
	9/7	9/11	9/14	*12.00*	*18.00*	*16.00*	*61.00*	*-15.00*
	9/14	9/18	9/21	*12.00*	*17.00*	*15.00*	*52.00*	*-8.00*
	9/21	9/25	9/28	*12.00*	*17.00*	*15.00*	*48.00*	*-4.00*
					654.00		651.00	3.00
CASH MANAGEMENT BILLS								
14-DAY BILL	8/29 Matures 9/15	8/31	9/1		*25.00*		*25.00*	*0.00*
8-DAY BILL	9/5 Matures 9/15	9/6	9/7		*12.00*		*12.00*	*0.00*
								0.00
COUPONS						CHANGE IN SIZE		
10-Year TIPS	7/10	7/13	7/17		9.00		17.22	-8.22
20-Year TIPS (R)	7/20	7/25	7/31		7.00	1.00		
2-Year Note	7/24	7/26	7/31		22.00			
5-Year Note	7/24	7/27	7/31		14.00		22.52	20.48
3-Year Note	8/2	8/7	8/15		*21.00*			
10-Year Note	8/2	8/9	8/15		*13.00*			
30-Year Note ®	8/2	8/10	8/15		*12.00*	*-2.00*	*22.38*	*23.62*
2-Year Note	8/24	8/29	8/31		*22.00*			
5-year Note	8/24	8/30	8/31		*14.00*		*23.81*	*12.19*
10-Year Note (R)	9/7	9/12	9/15		*8.00*			*8.00*
2-Year Note	9/25	9/27	10/2 *		*22.00*			
5-year Note	9/25	9/28	10/2 *		*14.00*		*23.66*	*12.34*
					178.00		109.58	56.07

Estimates are italicized

NET CASH RAISED THIS QUARTER: 59.07

R = Reopening

* The September two and five-year note auctions settle in October and thereby are not part of this quarter's cash flow.

US TREASURY FINANCING SCHEDULE FOR 4th QUARTER 2006
BILLIONS OF DOLLARS

ISSUE	ANNOUNCEMENT DATE	AUCTION DATE	SETTLEMENT DATE	OFFERED AMOUNT 4-WK	OFFERED AMOUNT 3-MO	OFFERED AMOUNT 6-MO	MATURING AMOUNT	NEW MONEY
4-WEEK AND 3&6 MONTH BILLS	9/28	10/2	10/5	*12.00*	*17.00*	*15.00*	*44.00*	*0.00*
	10/5	10/9	10/12	*14.00*	*18.00*	*16.00*	*40.00*	*8.00*
	10/12	10/16	10/19	*14.00*	*18.00*	*16.00*	*41.00*	*7.00*
	10/19	10/23	10/26	*18.00*	*18.00*	*16.00*	*41.00*	*11.00*
	10/26	10/30	11/2	*18.00*	*18.00*	*16.00*	*43.00*	*9.00*
	11/2	11/6	11/9	*22.00*	*18.00*	*16.00*	*45.00*	*11.00*
	11/9	11/13	11/16	*24.00*	*18.00*	*16.00*	*45.00*	*13.00*
	11/16	11/20	11/24	*24.00*	*18.00*	*16.00*	*50.00*	*8.00*
	11/22	11/27	11/30	*20.00*	*18.00*	*16.00*	*50.00*	*4.00*
	11/30	12/4	12/7	*16.00*	*18.00*	*16.00*	*54.00*	*-4.00*
	12/7	12/11	12/14	*14.00*	*18.00*	*16.00*	*56.00*	*-8.00*
	12/14	12/18	12/21	*11.00*	*18.00*	*16.00*	*55.00*	*-10.00*
	12/21	12/26	12/28	*10.00*	*18.00*	*16.00*	*51.00*	*-7.00*
					657.00		*615.00*	*42.00*
CASH MANAGEMENT BILLS								
15-DAY BILL	11/28 Matures 12/15	11/29	11/30		*25.00*		*25.00*	*0.00*
8-DAY BILL	12/5 Matures 12/15	12/6	12/7		*12.00*		*12.00*	*0.00*
								0.00
COUPONS						CHANGE IN SIZE		
10-Year TIPS ®	10/10	10/12	10/16		*8.00*		*17.30*	*-9.30*
5-Year TIPS®	10/19	10/23	10/31		*8.00*	*1.00*		
2-Year Note	10/23	10/25	10/31		*22.00*			
5-Year Note	10/23	10/26	10/31		*14.00*		*22.48*	*21.52*
3-Year Note	11/1	11/7	11/15		*21.00*			
10-Year Note	11/1	11/8	11/15		*13.00*		*57.56*	
2-Year Note	11/21	11/28	11/30		*22.00*			
5-year Note	11/21	11/29	11/30		*14.00*		*22.67*	*13.33*
10-Year Note®	12/7	12/12	12/15		*8.00*			*8.00*
2-Year Note	12/21	12/27	1/2 *		*22.00*			
5-year Note	12/21	12/28	1/2 *		*14.00*		*24.00*	*12.00*
					166.00		144.01	45.89

Estimates are italicized

NET CASH RAISED THIS QUARTER: 87.89

R = Reopening

* The September two and five-year note auctions settle on October 2. As a result, that borrowing is counted as part of the fourth quarter's net cash raised. The December auctions settle in January and thereby are not part of the October-December cash flow pattern.

PRESS ROOM

August 1, 2006
hp-39

Adam Szubin Named New OFAC Director

U.S. Treasury Secretary Henry M. Paulson has named Adam Szubin as the new Director of the Treasury's Office of Foreign Assets Control (OFAC).

In the role of OFAC Director, Szubin will be responsible for administering and enforcing the United States Government's economic sanction programs to advance foreign policy and national security objectives. These programs target supporters of terrorism, proliferators of weapons of mass destruction (WMD), international narcotics traffickers, and select foreign countries.

"As the new Director of OFAC, I believe that Adam will continue to strengthen the office's efforts to protect the national and economic security of the United States," said Stuart Levey, Treasury's Under Secretary for the Office of Terrorism and Financial Intelligence (TFI).

During his tenure at the Treasury, Szubin has served as the Senior Advisor to the Under Secretary for Terrorism and Financial Intelligence. In this capacity, he helped to develop and coordinate the implementation of policies on a range of issues, including terrorist financing, money laundering, sanctions programs, rogue regimes, WMD proliferation, and intelligence analysis. Szubin chaired the Money Laundering Threat Assessment Working Group, which produced the first government-wide analysis of U.S. money laundering vulnerabilities.

"Adam's ideas and expertise helped to create the solid foundations on which the Office of Terrorism and Financial Intelligence has grown over the past two years. As a central engineer of TFI's policies, Adam has demonstrated tremendous ability to apply innovative strategies to combat the range of illicit threats we face," said Levey.

Szubin came to the Treasury from the Department of Justice, where he served as Counsel to the Deputy Attorney General, coordinating the Department's efforts to combat terrorism financing. Prior to assuming that position, he worked as a trial attorney in the Civil Division of the Justice Department, serving as a member of the Terrorism Litigation Task Force.

Szubin clerked for Judge Ronald Gilman on the U.S. Court of Appeals for the Sixth Circuit. He graduated from Harvard Law School, cum laude, and Harvard College, magna cum laude, and was a Fulbright scholar. Szubin lives with his wife in Washington, DC.

Szubin replaces Robert Werner, who served as the Director of OFAC until his departure earlier this year. Werner now serves as the Director of the Treasury's Financial Crimes Enforcement Network (FinCEN). Barbara Hammerle has served as Acting OFAC Director since Werner's departure.

The Office of Foreign Assets Control (OFAC) is charged with administering and enforcing U.S. economic and trade sanctions based on foreign policy and national security goals. OFAC currently administers roughly 30 programs that target terrorists, rogue countries and regimes, narcotics traffickers, proliferators of weapons of mass destruction and other illicit economic and national security threats.

PRESS ROOM

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August 1, 2006
HP-40

Treasury and IRS Issue Proposed and Temporary Regulations on the Tax Treatment of Services Under the Transfer Pricing Rules

WASHINGTON, DC - The Treasury Department and the IRS today issued proposed and temporary regulations on the tax treatment of services transactions, including services transactions related to intangible property, under the related party transfer pricing rules. The regulations update the existing rules regarding related party services transactions (which have not been revised since their issuance in 1968) to reflect an increasingly global economy, as well as the significance of cross-border services.

"The proposed and temporary regulations respond appropriately to comments that the proposed regulations would not have achieved their intended purpose of simplifying transfer pricing for low-margin services," explained Treasury International Tax Counsel Hal Hicks. "The new guidance takes low-margin services off the table and makes administration of the rules more productive for both taxpayers and the IRS. The regulations are issued in proposed and temporary form with a delayed effective date in order to allow taxpayers sufficient time to implement any necessary internal procedural changes and to provide further comments before finalization. Along with the proposed cost sharing regulations issued last year and forthcoming re-proposed global dealing regulations, the proposed and temporary services regulations modernize our transfer pricing rules to keep them current with changing business practices."

Key Highlights of the Proposed and Temporary Regulations:

- Reduce administrative and compliance burdens for low-margin services.
- Ensure that valuable intangibles cannot be transferred outside the United States for less than arm's length consideration.
- Update guidance on the transfer pricing methods to determine the arm's length price in a services transaction.
- The transfer pricing methods provided are generally consistent with current regulations applicable to transfers of tangible and intangible property and are consistent with international standards in this area.
- In response to significant comments received on the 2003 proposed regulations, the Simplified-Cost Based Method for pricing low-margin services is eliminated. In its place, the proposed and temporary regulations set forth the Services Cost Method, which provides two avenues for routine back-office services to be charged at cost with no markup. This method reduces complexity and enables taxpayers to better comply with their obligations under section 482, while also allowing the IRS to appropriately focus its audit resources only on high-margin services.
- Coordinate the rules applicable to services related to intangibles with the transfer pricing rules applicable to transfers of intangible property.

To update the 1968 regulations as quickly as possible while still allowing for more public input before finalization, the regulations are issued in temporary form with a delayed effective date for taxable years beginning after December 31, 2006. The Treasury Department and IRS request comments on the rules contained in the proposed and temporary regulations, on the services identified in the accompanying announcement that are eligible to be priced at cost, and any additional guidance that should be provided in the final regulations.

ATTACHMENTS:

Announcement and proposed and temporary regulations under section 482.

REPORTS

- Service Reg 0801
- NPRM 0801
- NOT-127827

[4830-01-p]

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Parts 1 and 31

[REG-146893-02]
[REG-115037-00]
[REG-138603-03]

RIN 1545-BB31, 1545-AY38, 1545-BC52

Treatment of Services Under Section 482
Allocation of Income and Deductions from Intangibles
Stewardship Expense

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking by cross-reference to temporary regulations, notice of proposed rulemaking, and notice of public hearing.

SUMMARY: In a separate part to this issue of the **Federal Register**, the IRS is issuing temporary regulations relating to the treatment of controlled services transactions under section 482. These temporary regulations also provide guidance regarding the allocation of income from intangibles, in particular with respect to contribution by a controlled party to the value of an intangible owned by another controlled party as it relates to controlled services transactions and modify the regulations under section 861 concerning stewardship expenses to be consistent with the changes made to the regulations under section 482. The text of those regulations also serves as the text of these proposed regulations. These proposed regulations also contain a coordination rule with global dealing operations. The Treasury Department and the IRS are presently working on new global dealing regulations and intend that when final regulations are issued, those regulations, not §1.482-9T, will govern the evaluation of the activities performed by a global dealing operation within the scope of those regulations. Pending finalization of the global

dealing regulations, taxpayers may rely on the proposed global dealing regulations, not the temporary services regulations, to govern financial transactions entered into in connection with a global dealing operation as defined in proposed §1.482-8. Therefore, proposed regulations under §1.482-9(m)(5) clarify that a controlled services transaction does not include a financial transaction entered into in connection with a global dealing operation. These proposed regulations potentially affect controlled taxpayers within the meaning of section 482. This document also provides notice of a public hearing on these proposed regulations.

DATES: Written or electronic comments must be received by **[INSERT DATE 90 DAYS AFTER PUBLICATION OF THIS DOCUMENT IN THE FEDERAL REGISTER]**.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG-146893-02, REG-115037-00, and REG-138603-03), Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be sent electronically, via the IRS internet site at www.irs.gov/regs or via Federal eRulemaking Portal at www.regulations.gov (IRS REG-146893-02, REG-115037-00, and REG-138603-03).

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Thomas A. Vidano, (202) 435-5265, or Carol B. Tan, (202) 435-5265 for matters relating to section 482, or David Bergkuist (202) 622-3850 for matters relating to stewardship expenses; concerning submission of comments, the hearing, and/or, to be placed on the building access list to attend the hearing, [Insert Name], (202) 622-7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background and Explanation of Provisions

Temporary regulations in the Rules and Regulations section of this issue of the **Federal Register** amend the Income Tax Regulations (26 CFR parts 1 and 31) relating to section 482.

The temporary regulations set forth guidance on the treatment of controlled services transactions, the allocation from intangibles under section 482, and stewardship expenses under section 861. The text of those regulations also serves as the text of these proposed regulations. The preamble to the temporary regulations explains the temporary regulations and these proposed regulations. These proposed regulations potentially affect controlled taxpayers within the meaning of section 482.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the regulation does not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Internal Revenue Code (Code), this regulation has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. The IRS and Treasury Department specifically request comments on the clarity of the proposed rule and how it may be made easier to understand. All comments will be available for public inspection and copying.

A public hearing will be scheduled if requested in writing by any person that timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place for the public hearing will be published in the **Federal Register**.

Drafting Information

The principal authors of these regulations are Thomas A. Vidano and Carol B. Tan, Office of Associate Chief Counsel (International).

List of Subjects

26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

26 CFR Part 31

Employment taxes, Income taxes, Penalties, Pensions, Railroad retirement, Reporting and recordkeeping requirements, Social security and Unemployment compensation.

Proposed Amendments to the Regulations

Accordingly, 26 CFR parts 1 and 31 are proposed to be amended as follows:

PART 1--INCOME TAXES

Par. 1. The authority citation for part 1 is amended by adding an entry in numerical order to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Section 1.482-9 also issued under 26 U.S.C. 482. * * *

Par. 2. Section 1.482-0 is amended as follows:

1. The section heading is revised.

2. The entries for §1.482-2(b) are revised.

3. The entries for §1.482-4(f)(3), (f)(4) and (f)(5) are revised and new entries for §1.482-4(f)(6) are added.

4. New entries for §§1.482-6T(c)(3)(i)(B)(1) and (2) and 1.482-9T are added.

The revisions and additions read as follows:

§1.482-0 Outline of regulations under section 482.

* * * * *

[The text of the proposed amendment to §1.482-0 is the same as the text of §1.482-0T published elsewhere in this issue of the **Federal Register**].

Par. 3. Section 1.482-1 is amended as follows:

1. Paragraphs (a)(1), (b)(2)(i), (d)(3)(ii)(C) Example 3, (d)(3)(v), (f)(2)(ii)(A), (f)(2)(iii)(B), (g)(4)(i), (g)(4)(iii) and paragraph (i) are revised.

2. Paragraphs (d)(3)(ii)(C), Example 4 and Example 5 and (j) are added.

The additions and revisions read as follows:

§1.482-1 Allocation of income and deductions among taxpayers.

(a)(1) [The text of the proposed amendment to §1.482-1(a)(1) is the same as the text of §1.482-1T(a)(1) published elsewhere in this issue of the **Federal Register**].

* * * * *

(b) * * * (1) * * *

(b)(2)(i) [The text of the proposed amendment to §1.482-1(b)(2)(i) is the same as the text of §1.482-1T(b)(2)(i) published elsewhere in this issue of the **Federal Register**].

* * * * *

(d) * * *

(3) * * *

(ii) * * *

(C) * * *

Example 3. [The text of the proposed amendment to §1.482-1(d)(3)(ii)(C), Example 3 is the same as the text of §1.482-1T(d)(3)(ii)(C) Example 3 published elsewhere in this issue of the **Federal Register**].

Example 4. [The text of the proposed amendment to §1.482-1(d)(3)(ii)(C) Example 4 is the same as the text of §1.482-1T(d)(3)(ii)(C) Example 4 published elsewhere in this issue of the **Federal Register**].

Example 5. [The text of the proposed amendment to §1.482-1(d)(3)(ii)(C) Example 5 is the same as the text of §1.482-1T(d)(3)(ii)(C) Example 5 published elsewhere in this issue of the **Federal Register**].

Example 6. [The text of the proposed amendment to §1.482-1(d)(3)(ii)(C) Example 6 is the same as the text of §1.482-1T(d)(3)(ii)(C) Example 6 published elsewhere in this issue of the **Federal Register**].

(v) Property or services. [The text of the proposed amendment to §1.482-1(d)(3)(v) is the same as the text of §1.482-1T(d)(3)(v) published elsewhere in this issue of the **Federal Register**].

* * * * *

(f) * * *

(2) * * *

(ii)(A) [The text of the proposed amendment to §1.482-1(f)(2)(ii)(A) is the same as the text of §1.482-1T(f)(2)(ii)(A) published elsewhere in this issue of the **Federal Register**].

(iii) * * *

(B) [The text of the proposed amendment to §1.482-1(f)(3)(iii)(B) is the same as the text of §1.482-1T(f)(3)(iii)(B) published elsewhere in this issue of the **Federal Register**].

* * * * *

(g) * * *

(4) * * * (i) * * * [The text of the proposed amendment to §1.482-1(g)(4)(i) is the same as the text of §1.482-1T(g)(4)(i) published elsewhere in this issue of the **Federal Register**].

(iii) * * *

<u>Example 1</u>. [The text of the proposed amendment to §1.482-1(g)(4)(iii) <u>Example 1</u> is the same as the text of §1.482-1T(g)(4)(iii) Example 1 published elsewhere in this issue of the **Federal Register**].

* * * * *

(i) [The text of the proposed amendment to §1.482-1(i) is the same as the text of §1.482-1T(i) published elsewhere in this issue of the **Federal Register**].

* * * * *

(j) [The text of the proposed amendment to §1.482-1(j) is the same as the text of §1.482-1T(j)(1) and (2) published elsewhere in this issue of the **Federal Register**].

Par. 4. Section 1.482-2 is amended as follows:

1. Paragraph (b) is revised.

2. Paragraph (e) is added.

The revision and addition reads as follows:

<u>§1.482-2 Determination of taxable income in specific situations</u>.

* * * * *

(b) [The text of the proposed amendment to §1.482-2(b) is the same as the text of §1.482-2T(b) published elsewhere in this issue of the **Federal Register**].

* * * * *

(e) [The text of the proposed amendment to §1.482-2(e) is the same as the text of §1.482-2T(e)(1) and (2) published elsewhere in this issue of the **Federal Register**].

Par. 5. Section 1.482-4 is amended as follows:

1. Paragraph (f)(3) is revised.
2. Paragraphs (f)(4) and (f)(5) are redesignated as paragraphs (f)(5) and (f)(6), respectively.
3. New paragraphs (f)(4) and (f)(7) are added.

The revision and addition read as follows:

<u>§1.482-4 Methods to determine taxable income in connection with a transfer of intangible property</u>.

* * * * *

(f) * * *

(3) [The text of the proposed amendment to §1.482-4(f)(3) is the same as the text of §1.482-4T(f)(3) published elsewhere in this issue of the **Federal Register**].

* * * * *

(4) [The text of the proposed amendment to §1.482-4(f)(4) is the same as the text of §1.482-4T(f)(4) published elsewhere in this issue of the **Federal Register**].

* * * * *

(7) [The text of the proposed amendment to §1.482-4(f)(7) is the same as the text of §1.482-4T(f)(7)(i) and (ii) published elsewhere in this issue of the **Federal Register**].

* * * * *

Par. 6. Section 1.482-6 is amended by revising paragraphs (c)(2)(ii)(B)(1), (c)(2)(ii)(D), (c)(3)(i)(A), (c)(3)(i)(B), and (c)(3)(ii)(D), and adding paragraph (d) to read as follows:

§1.482-6 Profit split method.

* * * * *

(c) * * *

(2) * * *

(ii) * * *

(B) * * * (1) * * * [The text of the proposed amendment to §1.482-6(c)(2)(ii)(B)(1) is the same as the text of §1.482-6T(c)(2)(ii)(B)(1) published elsewhere in this issue of the **Federal Register**].

* * * * *

(D) [The text of the proposed amendment to §1.482-6(c)(2)(ii)(D) is the same as the text of §1.482-6T(c)(2)(ii)(D) published elsewhere in this issue of the **Federal Register**].

* * * * *

(3) * * *

(i) * * * (A) [The text of the proposed amendment to §1.482-6(c)(3)(i)(A) is the same as the text of §1.482-6T(c)(3)(i)(A) published elsewhere in this issue of the **Federal Register**].

(B) [The text of the proposed amendment to §1.482-6(c)(3)(i)(B) is the same as the text of §1.482-6T(c)(3)(i)(B) published elsewhere in this issue of the **Federal Register**].

* * * * *

(ii) * * *

(D) [The text of the proposed amendment to §1.482-6(c)(3)(ii)(D) is the same as the text of §1.482-6T(c)(3)(ii)(D) published elsewhere in this issue of the **Federal Register**].

* * * * *

(d) [The text of the proposed amendment to §1.482-6(d) is the same as the text of §1.482-6T(d)(1) and (2) published elsewhere in this issue of the **Federal Register**].

Par. 7. Section 1.482-8 is amended by adding Examples 10 through 12 to read as follows:

§1.482-8 Examples of the best method rule.

* * * * *

(a) Example 10. Cost of services plus method preferred to other methods. [The text of the proposed amendment to §1.482-8(a) Example 10 is the same as the text of §1.482-8T(a) Example 10 published elsewhere in this issue of the **Federal Register**].

Example 11. CPM for services preferred to other methods. [The text of the proposed amendment to §1.482-8(a) Example 11 is the same as the text of §1.482-8T(a) Example 11 published elsewhere in this issue of the **Federal Register**].

Example 12. Residual profit split preferred to other methods. [The text of the proposed amendment to §1.482-8(a) Example 12 is the same as the text of §1.482-8T(a) Example 12 published elsewhere in this issue of the **Federal Register**].

(b) [The text of the proposed amendment to §1.482-8(b) is the same as the text of §1.482-8T(b)(1) and (2) published elsewhere in this issue of the **Federal Register**].

Par. 8. A new §1.482-9 is added to read as follows:

§1.482-9 Methods to determine taxable income in connection with a controlled services transaction.

(a) through (m)(5) [The text of the proposed §1.482-9(a) through (m)(5) is the same as the text of §1.482-9T(a) through (m)(5) published elsewhere in this issue of the **Federal Register**].

(m)(6) Global dealing operations. A controlled services transaction does not include a financial transaction entered into in connection with a global dealing operation as defined in §1.482-8.

(n) [The text of the proposed §1.482-9(n) is the same as the text of §1.482-9T(n)(1) and (n)(2) published elsewhere in this issue of the **Federal Register**].

Par. 9. Section 1.861-8 is amended by revising paragraphs (a)(5), the fifth and sixth sentences in paragraph (b)(3), (e)(4), (f)(4)(i), (g) Examples 17, 18, and 30, and the first sentence in paragraph (h) introductory text to read as follows:

§1.861-8 Computation of taxable income from sources within the United States and from other sources and activities.

(a) * * *

(5) [The text of the proposed amendment to §1.861-8(a)(5) is the same as the text of §1.861-8T (a)(5) published elsewhere in this issue of the **Federal Register**]

(b) * * *

(3) * * * [The text of the proposed amendment to §1.861-8(b)(3) is the same as the text in §1.861-8T(b)(3) published elsewhere in this issue of the **Federal Register**]. * * *

* * * * *

(e) * * *

(4) [The text of the proposed amendment to §1.861-8(e)(4) is the same as the text of §1.861-8T(e)(4) published elsewhere in this issue of the **Federal Register**].

(f) * * *

(4)* * * (i) [The text of the proposed amendment to §1.861-8(f)(4)(i) is the same as the text of §1.861-8T(e)(4)(i) published elsewhere in this issue of the **Federal Register**].

(g) * * *

Example 17. [The text of the proposed amendment to §1.861-8(g) Example 17 is the same as the text of §1.861-8T(g) Example 17, published elsewhere in this issue of the **Federal Register**].

Example 18. [The text of the proposed amendment to §1.861-8(g) Example 18 is the same as the text of §1.861-8T(g) Example 18, published elsewhere in this issue of the **Federal Register**].

* * * * *

Example 30. [The text of the proposed amendment to §1.861-8(g) Example 30 is the same as the text of §1.861-8T(g) Example 30, published elsewhere in this issue of the **Federal Register**].

(h) [The text of the proposed amendment to §1.861-8(h) is the same as the text of §1.861-8T(h)(1) published elsewhere in this issue of the **Federal Register**]. * * *

* * * * *

Par. 10 Section 1.6038A-3(a)(3) is amended by revising paragraph (a)(3) Example 4 and (i) to read:

§1.6038A-3 Record maintenance.

(a) * * *

(3) * * *

Example 4. [The text of the proposed amendment to §1.6038A-3, Example 4 is the same as the text of §1.6038A-3T, Example 4 published elsewhere in this issue of the **Federal Register**].

* * * * *

(i) [The text of the proposed amendment to §1.6038A-3(i) is the same as the text of §1.6038A-3T(i)(1) and (2) published elsewhere in this issue of the **Federal Register**].

Par. 11. Section 1.6662-6 is amended by revising paragraphs (d)(2)(ii)(B), (d)(2)(iii)(B)(4), (d)(2)(iii)(B)(6) and (g) to read as follows:

<u>§1.6662-6 Transactions between persons described in section 482 and net section 482 transfer price adjustments</u>.

* * * * *

(d) * * *

(2) * * *

(ii) * * *

(B) [The text of the proposed amendment to §1.6662-6(d)(2)(ii)(B) is the same as the text of §1.6662-6T(d)(2)(ii)(B) published elsewhere in this issue of the **Federal Register**].

* * * * *

(iii) * * *

(B) * * * (4) [The text of the proposed amendment to §1.6662-6(d)(2)(iii)(B)(4) is the same as the text of §1.6662-6T(d)(2)(iii)(B)(4) published elsewhere in this issue of the **Federal Register**].

* * * * *

(6) [The text of the proposed amendment to §1.6662-6(d)(2)(iii)(B)(6) is the same as the text of §1.6662-6T(d)(2)(iii)(B)(6) published elsewhere in this issue of the **Federal Register**].

* * * * *

(g) [The text of the proposed amendment to §1.6662-6(g) is the same as the text of §1.6662-6T(g)(1) and (2) published elsewhere in this issue of the **Federal Register**].

PART 3--EMPLOYMENT TAXES AND COLLECTION OF INCOME TAX AT THE SOURCE

Par. 12. The authority citation for part 31 continues to read as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 13. Section 31.3121(s)-1 is amended by revising paragraphs (c)(2)(iii) and (d) to read as follows:

§31.3121(s)-1 Concurrent employment by related corporations with common paymaster.

* * * * *

(c) * * *

(2) * * *

(iii) [The text of the proposed amendment to §31.3121(s)-1(c)(2)(iii) is the same as the text of §31.3121(s)-1T(c)(2)(iii) published elsewhere in this issue of the **Federal Register**].

* * * * *

(d) [The text of the proposed amendment to §31.3121(s)-1(d) is the same as the text of §31.3121(s)-1T(d)(1) and (2) published elsewhere in this issue of the **Federal Register**].

* * * * *

Mark E. Matthews,
Deputy Commissioner for Services and Enforcement.

Part IV - Items of General Interest

Announcement that identifies specified covered services eligible for services cost method under section 482 regulations

Announcement 2006-50

BACKGROUND

In 2003, the Treasury Department issued proposed section 482 regulations that set forth a simplified cost based method (SCBM). Prop. § 1.482-9(f). That method was intended to preserve the salutary aspects of the cost safe harbor in current § 1.482-2(b) while at the same time eliminating problematic features of those rules. In light of public comments, however, the Treasury Department has issued temporary and proposed regulations, concurrently with this announcement, that eliminate the SCBM and replace it with the services cost method (SCM). According to these temporary and proposed regulations, two categories of covered services, "specified covered services" and "low margin covered services," are eligible for the SCM. This announcement relates to "specified covered services," which are support services identified in a revenue procedure published by the IRS.

Included with this announcement is the proposed revenue procedure identifying specified covered services. The Service invites comments from interested members of the public prior to publishing the revenue procedure. The temporary regulations have a delayed effective date for tax years beginning after December 31, 2006. It is contemplated that a final revenue procedure will be issued after taking into account comments on this announcement and that this final revenue procedure will be effective concurrent with the effective date of the temporary regulations.

Comments (eight copies) should be sent to Associate Chief Counsel (International) CC:INTL:FO, Internal Revenue Service, 1111 Constitution Avenue, NW, Room 4554, Washington, DC, 20224, making reference in the comments to Control Number NOT-127827-06. To ensure that comments are given full consideration, they should be submitted by October 6, 2006.

Despite substantial changes over the past 30 years in the nature of services performed by controlled parties, the existing cost safe harbor for services in current § 1.482-2(b) has not been modified since its original adoption in 1968. The Treasury Department in 2003 issued proposed regulations that set forth a simplified cost based method (SCBM) intended to preserve some benefits of the current § 1.482-2(b) cost safe harbor, such as appropriately reduced administrative and compliance burdens for low margin services. At the same time, the SCBM was intended to bring existing rules more in line with the arm's length standard and to eliminate some of the problematic features of those rules.

A number of commentators suggested that the SCBM was counterproductive to its stated goals. Namely, commentators contended that to apply the SCBM, taxpayers would potentially need to expend substantial sums to prepare comparability studies, perhaps separately for each of numerous back office services. They contended that, although taxpayers have in-depth knowledge concerning their businesses and the relative value added by their back offices, the SCBM called for quantitative judgments that business people are not qualified to make by themselves, especially in the prevailing compliance environment. As a matter of proper accountability, taxpayers would be required as a practical matter to devote significant compliance resources to enlist outside consultants or otherwise to develop support for those judgments.

In light of the extensive public comments concerning the SCBM, the Treasury Department and the IRS have substantially redesigned the relevant provisions. Recognizing that the section 482 services regulations potentially affect a large volume of intragroup back office services that are common across many industries, it is in the interest of sound tax administration to minimize the compliance burdens applicable to such services, which would typically bear low arm's length markups.

Accordingly, the temporary and proposed regulations eliminate the SCBM and replace it with the services cost method (SCM), as set forth in §1.482-9T(b). The SCM evaluates whether the price for covered services, as defined, is arm's length by reference to the total services costs with no markup. Where the conditions on application of the method are met, the SCM will be considered the best method for purposes of §1.482-1(c).

Section 1.482-9T(b)(4) provides for two categories of covered services eligible for the SCM, if the other conditions on application of the method are met. The first category consists of specified covered services identified in a revenue procedure published by the IRS. These specified covered services are so identified because they constitute support services of a type common across industry sectors that generally do not involve a significant arm's length markup on total services costs. A second category of services, low margin covered services, constitutes services that have a median comparable arm's length markup on total services costs of less than or equal to 7 percent.

The identification of specific activities that qualify for the SCM as a threshold matter should assist in maintaining appropriately reduced administrative burdens for low margin services. Since the Government has made the initial determination that these specified covered services are eligible to be priced under the SCM, taxpayers may rely upon this listing and need not perform their own independent analysis of comparable service providers.

Although specified covered services cover a wide range of support activities, the Treasury Department and the IRS recognize that the listing may not include the entire universe of low margin services. In the case of other low margin services, taxpayers may seek to demonstrate that the services qualify under the alternative mechanism in §1.482-9T(b)(4)(ii), as services with a median comparable arm's length markup on total services costs of less than or equal to 7 percent. Both specified covered services and low margin covered services must also meet the requirements of §1.482-9T(b)(2) (services that the taxpayer reasonably concludes in its business judgment do not contribute significantly to the fundamental risks of success or failure) and must not be identified in §1.482-9T(b)(3)(ii) (excluded transactions).

As explained above, this announcement contains an initial listing of specified covered services. The Treasury and the IRS solicit public input both on whether the list of services sufficiently covers the full range of back office services typical within multinational groups, as well as on the descriptions provided for these covered services. It is contemplated that a final revenue procedure, reflecting revisions based on comments received, will be issued to coincide with the effective date of the temporary and proposed regulations for taxable years beginning after December 31, 2006.

DRAFTING INFORMATION

The principal author of this announcement is Thomas A. Vidano of the Office of Associate Chief Counsel (International). For further information regarding this announcement contact Thomas A. Vidano at (202) 435-5265 (not a toll-free call).

Part III

Administrative, Procedural, and Miscellaneous

[26 CFR 1.482-9T]: Methods to determine taxable income in connection with a controlled services transaction
(Also:)

Rev. Proc. [2006-XX]

SECTION 1. PURPOSE

This revenue procedure identifies specified covered services within the meaning of Section 1.482-9T(b)(4)(i). The activities identified in this revenue procedure are support services common among taxpayers in a variety of industry sectors, and generally do not involve a significant arm's length markup on total services costs. Services identified in this revenue procedure must meet the other conditions set forth in Section 1.482-9T(b) to be evaluated under the services cost method.

SECTION 2. BACKGROUND

The section 482 regulations provide pricing methods for transactions between controlled parties, including transactions involving services. The existing regulations for transactions involving services were issued in 1968. Section 1.482-2(b) of the existing regulations provides a "cost safe harbor" that permits certain "non-integral" services to be priced at cost. In 2003, the Treasury Department and IRS issued proposed regulations that set forth a simplified cost based method (SCBM) intended to preserve some benefits of the current § 1.482-2(b) cost safe harbor. A number of commentators noted that SCBM called for quantitative judgments that business people are not qualified to make by themselves. As a practical matter, taxpayers would be required to devote significant compliance resources to enlist outside consultants or otherwise to develop support for those judgments.

In 2006, the Treasury Department and the IRS issued temporary regulations that eliminated the SCBM and replaced it with the services cost method (SCM), as set forth in §1.482-9T(b). The Treasury Department and IRS recognized that because the section 482 services regulations potentially affect a large volume of intragroup back office services that are common across many industries, it is in the interest of sound tax administration to minimize the compliance burden of such services, which would typically bear low arm's length markups.

The SCM evaluates whether the price for covered services, as defined, is arm's length by reference to the total services costs with no markup. Section 1.482-9T(b)(4) provides for two categories of covered services eligible for the SCM. The first category consists of specified covered services that will be identified in this revenue procedure. These specified covered services are so identified because they constitute support services of a type common across industry sectors that generally do not involve a significant arm's length markup on total services costs. A second category of services, low margin covered services, not addressed in this revenue procedure have a median comparable arm's length markup on total services costs of less than or equal to 7 percent.

SECTION 3. SCOPE

The following categories of services are eligible for treatment under section 1.482-9T(b)(4)(i):

Payroll:

1. Compiling and posting employee time and other information needed to calculate periodic compensation to employees. Computing employees' time worked, production, and commissions. Computing and posting wages and deductions to appropriate accounting records. Preparing paychecks, travel reimbursement and expense reimbursement.
2. Preparing payroll tax forms (such as the preparation of Forms 940, 941 and W-2 in order to comply with U.S. requirements or similar requirements under another country's laws).

Premiums for Unemployment, Disability and Workers Compensation:

3. Processing employees' unemployment insurance premiums, disability premiums and workers compensation premiums.

Accounts Receivable:

4. Compiling, analyzing and recording current credit data and other financial information regarding individuals or firms (including preparing reports with this information for use in decisionmaking).
5. Compiling and recording billing, accounting and other numerical data for billing purposes. Preparing billing invoices for services rendered or for delivery or shipment of goods.
6. Locating and notifying customers of delinquent accounts by mail (either electronic or otherwise) or telephone to solicit payment. Receiving payment from customers and posting payment to customer's account. If customer fails to respond, preparing statements to credit department, initiating repossession proceedings or service disconnection. Keeping records of collection activities and status of accounts.

Accounts Payable:

7. Compiling information and records to draw up purchase orders for procurement of materials and services.
8. Making payment to vendors and posting payment to status of accounts.

General Administrative:

9. Performing clerical and administrative functions such as drafting correspondence, scheduling appointments, and organizing and maintaining paper and electronic files.

10. Performing data entry through use of a keyboard or scanning device, including verifying data and preparing materials for printing.
11. Using a word processor/computer or typewriter to generate (without substantial modification) letters, reports, forms, or other material from another person's rough draft, corrected copy, or voice recording.
12. Performing duties relating to office management systems and procedures, such as answering telephones, bookkeeping, typing, word processing, office machine operation, and filing.
13. Operating any of the following office machines: photocopying, scanning and facsimile machines.

Public Relations:

14. Preparation and distribution of internal and external corporate communications.

Meeting Coordination:

15. Coordinating activities of staff and convention personnel to make arrangements for group meetings and conventions.

Accounting and Auditing:

16. Gathering and reviewing information in accounting records for use in preparing financial statements.
17. Computing, classifying, and recording numerical data to maintain accurate and complete financial records, performing any combination of calculating, posting, and verifying duties to obtain primary financial data for use in maintaining accounting

records, checking the accuracy of figures, calculations, and postings pertaining to business transactions recorded by other workers.

Tax:

18. Processing tax payments according to prescribed laws and regulations.
19. Gathering information from accounting records and including that information in the preparation of income, property, sales/use, VAT, excise and other tax returns.

Compliance:

20. Gathering information and preparing documentation relating to eligibility for or compliance with laws and regulations governing contracts, licenses and permits.
21. Gathering information, verifying data and preparing documentation relating to compliance with laws and regulations governing financial and securities institutions and financial and real estate transactions. Examining and verifying correctness of, or establishing authenticity of records.

Budgeting:

22. Compiling data for use by cost estimators in determining cost projections and in preparing budget estimates, including verifying information for completeness, accuracy, and conformance with internal procedures and regulations.
23. Compiling data to prepare budget and accounting reports for management.

Treasury Activities:

24. Establishing bank accounts and lockboxes for use by controlled parties, including overdraft facilities and lines of credit.

Statistical Assistance:

25. Compiling data for use in statistical studies.

Staffing, Recruiting and Related Services:

26. Providing staffing support that includes creating job announcements, determining eligibility, evaluating qualifications of candidates, conducting background checks on final candidates, verifying references, developing performance evaluation procedures and forms, and conducting exit interviews for departed employees.
27. Coordinating with temporary employment agencies, applicants, and management throughout the recruiting process.
28. Providing information to applicants regarding open positions, the application and recruiting process, and employment policies.
29. Providing administrative support that includes sourcing and processing resumes, arranging interview schedules for open positions, preparing offer letters, and entering new employee information into the human resource system.
30. Establishing and maintaining employee files relating to payroll, performance and other personnel issues.
31. Assisting with new employee orientations and paperwork.
32. Implementing recruiting plan and locating potential candidates by working with professional search firms, colleges, universities and professional associations. Organizing and attending job fairs and other recruitment events.
33. Developing recruiting and marketing materials and assisting in developing and maintaining content for recruiting website.

34. Analyzing recruiting data and review all job analysis, promotion and placement products.

35. Posting job opening advertisements in appropriate markets through publications, journals and other media.

36. Managing company-wide job postings and employee referral program.

Training Services:

37. Assisting in training of personnel including assessing development and training needs, creating and conducting internal development and training programs and communicating training opportunities to personnel.

38. Arranging for management training on employment law compliance, employer liability avoidance, interviewing, hiring, terminations, promotions, performance reviews, safety, and sexual harassment.

Benefit Services:

39. Implementing employee compensation and benefits including healthcare, life insurance, 401(k), pension, worker's compensation, unemployment, dental, profit sharing, employee incentive compensation, and employee assistance programs.

40. Providing guidance and direction to employees regarding elections for benefits, applications for benefits and receipt of benefits (including providing assistance to employees in completing all necessary forms).

41. Arranging annual benefit enrollment meetings and employee benefit seminars.

42. Processing employee benefits inquiries and complaints, and reconciling billing issues.

43. Coordinating with hospitals, physicians, insurers, employees, and beneficiaries to facilitate proper and complete utilization of benefits for all employees.

Computer Support:

44. Providing technical assistance to users of computer systems and other information technology devices. Answering questions or resolving technical problems relating to computer systems and other information technology devices in person, via telephone or from remote location. Providing assistance concerning the use of computer hardware and software, including printing, installation, word processing, electronic mail, and operating systems.

Database Administration:

45. Maintaining and testing existing computer databases (including implementing security measures to safeguard computer databases), but not to include analyzing user needs or developing hardware or software solutions (such as systems integration, website design, writing computer programs, modifying general applications software, or recommending the purchase of commercially available hardware or software).

Network and Computer System Administration:

46. Supporting an organization's existing local area network (LAN), wide area network (WAN), and Internet system or a segment of a network system, regular maintenance of network hardware and software, monitoring network to ensure network availability to all system users and performing necessary maintenance to support network availability, supervising other network support and client server

specialists (including implementing network security measures), but not to include analyzing user needs or developing hardware or software solutions (such as systems integration, website design, writing computer programs, modifying general applications software, or recommending commercially available software).

Legal Services:

47. General legal services performed on behalf of the taxpayer by in-house legal counsel, including but not limited to, drafting and review of contracts, legal documents, and opinions, representation and advocacy before courts, administrative agencies, arbitrators, legislatures, or other bodies. Support and administrative functions associated with the above activities (legal research, secretarial, filing and document retrieval, etc.).

Insurance Claims Management:

48. Coordination with third party insurers, including preparing claims for submission to such third party insurers.

SECTION 4. APPLICATION

The services cost method (SCM) as set forth in §1.482-9T(b) evaluates whether the price for covered services, as defined, is arm's length by reference to the total services costs with no markup. Two categories of covered services are eligible for the SCM. The first category, specified covered services, is described in §1.482-9T(b)(i) and is limited to services that are described in this revenue procedure. The second category, low margin covered services, is not described in this revenue procedure.

SECTION 5. EFFECTIVE DATE

This revenue procedure is generally effective for taxable years beginning after December 31, 2006. Taxpayers may elect to apply retroactively the provisions of §1.482-9T to certain taxable years. See §1.482-9T(n)(1). In the case of a valid election, this revenue procedure would also apply to the taxable years subject to such an election.

SECTION 6. DRAFTING INFORMATION

The principal author of this revenue procedure is Thomas A. Vidano of the Office of Associate Chief Counsel (International). For further information regarding this revenue procedure contact Thomas A. Vidano at (202) 435-5265 (not a toll free call).

PRESS ROOM

August 1, 2006
HP-41

Remarks Prepared for Delivery
by Treasury Secretary Henry M. Paulson
At Columbia University

New York, NY – It's good to be back at CBS – a great school with a storied history that includes Benjamin Graham and David Dodd as faculty members, and Warren Buffett as a student. And while the business school didn't exist in the 18th century, the rigorous education Alexander Hamilton received as a Columbia undergraduate – inside and outside the classroom – no doubt paved the way for his groundbreaking work as America's first Treasury Secretary.

Today, CBS graduates are excelling in multiple fields, and what's more, you have a great sense of humor. I watched your Glenn Hubbard-Ben Bernanke video and I would guess that Ben would find it at least as funny as Glenn and I did. I don't usually get a lot of laughs in my speeches – at least not on purpose – so I was tempted to begin or end with the video!

I chose New York for my first public remarks because this city is unquestionably the world's financial capital. New York is home to financial institutions that are leaders in the U.S. and in every major market around the globe – and that is saying something! I also chose to come to New York because I know from experience that the solutions to our nation's challenges are not always found in Washington.

Today I will address the state of the U.S. economy, with a particular emphasis on our long-term challenges. These are problems that do not lend themselves to quick fixes – but they must be solved.

My approach as Treasury Secretary will be bipartisan. And in my early meetings in Congress, with Democrats and Republicans, I have communicated my sincere desire to work with both political parties to meet our long-term challenges.

We are fortunate to be able to address these challenges from a position of economic strength here at home. I spent 32 years working in a business, which gave me hands-on experience with markets and economies around the world. And over the past year, the global economy has been more robust than at any point I can recall during this period.

In Asia, not only are China and India growing, but so are South Korea and Japan. In Latin America, Mexico, Brazil and others are experiencing strong growth and improved fiscal performance. In Europe there are signs of moderate recovery in countries like Germany and France. And here at home the economic growth has been strong.

Last week the Commerce Department announced its advance estimate of GDP growth for the second quarter, which was 2.5 percent -- or half a percentage point below what most economists were expecting. We have to be careful not to put too much emphasis on any one quarter, and remember that this was an advance estimate that will be revised. However, for the past few years -- and for the first quarter of 2006 in particular -- the economy had been growing at a rate that was simply not sustainable over the long run. It would appear that what we are seeing is the economy transitioning to a more sustainable rate of growth, similar to the pattern we saw in the mid-1990s.

The economic strength here in our country would have been difficult to foresee even a few years ago, when the U.S. economy was reeling from the impact of the 9/11 terrorist attacks, the bursting of the stock-market bubble, and the recession. This is worth remembering because when things look the bleakest, they almost never are as bad as they seem. Similarly, when they look too good to be true – as they did during the dotcom and telecom bubble of the late 1990s – they almost always are.

The U.S. economy is on a more solid footing, and is stronger than most of us would have predicted. The unemployment rate has held below 5 percent for seven straight months, and we have seen 5.4 million new jobs created since August 2003. I witnessed this recovery on a first-hand basis -- one day at a time -- through the lens of our resilient, broad, deep capital markets, and through the dozens of institutional investors and American corporations who were the clients with whom I worked.

This remarkable recovery is a true testament to the strength and resilience of our nation's extraordinary economic system and entrepreneurial spirit. I can assure you that the President's tax cuts and economic policies played a major role in this recovery, by helping to restore market confidence, investor confidence, business confidence and consumer confidence. I watched the tax cuts and economic policies change behavior in very real and tangible ways.

There have been plenty of challenges over the last five years, not the least of which were the corporate scandals involving such companies as Enron and WorldCom. Corrective measures to address corporate scandals and increase investor confidence also played a role in the recovery. I take pride in the fact that when there is a problem in the United States – like no other nation in the world – we shine a light on it and move quickly to clean it up.

Often the pendulum swings too far and we need to go through a period of readjustment. But there is no doubt that certain legal and regulatory actions were critical to restoring confidence. The challenge before us now is how to achieve the right regulatory balance to allow us to be competitive in today's world while guarding against the recurrence of past abuses.

The overall dynamism and strength of the U.S. economy remains the model for the rest of the world. The indicators of this strength are many, but income mobility has always been a particular hallmark of the U.S. economy. This mobility is facilitated by our open and flexible economic environment, where there are relatively few obstacles to education, work, or innovation. Workers often change jobs in pursuit of better pay or to broaden their skills.

Indeed, the average American between the ages of 18 and 38 has held slightly more than 10 jobs. The bulk of these job changes are voluntary and increase the wages of the job changers. When we read about the American workers or American families earning the median income, let's remember that many of them are on their way up the income ladder.

Millions of Americans, and generations of immigrants, have been able to ascend this ladder because of the opportunities derived from our economy's growth. And while income mobility can be downward as well as upward, what is significant is the volume of mobility. Among families with the lowest 20 percent of incomes, about half move to a higher income classification within ten years. Similarly, about half of the families with the highest 20 percent of incomes had not been there ten years before. Behind these numbers are countless stories of individual achievement that reflect our dynamic economy and our dynamic workforce.

That in my judgment is the hallmark of our economic system, and we need to work to ensure that all Americans continue to have the opportunities to realize their full potential. From the position of strength we enjoy today, we can address the longer-term challenges that will face our economy in the years to come. These include:

- Reforming entitlement programs.
- Advancing energy security.

- Maintaining and strengthening trade and investment policies that benefit American workers.
- And addressing issues of wage growth and uneven income distribution.

Before I begin, I know there is always interest in the Treasury Secretary's views on the dollar. I believe that a strong dollar is in our nation's interest and that currency values should be determined in open and competitive markets in response to underlying economic fundamentals.

So you will see me continue to focus on policies that maintain and strengthen confidence in the U.S. economy and increase productivity. These policies must deal with our long-term challenges.

The biggest economic issue facing our country is the growth in spending on the major entitlement programs: Medicare, Medicaid, and Social Security. The cost to the federal government of these three programs, without fundamental reform, is projected to more than double, from the current level, 8 percent of GDP, to nearly 17 percent by 2060. If left unchecked these programs would significantly impair our economic flexibility and erode our competitiveness.

Demographics don't lie and demographics aren't partisan. Social Security was created in 1935. Today, people are living longer than they did in 1935, yet Social Security's basic structure has barely changed. Just 3.3 workers are paying into the system to support each beneficiary, while 16 workers did so in 1950. The President put forward a plan last year to strengthen and modernize Social Security. The longer we wait to fix this problem the more limited will be the options available to us, the greater the cost and the more severe the economic impact on our nation.

The financial burdens associated with Medicare and Medicaid are larger and even more complex. Like Social Security, they are linked to the aging of America, and the good news of our increased life expectancy. But they are complicated further by the rapidly rising cost of health care and the structure of our health-care system, which is riddled with inefficiencies and poorly-aligned incentives.

I've only been Treasury Secretary for a short time. In my first days in office, many in Washington have told me that reform of entitlement programs is just too difficult to achieve. They tell me that politicians will demagogue this issue and use it as a political weapon.

I have always tried to live by the philosophy that when there is a big problem that needs fixing, you should run toward it, rather than away from it. That is one of the reasons I decided to come to Washington, and that is the reason I admire the President's political courage and willingness to address entitlement reform. The entitlement challenge is difficult, but it is fixable. And given our expanding economy we can approach the issue from a position of strength.

So the President has instructed me to work with Congress on a bipartisan basis to find workable solutions – solutions that will help to keep our economy competitive in the years, and decades to come – and solutions that should not place an unfair burden on future generations. These solutions should be built on what we can agree on, not what divides us.

Another serious long-term structural challenge is energy security. Today this is top of mind for many Americans because they are paying about three dollars per gallon at the gas pump – a cost that generates real hardship for all those who are trying to make ends meet. These prices are largely attributable to a strong global economy that brings with it an increasing demand for oil, particularly in rapidly growing and developing emerging markets such as China and India.

The fact that our economy has remained strong in the face of these high oil prices is a testament to its remarkable resilience. The global demand for oil is outstripping supply and we as a nation have a long-term structural problem:

- We consume much more oil than we produce.
- We are too dependent on foreign sources of oil.
- And too much of it comes from troubled parts of the world.

And this will still be true if gas prices decline.

The President and this Administration are focused on this problem, and have made important proposals and progress in a number of areas. But everyone I have talked with, from the President, to Sam Bodman, our Secretary of Energy, to Senators and Congressman on both sides of the aisle, agree that much more has to be done. It is a major long-term challenge and one we need to fix through a comprehensive approach. We need to do more on the supply side, and we need to do more to conserve energy. In addition, we need to do much more in terms of investing in new technologies and further developing alternative sources of energy, including nuclear power and ethanol. In doing so, we need to encourage market-based solutions. Moreover, an energy policy that takes us toward greater energy security should also lead to cleaner air and cleaner water.

We also need to expand opportunities for American workers and businesses to compete in the global economy. The goods we export – from corn to computers – create high-paying jobs for millions of Americans. And foreign investments in our country are responsible for more than five million U.S. jobs. Simply put, we need to continue working to open markets abroad, and to keep our own markets open.

As Treasury Secretary I will be a strong advocate for free trade and will encourage other countries to open their markets to American goods, services, and capital. When I travel to Asia early this fall trade will be a top agenda item. The world is a competitive place. And if we are to retain our competitive advantage, we need to welcome competition, and not run away from it.

But I must tell you, in all candor, that I am very concerned about the anti-trade rhetoric I hear coming from some quarters here and around the world. I have spent my career advising clients on international matters, working in U.S. and foreign capital markets, and investing in countries around the globe -- ranging from developing countries like China, to highly-developed economies, such as those in Japan and Germany.

If this experience has taught me anything it is that nations that reform their economies, and open themselves to trade and competition, benefit their own citizens greatly. They see more jobs and higher living standards. And those nations that don't take these steps are left behind. But in many countries – even those that have seen the greatest gains from open markets – there is a disturbing wave of protectionism. A number of countries are increasingly viewing market access as something that should apply to someone else's home market and not their own.

Sadly, I have seen this mindset paralyze the Doha round of global trade negotiations. I know the President and U.S. trade negotiators led by U.S. Trade Representative Susan Schwab have worked doggedly to achieve a balanced, multilateral agreement, and we will continue to try to find a way to move forward with the global negotiations. At the same time, we will continue to press for liberalization through important regional and bilateral agreements.

I firmly believe that this country benefits as much from trade as any country in the world. The challenge is how best to convey the benefits of trade to the American people. Unfortunately the clear benefits of trade – such as stronger economic growth, more jobs, and a higher standard of living for Americans – are broader, sometimes take longer to manifest themselves and are less visible than some of the immediate dislocations which are linked to trade.

These dislocations are very real and painful, such as when an individual factory closes and hard-working men and women lose their jobs. The answer, however, is not new trade restraints, which hurt all Americans, but rather thinking more creatively about how we can be more competitive and how we can assist those who face hardships.

The final challenge I will touch on today is wage growth and income distribution. There is no question that the strong economic growth of recent years has made people better off than they would have been in a low-growth or no-growth environment.

But we still have challenges, and amid this country's strong economic expansion, many Americans simply aren't feeling the benefits. Many aren't seeing significant increases in their take-home pay. Their increases in wages are being eaten up by high energy prices and rising health-care costs, among others.

But we must also recognize that, as our economy grows, market forces work to provide the greatest rewards to those with the needed skills in the growth areas. This means that those workers with less education and fewer skills will realize fewer rewards and have fewer opportunities to advance. In 2004, workers with a bachelor's degree earned almost $23,000 more per year, on average, than workers with a high school degree only. This gap has grown more than 60 percent since 1975.

This trend dates back many years, and was evident in the recovery of the 1990s. It is simply an economic reality, and it is neither fair nor useful to blame any political party. It stems from a number of factors, including technology and U.S. integration with the global economy. Rather than playing the blame game, we must focus on helping workers move up the economic ladder.

The first priority must be to keep our economy strong, which helps create new and better opportunities for all Americans. But, we also need to continue our focus on helping people of all ages pursue first-rate education and retraining opportunities, so they can acquire the skills needed to advance in a competitive worldwide environment. As you know, this has been one of the President's major priorities. Moreover, if we can keep our economy growing, and maintain the gains in productivity, this should drive increases in living standards. That was certainly the experience in the 1990s, when income growth eventually followed increases in employment and productivity.

And while that was a period of high productivity growth – 2.5 percent per year – today it is even higher, averaging more than 3 percent since 2001. In many ways, productivity is fundamental to the long-term strength and competitiveness of the U.S. economy and the financial well-being of all Americans.

As we focus on how to translate our economic growth to greater take-home pay, let's not confuse the facts. As I said earlier, the President's tax cuts energized the economy, and federal taxes take a smaller bite out of people's paychecks. And while part of the benefit of these tax cuts is being masked by higher energy prices and rising health-care costs, among others, Americans still have more money in their pockets because of the President's tax cuts.

Now, I can't give a speech on the economy without talking about the federal deficit, given how much discussion there is of the issue. The recent surge in tax revenues has driven the deficit down to just 2.3 percent of our gross domestic product – about the same as the average over the past 40 years and putting the Administration well ahead of the President's goal to cut the deficit in half by 2009. This is even more noteworthy given that it has occurred while we have been financing a war and bearing the costs of devastating hurricanes on the Gulf coast.

We've made progress, but the deficit is still too large. I wish it were less and I am working with my colleague and friend Rob Portman, the Director of the Office of Management and Budget, to restrain federal spending. But let's be honest with each other. The big budget issue is the longer-term structural entitlements challenge staring us in the face.

And the decision we make on this issue will not only be vitally important to the future of our country, but of great interest and importance to people around the world, particularly business school students like you who live in developing countries. This was driven home to me six or seven years ago when I spoke at a

Chinese business school, before a standing-room only audience in a large auditorium.

As I recall, I was feeling somewhat guilty because on the advice of my Beijing colleagues I was reading – and not particularly well, I might add – a very long prepared text, which seemed, at least to me, to be rather boring. If I had done something like this at CBS, Wharton, or Harvard Business School, the students would have been streaming out of the room 10 minutes into the speech. But these students listened in total silence; you could have heard a pin drop.

After the speech, I was flooded with questions. And, as I was leaving, I was mobbed for autographs. I was beginning to think I was a rock star or at least a dynamic public speaker! But then it dawned on me . . . I was just a window on U.S. capitalism. These students were in awe of our economic system and wanted to learn. For them, America is the beacon of capitalism and a model to be emulated. I don't expect you to be in awe of what you have always taken for granted. And I encourage you to be grateful for all that you have inherited and all that you can accomplish. Don't ever take it for granted. Because I can assure you that keeping a positive attitude and a sense of gratitude will go a long way in determining your future success, and ours as a nation.

PRESS ROOM

August 1, 2006
HP-42

Assistant Secretary to Hold
Quarterly Refunding Press Conference

U.S. Treasury Assistant Secretary for Financial Institutions Emil W. Henry, Jr. will hold a press conference to announce the results of the August quarterly refunding on Wed., Aug. 2 at 10:00 a.m. in Treasury's media room. Changes in Treasury's debt management policy are developed through the quarterly refunding process.

Media without Treasury press credentials should contact Frances Anderson at (202) 622-2960, or frances.anderson@do.treas.gov with the following information: name, Social Security number, and date of birth. To watch this event webcast live, please visit www.treas.gov.

Who
Assistant Secretary for Financial Institutions Emil W. Henry, Jr.

What
Quarterly Refunding Press Conference and Live Webcast

When
Wed., Aug. 2 10:00 a.m. (EDT)

Where
Treasury Department
Media Room - 4121
1500 Pennsylvania Ave., NW
Washington, DC

PRESS ROOM

August 2, 2006
HP-43

**Minutes Of The Meeting Of The
Treasury Borrowing Advisory Committee
Of The Bond Market Association
August 1, 2006**

The Committee convened in closed session at the Hay-Adams Hotel at 11:35 a.m. All Committee members were present except Ina Drew. Under Secretary Randy Quarles, Assistant Secretary Emil Henry, Deputy Assistant Secretary James Clouse and Office of Debt Management Director Jeff Huther welcomed the Committee and gave them the charge.

As background to the discussion of the questions in the charge, Director Huther began by briefly presenting the August Quarterly Refunding charts found at http://www.treas.gov/offices/domestic-finance/debt-management/qrc/2006/2006-q3-chart.pdf

The Committee then addressed the first question in the Committee charge (attached) regarding the development of a framework for evaluating Treasury's liability portfolio. Deputy Assistant Secretary Clouse presented a series of slides regarding Treasury efforts to develop an analytical framework for evaluating Treasury's portfolio choices on issues such as maturity composition, the appropriate mix of nominal versus inflation-protected securities, and other aspects of debt management.

DAS Clouse described the preliminary version of the model that the Office of Debt Management has been constructing. Key inputs to the model include GDP, CPI, deficits, nominal and real yield curves, interest-rate volatilities and the auction calendar. The model's independent variable is the mix and type of securities issued. Key outputs from this model are "steady state" (long-term) portfolio characteristics, mean and variance of interest costs, and debt turnover.

The model could be used to develop a baseline scenario from which alternative financing strategies can be evaluated. Some examples of the types of analytical measures that can be obtained from the model included debt-to-GDP ratio, mean interest cost, interest cost "smoothness", interest cost uncertainty, deficit uncertainty, and cash balance uncertainty. Once a baseline is established, Treasury could use the model to assess the impact of adding or eliminating new securities, altering the auction schedule, understanding the effects of changes in economic parameters, and better understanding of certain tail risks. DAS Clouse showed example charts where scenario analysis had been done assuming a short and longer-term bias in the maturity of securities issued by the Treasury.

In their discussion of the model, members suggested the need to better define model constraints, including capturing Treasury's desire for flexibility given the volatility of the fiscal situation. Another member suggested that deficit uncertainty is the biggest factor in this kind of model and getting a better sense on the link between GDP and tax receipts would be beneficial. It was also noted that the model appeared to be highly sensitive to interest-cost factors and that those factors would overwhelm the model outputs in a manner that may push Treasury to borrow

http://www.treas.gov/press/releases/hp43.htm short-term, without fully modeling the risks of shorter-term borrowing. Another member suggested that Treasury needs to better define forecast horizons, prioritize magnitudes of risk constraints including the nature of the risk (symmetrical or asymmetrical), and get a feel for the variance of the risks in order to have a more meaningful model, which would reflect Treasury's concern regarding rollover risk, tail events, and the need for a balanced portfolio.

One member asked why average maturity was not a factor in the model. Director Huther indicated that average maturity was a proxy for interest-cost volatility measures and that interest-cost volatility was measured directly in the model. DAS Clouse indicated that the model could be enhanced in the future to supply more metrics.

A member asked when Treasury thought the model would be out of the preliminary stages and in a production stage. DAS Clouse thought that the development of the model would be an evolving effort, where feedback from the Committee would be sought continuously, but that in 2007 a production model may be available.

The Committee then addressed the second question in the charge regarding shifting to a quarterly issuance cycle for 30-year bonds beginning in February 2007. Director Huther presented two slides describing the effects of quarterly bond issuance. The first slide highlighted the increase in the risk to dealers as measured by the dollar value of a basis point (DV01) and how that risk had increased since the reintroduction of the 30-year bond. The second slide showed the impact of quarterly issuance on the average maturity. Because of concern over minimum auction sizes necessary for liquidity, the total annual issuance of 30-year bonds would rise slightly from current levels if Treasury went to quarterly issuance, increasing average length.

The Committee began to discuss market activity in the long end. Some members felt that active trading was less important in the long-end of the market than at other points on the curve. There was fundamental demand for the bond from investors that want to buy and hold the bond which explains some of the lower trading volume. One member noted that market activity long-end was less about trading demand and more about hedging demand. Another member noted that international buying was occurring in the intermediate sector of the curve so there may be less volatility of demand at the long-end of the curve.

Members also noted that many corporate issuance hedgers had not rolled into the new 30-year bond but continued to hedge using the Feb 2031 issue. It was suggested that reason that hedgers had not rolled into the new bond was because hedgers know the investors that lend the Feb 2031 bonds and can more easily reverse in the bonds from those owners when they need them for hedging purposes.

Other members commented that active trading was still important in the long end and cautioned about going too low in auction sizes, noting that an active Treasury market supports swaps, futures markets and other financial derivatives markets.

Members noted that pension fund demand for bonds, while not as robust as the initial auction in February suggested it would be, would nevertheless constitute a strong source of demand at some future point.

Members generally felt that the market was not expecting quarterly issuance of 30-year bonds, and there was currently not overwhelming demand for 30-year bonds, but that markets were expecting Treasury to make a statement regarding the creation of a May/November coupon cycle so as to fill out the STRIPS market. To the degree that quarterly issuance is one means of creating a May/November cycle, the decision to do quarterly issuance would probably not shock the market. Another member suggested that having just brought the bond back in February, it may be too early to make the decision to go to quarterly issuance; that a decision so soon would perhaps run counter to Treasury's policy of "regular and predictable" changes in debt management. Another member suggested that going to quarterly issuance, which would involve increasing issue amounts, while borrowing needs were falling and bills outstanding were historically low, may be interpreted by some market participants as market timing by Treasury.

Next, the Committee was asked about the appropriate role of Treasury in deterring artificial reductions in the floating supply of particular securities in the Treasury market. Director Huther emphasized that Treasury recognizes the value of unfettered trading in the market, and that Treasury was largely concerned with appropriate responses when developments may impair market liquidity and ultimately increase the Treasury's cost of borrowing.

Director Huther outlined the current tools for addressing the artificial reductions in supply including "jawboning" i.e., talking with market participants, large position reporting, or reopening issues. The Committee generally felt that the market works very well and that the bar should be very high before there is intervention by Treasury, and that Treasury had the appropriate tools for dealing with this. One member noted that there are incentives to move away from highly regulated markets and that Treasury should not do anything to increase regulatory burdens. The Committee generally felt that the only time Treasury should step in is if there were systemic problems, such as significant amounts of fails.

Finally, the Committee discussed its borrowing recommendations for the August refunding and the remaining financing for this quarter as well as the October – December quarter. Charts containing the Committee's recommendations are attached.

The meeting adjourned at 12:50 p.m.

The Committee reconvened at the Hay-Adams Hotel at 6:00 p.m. All the Committee members were present except for Ina Drew. The Chairman presented the Committee report to Undersecretary Quarles. A brief discussion followed the Chairman's presentation but did not raise significant questions regarding the report's content.

The meeting adjourned at 6:20 p.m.

Jeff Huther
Director
Office of Debt Management
August 1, 2006

Certified by:

Thomas G. Maheras, Chairman
Treasury Borrowing Advisory Committee
Of The Bond Market Association
August 1, 2006

Attachments:
Treasury Borrowing Advisory Committee discussion charts

Treasury Borrowing Advisory Committee Quarterly Meeting
Committee Charge – August 1, 2006

Portfolio Composition

Treasury continues to develop a framework for evaluating our portfolio of marketable debt securities. Recognizing the limitations inherent in models of this sort, we would like the Committee's suggestions on the types of model outputs that would be useful in guiding future policymaking .

Thirty-Year Bond Auction Cycle Change

We seek the Committee's views on Treasury shifting to a quarterly issuance cycle for 30-year bonds beginning in February 2007. In the context of overall bond market conditions and the Committee's assessment of Treasury financing needs (we believe quarterly issuance would require slightly higher annual issuance to ensure adequate liquidity in the bond sector), does the Committee recommend issuing bonds quarterly or maintaining semi-annual issuance in 2007?

Role of Regulators in the Treasury Market

Several incidents over the past eighteen months suggest that the incentive to artificially reduce the supply of Treasury securities in the financing market has risen with the increases in short term rates. While we recognize the value of unfettered trading in the market, we are also concerned that at times these developments may impair market liquidity and ultimately increase the Treasury's cost of borrowing. We would like the Committee's views on the appropriate role of Treasury in deterring artificial reductions in supply.

Financing this Quarter

We would like the Committee's advice on the following:

- The composition of Treasury notes to refund approximately $22.4 billion of privately held notes and bonds maturing or called on August 15, 2006.
- The composition of Treasury marketable financing for the remainder of the July-September quarter, including cash management bills
- The composition of Treasury marketable financing for the October-December quarter.

http://w

PRESS ROOM

August 3, 2006
hp-44

Treasury Assistant Secretary Fratto to Hold Weekly Press Briefing

Treasury Assistant Secretary for Public Affairs Tony Fratto will hold the weekly media briefing on Monday, August 7 in Main Treasury's Media Room. The event is open to all credentialed media

- **Who** Assistant Secretary for Public Affairs Tony Fratto
- **What** Weekly Briefing to the Press
- **When** Monday, August 7, 11:15 AM (EDT)
- **Where** Treasury Department
  Media Room (Room 4121)
  1500 Pennsylvania Ave., NW
  Washington, DC

Note: Media without Treasury press credentials should contact Frances Anderson at (202) 622-2960, or frances.anderson@do.treas.gov with the following information: name, Social Security number, and date of birth.

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PRESS ROOM

August 3, 2006
hp-45

Treasury Designates Director, Branches of Charity Bankrolling Al Qaida Network

The U.S. Department of the Treasury today designated the Philippine and Indonesian branch offices of the Saudi-based International Islamic Relief Organization (IIRO) for facilitating fundraising for al Qaida and affiliated terrorist groups. Treasury additionally designated Abd Al Hamid Sulaiman Al-Mujil, the Executive Director of the Eastern Province Branch of IIRO in the Kingdom of Saudi Arabia.

"Abd Al Hamid Sulaiman Al-Mujil, a high-ranking IIRO official in Saudi Arabia, has used his position to bankroll the al Qaida network in Southeast Asia. Al-Mujil has a long record of supporting Islamic militant groups, and he has maintained a cell of regular financial donors in the Middle East who support extremist causes," said Stuart Levey, Treasury's Under Secretary for Terrorism and Financial Intelligence (TFI). "Today we are holding him to account."

The IIRO was established in 1978 and, according to its website, the organization has branch offices in over 20 countries in Africa, Europe, Asia, and the Middle East.

"It is particularly shameful when groups that hold themselves out as charitable or religious organizations defraud their donors and divert funds in support of violent terrorist groups," said Levey. "We have long been concerned about these IIRO offices; we are now taking public action to sever this link in the al Qaida network's funding chain."

Today's action was taken pursuant to Executive Order 13224, which is aimed at detecting and disrupting financial flows to terrorists. Under this authority, U.S. persons are prohibited from engaging in transactions with the designees, and any assets they may have under U.S. jurisdiction are frozen.

IDENTIFIER INFORMATION

Abd Al Hamid Sulaiman Al-Mujil

Abd Al Hamid Sulaiman Al-Mujil (Al-Mujil) is the Executive Director of the IIRO Eastern Province (IIRO-EP) branch office in the Kingdom of Saudi Arabia. Al-Mujil has been called the "million dollar man" for supporting Islamic militant groups.

Al-Mujil provided donor funds directly to al Qaida and is identified as a major fundraiser for the Abu Sayyaf Group (ASG) and Jemaah Islamiyah (JI). Both ASG and JI are al Qaida-associated terrorist groups in Southeast Asia designated pursuant to the authorities of E.O. 13224. These terrorist groups are also on the United Nations 1267 Committee's consolidated list of individuals and entities associated with the Taliban, al Qaida and/or Usama Bin Ladin.

In 2004, Al-Mujil invited a Philippines-based JI supporter to Saudi Arabia under the cover of traveling for the hajj (the Muslim pilgrimage), and planned to provide him with cash to carry back to the Philippines to support organizations including JI.

Al-Mujil was also present in Afghanistan in the late 1990s and personally knew Usama Bin Ladin and deceased al Qaida co-founder Abdallah Azzam. Al-Mujil traveled continuously to meet with members of Bin Ladin's organization in Arab countries. In the 1990s, Al-Mujil established a relationship with senior al Qaida operational planner Khalid Shaykh Muhammad.

Al-Mujil has a long history of providing support to terrorist organizations. He has contributed direct financial assistance to ASG leaders, including Abdurajak Janjalani (deceased).

The Indonesian and Philippines branches of IIRO have received support from IIRO-EP, which in turn is controlled by Al-Mujil. Indeed, he is often responsible for authorizing payment transfers for IIRO Philippines (IIRO-PHL) and IIRO Indonesia (IIRO-IDN).

Name: Abd al-Hamid Sulaiman Al-Mujil

AKAs:

- Dr. Abd al-Hamid Al-Mujal
- Dr. Abd Abdul-Hamid bin Sulaiman Al-Mu'jil
- Dr. Abd Al-Hamid Al-Mu'ajjal
- Abd al-Hamid Mu'jil
- A.S. Mujel
- Abu Abdallah

DOB: 28 April 1949
Nationality: Saudi Arabian

International Islamic Relief Organization, Philippines Branch Offices

The IIRO-PHL is a source of funding for the al Qaida-affiliated ASG. IIRO-PHL has served as a liaison for the ASG with other Islamic extremist groups. A former ASG member in the Philippines familiar with IIRO operations in the country reported that a limited amount of foreign IIRO funding goes to legitimate projects and the rest is directed to terrorist operations.

The Philippine branches of the IIRO were founded sometime in the late 1980s or early 1990s by Muhammad Jamal Khalifah, who is Usama bin Laden's brother-in-law and has been identified as a senior al Qaida member. IIRO-PHL's director, Abd al-Hadi Daguit, is a trusted associate of Khalifah.

While working as the director of IIRO-PHL, Khalifah maintained close connections with al Qaida through his relations with senior al Qaida supporters, including Specially Designated Global Terrorist (SDGT) Wa'el Hamza Julaidan. At the time Khalifah directed the IIRO-PHL, he employed an ASG intelligence officer as the provincial director of the IIRO-PHL in the Tawi-Tawi region of the Southern Philippines until that officer's death in 1994.

In the mid 1990s, a major ASG supporter, Mahmud Abd Al-Jalil Afif, served as the director of the IIRO-PHL and used the organization to funnel money to terrorist groups including the ASG. Afif was implicated in the assassination of Father Salvatore Carzeda in San Jose Gusu, Zamboanga City, Philippines on June 20, 1992.

AKAs:

- International Islamic Relief Agency
- International Relief Organization
- Islamic Relief Organization
- Islamic World Relief
- International Islamic Aid Organization
- Islamic Salvation Committee
- IIRO

- The Human Relief Committee of the Muslim World League
- World Islamic Relief Organization
- Al Igatha Al-Islamiya
- Hayat al-Aghatha al-Islamia al-Alamiya
- Hayat al-Igatha
- Hayat Al-`Igatha
- Ighatha
- Igatha
- Igassa
- Igasa
- Igase
- Egassa

Address: International Islamic Relief Organization, Philippines Offices
201 Heart Tower Building
108 Valero Street
Salcedo Village, Makati City
Manila, Philippines

Other Locations: Zamboanga City, Philippines
Tawi Tawi, Philippines
Marawi City, Philippines
Basilan, Philippines
Cotabato City, Philippines

International Islamic Relief Organization, Indonesia Branch Office
The IIRO Indonesia director has channeled money to two Indonesia-based, JI-affiliated foundations. Information from 2006 shows that IIRO-IDN supports JI by providing assistance with recruitment, transportation, logistics, and safe-havens. As of late 2002, IIRO-IDN allegedly financed the establishment of training facilities for use by al Qaida associates.

AKAs:

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- Hayat al-Igatha
- Hayat Al-`Igatha
- Ighatha
- Igatha
- Igassa
- Igasa
- Igase
- Egassa

Address: International Islamic Relief Organization, Indonesia Office
Jalan Raya Cipinang Jaya No. 90
East Jakarta, 13410, Indonesia

P.O. Box 3654
Jakarta, Indonesia 54021

PRESS ROOM

August 3, 2006
hp-46

Remarks of David G. Nason
Deputy Assistant Secretary, Financial Institutions Policy
U.S. Department of the Treasury

Before the National Organization of Life and Health Insurance Guaranty Associations

Baltimore, MD - Thank you for that kind introduction Charlie. It is a real pleasure for me to be here today. I appreciate the opportunity to be back together to talk about insurance issues and about what is generally happening at the Treasury.

These are interesting and fascinating times to be at the Treasury Department. As you know, we have a newly-minted Secretary – Henry "Hank" Paulson. I can report that the Department is buzzing with excitement and enthusiasm about out new leader. Secretary Paulson is extremely energetic and he has high expectations for the Department going forward. We are very fortunate that he heeded the call to public service and I very much look forward to working with him to ensure that the U.S. financial system remains the most competitive in the world.

Treasury is spending more time studying insurance regulation and the insurance marketplace than it has in the past. Some of this is required – Congress gave us the responsibility to implement and manage the Terrorism Risk Insurance Program, and some of it is simply because we at Treasury recognize that insurance plays a critical and growing role in our financial marketplace.

I would like to use my time here today to talk about a few things. First, from my initial meeting with Charlie to now, I can report that I have learned much about the state-based guaranty system and its many merits and benefits. Second, I want to share with you some of Treasury's most recent thinking about modernization of the insurance regulatory system. Lastly, I want to talk briefly about terrorism insurance.

Role of State Guaranty System

As Treasury considers the various approaches to modernization of insurance regulation, one thing is clear -- the state guaranty fund system has worked well as a mechanism to protect our nation's insurance consumers.

As a devout believer in our free-market system, I recognize that insolvencies in the insurance business like in any other businesses are a fact of life. Not surprisingly, the historical causes of insurance company insolvencies vary greatly. Common causes have included incompetent management, outright fraud, bad investments, or the mismatching of assets to insurance liabilities. These factors are not unique to insurance, of course, but, like other "safety net" businesses, insurance insolvencies are viewed differently by some. This was not always the case, however. For a very long time, policyholders of failed insurance companies were largely left without real recourse, with no independent protection mechanism.

It was not until the 1960s where our citizenry made the decision that it was unacceptable to leave policyholders unprotected, and the notion of "insuring insurance" through state guaranty funds began to spread. In 1969, the National Association of Insurance Commissioners (NAIC) adopted a Post-Assessment Property and Liability Insurance Guaranty Association Model Act, and in 1970 adopted a similar model act for the life and health industry. The guaranty fund movement was spurred in the 1980s by a tidal wave of insurance insolvencies, but it was not until 1992 that all states, the District of Columbia and Puerto Rico enacted guaranty fund legislation for life/health insurance companies.

Since that time, guaranty funds have been able to react under crisis conditions to events of insolvency, and have constantly reinvented themselves to fulfill their mission. The guaranty fund system withstood the Baldwin-United Corporation bankruptcy and its resulting effects. These events, of course, were the reasons that NOLHGA was created (under the auspices of the ACLI). At this point, it was clear that the specter of any large, multistate insolvency could create an untenable situation with individual state guaranty funds operating independently of one another.

The real test for the system came in 1991 – generally referred to as the "year from hell" for the guaranty fund system. There were 23 new multi-state insolvencies that year – an all-time record. However, the system met the challenges through creativity and was able to put together coordinated rehabilitation plans for three major life insurance companies: Executive Life, Guarantee Security Life, and Mutual Benefit Life. These events spurred legislative proposals supporting the creation of a federal guaranty system and complete federal preemption of insurance regulation.

For a variety of reasons, these proposals failed and the state guaranty system survived. Because of the good work of your organizations, the state guaranty fund system has continued to develop and mature.

You are probably wondering why I chose to spend a few minutes summarizing the history of the state guaranty system at a conference hosted by a state-guaranty association. The reason is simple. While there are passionate views on virtually all aspects of the modernization debate – the viability and merit of the state guaranty system is rarely, if ever, called into question. This is important for Treasury to recognize as we continue to think about the complex issues in and around insurance regulation.

Insurance Regulatory Modernization

As most of you know, Treasury recently provided some views on insurance regulatory modernization in testimony before the Senate Banking Committee. As the Administration's principal voice on financial markets and financial institutions issues, Treasury pointed out that the issues surrounding insurance regulation are significant because the U.S. financial services industry is one of our country's most important areas of economic activity, and the insurance industry is a large part of the U.S. financial sector. Indeed, total assets held by U.S. insurance companies totaled $5.6 trillion, as compared with $11.82 trillion for the banking sector, and $10.5 trillion for the securities sector.

As we all know, insurance performs an essential function in our overall economy by providing a mechanism for businesses and the general population to safeguard their assets from a wide variety of risks. Insurance is also like other financial services in that its cost, safety, and ability to innovate and compete are heavily affected by both the substance and structure of its system of regulation.

The regulatory system for the insurance industry should be consistent with the efficient and cost-effective provision of its services, and there appears to be virtually no disagreement that the current insurance regulatory system needs to be modernized.

Treasury has been closely monitoring the developments of the various approaches to modernizing insurance regulation – ranging from the self-initiated approaches of state regulators and the NAIC; the establishment of federal standards for the harmonization of state insurance rules (the SMART Act, or a more modest incremental approach as reflected in a recent House bill which is limited to surplus lines and reinsurance); or the establishment of an optional federal charter (OFC) embodied in Senators Sununu and Johnson's bill, the National Insurance Act of

2006. While Treasury has not made a decision as to which approach would be most appropriate, everyone seems to agree that a thorough review is in order. We are in the process of that evaluation now.

As we examine approaches to modernizing insurance regulation, two of the main issues that Treasury is focusing on are:

- Potential economic inefficiency, resulting both from the substance of regulation (such as price controls), but also from its structure (multiple non-uniform regulatory regimes); and

- International impediments, both questions of comity (facilitating international firms' operations in the US) and competitiveness (facilitating US firms' operations abroad).

At the most fundamental level, the question posed in each of these areas is whether our current state-based system of insurance regulation is up to the task of meeting the challenges of today's evolving and increasingly global insurance market.

It makes sense that the Treasury would focus some of its attention on potential inefficiencies created by price controls. If a mandated price is set above a market clearing price, the result will be surpluses. If a mandated price is set below a market clearing price, the result will be shortages. The latter outcome is what we generally observe in insurance markets with strict price controls. When insurers are unable to charge what they feel is an adequate rate for their product, they generally tighten their underwriting standards in order to limit their writings to preferred risk, and thus be less likely to suffer additional insured losses.

One of the key aspects of inefficiency associated with price controls is reduced competition. Price controls might seem to benefit consumers by keeping insurance costs low and states have developed a system of residual markets to address shortages when prices are suppressed below market clearing levels. However, under residual market structures where insurers within a particular state share in the costs associated with providing coverage in the residual market, as the size of the residual market grows the number of insurers willing to undertake business within a given state may decrease. A reduction in the number of insurance companies operating within a particular state lessens competition and innovation, which in turn impacts the efficiency of the market.

We, mostly through the efforts of our colleagues in International Affairs, are also focusing on the global consequences of our current insurance regulatory system. While all insurance companies that are licensed to operate in the U.S. are subject to the same regulatory standards, foreign firms likely find adapting to such standards more difficult. From the international perspective, foreign officials have noted during bilateral financial regulatory discussions that our insurance market has at least 50 different regulators, and they or their insurance companies have no single regulator to coordinate with on insurance matters.

The U.S. insurance market, in particular the global nature of insurance, is vastly different than it was six decades ago when McCarran-Ferguson was enacted. We must acknowledge some of the good work the NAIC is doing to attempt to address these issues. The NAIC engages in regulatory cooperation with international insurance regulators and through Memoranda of Understanding, and supports individual members by providing technical assistance to regulatory agencies. The NAIC also coordinates closely with Office of the U.S. Trade Representative in international financial services negotiations, and it participates in Treasury's financial markets regulatory dialogues with various countries, including China, Japan, and the EU.

To sum up, there is significant work underway in international insurance regulation to reflect the changes taking place in the U.S. and global insurance markets. In evaluating proposals to modernize our system of insurance regulation, we, too, need to consider what will best serve us in maintaining an insurance marketplace that attracts capital and does not set up artificial and costly barriers.

And, although it has not been the primary focus of our attention, as we consider these issues, we have to understand fully and appreciate how the state guaranty funds will be affected by the various proposals. This is a very complex issue that requires significant attention. Both the SMART Act and the Senate OFC approach maintain the current state guaranty fund system, but each takes different approaches.

The SMART Act has an entire title devoted to the receivership of insurance companies. The state guaranty fund system appears to be "built-in" to the SMART Act, which defines a "guaranty association" as "an insurance guaranty fund or association or any similar entity now or hereinafter created by state statute to pay, continue, or otherwise assure payment of, in whole or in part, the contractual claim obligations of impaired or insolvent insurers or health maintenance organizations." It is our understanding that this approach seems workable but further refinements might be necessary such as requiring more coordination and cooperation among regulators, receivers, and guaranty funds.

The Senate's OFC approach is quite different. It requires that an insurer that opts for a federal charter must become and continue to be a member of the state guaranty funds in each "qualified" state in which it does business. In order to be "qualified," a state must have a guaranty fund based on the NAIC models for guaranty funds. If a national insurer were to do business in a "non-qualified" state, then that insurer would have to become a member of the National Insurance Guaranty Corporation (NIGC). This concept of triggering a NIGC is similar to the approach taken in the Gramm-Leach Bliley Act, which provided for the triggering of the National Association of Registered Agents and Brokers if states did not accomplish a required degree of reciprocity in the licensing of agents. The NIGC is an effort to require the states to adopt the NAIC models without technically preempting state law.

These are not easy issues and, as we go forward with our analysis, we would appreciate your assistance. Like our overall position on insurance regulatory modernization, we do not have a particular view on which guaranty fund approach is best. Whatever option is ultimately pursued, care should be taken not to disrupt something that is working efficiently for the benefit of consumers.

To sum up, it is clear to us, and we think it is to most observers, that our current system of insurance regulation requires modernization to meet our current challenges. The existing system of regulation has the potential to lead to inefficient economic outcomes. That raises the cost and reduces the supply of insurance products to consumers. It may deter international participation in our domestic markets and creates obstacles to our own insurance firms' international expansion. These are all important issues that we look forward to working on in the coming months and years.

Terrorism Risk Insurance

Now let me turn another key insurance issue – terrorism risk insurance. Following the significant economic dislocation that occurred in the wake of the September 11 attacks, the President and Congress acted by passing the Terrorism Risk Insurance Act of 2002, known as "TRIA." TRIA ensured the continued widespread availability and affordability of commercial property and casualty terrorism coverage by basically placing the government in the reinsurance business.

In June of last year, Treasury delivered to Congress its report on the effectiveness of TRIA. Treasury concluded that TRIA had been effective in achieving its fundamental goal of enhancing the availability and affordability of commercial property and casualty terrorism risk insurance, including allowing time for rebuilding the capacity of the private sector.

The Administration laid out its key principles before it would accept any extension of TRIA. These were:

- a temporary extension
- encourage the private insurance market to develop innovative solutions and build capacity, and
- reduce exposure to taxpayers.

Congress acted, and on December 22, 2005, President Bush signed into law an extension of TRIA. The extension addressed many of the necessary changes sought by the Administration: the extension of the Program was limited to two-years (now expires on December 31, 2007); insurer retentions were increased to encourage greater private sector participation (both through higher deductibles and increased co-payments); and certain lines of insurance where the private sector appears capable of managing terrorism risk were removed from the Program.

A provision in the TRIA extension requires an analysis by the President's Working Group on Financial Markets (PWG) regarding the long-term availability and affordability of terrorism insurance, including group life coverage and coverage for chemical, nuclear, biological, and radiological events. The PWG's report is due to Congress by September 30 of this year.

There is or was some confusion about whether the PWG was created solely to write this report. The PWG was created by executive order by President Reagan in 1988 in response to the 1987 stock market crash. Following the issuance of its report in 1988 and follow-up work in 1991, the Working Group became largely inactive until 1994 when, at the urging of Congress and others, it was reactivated by the Secretary of the Treasury. Since that time, it has met on a regular basis. The PWG is chaired by the Secretary of the Treasury and includes the chairs of the Federal Reserve Board, the Securities and Exchange Commission, and the Commodity Futures Trading Commission.

For the report on terrorism insurance, the PWG is required to consult with the NAIC, industry and policyholder stakeholders. As a means of meeting this consultation requirement in the most efficient and most transparent manner, and given the short time frame to complete the report, Treasury, as chair of the PWG, published a Notice in the Federal Register seeking comments concerning the long-term availability of terrorism risk insurance. The Notice asked a number of specific questions targeted at key factors such as reinsurance availability, modeling improvements, pricing decisions, and the interaction with state regulations. Some specific examples of the questions we asked include:

- In the long-term, what are the key factors that will determine the amount of private-market insurer and reinsurer capacity available for terrorism risk insurance coverage and how will this evolve in the long-term?
- What improvements have taken place in the ability of insurers to price terrorism risk insurance, including the development and use of modeling?
- To what extent have alternate risk transfer methods (*e.g.*, catastrophe bonds or other capital market instruments) been used for terrorism risk insurance, and what is the potential for the long-term development of these products?
- Have state approaches made coverage more or less available and affordable, such as through permitted exclusions and rate regulation? To what extent will the long-term availability and affordability of terrorism risk insurance be influenced by state insurance regulation?

The nature of these questions should indicate the importance of the PWG's task. Especially given our limited timeframe, this is not an easy analysis to perform. We received about 40 detailed responses to our Notice. The responses have proved very useful as the PWG moves forward. In addition, we have been responsive to calls for additional outreach. The PWG has also met with insurance regulators, policyholder groups, insurers, reinsurers, modelers, and other governmental agencies to gather further information. We look forward to completing our work on this important issue and reporting our findings to Congress within the statutory timeframe. At Treasury, we recognize that there will be ample debate going forward about the proper role, if any, for the federal government in the terrorism insurance marketplace.

As you can see, we have a lot on our plate at the Treasury Department. These are exciting times to be here and I am thankful for the opportunity to serve. Thank you for having me here today, and I would be happy to take a few questions.

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PRESS ROOM

August 2, 2006
hp-47

Treasury Announces Entry into Force of Protocol Amending U.S.-Sweden Income Tax Treaty

WASHINGTON, DC - The Treasury Department today announced that the protocol amending the income tax treaty between the United States and Sweden will enter into force August 31, 2006. Under the terms of the protocol, each country is required to notify the other when its constitutional requirements for entry into force have taken place, with the protocol entering into force on the thirtieth day after the second of the required notifications. This process was completed by the delivery of the second such notification on the first of August.

The protocol amends the existing U.S.-Sweden tax treaty, which was concluded in 1994, and takes into account developments over the last decade. The protocol provides for the elimination of source-country withholding taxes on certain intercompany dividends and certain dividends paid to pension funds. The protocol also reflects a modernization of the anti-treaty shopping rules.

The United States and Sweden signed the protocol at a ceremony at the State Department on September 30, 2005. The United States Senate gave advice and consent to ratification of the protocol on March 31, 2006.

With the entry into force of the protocol on August 31, 2006, the protocol generally will be effective for taxable periods beginning on or after January 1, 2007. The provisions of the protocol relating to withholding taxes will be effective for amounts paid or credited on or after October 1, 2006.

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PRESS ROOM

August 7, 2006
HP-48

Joint Statement of Treasury Secretary Henry M. Paulson Jr., and Commerce Secretary Carlos M. Gutierrez on Colombian and Western Hemisphere Democracy and Progress

"Today, the people of Colombia are celebrating the inauguration of President Alvaro Uribe, who has continued his country's journey on the path of democracy, peace and prosperity. Colombians should be proud of their fight against terrorism and narco-traficking, and of the strength of their democracy as demonstrated by their recent open and fair elections. The Colombian people have also wisely linked their future to promoting economic freedom and investment so as to raise living standards. And they have supported President Uribe's work to strengthen public finances, reduce inflation, and target public spending to reach the poor. Colombia's record has shown the effectiveness of these policies for reducing poverty as well as for sustaining growth. The United States will continue to support Colombia on its historic journey.

"Indeed, over the last few decades positive change has swept throughout the Hemisphere, expanding democracy, the rule of law, economic reforms and social justice. While some would turn the clock back to an undemocratic past of restricted freedoms, and stunted economies, today the vast majority of people in the Americas live in democracy, peace, and increasing opportunity.

"The march of hemispheric progress will continue, and it remains the responsibility of democracies to nurture and support the spread of liberty.

"We salute the freedom loving people of Colombia and the region for their struggle to build free and democratic societies."

- 30 -

\ugust 8, 2006
:006-8-8-9-42-55-14739

U.S. International Reserve Position

The Treasury Department today released U.S. reserve assets data for the latest week. As indicated in this table, U.S. reserve assets :otaled $67,792 million as of the end of that week, compared to $67,814 million as of the end of the prior week.

I. Official U.S. Reserve Assets *(in US millions)*

	July 28, 2006			August 4, 2006		
TOTAL	67,814			67,792		
1. Foreign Currency Reserves [1]	Euro	Yen	TOTAL	Euro	Yen	TOTAL
a. Securities	11,949	11,043	22,992	12,088	11,097	23,185
Of which, issuer headquartered in the U.S.			0			0
b. Total deposits with:						
b.i. Other central banks and BIS	11,879	5,390	17,269	12,021	5,415	17,436
b.ii. Banks headquartered in the U.S.			0			0
b.ii. Of which, banks located abroad			0			0
b.iii. Banks headquartered outside the U.S.			0			0
b.iii. Of which, banks located in the U.S.			0			0
2. IMF Reserve Position [2]			7,901			7,472
3. Special Drawing Rights (SDRs) [2]			8,611			8,658
4. Gold Stock [3]			11,041			11,041
5. Other Reserve Assets			0			0

II. Predetermined Short-Term Drains on Foreign Currency Assets

	July 28, 2006			August 4, 2006		
	Euro	Yen	TOTAL	Euro	Yen	TOTAL
1. Foreign currency loans and securities			0			0
2. Aggregate short and long positions in forwards and futures in foreign currencies vis-à-vis the U.S. dollar:						
2.a. Short positions			0			0
2.b. Long positions			0			0
3. Other			0			0

III. Contingent Short-Term Net Drains on Foreign Currency Assets

	July 28, 2006			August 4, 2006		
	Euro	Yen	TOTAL	Euro	Yen	TOTAL
Contingent liabilities in foreign currency			0			0
.a. Collateral guarantees on debt due within 1 year						
.b. Other contingent liabilities						
. Foreign currency securities with embedded options			0			0
. Undrawn, unconditional credit lines			0			0
.a. With other central banks						
!.b. With banks and other financial institutions						
leadquartered in the U.S.						
!.c. With banks and other financial institutions						
leadquartered outside the U.S.						
!. Aggregate short and long positions of options in oreign						
Currencies vis-à-vis the U.S. dollar			0			0
4.a. Short positions						
4.a.1. Bought puts						
4.a.2. Written calls						
4.b. Long positions						
4.b.1. Bought calls						
4.b.2. Written puts						

Notes:

I/ Includes holdings of the Treasury's Exchange Stabilization Fund (ESF) and the Federal Reserve's System Open Market Account SOMA), valued at current market exchange rates. Foreign currency holdings listed as securities reflect marked-to-market values, and deposits reflect carrying values. Foreign Currency Reserves for the latest week may be subject to revision. Foreign Currency Reserves for the prior week are final.

2/ The items, "2. IMF Reserve Position" and "3. Special Drawing Rights (SDRs)," are based on data provided by the IMF and are valued in dollar terms at the official SDR/dollar exchange rate for the reporting date. The entries for the latest week reflect any necessary adjustments, including revaluation, by the U.S. Treasury to IMF data for the prior month end.

3/ Gold stock is valued monthly at $42.2222 per fine troy ounce.

PRESS ROOM

August 8, 2006
HP-49

Treasury Announces Entry into Force of U.S.-Bangladesh Income Tax Treaty

WASHINGTON, DC – The Treasury Department announced today that Deputy Treasury Secretary Robert M. Kimmitt and Finance Minister of the People's Republic of Bangladesh Md. Saifur Rahman exchanged instruments of ratification for the U.S.-Bangladesh Income Tax Convention on August 7, 2006. This exchange of instruments brings the tax treaty into force.

The United States and Bangladesh signed the tax treaty at a ceremony in Dhaka, Bangladesh on September 27, 2004. The United States Senate gave advice and consent to ratification of the treaty on March 31, 2006.
At the exchange, Deputy Secretary Kimmitt stated, "Treasury is pleased to bring this agreement into force on behalf of the United States, as it will help to reduce tax barriers to cross-border investment as well as stimulate new investment and development – all critical components to long-term U.S. economic strength and sustainability."

With the entry into force of the treaty on August 7, 2006, the treaty generally will be effective for taxable periods beginning on or after January 1, 2007. The provisions of the treaty relating to withholding taxes will be effective for amounts paid or credited on or after October 1, 2006.

PRESS ROOM

August 9, 2006
HP-50

Statement of Treasury Secretary Henry M. Paulson on John L. Weinberg

I was saddened this week to learn of the passing of John Weinberg. John was a trusted friend and mentor and my thoughts and prayers are with his family.

I was fortunate to have had the opportunity to work with and learn from John throughout my career. He was an innovative and dedicated leader who provided over fifty years of service to Goldman Sachs.

Most importantly, John preserved the firm's integrity and values set in place by his father, Sidney Weinberg, Goldman's chairman from 1930-1969. He will also be remembered for his devotion to service – to his colleagues, to his community, and to his country.

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PRESS ROOM

August 9, 2006
hp-51

Treasury Secretary Paulson to attend APEC finance ministers meetings in Hanoi, Vietnam

Treasury Secretary Henry Paulson will travel to Hanoi, Vietnam to attend the finance ministers meeting of the Asia-Pacific Economic Cooperation Forum (APEC) on September 7-8.

Secretary Paulson will use this opportunity to expand on our dialogue with the major economies in the Asia-Pacific region. He will emphasize the importance of continued economic reform, underline the importance of trade liberalization – including in the financial sector, and encourage greater efforts to thwart the financing of terrorism.

In addition to bilateral meetings with his counterparts attending the APEC meetings, Secretary Paulson expects to meet with Vietnamese officials who are leading the country's reform program and integration into the global economy.

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PRESS ROOM

August 9, 2006
HP-52

-UPDATED-
Media Advisory: Treasury Secretary Paulson to Visit Chicago

Washington, D.C.--Treasury Secretary Henry M. Paulson will travel to Chicago, IL on Friday, August 11 to discuss the U.S. economy with market participants and business owners.

While in Chicago, the Secretary will visit the Chicago Board of Options Exchange, Chicago Board of Trade, and the Chicago Mercantile Exchange. The Chicago market exchanges play a crucial role in allocating capital in our economy. America's deep, liquid, efficient capital markets help to keep the U.S. economy the most dynamic and resilient in the world.

Secretary Paulson will also meet with small business owners to discuss current economic conditions. The following events are open to credentialed media:

WHAT	Chicago Board of Options Exchange Opening Bell Ceremony and Floor Tour
WHEN	8:25 a.m. CDT
WHERE	400 LaSalle, Chicago, IL
CONTACT	Sharon Stanciel, 213-786-7702, stanciel@cboe.com

***

WHAT	Chicago Board of Trade Floor Tour
WHEN	9:45 a.m. CDT
WHERE	141 West Jackson Blvd., Chicago, IL
CONTACT	Maria Gemski, 312-341-3257, mgem46@cbot.com

***

WHAT	Chicago Mercantile Exchange Floor Tour
WHEN	11:15 a.m. CDT
WHERE	30 South Wacker Drive, Chicago, IL
CONTACT	Collen Lazar, 312-930-8218, clazar@cme.com

***

WHAT	Lunch with Small Business Owners
WHEN	12:00 p.m. CDT
WHERE	Shaw's Crab House, 21 East Hubbard Street, Chicago, IL
NOTE	Photos at top; press must arrive by 12:00 p.m. (CDT)

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PRESS ROOM

To view or print the Microsoft Word content on this page, download the free Microsoft Word Viewer.

August 10, 2006
HP-53

Quarles Announces Intent to Return to Private Sector after Long Treasury Service, Accomplishments

Treasury Secretary Henry Paulson today praised the accomplishments of Under Secretary of the Treasury for Domestic Finance Randal K. Quarles during his service to the Bush Administration. Mr. Quarles, who served in senior roles at the Treasury since August 2001, submitted his resignation to the President effective on the adjournment of the 109th Congress. Before serving as Under Secretary, Mr. Quarles was Assistant Secretary of the Treasury for International Affairs (2001-2005) and U.S. Executive Director of the International Monetary Fund (2001-2002).

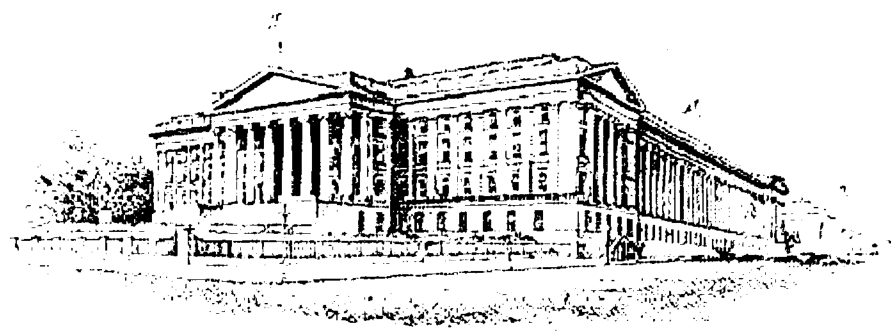
"Randy has played a major role in an unusually broad range of matters – from the Argentine debt default to terrorism risk insurance, and from Chinese currency flexibility to GSE reform," said Secretary Paulson. "I was disappointed to learn when I arrived that Randy had long planned to return to the private sector around the time of this year's mid-term elections, but I am fortunate that he has agreed to be very active in helping me formulate my policy agenda, and over the long term I will continue to rely on his advice and counsel."

Mr. Quarles has played a major role in some of the most significant economic policy issues faced by the Treasury during the Bush Administration, including:

- Response to the Argentine debt default
- Chinese currency flexibility
- Government-sponsored enterprise reform (Fannie Mae and Freddie Mac)
- Investment policy, acting as Treasury's point person on the Committee on Foreign Investment in the United States from 2001-2005
- Pension reform, acting as Treasury's board representative to the PBGC from 2005-2006
- Iraqi and Afghan economic reconstruction
- Debt relief and increased grant aid for the world's poorest countries, including negotiation of the historic HIPC debt relief agreement reached in London in 2005
- Extension of the Terrorism Risk Insurance Act
- Negotiation of the financial services provisions of six free trade agreements
- Development of the finance initiatives for four G8 summits, for which he served as Finance Sous-Sherpa
- Reform of collective action provisions in sovereign debt workouts
- The U.S./E.U. financial services dialogue, which he led and which brought the Federal Reserve, the SEC, and the European Commission together to resolve cross-border financial regulatory issues such as those raised by Sarbanes-Oxley
- Reintroduction of the 30-year Treasury bond
- Representation of the Treasury in a host of international forums over many years, including the G7, the G10, the G20, the IMF, the OECD, and the Financial Stability Forum

REPORTS

- Quarles Resignation Letter



DEPARTMENT OF THE TREASURY
OFFICE OF PUBLIC AFFAIRS

August 10, 2006

Dear Mr. President:

I am honored to have had the opportunity to serve in your administration for the last five years as U.S. Executive Director of the IMF, Assistant Secretary of the Treasury for International Affairs, and currently as Under Secretary of the Treasury for Domestic Finance. My service in these roles has been a great privilege, and I am proud of the contribution my colleagues and I have been able to make. As I stressed when asked to extend my work at the Treasury into the second term of your administration, however, the burdens of this lengthy public service on my family have been great, and I noted then that it would be time for me to return to the private sector around the date of the mid-term elections. In line with those discussions, and in order to allow for the selection of a successor and an appropriate transition, I am now submitting my resignation as Under Secretary of the Treasury, which I would propose be effective when the 109th Congress adjourns.

The last five years have been challenging and eventful ones for the economy and the financial system. At the Treasury, we dealt with severe financial stress in a number of emerging markets, including the Argentine sovereign bond default, the largest in history. We took steps to improve the mechanism for collective action in sovereign debt workouts. We maintained an important dialogue with the EU on financial sector matters that addressed cross-border complications of our evolving financial regulations. We undertook the financial diplomacy that began China's movement to greater currency flexibility. We reached agreement to relieve the HIPC countries' unsustainable burdens of debt and to increase aid in the form of grants. And we put together an international coalition to freeze terrorist assets as well as negotiating the reduction of Iraq's debt burden by 80%.

We have also worked to promote investment and job creation, from both domestic and international capital; to improve the resiliency of the financial sector to both physical and financial shocks; to develop an appropriate policy response to the issues surrounding terrorism risk insurance; to increase transparency in the government's financial accounting; to refine our debt management practices, including the reintroduction of the 30-year Treasury bond; and to improve our financial regulatory system, including addressing the systemic risks associated with the activities of the housing GSEs.

I am honored to have had a role in all these efforts, and to have had your confidence and the confidence of Secretaries O'Neill, Snow, and Paulson in executing that role. I am particularly honored to have worked with my relentlessly dedicated and enormously professional colleagues on the Treasury staff, who are one of our country's great national assets. Thank you again for the privilege of serving under your leadership.

Sincerely,

Randal K. Quarles

The President
The White House
Washington, D.C.

PRESS ROOM

August 4, 2006
HP-54

Treasury Announces Entry into Force of Protocol Amending U.S.-Sweden Income Tax Treaty

WASHINGTON, DC - The Treasury Department today announced that the protocol amending the income tax treaty between the United States and Sweden will enter into force August 31, 2006. Under the terms of the protocol, each country is required to notify the other when its constitutional requirements for entry into force have taken place, with the protocol entering into force on the thirtieth day after the second of the required notifications. This process was completed by the delivery of the second such notification on the first of August.

The protocol amends the existing U.S.-Sweden tax treaty, which was concluded in 1994, and takes into account developments over the last decade. The protocol provides for the elimination of source-country withholding taxes on certain intercompany dividends and certain dividends paid to pension funds. The protocol also reflects a modernization of the anti-treaty shopping rules.

The United States and Sweden signed the protocol at a ceremony at the State Department on September 30, 2005. The United States Senate gave advice and consent to ratification of the protocol on March 31, 2006.

With the entry into force of the protocol on August 31, 2006, the protocol generally will be effective for taxable periods beginning on or after January 1, 2007. The provisions of the protocol relating to withholding taxes will be effective for amounts paid or credited on or after October 1, 2006.

PRESS ROOM

August 10, 2006
HP-55

Assistant Secretary for Terrorist Financing
Pat O'Brien
Prepared Remarks
--The President's New International Initiative to Combat Kleptocracy--

One of the key missions of the U.S. Treasury Department is to safeguard the U.S. and international financial systems against financial crime. A critical component of this charge is ensuring that the international financial system is not available to kleptocrats seeking to transfer their ill-gotten gains.

The importance of this mission is not only recognized by the United States, but also our partners around the globe. Indeed, the G8 Leaders just last month underscored this importance by committing "to prosecute acts of corruption and to prevent(ing) corrupt holders of public office from gaining access to the fruits of their kleptocratic activities in our financial systems."

Treasury, together with the Departments of Justice and State, actively assist countries seeking to recover official assets looted by kleptocrats. At the request of foreign governments, or pursuant to UN Security Council Resolutions and U.S. laws and executive orders, Treasury financial investigators can provide key support in identifying and tracing looted assets belonging to foreign countries. In certain cases Treasury can also be granted specific authority to freeze kleptocrats and their networks out of the US financial system.

For example, on June 19, 2006, President Bush issued Executive Order 13405 – Blocking the Property of Certain Persons Undermining Democratic Processes or Institutions in Belarus – which explicitly incorporated kleptocratic behavior in Belarus as a basis for designation.

This targeted measure serves as an example of the means available to the U.S. Government to deter other public officials from using the international financial system to move the proceeds of grand scale corruption.

A large part of the Treasury Department's anti-kleptocracy efforts involve working to close the vulnerabilities in the financial system. Treasury continues to forge a coalition of international financial centers to strengthen our ability to detect illicit use of the financial system by kleptocrats and other illicit actors.

Treasury does this through such means as bilateral technical assistance, as well as coordination with international financial institutions, the Financial Action Task Force, and the UN and other international organizations. Indeed, playing a critical role is the FATF, which is the premier international inter-governmental organization for the development and promotion of national and international policies, standards, and norms to combat money laundering and terrorist financing. The FATF standards recognize and reflect the close nexus between money laundering and corruption, as kleptocrats moving their corruption proceeds routinely need to launder funds in order to hide the true origins of their funds and move monies from their home country.

The FATF, along with the International Monetary Fund and the World Bank, assesses countries' compliance with the anti-money laundering and counter-terrorist financing standards (AML/CFT). These standards include recommendations requiring enhanced due diligence for politically exposed persons in order to identify and prevent the transfer of the illicit proceeds of kleptocrats. Ensuring international compliance with these standards is an important step in ensuring that kleptocrats do not profit from their criminally derived proceeds.

With Treasury leadership, the IMF and World Bank endorsed the inclusion of comprehensive AML/CFT assessments as a regular part of all financial sector assessments and ongoing surveillance. Treasury also supports World Bank and IMF efforts to provide technical assistance to strengthen AML/CFT regimes worldwide. The frequency of technical assistance programs has increased in recent years, in part due to U.S. leadership within the G-7 and the international financial institutions.

Treasury – through the FinCEN, the U.S. financial intelligence unit (FIU) – also improves countries' capacity through conducting assessments of, providing training programs and briefings for, and engaging in personnel exchanges with foreign FIUs. FinCEN also provides AML/CFT financing training and other support to partner international policymakers and regulators.

Finally, Treasury recognizes that an important final piece to our national strategy against kleptocrats is establishing an appropriate mechanism for the return of assets. The Treasury applauds the World Bank Group's efforts to explore its role in the restitution of looted assets and the responsible management of these recovered assets.

Treasury understands that protecting the financial system from abuse by kleptocrats – among other illicit financiers – is integral to international financial stability and global security and to this end, we continue to work for closer bilateral and international cooperation. Preventing kleptocrats, terrorists, proliferators, and other rogue actors from using the financial system to bankroll their agendas is truly a critical component of our national and economic security.

PRESS ROOM

August 11, 2006
HP-56

Treasury Assistant Secretary Fratto to Hold Weekly Press Briefing

Treasury Assistant Secretary for Public Affairs Tony Fratto will hold the weekly media briefing on Monday, August 14 in Main Treasury's Media Room. The event is open to all credentialed media.

Who
Assistant Secretary for Public Affairs Tony Fratto

What
Weekly Briefing to the Press

When
Monday, August 14, 11:15 AM (EDT)

Where
Treasury Department
Media Room (Room 4121)
1500 Pennsylvania Ave., NW
Washington, DC

Note
Media without Treasury press credentials should contact Frances Anderson at (202) 622-2960, or frances.anderson@do.treas.gov with the following information: name, Social Security number, and date of birth.

PRESS ROOM

August 9, 2006
HP-57

Remarks by Deputy Secretary Robert M. Kimmitt at Singapore National Day and Singapore Armed Forces Day Reception

Washington, DC – Ambassador Chan, Excellencies, my friend Secretary Jim Nicholson, Ladies and Gentlemen - I am honored to speak on the occasion of Singapore's 41st birthday and the 38th annual celebration of the Singapore Armed Forces. Since 1965, when the Lion City became an independent nation, we have cooperated closely and effectively to advance economic development, stability, and security in the Asia-Pacific region. Few bilateral relationships have been as important or mutually rewarding, and no one personifies the friendship between Singapore and the United States better than Chan Heng Chee. A year ago today, Ambassador Chan received Singapore's Meritorious Service Medal, the highest award that can be conferred on National Day. She is truly one of the leaders of the diplomatic establishment in Washington and just completed a decade of outstanding service as ambassador. Madame Ambassador, thank you for your service in the interests of both our countries.

Singapore and the United States are both "melting pots" that have built successful multi-ethnic societies by harnessing the energy and talents of our diverse populations. We share a commitment to good governance, the rule of law, and open economic systems that improve lives by promoting growth. During its formative years, Singapore had the wisdom and courage to open its markets to foreign trade and investment. Over the past four decades, Singapore has achieved extraordinary economic growth, and its four million citizens now enjoy a standard of living that would have appeared impossible in 1965.

Singapore and the United States continue to exercise leadership in breaking down barriers to trade and investment in the Asia-Pacific region. Already, the Free Trade Agreement between our countries has become an international example of a high-quality FTA. The agreement has helped our bilateral trade increase by about 25% since 2003, and Singapore is now one of our dozen largest trading partners. Though bilateral and regional initiatives are part of the solution, a successful conclusion to the WTO Doha Development Round is also essential.

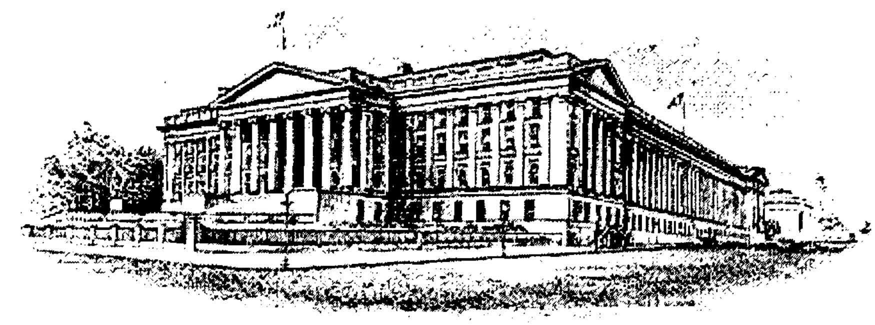
Investment is also a cornerstone of our economic relationship. Singapore owns and operates businesses in the United States that provide good jobs for American workers, and many American firms operate profitably in Singapore. The Treasury Department and Administration remain firmly committed to an open investment policy that protects security and promotes growth in both of our economies. We want our partners, like Singapore, to know that the United States is open for business and open to foreign investment.

Of course, economic growth depends on more than sound economic policy. In addition to excellent relations between our military services, Singapore and the United States have been closely aligned in fighting terrorism and the conditions that feed terrorist groups. The Treasury Department and Singaporean colleagues have enjoyed strong cooperation combating illicit activities of all kinds, including those associated with North Korea.

The United States and Treasury Department are committed to Singapore and to Southeast Asia. Next month, Secretary Paulson will travel to Hanoi for the APEC Finance Ministers' Meeting. The Secretary will also visit Singapore for the World Bank/IMF meetings. The international financial institutions need to reflect the reality of Asia's increased importance in the global economy. The United States has helped lead the effort to give Asian economies greater voice in the IMF, and we hope to see it bear fruit in Singapore.

We are also increasing our direct engagement with Singapore and its ASEAN neighbors. This year, the Treasury Department intends to establish a post for a financial representative to Southeast Asia. I have the pleasure of introducing her this evening: Susan Baker is an accomplished financial expert with years of Southeast Asian experience. Before joining the Treasury, she worked in the region as a World Bank consultant, as a financial analyst in the private sector, and with the Indonesian Ministry of Finance through a Harvard University program.

Singapore has long recognized the benefits of a strong U.S. presence and engagement in Asia. Prime Minister Lee has said that American security forces and political influence helped provide the conditions under which developing Asian economies like Singapore could flourish. Thus, even as China, India, and other economies grow, the United States can and will continue to serve as a force for stability and growth in Asia. In that endeavor, as for the past 41 years, we will have no more valued partner than Singapore.



U.S. TREASURY DEPARTMENT OFFICE OF PUBLIC AFFAIRS

EMBARGOED UNTIL 9 a.m. (EDT), August 15, 2006
CONTACT Brookly McLaughlin (202) 622-2920

TREASURY INTERNATIONAL CAPITAL DATA FOR JUNE

Treasury International Capital (TIC) data for June are released today and posted on the U.S. Treasury web site (www.treas.gov/tic). The next release date, which will report on data for July, is scheduled for September 18, 2006.

Net foreign purchases of long-term securities were $75.1 billion.

- Net foreign purchases of long-term domestic U.S. securities were $84.7 billion. Of this, net purchases by foreign official institutions were $2.3 billion and net purchases by private foreign investors were $82.4 billion.

- U.S. residents purchased a net $9.6 billion in foreign securities.

Foreigners' Transactions in Long-Term Securities with U.S. Residents
(Billions of dollars, not seasonally adjusted)

				12 Months Through					
		2004	2005	Jun-05	Jun-06	Mar-06	Apr-06	May-06	Jun-06
1	Gross Purchases of Domestic Securities	15178.9	17175.0	16170.8	18198.6	1681.4	1371.7	1919.8	1674.8
2	Gross Sales of Domestic Securities	14262.4	16164.3	15293.8	17126.1	1592.6	1310.6	1835.6	1590.1
3	**Domestic Securities Purchased, net** (line 1 less line 2) /1	**916.5**	**1010.7**	**877.1**	**1072.6**	**88.9**	**61.1**	**84.2**	**84.7**
4	**Private, net /2**	**680.9**	**889.5**	**712.6**	**959.0**	**88.0**	**39.5**	**85.8**	**82.4**
5	Treasury Bonds & Notes, net	150.9	270.0	146.7	211.0	9.2	-7.6	21.8	31.4
6	Gov't Agency Bonds, net	205.7	187.8	187.9	227.0	15.1	9.6	26.1	18.5
7	Corporate Bonds, net	298.0	353.1	327.7	413.4	46.2	34.3	36.3	37.7
8	Equities, net	26.2	78.7	50.3	107.6	17.5	3.2	1.5	-5.2
9	**Official, net**	**235.6**	**121.1**	**164.5**	**113.6**	**0.9**	**21.5**	**-1.6**	**2.3**
10	Treasury Bonds & Notes, net	201.1	69.2	120.3	31.3	-7.3	11.0	-13.6	-4.4
11	Gov't Agency Bonds, net	20.8	32.0	28.1	48.0	3.9	5.5	8.5	4.4
12	Corporate Bonds, net	11.5	19.0	15.1	25.0	2.6	1.7	2.4	1.1
13	Equities, net	2.2	1.0	0.9	9.3	1.6	3.4	1.2	1.3
14	Gross Purchases of Foreign Securities	3123.1	3681.4	3208.0	4586.4	455.1	398.7	537.6	445.6
15	Gross Sales of Foreign Securities	3276.0	3854.0	3401.7	4760.8	474.2	412.8	558.2	455.2
16	**Foreign Securities Purchased, net** (line 14 less line 15) /3	**-152.8**	**-172.6**	**-193.8**	**-174.4**	**-19.1**	**-14.1**	**-20.6**	**-9.6**
17	Foreign Bonds Purchased, net	-67.9	-45.1	-91.9	-55.8	-7.1	-6.0	-15.6	-10.3
18	Foreign Equities Purchased, net	-85.0	-127.5	-101.8	-118.7	-12.0	-8.1	-4.9	0.7
19	**Net Long-Term Flows** (line 3 plus line 16)	**763.6**	**838.1**	**683.3**	**898.2**	**69.7**	**46.9**	**63.6**	**75.1**

/1 Net foreign purchases of U.S. securities (+)
/2 Includes International and Regional Organizations
/3 Net U.S. purchases of foreign securities (-)

PRESS ROOM

ɟust 15, 2006
)6-8-15-12-8-11-26799

U.S. International Reserve Position

ɜ Treasury Department today released U.S. reserve assets data for the latest week. As indicated in this table, U.S. reserve assets ɜled $67,253 million as of the end of that week, compared to $67,792 million as of the end of the prior week.

I. Official U.S. Reserve Assets *(in US millions)*

	August 4, 2006			August 11, 2006		
TOTAL		67,792			67,253	
Foreign Currency Reserves [1]	**Euro**	**Yen**	**TOTAL**	**Euro**	**Yen**	**TOTAL**
Securities	12,088	11,097	23,185	11,956	10,912	22,868
f which, issuer headquartered in the U.S.			0			0
Total deposits with:						
i. Other central banks and BIS	12,021	5,415	17,436	11,900	5,324	17,224
.ii. Banks headquartered in the U.S.			0			0
.ii. Of which, banks located abroad			0			0
.iii. Banks headquartered outside the U.S.			0			0
.iii. Of which, banks located in the U.S.			0			0
. IMF Reserve Position [2]			7,472			7,467
. Special Drawing Rights (SDRs) [2]			8,658			8,652
. Gold Stock [3]			11,041			11,041
. Other Reserve Assets			0			0

II. Predetermined Short-Term Drains on Foreign Currency Assets

	August 4, 2006			August 11, 2006		
	Euro	**Yen**	**TOTAL**	**Euro**	**Yen**	**TOTAL**
1. Foreign currency loans and securities			0			0
2. Aggregate short and long positions in forwards and futures in foreign currencies vis-à-vis the U.S. dollar:						
2.a. Short positions			0			0
2.b. Long positions			0			0
3. Other			0			0

III. Contingent Short-Term Net Drains on Foreign Currency Assets

	August 4, 2006			August 11, 2006		
	Euro	Yen	TOTAL	Euro	Yen	TOTAL
Contingent liabilities in foreign currency			0			0
ı. Collateral guarantees on debt due within 1 year						
). Other contingent liabilities						
Foreign currency securities with embedded options			0			0
Undrawn, unconditional credit lines			0			0
a. With other central banks						
b. With banks and other financial institutions						
eadquartered in the U.S.						
c. With banks and other financial institutions						
eadquartered outside the U.S.						
Aggregate short and long positions of options in ıreign						
urrencies vis-à-vis the U.S. dollar			0			0
.a. Short positions						
.a.1. Bought puts						
.a.2. Written calls						
.b. Long positions						
.b.1. Bought calls						
.b.2. Written puts						

Notes:

/ Includes holdings of the Treasury's Exchange Stabilization Fund (ESF) and the Federal Reserve's System Open Market Account ƷOMA), valued at current market exchange rates. Foreign currency holdings listed as securities reflect marked-to-market values, and eposits reflect carrying values. Foreign Currency Reserves for the latest week may be subject to revision. Foreign Currency leserves for the prior week are final.

/ The items, "2. IMF Reserve Position" and "3. Special Drawing Rights (SDRs)," are based on data provided by the IMF and are alued in dollar terms at the official SDR/dollar exchange rate for the reporting date. The entries for the latest week reflect any ecessary adjustments, including revaluation, by the U.S. Treasury to IMF data for the prior month end.

ı/ Gold stock is valued monthly at $42.2222 per fine troy ounce.

PRESS ROOM

August 15, 2006
HP-59

Department of the Treasury
2006 - 2007 Priority Guidance Plan
Joint Statement by:
Eric Solomon
Deputy Assistant Secretary (Regulatory Affairs)
U.S. Department of the Treasury
Mark W. Everson
Commissioner
Internal Revenue Service

We are pleased to announce the release of the 2006 - 2007 Priority Guidance Plan.

In Notice 2006-36, we solicited suggestions from all interested parties, including taxpayers, tax practitioners, and industry groups. We recognize the importance of public input to formulate a Priority Guidance Plan that focuses resources on guidance items that are most important to taxpayers and tax administration.

The 2006 - 2007 Priority Guidance Plan contains 264 projects to be completed over a twelve-month period, from July 2006 through June 2007. In addition to the items on this year's plan, the Appendix lists the more routine guidance that is published each year.

In 2002, we began issuing updates to the Priority Guidance Plan during the plan year. We intend to update and republish the Priority Guidance Plan periodically again this year to reflect additional guidance that we intend to publish during the plan year. The periodic updates allow us flexibility throughout the plan year to consider comments received from taxpayers and tax practitioners relating to additional projects and to respond to developments arising during the plan year. For example, we updated the 2005 - 2006 Priority Guidance Plan to reflect the publication of substantial guidance providing relief relating to last year's hurricanes, the announcement of a global tax shelter settlement initiative and an announcement describing the Compliance Assurance Process pilot program. In the past, we have updated the Priority Guidance Plan to add projects necessary to implement recently enacted tax legislation. We will continue to evaluate the priority of each guidance project in light of developments arising during the 2006 - 2007 plan year.

The published guidance process can be fully successful only if we have the benefit of the insight and experience of taxpayers and practitioners who must apply the rules. Therefore, we invite the public to continue to provide us with their comments and suggestions as we write guidance throughout the plan year.

Additional copies of the 2006 - 2007 Priority Guidance Plan can be obtained from the IRS website on the Internet at http://www.irs.gov/pub/irs-utl/2006-2007pgp.pdf. Copies can also be obtained by calling Treasury's Office of Public Affairs at (202) 622-2960.

PRESS ROOM

August 15, 2006
HP-60

Treasury Designates Two Syrian Officials

The U.S. Department of the Treasury today named two individuals Specially Designated Nationals (SDNs) of Syria pursuant to Executive Order 13338, which is aimed at financially isolating individuals and entities that are directly or significantly contributing to Syria's support for designated terrorist groups, or its military or security presence in Lebanon, or that are acting for or on behalf of other SDNs of Syria.

"For decades, Syria has promoted instability and violence in the Middle East. Even after its withdrawal from Lebanon last year, Syria continues to choose destabilization and support for violence over peace in the region," said Pat O'Brien, Treasury's Assistant Secretary for Terrorist Financing. "Until Syria takes concrete steps to become a responsible member of the international community, the United States will make known rogue actors supporting the country's destabilizing agenda."

Major General Hisham Ikhtiyar has been designated for significantly contributing to the Syrian Government's support for designated terrorist organizations, including Hizballah, the Popular Front for the Liberation of Palestine-General Command (PFLP-GC), and Palestinian Islamic Jihad (PIJ). During his leadership of the Syrian Government's General Intelligence Directorate (GID), Ikhtiyar directed GID activities that significantly contributed to the Syrian Government's military and security presence in Lebanon.

Additionally, the Treasury designated today Brigadier General Jama'a Jama'a, who significantly contributed to the Syrian Government's military and security presence in Lebanon while serving as commander at the Syrian Military Intelligence (SMI) headquarters in Beirut, Lebanon. SMI is the primary entity responsible for coordinating and implementing the Syrian Government's policies in Lebanon.

Today's designation freezes any assets the designees may have located in the United States, and prohibits U.S. persons from engaging in transactions with these individuals.

Identifying Information

Major General Hisham Ikhtiyar
AKAs:
Hisham Ahmad al-Ikhtiyar
Hisham al-Ikhtiyar
Hisham al Ikhtiyar
Hisham al Ikhteyar
Hisham Ikhteyar
Hisham Bakhtiyar
Hisham Ichtijar
Hisham Bakhtiar

Address:
Maliki, Damascus, Syria

DOB:
1941

Ikhtiyar has served as a senior advisor to Syrian President Bashar al-Asad. Ikhtiyar was the director of the GID from December 2001 until June 2005, when he was appointed by Asad to be director of Syria's Ba'ath Party Regional Command National Security Bureau (NSB).

As the central civilian intelligence service in Syria, the GID conducts surveillance of the Syrian population at large, directs foreign intelligence, and monitors activities in Lebanon.

The NSB coordinates the work of Syria's intelligence agencies, including the GID. The primary mission of the NSB is to formulate strategic political and security recommendations for President Asad.

During Ikhtiyar's tenure as GID director, the GID in Lebanon maintained active informant networks and carried out intelligence operations. Also during Ikhtiyar's tenure in 2004, PIJ was in regular contact with Syrian security organizations in order to secure logistical support. The GID under Ikhtiyar is believed to have provided logistical support to the PFLP-GC.

Brigadier General Jama'a Jama'a
AKAs:
Jami Jami
Jamea Kamil Jamea
Jama' Jama'
Jam'i Jam'i

DOB:
16 June 1954

POB:
Jablah, Zama, Syria

In his role as commander at SMI's headquarters in Beirut, Lebanon, Jama'a Jama'a acted for or on behalf of SDN Rustum Ghazali, designated for his role in the Syrian Government's continued support for terrorism and his contribution to the Syrian Government's security and military presence in Lebanon. Ghazali was head of the SMI in Lebanon from late 2002 until the Syrian withdrawal in April 2005.

Background on Executive Order 13338

President George W. Bush signed E.O. 13338 on May 11, 2004 in response to the Syrian government's continued support of international terrorism, sustained occupation of Lebanon, pursuit of weapons of mass destruction and missile programs and undermining of U.S. and international efforts in Iraq. Syria's acts threaten the national security, foreign policy and economy of the United States.

The Order declared a national emergency with respect to Syria, and authorized the Secretary of the Treasury to block the property of certain persons and directing other U.S. Government agencies to impose a ban on exports to Syria.

The Treasury may designate individuals and entities found to be or to have been:

- Directing or otherwise significantly contributing to the Government of Syria's provision of safe haven to or other support for any person whose property or interests in property are blocked under United States law for terrorism-related reasons, including, but not limited to, Hamas, Hizballah, Palestinian Islamic Jihad, the Popular Front for the Liberation of Palestine, the Popular Front for the Liberation of Palestine-General Command, and any persons designated pursuant to Executive Order 13224 of September 23, 2001;
- Directing or otherwise significantly contributing to the Government of Syria's military or security presence in Lebanon;
- Directing or otherwise significantly contributing to the Government of Syria's pursuit of the development and production of chemical, biological, or nuclear

weapons and medium- and long-range surface-to-surface missiles;

- Directing or otherwise significantly contributing to any steps taken by the Government of Syria to undermine United States and international efforts with respect to the stabilization and reconstruction of Iraq; or
- Owned or controlled by, or acting or purporting to act for or on behalf of, directly or indirectly, any person whose property or interests in property are blocked pursuant to this order.

Click the following link for the full text of E.O. 13338:
http://www.whitehouse.gov/news/releases/2004/05/20040511-6.html

PRESS ROOM

August 16, 2006
hp-61

Remarks of Anna Escobedo Cabral U.S. Treasurer
U.S. Department of the Treasury
At the Treasurer's Forum on Financial Literacy and Education
Before the American Numismatic Association World's Fair of Money

Thank you. I am thrilled to be in Denver today. I greatly appreciate your interest and thank you for taking time out of your busy schedule to join me.

I am also especially grateful to the American Numismatic Association and to Chris Cipoletti for this fantastic opportunity – an opportunity to tell you a little bit about some of the financial education initiatives in Treasury's focus– efforts that provide access to tools that can help people make wiser money management decisions for each stage of their life.

I will just spend a few minutes highlighting our work in this area – and then I would of course invite you to ask me any questions related to the Department's Financial Education efforts.

Quite frankly, Treasury is greatly involved in questions of managing money – our agency is involved in collecting and distributing public funds. So, it is no wonder that this function provides us with a unique and ideal opportunity to be a significant voice and provide education to the public in this area. In fact, this opportunity has created an ideal platform for Treasury to advance the task of enhancing federal financial education materials, as well as enhancing coordination of federal efforts focused on improving financial literacy levels across the country. Here are just a few ways we are doing so.

Treasury's financial education team understands that maintaining an open discussion about this issue is one important way to improve our efforts in this regard. And we acknowledge that it is crucial for the federal government to maintain that open line of communication with state and local governments, as well as the nonprofit, private and public sectors. It is necessary if we are to continue to work together toward building our knowledge about the personal finance needs of the people of this country, particularly in the context of our growing economy.

Treasury takes a lead role in facilitating a national dialogue on improving financial education. Working in concert with other federal agencies, we are working hard to provide our citizens with the right tools that can teach them how to make sound financial decisions – decisions that can help people prepare for a secure financial future. How?

Here is one significant way. Treasury leads the efforts of a federal commission comprised of twenty federal agencies – the Financial Literacy and Education Commission. This Commission is tasked with harnessing existing federal financial education resources to improve financial literacy for all Americans.

There is general agreement among financial education advocates and many government and community leaders that education, and in particular personal financial savvy, can significantly help improve individual lives. Not only that, it is also important to helping our economy to continue to thrive.

That is why in December 2003, President Bush signed legislation establishing this federal commission – the Financial Literacy and Education Commission. As part of its work, in 2004 it launched a national financial education web site and national toll-free number – www.mymoney.gov and 1-888-mymoney.

I hope you take a moment to check out the mymoney.gov website. The information provided on that site is available in both English and Spanish. I encourage teachers, volunteers and community-based organization heads present here today to add this link to your websites.

There you will find a multitude of free federal resources on a whole host of personal finance topics including: budgeting, taxes, credit, financial planning, paying for education, retirement planning and more to just name a few.

Through the website and through the toll-free number, you have the option of ordering a sample of some of the publications that are available on the web. We call this package the "My Money Tool Kit". It has information to help you choose and use credit cards, get out of debt, protect your credit record, understand your Social Security benefits, insure your bank deposits, and start a savings and investing plan.

I should also mention that the Financial Literacy and Education Commission is led by the Secretary of the Treasury, Hank Paulson and this spring, Treasury and the 19 other members of this commission also released a strategy for financial education – "Taking Ownership of the Future; The National Strategy for Financial Literacy." This national strategy will be implemented through various Calls to Action at the end of each chapter at a separate portion of this conference.

The strategy looks at a variety of important topics, such as homeownership, credit management, retirement savings, and "banking the unbanked" – an issue that my office has currently been particularly focused on and is researching extensively.

It also describes the challenges and guideposts for possible solutions. Sometimes the solutions come from the Federal government, but often nonprofit organizations, businesses and other private sector players provide important resources for those wishing to learn more about financial matters.

It also puts forward examples of financial education programs that community leaders, business people, and volunteers can all look to as they design programs of their own to enhance financial literacy.

And at the end of each chapter in the strategy, you will notice that Calls to Actions are highlighted. It is our hope that these calls to Actions will provide a springboard for further open and inclusive discussion on a whole myriad of issues.

Finally, I'd like to share with you information about another very special campaign my office has been involved in – the Go Direct campaign.

About a year and half ago, the Treasury and Federal Reserve Banks launched a campaign called Go Direct, in Spanish known as Directo A Su Cuenta. Its focus is to motivate seniors to receive their Social Security benefits by direct deposit.

As the U.S. Treasurer, it has been a real privilege to be part of Go Direct and to teach eligible citizens about it.

Again, Go Direct focuses on motivating federal benefit recipients to sign up for direct deposit. It not only communicates the importance of direct deposit – it also provides the means by which seniors can make the switch from a paper check to direct deposit. We have a dedicated call center staffed by bilingual personnel ready to assist all beneficiaries. Since July 2005, almost 400,000 beneficiaries have signed up for direct deposit through the call center alone.

The call center is only one of many ways we are helping beneficiaries sign up for direct deposit. Our Web sites: www.GoDirect.org and www.DirectoASuCuenta.org, allows beneficiaries to access a step-by-step online tool to sign up – either on their own or through their bank or credit union.

It's a known fact that direct deposit is not only the most secure way for receiving Social Security benefits; it is also the most convenient way for all beneficiaries to have immediate access to their benefits. However, despite 95 percent of Americans having heard or read about identity theft, a survey sponsored by the U.S. Department of Treasury and the Federal Reserve Banks revealed that many are unaware of the security benefits of direct deposit over paper checks.

That is why I urge you to help us spread the word about this great free service. Keep in mind that direct deposit can also provide seniors receiving SSA payments with a sense of control of their money. This is true even under the most difficult circumstances. As you know Hurricane Katrina displaced tens of thousands of beneficiaries just days before their checks arrived in the mail. In uncertain times like these, enrolling in direct deposit can offer a much needed peace of mind to federal benefit recipients.

I hope this has provided you with some basic information for you to share with your friends, families and colleagues. I encourage you to help us get the word out about these valuable resources. Now, I won't ask you to share the money you've purchased and collected here today, but please do share the financial education information you've collected and share it with others. Education is an asset we should definitely help circulate too!

Thank you again for your time and attention. Now I would like to open up the floor to questions.

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PRESS ROOM

August 18, 2006
HP-62

Treasury Assistant Secretary Fratto to Hold Weekly Press Briefing

Treasury Assistant Secretary for Public Affairs Tony Fratto will hold the weekly media briefing on Monday, August 21 in Main Treasury's Media Room. The event is open to all credentialed media.

Who
Assistant Secretary for Public Affairs Tony Fratto

What
Weekly Briefing to the Press

When
Monday, August 21, 11:15 AM (EDT)

Where
Treasury Department
Media Room (Room 4121)
1500 Pennsylvania Ave., NW
Washington, DC

Note
Media without Treasury press credentials should contact Rowena Holloway at (202) 622-2960, or Rowena.holloway@do.treas.gov with the following information: name, Social Security number, and date of birth.

PRESS ROOM

August 18, 2006
hp-63

US Treasurer to Participate in Grassley's Iowa Women's Conference

U.S. Treasurer Anna Escobedo Cabral will visit West Des Moines, Iowa on Monday to participate in Senator Chuck Grassley's 2006 Women's Conference. The Treasurer will discuss current economic and financial education initiatives at the U.S. Treasury Department.

Who	U.S. Treasurer Anna Escobedo Cabral
What	Remarks on the Economy, Financial Education Initiatives
When	Monday, August 21 11:45 a.m. (CDT)
Where	Hy-Vee Conference Center 5820 Westown Parkway West Des Moines, Iowa

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PRESS ROOM

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August 18, 2006
hp-64

White House Economic Team Speaks with Reporters

Treasury Secretary Henry M. Paulson was joined today by OMB Director Rob Portman and CEA Chairman Edward Lazear for a conference call with reporters following their meeting with the President and his economic team at Camp David this morning. The economic team met Friday to discuss the Administration's agenda to maintain continued and strong economic growth.

A transcript of the call is attached.

REPORTS

- Transcript of Conference Call with Reporters

THE WHITE HOUSE

Office of the Press Secretary

For Immediate Release August 18, 2006

PRESS BRIEFING BY
SECRETARY HENRY PAULSON, DEPARTMENT OF TREASURY,
DIRECTOR ROB PORTMAN, OFFICE OF MANAGEMENT AND BUDGET,
AND CHAIRMAN EDWARD LAZEAR, COUNCIL OF ECONOMIC ADVISERS,
ON THE PRESIDENT'S MEETING WITH ECONOMIC ADVISORS

Via Teleconference

1:03 P.M. EDT

SECRETARY PAULSON: Good afternoon. I'm Hank Paulson, and the newest member of the economic team. This was my first session -- economic session at Camp David. And I found it particularly interesting and productive.

And what we did was, by getting out of Washington, D.C. and getting into a relaxing environment, I think we were able to have quite an interesting and productive session where we dug deeper into some of the longer-term issues, some of the complex issues we're dealing with. Now as you know, all of this was against the backdrop of an economy that's been performing well for some time now. We had a good discussion -- Ed Lazear began by talking about the economy, but most of the session was spent talking about some of the longer-term challenges.

The biggest section was on entitlement reform, so we talked a lot about that, and different approaches, the nature of the problem. We had a brainstorming session. We talked about the budget, we talked about tax reform, we talked about wage growth -- good discussion about that.

And what struck me -- my biggest takeaway here was how engaged the President was on all of these issues, and how well the team worked together and how well the discussion went.

So with that, as a backdrop, why don't I throw it open to questions?

Q Secretary Paulson, I wonder, considering the strength of the economy that you have referred to, and often refer to, why do you think that polls show that the public doesn't give the President more credit for managing a good economy?

SECRETARY PAULSON: That's, I think, the $64,000 question. And as I've thought about it, I think a big part of it relates to the fact that many Americans aren't feeling the benefit because they are clearly better off as a result of a strong economic growth and job creation. They're much better off than they would be if the economy were growing slower or weren't growing. But many of the Americans aren't feeling it in terms of their own economic situation. Part of this is a result of energy costs, health care, and so that's -- as I said, that's part of it.

I would be optimistic that if we can keep the job creation, keep making new jobs and productivity levels high, that you're going to see wage growth follow this. And we've seen some encouraging signs if you look over the last couple quarters. And that's part of it.

And then there's the other question which really -- or the other part of this, which I think relates to a trend that's been going on now for 20 years at least, which really has more to do with the integration of the U.S. into the global economy and technology, and that's that, clearly, we're seeing a trend that the greatest rewards are going to those who have the skills to really adapt to the opportunities in the economy. And so that's a trend. The answer to that is clearly education and training. But I think one thing we all feel pretty strongly about, that whatever the issues are we're dealing, we're dealing with -- it's easier to deal with them with a strong growing economy that's creating new jobs.

CHAIRMAN LAZEAR: May I just add a point just to Secretary Paulson -- the other thing I would say is that if we look at the behavior rather than the responses to polls, the behavior is consistent with a strong economy. We see consumption being high. In fact, the saving rate is negative right now. We see people entering the labor market at very high levels. Labor force participation was up last month primarily because jobs are available and because wages are growing; business investment is strong; investment in non-commercial real estate is strong.

So all of the indicators are that the behavior does not reflect the kind of language that we're seeing in the polls.

DIRECTOR PORTMAN: I would also add, not as the budget director, but as someone who has looked at some of these polls, that, in fact, people do believe their personal situation is better. In fact, if you look at the recent ABC/Washington Post poll last week -- I think it was reported this week, it shows that about 60 percent of people think that their situation is good or very good.

And yet, with regard to the economy, you are correct. There is less confidence in the economy. That's a disconnect, and that disconnect can be explained partly by what I think Secretary Paulson was explaining. But partly it is we probably haven't done as good a job communicating the strength of our economy because people are doing well. They feel as though what they -- over 60 percent of people feel that the economy is doing well for them individually, but they are concerned about the macro-economy.

So part of what we learned today in talking to Chairman of the Council of Economic Advisers, and Secretary of Treasury, and others, was that, in fact, we have a strong and growing economy. We still have the strongest economy, by the way, among the G7 countries, our primary trading partners. And we had 4 percent growth in the first half. And we look to continue growth, continue relatively high productivity, which, as Secretary Paulson said, will lead to higher wage growth.

And we're also seeing, of course, a very positive impact, therefore, on the budget. Pro-growth economic policies have led to increases in revenues, which, in fact, have taken the budget projections down, not just for us but the Congressional Budget Office reported yesterday that they, too, concur with us that the budget will be lower this year than projected. And in fact they believe it will be even lower than we're projecting now, partly driven, again, by the increased revenues from a better economy.

Q Oh, hi. Thanks for taking my question. I guess I'd like to ask if you discussed whether the global war on terror and the war in Iraq in particular are affecting people's views of the domestic economy.

SECRETARY PAULSON: We didn't talk about that specifically, but -- and it's difficult to know what's affecting people's views, but our conversation was focused very much on the economy, what's going on in the economy, how can we keep it growing, what are the concerns, if any, we might have looking to the future.

Q Do you have opinions -- do any of you have any opinion about that, whether there is a sort of overhang on that?

CHAIRMAN LAZEAR: The one thing that we do know is that the more narrowly focused our polls on the economy, the better are the responses. So if you look at polls, for example, after al Zarqawi was caught, the general view of the economy at that time jumped 13 percentage points. And of course that had almost no effect on the economy to speak of, and yet people's opinion of it went way up. So if we look at numbers that are related, say to the economy specifically, look at the Conference Board's numbers, you tend to see higher ratings there.

So the polls that focus on the economy, per se, and only the economy, I think do give us better numbers, and that's probably because there is some relation between the way people see the economy and the general situation in the global war on terror.

Q Okay, thanks.

Q You referenced the CBO report yesterday. One of the findings of that report was that if the President's tax cuts are extended through 2016, the cost of that plus fixing the AMT would be $3.2 trillion. And that would be on top of a deficit that they're projecting out the next 10 years of $1.7 trillion. Does that estimate square with the estimates that the administration makes? And what kind of problem does that present for you in trying to get the President's tax cuts made permanent?

SECRETARY PAULSON: As we look at the tax cuts, we see a very positive impact of a strong economy that's growing. And when we look at the deficit, we -- all of us wish it were less, but as we look at it as a percentage of GDP, it's at a very comfortable level as a percentage of GDP. And it's really quite noteworthy that the deficit is where it is today, given the fact that we've had hurricanes, given the fact that we've got the need to finance a war.

So our focus was largely on where the real problem lies, and that's with the entitlement and entitlement spending, and what that's going to do to the economy and what it's going to do to the deficit. And that really would be a long-term, structural deficit problem unless we can come up with a fix for it. And we think it's quite possible to come up with a fix that's quite doable; the question is whether we can get the support from Congress to get something done.

DIRECTOR PORTMAN: Just briefly on the CBO and OMB numbers, and their differences, we've now had time to analyze the CBO projections. And it's remarkable how similar we are. I take from your question some of the differences in our modeling. One is, of course, we show the tax relief going out; we show it being permanent. That's cooked into our numbers. So anything you see from OMB and the administration does assume that the tax relief from 2001 and 2003 continues.

CBO, on the other hand, on the emergency spending, assumes -- as they must under their rules -- that whatever emergency spending we did, say, this year with regard to Katrina would continue out indefinitely, same with the global war on terror and any of the Iraq costs, so the amounts we called emergency spending continues out.

But with taking those two differences into account, it is really remarkable how similar we are -- both on our revenue projections and on our outlays -- on our spending projections. In fact, in 2012, as you know, both CBO and OMB show significant reductions in the deficit to the point that it's down to roughly $50 billion each.

I will tell you that in terms of the tax question you ask, one interesting thing to look at is the impact of revenue on our economy, and in particular what percentage of revenue we are raising as a part of our economy. Historically, the average is about 18.2 percent. This year, based on CBO's projections and our projections, we will be slightly above that with tax relief in place.

And again, going forward as Secretary Paulson has said, the big issue is actually on the spending side. And OMB and CBO, again, have very similar projections there. But in terms of the tax relief, if you were not to continue the tax relief, you do have rising revenue as a percentage of the economy. The 18.2 percent is exceeded, and somewhat substantially, over some of those out years, so it's just something to look at. The numbers are very similar. They tell the same story, and that story is that a growing economy has resulted in increased tax revenues, with some reasonable constraint in spending, that has resulted in better deficit projections, going again to the point that in the next five years we see a trend of a declining deficit, even from the levels today, which are consistent with the historical deficit numbers, in terms of a percentage of GDP.

Q Secretary Paulson, I was wondering if you could elaborate a little more on the brainstorming session that you referred to, and also tell us a little bit about -- there are concerns that tax reform is being moved back on the agenda again to make room for Social Security reform. I'm kind of wondering what the plan is there, and if you're going to push Social Security reform, what you're going to do differently from Secretary Snow's efforts last year?

SECRETARY PAULSON: Maybe my word brainstorming was a bit of an exaggeration, but there certainly was a free-flowing discussion where we exchanged ideas on approaches to entitlement reform, because when you talk about entitlement reform here, we're spending a lot of time talking about not just Social Security reform, but Medicare, Medicaid, in order of magnitude, differing in terms of the complexity. And really, a lot of the discussion really concerns the issue you've just raised as what's the role of tax reform in all of this.

So we spent a fair amount of time, and it's very -- in my view, tax reform is not taking a backseat. Tax reform is integrally related. It's just an integral part. You can't talk about the whole entitlement question without thinking about the budget, and you can't think about either of them without talking about taxes. And so tax policy, entitlement reform and the budget were part of the discussion.

Q Thank you.

CHAIRMAN LAZEAR: I would just add one thing to that, and that is that the President is very much aware that the American people are calling for simplification of the tax code and for a tax code that is both fair and pro-growth. And that was definitely on the table and a subject of discussion. So that was something that he's been thinking about for a number of years now, and it's alive and well, and, I would say, an active part of the discussion.

END 1:19 P.M. EDT

PRESS ROOM

August 21, 2006
hp-65

Remarks of Anna Escobedo Cabral
U.S. Treasurer
U.S. Department of the Treasury

Before Senator Grassley's 2006 Women's Conference

Des Moines, Iowa- Thanks very much for that kind introduction. It is a pleasure to be in Des Moines today.

My special thanks go out to Senator Grassley, his lovely wife Barbara, as well as his staff for this invitation and warm hospitality. Also, sir, congratulations on your arduous work in helping move forward comprehensive pension legislation through the Senate. Efforts such as these will certainly help create an added incentive for employees, and particularly women from all walks of life, to save more and plan for retirement. That is so important! After all, women are so often the nurturers of the home and the key breadwinner.

I actually want to talk to the women in the audience today about the amazing opportunity we find before us as we have see our economy grow, particularly over the past 37 months. And I want to talk to you about fantastic resources you can tap into that are available to you through various federal government sources.

But first, I want to tell you a little bit about my background and why these issues are of such great importance to me personally.

Quite frankly, when I first went away to college, I was one of just a few Latino students at my school, and really the first in my family to pursue an undergraduate education. You see, my family was of very humble means, and although my parents had a very big heart and watched over us children very well, I didn't really even think about attending college at first. It was thanks to a high school teacher, Mr. Lamm, that I was able to apply for college and find the scholarship dollars necessary to fund my education.

Back then I was deeply troubled that many did not get the chance at the same opportunity I did.

But now, I can do something about it. So I try. And I ask for your help and too. I ask you to try – either by mentoring a young student or by simply doing what you're doing now for your communities.

As young or well-established businesswomen and professionals, you are in an ideal position to really serve as a role model for a student or a young professional. Quite frankly, your inspiration, your story, can really make the point of what is possible. I want to commend each and every person here in this room today – many of you are leaders in your communities and your service is truly commendable.

As President Bush underscores, it is imperative that we encourage more students, including young women, to think about pursuing careers in mathematics and science. We need to increase the number of female representation in various careers – particularly in technology, science and finance.

The American economy needs our girls. We've moved from an industrial to a now highly technical marketplace. And in the next five to 10 years we are expecting a wave of people to retire from the federal government. We need to ensure that young professionals are equipped to meet the demands of a new competitive marketplace.

Competitiveness is a priority for President Bush. He has created the American Competitiveness Initiative to keep America the most innovative and competitive economy in the world. While this initiative will encourage more aggressive investment by businesses in research and development, increase Federal support for vital basic research, and improve math and science education for America's students, professional women must ensure that female students do not pass up these opportunities to develop their talent and ready themselves for the jobs of today and tomorrow.

But first, we must convince our children, our girls in particular, that they must invest in themselves. And we must invest in them, in our communities and in our nation.

The most important way to make this investment is by supporting sound financial policies advanced by our government and by making wise personal finance choices as individuals. Along that vein, I want to share with you just how this Administration, this President and Treasury are focused on these same goals on a large scale. Because many of you here likely are owners of your own business (or hope to do so some day), you probably share the President's view regarding just how important it is to promote sound and pro-growth economic policies, including immigration reform and financial education initiatives to improve levels of financial literacy across the country.

When we talk about growth and our economy – we luckily already have a tremendous start.

One of the favorite parts of my job as U.S. Treasurer is to visit different cities across the country and speak to fantastic groups like this one. But I must confess that I like this part of my job even more when I get to be the bearer of good news.

Quite frankly, I think the President and his economic team have certainly made this part of my job much easier because I have always been in the messenger for fantastic economic news ever since I first assumed my job as 42nd Treasurer of the U.S. Even before that!

In fact, today I am happy to report that more than 5.5 million jobs have been created since August of 2003 and we see that our economy still continues to grow at a steady pace. In the month of July 2006 alone, an additional 113,000 jobs were created in the U.S.

Additionally, in just the past 12 months, the economy has created more than 1.7 million new jobs. The unemployment rate still remains below the average of each of the past three decades. We're also seeing a wage pick up across the country.

Much of the economic momentum we've experienced in recent years can be explained by the President's firm commitment to promoting a pro-growth economic agenda. The resilience and strength of the U.S. economy is a fact – and this is true despite many of the recent and significant unforeseen challenges our country faced since the President first came into office – the effects of the tech stock market bubble burst, the monstrous 9/11 terrorist attacks on our soil and the devastation experienced by regions impacted by the Gulf Coast hurricanes in 2005.

The President's economic team nonetheless is focused on furthering policies which encourage enhanced opportunities for businesses to expand, as well as hire more workers to meet increased customer demands.

Thanks to the President's tax cuts, people are keeping more of the money they make. But these policies have also helped the federal government increase its tax revenue.

To put the strength and resilience of our economy into perspective, it may be useful to draw some comparisons. Consider that the U.S. economy is the fastest growing of any major industrialized nation in the world. Productivity is growing at the highest rate in years. In 2005, our economy grew faster than Japan and more than twice as fast as France. It also grew more than three-times as fast as Germany.

One important explanation for this resilient and growing economy, again, is that we left more to businesses to invest by lowering their tax burden. It's about simple economics – when you allow people to keep more of their own money, they have more money to invest, and more of it to start or expand a business, or to pay for other important things like a college education or a purchase of a first home.

I can assure you, that the President and his economic team will remain focused on furthering those proven and time-tested policies which encourage the innovator, the entrepreneur and the investor to dare believe in what's possible, in their own abilities and pursue dreams for a more fruitful future.

Nonetheless, increased opportunity requires increased preparation and education. We must be realistic – we can not expect that the government will solve all our problems – and we can't expect it to make money for us. We've got to do it for ourselves – and we have to create our own opportunities. Doing so will require that individuals, particularly those in our respective communities, acquire the necessary skills necessary to manage their money wisely and invest it intelligently.

I earlier mentioned the importance of improving personal finance knowledge for all people across the country. Although our economy continues to grow, we still have much work ahead of us to improve financial education.

This challenge could be attributed to a complex and burgeoning economy like ours, which creates more choices and sophisticated vehicles for saving and making one's money grow. But often, it can also be attributed to lack of knowledge about available opportunities and resources.

When we talk about financial education in today's terms, what we're really talking about is improving people's quality of life.

Education requires more than just presenting information in a nice neat package. We find that we can have a greater impact when this information is delivered through trusted channels. And, this sort of education in which we're all engaged in is really about helping to create new opportunities for people – opportunities like paying for a child's college education, purchasing a home, starting a business or planning for a secure retirement.

That is why Treasury has strengthened its commitment to helping people understand the value of establishing a relationship with a traditional financial institution and improve their financial literacy skills; and we are engaged in several campaigns and multi-agency efforts to improve financial education across the country.

I'll highlight just a few ways in which we're doing this. First, we're deeply involved in improving financial literacy through the work of a federal commission – The Financial Literacy and Education Commission. The Commission is led by the Secretary of the Treasury Hank Paulson, and it recently released a strategy to improve financial education during Financial Literacy Month, in April of 2006.

As President Bush recently noted, The Financial Literacy and Education Commission has an important role to play in helping citizens gain the knowledge and tools they need to compete and succeed in the 21st century.

I just want to spend a few more minutes telling you about it, because as leaders in your community, I know you will find this of interest. This Commission was created in 2003, and the twenty agencies that form it were tasked with developing a plan to improve the money management skills of people in the U.S. The Commission was also tasked with developing a federal financial education web site and toll-free hotline, which were launched in English and Spanish in October of 2004 – MyMoney.gov and 1-888-MyMoney. And very soon, the Commission will turn its attention to developing a multimedia campaign addressing financial education needs in the U.S. Since the strategy addressing the campaign has just been completed, the work on this campaign is just in its earliest phase.

The web site and hotline offer an amazing array of financial education tools in English and Spanish to help you, your family and your clients obtain basic information to help them make wise personal finance decisions – whether their current interest is in saving, investing, paying for a college education, purchasing a first-time home or even starting a business. All this information is easily accessible in this one-stop shop – these resources and the strategy I mentioned earlier are all accessible at www.mymoney.gov. I encourage you to visit it, and even add the link to your resources list on your web sites!

I think that in your line of work and given your level of commitment to your respective communities, you will also find the information in the national strategy very useful. The strategy is really a blue print – it is a first step. However, it is a significant first step toward addressing the issue of tackling the challenge of assisting the more than 10 million individuals that are currently "unbanked" or who do not have a relationship with a traditional financial institution.

Just to give you a quick overview of the strategy: the strategy looks at a variety of other important topics, such as homeownership, credit management, retirement savings, in addition to "banking the unbanked" – an issue that my office has currently been particularly focused on.

It also describes the challenges and guideposts for possible solutions.

Sometimes the solutions come from the Federal government, but often nonprofit organizations, businesses and other private sector players provide important resources for those wishing to learn more about financial matters.

The strategy also encourages Americans to take advantage of the many tools to help them save money to buy a home as I noted earlier, properly plan for retirement or better manage their monthly household income.

Finally, it puts forward examples of financial education programs that community leaders, business people like yourselves and volunteers can all look to as they design programs of their own to enhance financial literacy. It will not only be important to provide encouragement – it will also be important to facilitate easier and more convenient access to tools that can help people improve personal finance management skills, and hopefully ultimately influence the adoption of good personal finance habits. I know that through events like this one – many of you will become involved in advancing improvement in financial literacy levels across Iowa.

At the end of each chapter in the strategy, you will notice that Calls to Actions are highlighted. As a result, Treasury will be coordinating multicultural financial literacy forums to identify the needs of local communities, but also identify some of the best practices in financial education that are quite literally producing positive results.

Another very important campaign my office has been involved in, and that I very quickly want to tell you about, is the Go Direct campaign. About a year and half ago, the Treasury and Federal Reserve Banks launched a campaign called Go Direct – in Spanish it is known as Directo A Su Cuenta. The campaign's objective is to encourage seniors to receive their Social Security benefits by direct deposit.

It not only communicates the importance of direct deposit – but provides the means by which seniors can make the switch from a paper check to direct deposit. We have a dedicated call center staffed by bilingual personnel ready to assist all beneficiaries.

The call center is only one of many ways we are helping beneficiaries sign up for direct deposit. Our Web sites: www.GoDirect.org and www.DirectoASuCuenta.org, allow beneficiaries to access a step-by-step online tool to sign up – either on their own or through their bank or credit union.

Direct deposit is not only the most secure way for receiving Social Security benefits; it is also the most convenient way for all beneficiaries to have immediate access to their benefits. However, despite 95 percent of Americans having heard or read about identity theft, a survey sponsored by the U.S. Department of Treasury and the Federal Reserve Banks revealed that many are unaware of the security benefits of direct deposit over paper checks.

I urge you to help us spread the word about this fantastic resource too – especially to your clients. Many of them are employers and could potentially serve as great partners with Treasury in this effort. Keep in mind that direct deposit can also provide seniors receiving SSA payments with a sense of control of their money. This is true even under the most difficult circumstances. Again, as you know Hurricane Katrina displaced tens of thousands of beneficiaries just days before their checks arrived in the mail. In uncertain times like these, enrolling in direct deposit can offer a much needed peace of mind to federal benefit recipients.

Thank you again for your time and attention – this has been a tremendous opportunity to make new friends. It has been a real pleasure for me to share with you just a few of the efforts we're involved in here at Treasury and to highlight the President's priorities to keep our economy and businesses going strong. With your help and contributions, I know we will together continue to enhance opportunities for those who seek them.

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PRESS ROOM

August 21, 2006
HP-66

Senator Domenici to Join U.S. Treasury Official to Announce $26.4 Million in Community Development Awards

ACCION New Mexico among National Award Recipients

Senator Pete V. Domenici (R-N.M.) will join Director Arthur A. Garcia of the U.S. Treasury Department's Community Development Financial Institutions (CDFI) Fund during a visit to Albuquerque, NM on Friday, August 25 to announce $26.4 million in awards from the CDFI Fund.

Albuquerque was chosen as the site for the national award announcement to highlight award recipient ACCION New Mexico as a national leader in community development. ACCION New Mexico offers business credit to underserved entrepreneurs and has been recognized nationally for its innovative approaches to credit delivery among rural small business owners. The microlender was selected through a competitive review of 172 applications from organizations nationwide requesting more than $149 million in funding under the 2006 round of the CDFI Program* and is the only organization in New Mexico receiving an award.

Who:
CDFI Fund Director Arthur Garcia
Senator Pete V. Domenici (R-N.M.)

What:
$26.4 Million National Award Announcement

When:
Friday, August 25
10:15 a.m. (MDT) – Tour of Golden Crown (Open to press)
10:30 a.m. (MDT) – Award Announcement

Where:
Golden Crown Panaderia (Received financing from ACCION New Mexico)
1103 Mountain Road NW
Albuquerque, N.M.

***About the CDFI Program**
Through the CDFI Program, the CDFI Fund invests in and builds the capacity of private, for-profit and nonprofit financial institutions that serve low-income people and communities lacking adequate access to affordable financial products and services. The CDFI Fund selects awardees based on a competitive application process involving a Comprehensive Business Plan review. More information on the CDFI Fund and its programs can be found at www.cdfifund.gov .

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PRESS ROOM

August 23, 2006
hp-67

Treasury Pitches In to Improve Deployment Life for US Soldiers

Washington, DC- The U.S. Department of the Treasury today announced the successful installation of EagleCash$_{tm}$ at 12 U.S. Army bases in Iraq and Kuwait. EagleCash, the stored-value card program in partnership with the Department of the Army, safeguards and simplifies U.S. soldiers' cash management while they are stationed abroad.

EagleCash's smart card technology eliminates coin, currency, scrip, vouchers, money orders and other paper payment mechanisms and replaces them with a simple card and touch screen. The Army Finance Office cut the volume of paperwork required to issue checks to base exchange stores and postal facilities in half. The program also enhances the safety of soldiers and other personnel in deployed areas by reducing the number of missions required to supply the camps with currency.

Treasury's Financial Management Service (FMS) manages EagleCash with the assistance of the Federal Reserve Bank of Boston.

"This mission was a terrific collaboration among Treasury, the Federal Reserve Bank of Boston and the U.S. Department of the Army," said Donald Hammond, Treasury Fiscal Assistant Secretary. "The dedication of the EagleCash team in planning and personally executing this installation goes above and beyond routine program management and is an extraordinary service to the soldiers in Iraq and Kuwait, and all taxpayers."

In a place where soldiers have limited or no access to ATMs or bank tellers, EagleCash provides soldiers with easy access to cash without traveling across camp to stand in long lines at the Finance Office to receive cash. Cardholders can check balances and transaction history, and transfer funds between their EagleCash card and their U.S. bank accounts at self-service kiosks. Soldiers can make purchases at camp stores, the U.S. Post Office, and concessionaires who provide services like haircuts and alterations or sell food and regionally manufactured products.

Employees of Treasury, the Federal Reserve Bank of Boston, U.S. Army Finance Command, the U.S. Army's 266th Finance Command (Forward), 1st Personnel Command (Postal) (Forward), the Army and Air Force Exchange Service (AAFES), and independent contractors, traveled to Iraq and Kuwait this summer to implement the system. The Eagle Cash team installed 70 kiosks and 1,200 point-of-sale terminals to support the stored value card system. During the two-month mission, the team issued more than 4,500 EagleCash cards and processed transactions representing more than $22 million. As of Aug. 20, soldiers had used their EagleCash cards for more than 9,000 transactions at the self-service kiosks and 40,000 transactions at the base PX/BX and U.S. Post Office facilities.

To bring the stored value card system to the 12 bases in Iraq and Kuwait, the EagleCash team was required to: complete specialized Army warzone training; travel and establish a base of operation at each camp; provide briefings to Army leaders; install equipment; market the program and create awareness; enroll cardholders; train personnel; work with retailers to activate acceptance and settlement procedures; and monitor performance.

The success of this program is evidenced by the Army's plans to expand EagleCash to additional locations in Iraq, change financial policies to leverage the EagleCash infrastructure to further reduce cash, coin and paper, and issue EagleCash cards to soldiers in the U.S. before they deploy to Iraq and Kuwait.

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LINKS

- Photographs: Treasury Pitches In to Improve Deployment Life for US Soldiers

PRESS ROOM

August 23, 2006
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Photo: Treasury Pitches In to Improve Deployment Life for US Soldiers

Treasury's EagleCash team recently completed travel to Iraq and Kuwait to install smart card kiosks and terminals at 12 Army bases. ***Left****: A soldier uses an EagleCash kiosk in Al Faw Palace, formerly owned by Sadaam Hussein, near Baghdad, Iraq.* ***Right****: Treasury's EagleCash is making U.S. soldiers' deployment life in Tikrit, Iraq easier and safer.*

All media queries should be directed to
The Press Office at (202) 622-2960.
Only call this number if you are a member of the media.

ıust 23, 2006
6-8-23-14-5-16-28937

U.S. International Reserve Position

› Treasury Department today released U.S. reserve assets data for the latest week. As indicated in this table, U.S. reserve assets ılled $67,441 million as of the end of that week, compared to $67,253 million as of the end of the prior week.

I. Official U.S. Reserve Assets *(in US millions)*

	August 11, 2006			August 18, 2006		
TOTAL	67,253			67,441		
Foreign Currency Reserves [1]	**Euro**	**Yen**	**TOTAL**	**Euro**	**Yen**	**TOTAL**
Securities	11,956	10,912	22,868	12,016	10,951	22,967
ʼ which, issuer headquartered in the U.S.			0			0
Total deposits with:						
i. Other central banks and BIS	11,900	5,324	17,224	11,956	5,342	17,298
ii. Banks headquartered in the U.S.			0			0
ii. Of which, banks located abroad			0			0
iii. Banks headquartered outside the U.S.			0			0
iii. Of which, banks located in the U.S.			0			0
IMF Reserve Position [2]			7,467			7,474
Special Drawing Rights (SDRs) [2]			8,652			8,660
Gold Stock [3]			11,041			11,041
. Other Reserve Assets			0			0

II. Predetermined Short-Term Drains on Foreign Currency Assets

	August 11 2006			August 18, 2006		
	Euro	**Yen**	**TOTAL**	**Euro**	**Yen**	**TOTAL**
. Foreign currency loans and securities			0			0
. Aggregate short and long positions in forwards and futures in foreign currencies vis-à-vis the U.S. dollar:						
ʼ.a. Short positions			0			0
ʼ.b. Long positions			0			0
꞉. Other			0			0

III. Contingent Short-Term Net Drains on Foreign Currency Assets

	August 11, 2006			August 18, 2006		
	Euro	Yen	TOTAL	Euro	Yen	TOTAL
ͻontingent liabilities in foreign currency			0			0
. Collateral guarantees on debt due within 1 year						
. Other contingent liabilities						
ꟷoreign currency securities with embedded options			0			0
Undrawn, unconditional credit lines			0			0
ı. With other central banks						
). With banks and other financial institutions						
ɿadquartered in the U.S.						
:. With banks and other financial institutions						
ɿadquartered outside the U.S.						
Aggregate short and long positions of options in ʻeign						
ɪrrencies vis-à-vis the U.S. dollar			0			0
a. Short positions						
a.1. Bought puts						
a.2. Written calls						
b. Long positions						
b.1. Bought calls						
b.2. Written puts						

Notes:

Includes holdings of the Treasury's Exchange Stabilization Fund (ESF) and the Federal Reserve's System Open Market Account ιOMA), valued at current market exchange rates. Foreign currency holdings listed as securities reflect marked-to-market values, and ɘposits reflect carrying values. Foreign Currency Reserves for the latest week may be subject to revision. Foreign Currency ɘserves for the prior week are final.

The items, "2. IMF Reserve Position" and "3. Special Drawing Rights (SDRs)," are based on data provided by the IMF and are ılued in dollar terms at the official SDR/dollar exchange rate for the reporting date. The entries for the latest week reflect any ɘcessary adjustments, including revaluation, by the U.S. Treasury to IMF data for the prior month end.

Gold stock is valued monthly at $42.2222 per fine troy ounce.

PRESS ROOM

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August 23, 2006
HP-69

United States and the Federal Republic of Germany Exchange Diplomatic Notes Correcting Protocol to Income Tax Treaty

WASHINGTON, DC – The Treasury Department today announced that the United States and the Federal Republic of Germany exchanged diplomatic notes correcting typographical errors in the recently signed Protocol to the U.S.-German income tax treaty. The corrected text replaces the original text from the date on which the Protocol was signed and will be incorporated into the original text when the Protocol is printed in the Treaties and Other International Acts Series (TIAS).

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REPORTS

- US-Germany Exchange Diplomatic Notes Correcting Protocol (PDF)

The Department of State refers the Embassy of the Federal Republic of Germany to the Protocol signed in Berlin on June 1, 2006, Amending the Convention Between the United States of America and the Federal Republic of Germany for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital and to Certain Other Taxes, Signed on 29th August 1989 (hereinafter "Protocol").

A few inaccuracies were discovered upon review of the Protocol. The following seven inaccuracies relate to both language versions.

1. Paragraph 4 of Article 10 (Article IV of the Protocol)

   a) In the German version the words "ist Absatz 2 Buchstabe b nur anzuwenden" shall be replaced by the words "sind Absatz 2 Buchstabe b und Absatz 3 Buchstabe b nur anzuwenden" and

   b) in the English version the words "and subparagraph b) of paragraph 3" shall be added after the words "In the case of dividends paid by a REIT subparagraph b) of paragraph 2".

DIPLOMATIC NOTE

2. Subparagraph a) of paragraph 4 of Article 10 (Article IV of the Protocol)

   a) In the German version the words “der Nutzungsberechtigte der Dividenden eine natürliche Person ist, die mit nicht mehr als 10 vom Hundert an dem REIT beteiligt ist” shall be replaced by the words “der Nutzungsberechtigte der Dividenden eine natürliche Person oder ein Pensionsfonds ist und die natürliche Person oder der Pensionsfonds mit nicht mehr als 10 vom Hundert an dem REIT beteiligt ist” and

   b) in the English version the words “or a pension fund, in either case” shall be inserted after the word “individual”.

3. Subparagraph b) of paragraph 4 of Article 23 (Article XII of the Protocol)

   a) In the German version, the words “Absatz 3 Buchstabe a gilt nicht” shall be replaced by the words “Absatz 3 Buchstabe b und nicht Buchstabe a gilt” and

   b) in the English version, the words “The provisions of subparagraph a) of paragraph 3 shall not” shall be replaced by the words "The provisions of subparagraph b) and not the provisions of subparagraph a) of paragraph 3 shall".

4. Clause bb) of subparagraph e) of paragraph 2 of Article 28 (Article XIV of the Protocol)

   a) In the German version the full stop shall be replaced by a semicolon and the word "oder" and

   b) in the English version, the word "or" shall be added after the semicolon.

5. Chapeau of Article XIII of the Protocol

   a) In the German version the word "den" shall be replaced by the word "die" and the word "Absatz" shall be replaced by the word "Absätze" and

   b) in the English version the word "paragraph" shall be replaced by the word "paragraphs".

6. Subparagraph a) of paragraph 8 of the Protocol to the Convention (Article XVI of the Protocol)

   a) In the German version the words "auf Ausschüttungen einer solchen in der Bundesrepublik Deutschland ansässigen Gesellschaft" shall be inserted after the words "Artikel 10 Absatz 3 Buchstabe b" and

b) in the English version the words "to dividends paid by such a company that is a resident of the Federal Republic of Germany" shall be added at the end of the sentence.

7. Subparagraph h) of paragraph 22 of the Protocol to the Convention (Article XVI of the Protocol)

a) In the German version the number "6" shall be replaced by the word "neun" and

b) in the English version the word "six" shall be replaced by the word "nine".

The following three inaccuracies relate to the German language version only:

1. In subparagraph a) of paragraph 11 of Article 10 (Article IV of the Protocol)

a) the word "nach" shall be inserted before the words "dem Recht" and

b) the word "wurde" shall be added after the word "errichtet".

2. In subparagraph f) of paragraph 8 of Article 28 (Article XIV of the Protocol) the words "des Buchstabens f" shall be replaced by the words "des Buchstabens e".

3. In paragraph 4 of the Protocol to the Convention (Article XVI of the Protocol) the word "Einzelunternehmens" shall be replaced by the word "Einheitsunternehmens".

In order to correct the Protocol, the Department of State proposes that:

I. The German language version and the English language version be corrected as set out above; and

II. The corrected texts replace the defective texts as from the date on which the Protocol was signed.

If the Government of the Federal Republic of Germany concurs with the proposals contained in paragraphs I. and II. above, this note and the note in reply thereto expressing the approval of the Government of the Federal Republic of Germany shall constitute the correction of the German and English language versions of the Protocol, and shall become part of the original thereof.

MS

Department of State,

Washington, August 17, 2006.

Botschaft der Bundesrepublik Deutschland
Embassy of the Federal Republic of Germany
Embassade de la République fédérale d'Allemagne

Gz.: Wi 551.20

Verbal Note N°. 104/2006

The Embassy of the Federal Republic of Germany presents its compliments to the Department of State of the United States of America and has the honor to confirm receipt of its Note Verbale of August 17, 2006, which reads as follows:

"The Department of State refers the Embassy of the Federal Republic of Germany to the Protocol signed in Berlin on June 1, 2006, Amending the Convention Between the United States of America and the Federal Republic of Germany for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital and to Certain Other Taxes, Signed on 29th August, 1989 (hereinafter "Protocol").

A few inaccuracies were discovered upon review of the Protocol. The following seven inaccuracies relate to both language versions.

1. Paragraph 4 of Article 10 (Article IV of the Protocol)

a) In the German version the words "ist Absatz 2 Buchstabe b nur anzuwenden" shall be replaced by the words "sind Absatz 2 Buchstabe b und Absatz 3 Buchstabe b nur anzuwenden" and

US Department of State
Office of Austrian, German and Swiss Affairs
Room: 4228
2201 C Street, NW
Washington, D.C. 20520

b) in the English version the words "and subparagraph b) of paragraph 3" shall be added after the words "In the case of dividends paid by a REIT subparagraph b) of paragraph 2".

2. Subparagraph a) of paragraph 4 of Article 10 (Article IV of the Protocol)

a) In the German version the words "der Nutzungsberechtigte der Dividenden eine natürliche Person ist, die mit nicht mehr als 10 vom Hundert an dem REIT beteiligt ist" shall be replaced by the words "der Nutzungsberechtigte der Dividenden eine natürliche Person oder ein Pensionsfonds ist und die natürliche Person oder der Pensionsfonds mit nicht mehr als 10 vom Hundert an dem REIT beteiligt ist" and

b) in the English version the words "or a pension fund, in either case" shall be inserted after the word "individual".

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3. In paragraph 4 of the Protocol to the Convention (Article XVI of the Protocol) the word "Einzelunternehmens" shall be replaced by the word "Einheitsunternehmens".

In order to correct the Protocol, the Department of State proposes that:

I. The German language version and the English language version be corrected as set out above; and

II. The corrected texts replace the defective texts as from the date on which the Protocol was signed.

If the Government of the Federal Republic of Germany concurs with the proposals contained in paragraphs I and II above, this note and the note in reply thereto expressing the approval of the Government of the Federal Republic of Germany shall constitute the correction of the German and English language versions of the Protocol, and shall become part of the original thereof."

The Embassy of the Federal Republic of Germany has the honor to inform the Department of State of the United States of America that the Government of the Federal Republic of Germany agrees to the proposals made by the Government of the United States of America. Accordingly, the Note Verbale of the Department of State of the United States of America of August 17, 2006, and this Note in reply thereto constitute an Arrangement between the Government of the Federal Republic of Germany and the Government of the United States of America concerning the correction of the German and English language versions of the Protocol, the German and English versions of which shall be equally authentic.

The Embassy of the Federal Republic of Germany avails itself of this opportunity to renew to the Department of State of the United States of America the assurances of its highest consideration.

Washington, 17th August 2006

BOTSCHAFT DER BUNDESREPUBLIK DEUTSCHLAND WASHINGTON 14

PRESS ROOM

August 23, 2006
hp-70

Joint Statement from the Sub-Cabinet Meeting of the U.S.-India Financial and Economic Forum

Washington, D.C. – At the invitation of U.S. Treasury Under Secretary Timothy D. Adams, Indian Ministry of Finance Department of Economic Affairs Secretary, Ashok Jha, led an official delegation to Washington to co-chair the sub-cabinet meeting of the India-U.S. Financial and Economic Forum, which is part of the broader U.S.-India Economic Dialogue. The delegations discussed a number of key issues including developments in the global economy, policy responses to high oil prices, U.S. and Indian leadership in the WTO Doha Development Round negotiations, strengthening India's physical and financial infrastructure, and collective efforts to combat money laundering and the financing of terrorism.

Besides senior officials from the Ministry of Finance, Government of India and the U.S. Treasury Department, representatives from the Board of Governors of the Federal Reserve System, Office of the Comptroller of the Currency, U.S. Securities and Exchange Commission, National Association of Insurance Commissioners, Commodity Futures Trading Commission, Federal Deposit Insurance Corporation, Reserve Bank of India, and the Securities and Exchange Board of India, participated in the discussion.

In the meeting, the discussions focused on:

Global Economic Issues

The delegations discussed a range of issues facing the global economy. They noted that global growth remains exceptionally robust, the highest in three decades, despite continued high oil prices. The Indian economy remains strong, driven by domestic demand. Growth in the U.S. remains solid, in part due to sustained productivity growth, and fiscal consolidation is ahead of schedule. The two sides noted risks to the global economy which include the impact of sustained high oil prices and a disorderly adjustment of unbalanced growth in many parts of the world. India and the United States reiterated that a successful conclusion of the WTO Doha Development Round negotiations remains essential to promote global trade and growth.

Financial Sector and Infrastructure Issues

The delegations discussed the role of sound financial institutions and efficient financial markets in mobilizing savings and allocating resources efficiently to generate growth and help alleviate poverty. Both sides highlighted the important role that foreign direct investment can play in strengthening the productive base of the economy. The two sides discussed the role of financial sector development in stimulating resources for long-term financing.

U.S. officials discussed recent developments in the U.S. banking industry, as well as regulatory approaches to complex financial transactions and risk management. The U.S. side also emphasized the contribution of financial sector liberalization to growth and stressed the gains that could be achieved by greater foreign participation in the banking, insurance, and pension sectors, and in capital markets. The Indian side described the recent steps taken to liberalize the banking and insurance sectors and emphasized the importance of a calibrated, gradual approach to these issues, consistent with their overall policy objectives.

Indian officials affirmed their commitment to infrastructure development as a means of reducing poverty and expanding economic opportunities. They acknowledged the importance of encouraging private financing for infrastructure to complement public expenditure. Key components include an improved investment climate, financial sector development to enhance long-term financing, and improved project design.

The two sides acknowledged the importance of actions to detect and disrupt money laundering and financing of terrorism. They discussed implementation and enforcement of anti-money laundering laws within the financial sector. The delegations agreed to continue to work together to identify and freeze terrorist assets.

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PRESS ROOM

August 25, 2006
hp-71

U.S. Treasury, Sen. Domenici Announce $26.4 Million For Organizations Serving Economically Distressed Communities

Albuquerque, N.M. –U.S. Treasury Department's director of the Community Development Financial Institutions (CDFI) Fund, Arthur A. Garcia, awarded $26,373,877 in Albuquerque today to 73 organizations nationwide serving economically distressed communities. Senator Pete V. Domenici (R-N.M.) joined Garcia as he announced the awards, granted through CDFI Fund's Community Development Financial Institutions Program.

"These organizations are on the front lines of creating needed jobs and helping foster economic growth in our nation's rural and urban low-income communities," said CDFI Fund Director Garcia. "The awards the Treasury has given will provide these community-based lenders the resources to do even more for these communities. They could be used to finance more mortgages for first-time homebuyers, to provide the needed investment capital to start or expand small businesses or to conduct more financial education classes for people trying to understand and improve their credit history."

Treasury chose the city as the site for the national award announcement to highlight Albuquerque-based award recipient ACCION New Mexico as a national leader in community development. ACCION New Mexico offers business credit to underserved entrepreneurs and has been recognized nationally for its innovative approaches to credit delivery among rural small business owners. The organizations awarded were selected through a competitive review of 172 applications from organizations nationwide requesting more than $149 million in funding under the 2006 round of the CDFI Program.

Through the CDFI Program, the CDFI Fund invests in and builds the capacity of a nationwide network of community-based, private, for-profit and non-profit financial institutions with a primary mission of community development in economically distressed urban, rural and Native communities. These institutions – certified by the CDFI Fund as community development financial institutions, or CDFIs – are able to respond to gaps in local markets that traditional financial institutions are not adequately serving. CDFIs provide critically needed capital, credit, basic financial products such as savings and checking accounts and technical assistance such as financial literacy training to community residents and businesses, service providers, and developers working to meet the community and economic development needs of the communities they serve.

The vision of the CDFI Fund is an America in which all people have adequate access to affordable capital, credit and financial services.

For a list or other detailed information regarding these awards please visit the Fund's website at: http://www.cdfifund.gov

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PRESS ROOM

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August 25, 2006
HP-72

Fact Sheet – 2011 Taxes: Millions Could See Billions in Increases

REPORTS

- Fact Sheet – 2011 Taxes: Millions Could See Billions in Increases (PDF)

UNITED STATES DEPARTMENT OF THE TREASURY

WITHOUT PERMANENT TAX RELIEF, MILLIONS OF AMERICANS WILL SEE THEIR TAXES GO UP BY BILLIONS OF DOLLARS IN 2011

A Family of Four with Two Children…

- **$50k annual income** today ($56,300 in 2011) = **$2,092 increase** (from $1,583 to $3,675 tax bill) = **132% higher tax bill; or**
- **$60k annual income** today ($67,600 in 2011) = **$1,858 increase** (from $3,207 with to $4,275) = **58% higher tax bill.**

Tax Increases On Average…

- **115 million taxpayers – $1,716 increase;**
- **84 million women – $1,970 increase;**
- **48 million married couples – $2,726 increase;**
- **42 million families with children – $2,084 increase;**
- **12 million single women with children – $1,062 increase;**
- **17 million seniors – $2,034 increase; and**
- **26 million small business owners – $3,637 increase.**

More than 5 million low-income individuals and couples will no longer be exempt from individual income tax.

Tax Relief Brings Billions of Dollars to Americans…

- **$880 billion provided through 2005;**
- **$1.1 trillion by the end of 2006;**
- **$2.4 trillion over the next ten years (with permanent tax relief); and**
- **$3.5 trillion total through 2016 (if permanently extended).**

Assumes that the following provisions in the President's tax relief signed into law from 2001-2005 would be allowed, as scheduled, to expire at the end of 2010:

- Creation of the new 10 percent individual income tax bracket.
- Reduction in individual income tax rates above 15 percent rate bracket.
- Reduction of marriage penalties in the standard deduction, 15 percent rate bracket, and the earned income tax credit.
- Lowering the tax rate on capital gains and dividend income to 15 percent (0 percent for the lowest two rate brackets).
- Increase in the child tax credit to $1,000.
- Expansion of the partially refundable additional child tax credit.
- Increase in the child and dependent care tax credit.
- Simplification of the rules for determining income for the earned income tax credit

PRESS ROOM

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August 29, 2006
HP-73

Treasury Designates Key Hizballah Fundraising Organization

The U.S. Department of the Treasury today designated the Islamic Resistance Support Organization (IRSO), a key Hizballah fundraising organization.

"While some terrorist-supporting charities try to obscure their support for violence, IRSO makes no attempt to hide its true colors. IRSO's fundraising materials present donors with the option of sending funds to equip Hizballah fighters or to purchase rockets that Hizballah uses to target civilian populations," said Stuart Levey, Treasury's Under Secretary for Terrorism and Financial Intelligence (TFI) "IRSO works to inflict suffering rather than alleviate it."

IRSO was named today pursuant to Executive Order 13224, which is aimed at disrupting the financial lines supporting terrorism. This action shuts IRSO out of the U.S. financial system by prohibiting transactions with the organization by U.S. persons, as well as freezing any assets IRSO may have under U.S. jurisdiction.

Hizballah uses IRSO to solicit donations in support of its terrorist activities. Specifically, IRSO solicits funds for Hizballah through advertisements broadcast on Hizballah's al-Manar television station. IRSO has identified itself to prospective donors as one and the same as Hizballah.

Solicitation materials distributed by IRSO inform prospective donors that funds will be used to purchase sophisticated weapons and conduct operations. Indeed, donors can choose from a series of projects to contribute to, including, supporting and equipping fighters and purchasing rockets and ammunition.

Identifying Information

Islamic Resistance Support Organization
AKAs: Hayat al-Dam Lil-Muqawama al-Islamiya
Islamic Resistance Support Association

Location: Beirut, Lebanon

Background on Hizballah
Hizballah is a Lebanon-based terrorist group that, until September 11, 2001, was responsible for more American deaths than any other terrorist organization. Hizballah is known or suspected to have been involved in numerous terrorist attacks throughout the world, including the suicide truck bombings of the U.S. Embassy and U.S. Marine Corps barracks in Beirut in 1983 and the U.S. Embassy annex in Beirut in September 1984. Hizballah also executed the 1985 hijacking of TWA Flight 847 en route from Athens to Rome.

Most recently, in July 2006 Hizballah precipitated a violent conflict that resulted in scores of civilian casualties in Israel and Lebanon.

On January 25, 1995, the Annex to the Executive Order 12947 listed Hizballah as a Specially Designated Terrorist (SDT). The Department of State designated Hizballah as a Foreign Terrorist Organization (FTO) in 1997. Additionally, on

October 31, 2001, Hizballah was designated as a Specially Designated Global Terrorist under Executive Order 13224.

REPORTS

- IRSO Donation Forms Scan Document
- English Translation of IRSO Donation Forms

Front page of receipts

Unofficial Translation

Donation Receipt

No. 415626 (Second receipt is numbered: 034500)

[Organization's logo]

Date: [Redacted]

The Organization for Support of the Islamic Resistance thanks the honorable Mr. [Redacted] for his contribution in the amount of:

For:
Subscription ☐ Collection Box ☒ Donation ☐ Other...

Recipient's signature: [Redacted]

Note: It is required that the representative sign the card and confirm the date of validity.

Back Page of Receipts

The Organization for Support of the Islamic Resistance reminds [its contributors of] the following projects:

1. Monthly subscription plan.
2. Collection box project for the children and homes.
3. Al Quds replica project for display in stores and businesses.
4. Support for a mujahid project.
5. Equipping a mujahid project.
6. Contribution to the cost of a rocket. [Number is circled and marked by an x in ink].
7. Contribution to the cost of bullets.
8. Donations in kind project for (food, household items, clothing, shoes, etc.).
9. [Illegible text].

The Organization for Support to the Islamic Resistance authorizes the legal receipt of tithing and alms from every authority.

Contact the administration: 142
Contact the administration: 556943 (on Second receipt numbered: 034500)
Beirut: 556941/01.
The South: 743848/0? (on Second receipt numbered: 034500)
The Biqa': 374379/08.
The North: 437567/06.

August 29, 2006
HP-74

Treasury Designation Targets Elusive North Valle Cartel Leader

The U.S. Department of the Treasury's Office of Foreign Assets Control (OFAC) today added to its list of Specially Designated Narcotics Traffickers four individuals and two companies tied to Juan Carlos Ramirez Abadia, a leader of Colombia's North Valle drug cartel.

"Juan Carlos Ramirez Abadia has been one of the most powerful and most elusive drug traffickers in Colombia," said Adam J. Szubin, Director of OFAC. "Today we are exposing and taking action against elements of his financial network for the first time, including seemingly legitimate companies built upon narcotics proceeds."

The four individuals act as front persons for North Valle cartel leader Juan Carlos Ramirez Abadia (a.k.a. *Chupeta* or "Lollipop"), who was named a Specially Designated Narcotics Trafficker (SDNT) by OFAC in August 2000. These front individuals operate a Colombian pharmaceutical distribution company, *Disdrogas Ltda.*, on behalf of Juan Carlos Ramirez Abadia. Also designated today was a Colombian holding company named *Ramirez Abadia y Cia. S.C.S.*

Juan Carlos Ramirez Abadia began his illicit career in narcotics trafficking with Colombia's Cali drug cartel. He was indicted on federal drug trafficking charges in Colorado in 1994 and the Eastern District of New York in 1995. Juan Carlos Ramirez Abadia surrendered to Colombian authorities in 1996. Following his release from a Colombian prison in 2002, Ramirez Abadia continued his trafficking activities and closely allied himself with the North Valle drug cartel. In 2004, the District Court for the District of Columbia indicted the North Valle drug cartel under the Racketeer Influenced and Corrupt Organizations Act (RICO) and named Juan Carlos Ramirez Abadia as one of its leaders.

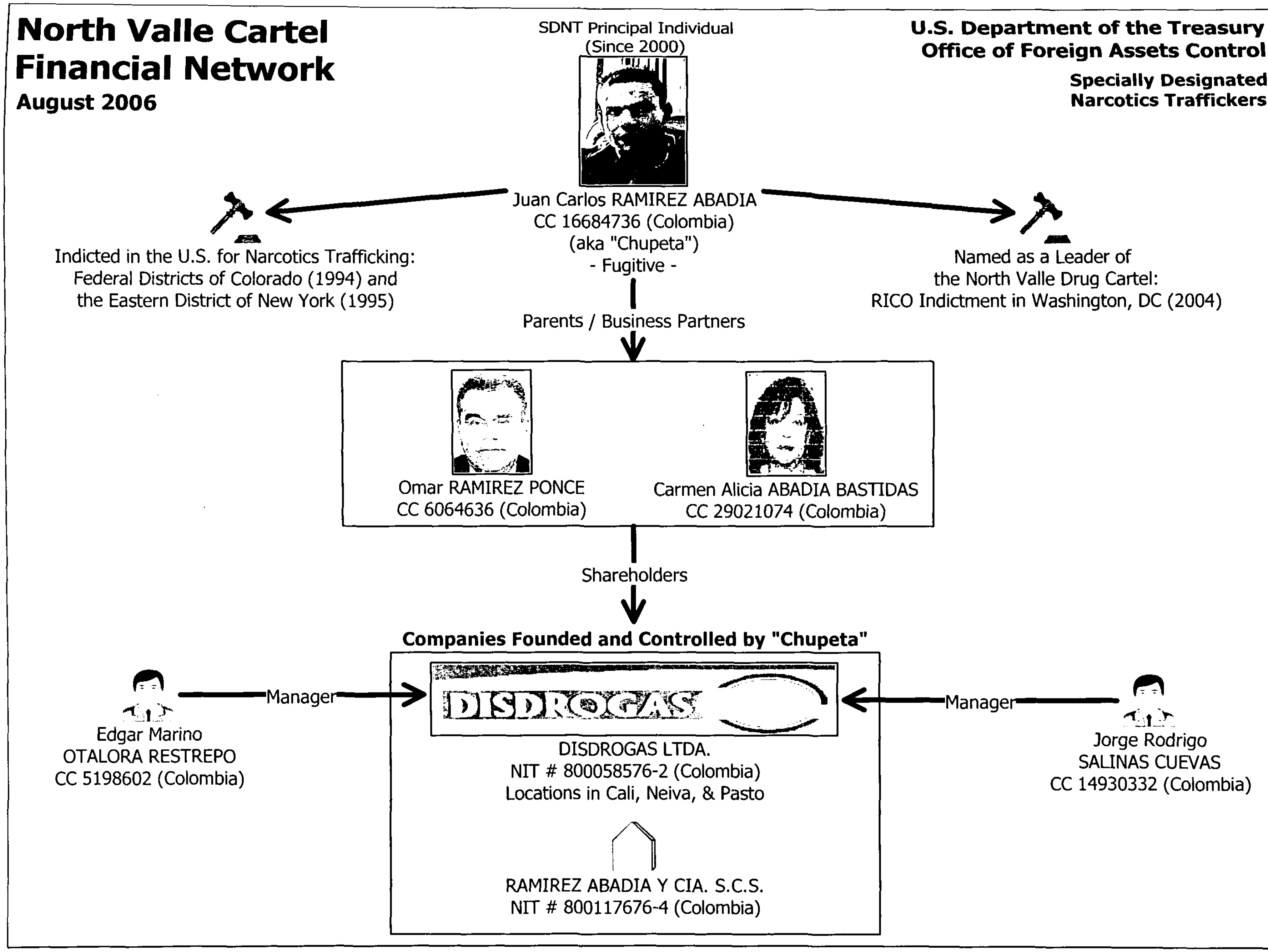
Ramirez Abadia founded the holding company *Ramirez y Cia. Ltda.* in the late 1980s, early in his narcotics trafficking career. Ramirez Abadia eventually changed the name of the company to *Disdrogas Ltda.* and placed the official ownership and management in the hands of persons he could trust to protect his asset. These trusted persons included his parents, Omar Ramirez Ponce and Carmen Alicia Abadia Bastidas, and his business associates Jorge Rodrigo Salinas Cuevas and Edgar Marino Otalora Restrepo, all of whom were named today by OFAC. In addition, OFAC has designated the Colombian holding company *Ramirez Abadia y Cia. S.C.S.*, which was created to hold real estate and other assets for Ramirez Abadia.

SDNTs are subject to the economic sanctions imposed against Colombian drug cartels in Executive Order 12978. Today's action freezes any assets found in the United States and prohibits all financial and commercial transactions by U.S. persons involving the designees.

The assets of a total of 1,294 businesses and individuals in Aruba, Colombia, Costa Rica, Ecuador, Mexico, Panama, Peru, Spain, Vanuatu, Venezuela, the Bahamas, the British Virgin Islands, the Cayman Islands, and the United States have been designated by OFAC pursuant E.O. 12978. The 489 currently designated businesses include agricultural, aviation, consulting, construction, distribution, financial, horse breeding, hotels, investment, manufacturing, maritime, mining, offshore, industrial paper, pharmaceutical, real estate and service firms. The SDNT list includes 19 kingpins from the Cali, North Valle and North Coast drug cartels in Colombia.

REPORTS

- North Valle Cartel's Financial Network.


North Valle Cartel
Financial Network
August 2006
U.S. Department of the Treasury
Office of Foreign Assets Control
Specially Designated
Narcotics Traffickers
SDNT Principal Individual
(Since 2000)
Juan Carlos RAMIREZ ABADIA
CC 16684736 (Colombia)
(aka "Chupeta")
- Fugitive -
Indicted in the U.S. for Narcotics Trafficking:
Federal Districts of Colorado (1994) and
the Eastern District of New York (1995)
Named as a Leader of
the North Valle Drug Cartel:
RICO Indictment in Washington, DC (2004)
Parents / Business Partners
Omar RAMIREZ PONCE
CC 6064636 (Colombia)
Carmen Alicia ABADIA BASTIDAS
CC 29021074 (Colombia)
Shareholders
Companies Founded and Controlled by "Chupeta"
Edgar Marino
OTALORA RESTREPO
CC 5198602 (Colombia)
Manager
DISDROGAS
Manager
Jorge Rodrigo
SALINAS CUEVAS
CC 14930332 (Colombia)
DISDROGAS LTDA.
NIT # 800058576-2 (Colombia)
Locations in Cali, Neiva, & Pasto
RAMIREZ ABADIA Y CIA. S.C.S.
NIT # 800117676-4 (Colombia)

PRESS ROOM

August 31, 2006
HP-75

Treasury Acting Assistant Secretary Robert Stein to Hold Economic Briefing

U.S. Treasury Acting Assistant Secretary for Economic Policy Robert Stein will hold a media briefing to review economic indicators from the last month as well as discuss the state of the U.S. Economy. The event is open to credentialed media:

Who
Acting Assistant Secretary for Economic Policy Robert Stein

What
Economic Media Briefing

When
Friday, September 1, 11:00 a.m. (EDT)

Where
Media Room – Main Treasury
1500 Pennsylvania Ave, NW
Washington, DC

Note
Media without Treasury press credentials should contact Frances Anderson at (202) 622-2960, or frances.anderson@do.treas.gov with the following information: name, Social Security number and date of birth.

ust 31, 2006
5-8-31-12-28-47-18027

U.S. International Reserve Position

Treasury Department today released U.S. reserve assets data for the latest week. As indicated in this table, U.S. reserve assets led $67,156 million as of the end of that week, compared to $67,441 million as of the end of the prior week.

I. Official U.S. Reserve Assets *(in US millions)*

	August 18, 2006			August 25, 2006		
TOTAL	67, 441			67,156		
Foreign Currency Reserves [1]	**Euro**	**Yen**	**TOTAL**	**Euro**	**Yen**	**TOTAL**
Securities	12,016	10,951	22,967	12,007	10,817	22,824
which, issuer headquartered in the U.S.			0			0
Total deposits with:						
i. Other central banks and BIS	11,956	5,342	17,298	11,922	5,273	17,195
ii. Banks headquartered in the U.S.			0			0
ii. Of which, banks located abroad			0			0
iii. Banks headquartered outside the U.S.			0			0
iii. Of which, banks located in the U.S.			0			0
IMF Reserve Position [2]			7,474			7,456
Special Drawing Rights (SDRs) [2]			8,660			8,640
Gold Stock [3]			11,041			11,041
. Other Reserve Assets			0			0

II. Predetermined Short-Term Drains on Foreign Currency Assets

	August 18 2006			August 25, 2006		
	Euro	**Yen**	**TOTAL**	**Euro**	**Yen**	**TOTAL**
. Foreign currency loans and securities			0			0
'. Aggregate short and long positions in forwards and futures in foreign currencies vis-à-vis the U.S. dollar:						
?.a. Short positions			0			0
?.b. Long positions			0			0
3. Other			0			0

III. Contingent Short-Term Net Drains on Foreign Currency Assets

	August 18, 2006			August 25, 2006		
	Euro	Yen	TOTAL	Euro	Yen	TOTAL
;ontingent liabilities in foreign currency			0			∩
. Collateral guarantees on debt due within 1 year						
. Other contingent liabilities						
·oreign currency securities with embedded options			0			0
Jndrawn, unconditional credit lines			0			0
. *With other central banks*						
. *With banks and other financial institutions*						
adquartered in the U.S.						
. *With banks and other financial institutions*						
adquartered outside the U.S.						
Aggregate short and long positions of options in eign						
ırrencies vis-à-vis the U.S. dollar			0			0
ı. *Short positions*						
ı.1. Bought puts						
ı.2. Written calls						
b. *Long positions*						
ɔ.1. Bought calls						
o.2. Written puts						

Notes:

Includes holdings of the Treasury's Exchange Stabilization Fund (ESF) and the Federal Reserve's System Open Market Account OMA), valued at current market exchange rates. Foreign currency holdings listed as securities reflect marked-to-market values, and posits reflect carrying values. Foreign Currency Reserves for the latest week may be subject to revision. Foreign Currency ɜserves for the prior week are final.

The items, "2. IMF Reserve Position" and "3. Special Drawing Rights (SDRs)," are based on data provided by the IMF and are lued in dollar terms at the official SDR/dollar exchange rate for the reporting date. The entries for the latest week reflect any ːcessary adjustments, including revaluation, by the U.S. Treasury to IMF data for the prior month end.

Gold stock is valued monthly at $42.2222 per fine troy ounce.

PRESS ROOM

August 31, 2006
HP-76

Senior Advisor to the U.S. Treasury Secretary Kimberly Reed

Who
Senior Advisor to the U.S. Treasury Secretary Kimberly Reed

What
Remarks to the West Virginia Chamber of Commerce's 70th Annual Meeting and the 2006 West Virginia Business Summit

When
Friday, September 1, 11:00 a.m. (EDT)

Where
The Greenbrier Hotel, Colonial Hall
300 West Main Street
White Sulphur Springs, West Virginia

PRESS ROOM

August 31, 2006
hp-77

Treasury Secretary Paulson to Deliver Speech on the International Economy

Treasury Secretary Henry M. Paulson will deliver a speech on Wednesday, September 13, at the Treasury Department. Secretary Paulson will discuss his views on the state of the international economy.

WHAT	Speech on the International Economy
WHEN	Wednesday, September 13, 11:00 a.m. (EDT)
WHERE	Treasury Department Cash Room 1500 Pennsylvania Ave., NW Washington, DC
NOTE	Media without Treasury press credentials should contact Frances Anderson at (202) 622-2960 or Frances.Anderson@do.treas.gov with the following information: full name, Social Security number, and date of birth.

-30-

PRESS ROOM

September 7, 2006
HP-77

Treasury Secretary Paulson to Deliver Speech on the International Economy

REMINDER

Treasury Secretary Henry M. Paulson will deliver a speech on Wednesday, September 13, at the Treasury Department. Secretary Paulson will discuss his views on the state of the international economy.

WHAT
Speech on the International Economy

WHEN
Wednesday, September 13, 11:00 a.m. (EDT)

WHERE
Treasury Department
Cash Room
1500 Pennsylvania Ave., NW
Washington, DC

NOTE
Media without Treasury press credentials should contact Frances Anderson at (202) 622-2960 or Frances.Anderson@do.treas.gov with the following information: full name, Social Security number, and date of birth. Please submit this information by Tuesday, September 12.

PRESS ROOM

September 1, 2006
HP-78

Treasury Assistant Secretary Fratto to Hold Weekly Press Briefing

Treasury Assistant Secretary for Public Affairs Tony Fratto will hold the weekly media briefing on Tuesday, September 5 in Main Treasury's Media Room. The event is open to all credentialed media.

WHO
Assistant Secretary for Public Affairs Tony Fratto

WHAT
Weekly Briefing to the Press

WHEN
Tuesday, September 5, 10:30 AM (EDT)

WHERE
Treasury Department
Media Room (Room 4121)
1500 Pennsylvania Ave., NW
Washington, DC

NOTE
Media without Treasury press credentials should contact Frances Anderson at (202) 622-2960 or Frances.Anderson@do.treas.gov with the following information: name, Social Security number, and date of birth.

PRESS ROOM

September 1, 2006
HP-79

U.S.-Isle of Man Tax Information Exchange Agreement Enters Into Force

WASHINGTON, DC – An exchange of letters between the United States and the Isle of Man was completed on June 26, 2006, thus bringing into force an agreement that allows for the exchange of information on tax matters between the United States and the Isle of Man.

PRESS ROOM

September 1, 2006
HP-80

Treasury Under Secretary Adams Releases Statement on IMF Reform

Washington, D.C. – Treasury Under Secretary for International Affairs Timothy D. Adams released the following statement on IMF reform:

I am pleased that the Fund's Executive Board has put on the table a reform package that will take into account the rapid growth in emerging markets and the evolution of economies around the world. All agree that it is also critical to ensure an appropriate voice for the poorest countries.

However, there is much important work left to be done after Singapore and it is crucial that the Fund's membership approach this endeavor in the spirit of re-making the Fund to look like the face of today's global economy.

The IMF management and membership now need to demonstrate that the institution will move swiftly to fundamental reform in step two. Significantly higher GDP share in a new quota formula and updated, strengthened, and rigorously applied guidelines for exchange rate surveillance are necessary components if the IMF is to remain the world's leading multilateral institution for macroeconomic and financial policy.

PRESS ROOM

September 5, 2006
HP-81

Paulson Swears In Moy as US Mint Director

Washington, DC – U.S. Treasury Secretary Henry Paulson swore in Edmund C. Moy as 38th Director of the U.S. Mint today.

"I want to thank President Bush and Secretary Paulson for this opportunity to join their outstanding team," Moy said. "I look forward to working with my colleagues to building an even stronger, better, more efficient United States Mint."

The U.S. Senate confirmed Moy on July 26. He previously served at the White House as Special Assistant to the President for Presidential Personnel.

Before joining the George W. Bush administration, Moy served as Senior Advisor at the Wall Street private equity firm of Welsh, Carson, Anderson and Stowe. Earlier in his career, he served in the administration of President George H.W. Bush from 1989 – 1993 as the Director of the Office of Managed Care for the Federal Health Care Financing Administration at the Department of Health and Human Services.

Moy, a Chinese-American, is active in organizations representing the Asian-American community. The Asian Pacific American Institute for Congressional Studies honored Moy and U.S. Senator Daniel K. Inouye (D-Hawaii) in May 2006 for their contributions to the Asian Pacific American community.

Moy received his bachelor's degree in economics, international relations and political science from the University of Wisconsin. Moy, his wife Karen, and daughter Nora live in the Washington, D.C. area.

The Mint generated $1.77 billion in revenues in FY 2005 and contributed $775 million to the U.S. Treasury General Fund. The agency also produced more than 15 billion coins in 2005, fulfilling the Mint's mission to produce the nation's circulating coinage for trade and commerce. To find out more log on to the Mint's website www.usmint.gov.

PRESS ROOM

eptember 5, 2006
006-9-5-14-6-49-2520

U.S. International Reserve Position

'he Treasury Department today released U.S. reserve assets data for the latest week. As indicated in this table, U.S. reserve assets otaled $66,642 million as of the end of that week, compared to $67,156 million as of the end of the prior week.

I. Official U.S. Reserve Assets *(in US millions)*

	August 25, 2006			September 1, 2006		
TOTAL	67,156			66,642		
1. Foreign Currency Reserves [1]	Euro	Yen	TOTAL	Euro	Yen	TOTAL
a. Securities	12,007	10,817	22,824	12,082	10,834	22,916
Of which, issuer headquartered in the U.S.			0			0
b. Total deposits with:						
b.i. Other central banks and BIS	11,922	5,273	17,195	11,991	5,278	17,269
b.ii. Banks headquartered in the U.S.			0			0
b.ii. Of which, banks located abroad			0			0
b.iii. Banks headquartered outside the U.S.			0			0
b.iii. Of which, banks located in the U.S.			0			0
2. IMF Reserve Position [2]			7,456			6,704
3. Special Drawing Rights (SDRs) [2]			8,640			8,712
4. Gold Stock [3]			11,041			11,041
5. Other Reserve Assets			0			0

II. Predetermined Short-Term Drains on Foreign Currency Assets

	August 25 2006			September 1, 2006		
	Euro	Yen	TOTAL	Euro	Yen	TOTAL
1. Foreign currency loans and securities			0			0
2. Aggregate short and long positions in forwards and futures in foreign currencies vis-à-vis the U.S. dollar:						
2.a. Short positions			0			0
2.b. Long positions			0			0
3. Other			0			0

III. Contingent Short-Term Net Drains on Foreign Currency Assets

	August 25, 2006			September 1, 2006		
	Euro	Yen	TOTAL	Euro	Yen	TOTAL

1. Contingent liabilities in foreign currency			0			0
1.a. Collateral guarantees on debt due within 1 year						
1.b. Other contingent liabilities						
2. Foreign currency securities with embedded options			0			0
3. Undrawn, unconditional credit lines			0			0
3.a. With other central banks						
3.b. With banks and other financial institutions						
Headquartered in the U.S.						
3.c. With banks and other financial institutions						
Headquartered outside the U.S.						
4. Aggregate short and long positions of options in foreign						
Currencies vis-à-vis the U.S. dollar			0			0
4.a. Short positions						
4.a.1. Bought puts						
4.a.2. Written calls						
4.b. Long positions						
4.b.1. Bought calls						
4.b.2. Written puts						

Notes:

1/ Includes holdings of the Treasury's Exchange Stabilization Fund (ESF) and the Federal Reserve's System Open Market Account (SOMA), valued at current market exchange rates. Foreign currency holdings listed as securities reflect marked-to-market values, and deposits reflect carrying values. Foreign Currency Reserves for the latest week may be subject to revision. Foreign Currency Reserves for the prior week are final.

2/ The items, "2. IMF Reserve Position" and "3. Special Drawing Rights (SDRs)," are based on data provided by the IMF and are valued in dollar terms at the official SDR/dollar exchange rate for the reporting date. The entries for the latest week reflect any necessary adjustments, including revaluation, by the U.S. Treasury to IMF data for the prior month end.

3/ Gold stock is valued monthly at $42.2222 per fine troy ounce.

PRESS ROOM

September 7, 2006
HP-82

**US Treasury Official to Help
DC Teens Avoid Paycheck Surprises**

Deputy Assistant Secretary for Financial Education Dan Iannicola, Jr. will visit teens at the Washington, D.C. Boys and Girls Club on Friday to teach them how to understand their paychecks and the withholding system. Iannicola will teach a class at Richard England Clubhouse #14 as part of "Money Matters" National Education Day, a coordinated volunteer effort by the American Payroll Association.

Who:
Deputy Assistant Secretary for Financial Education Dan Iannicola, Jr.

What:
Paycheck Class at the Boys and Girls Club

When:
Friday, Sept. 8 5:00 p.m.

Where:
Richard England Clubhouse #14
4103 Benning Road, NE
Washington, DC

PRESS ROOM

September 7, 2006
HP-83

Treasury Designation Targets Hizballah's Bank

The U.S. Department of the Treasury today designated two financial companies and one individual that provide financial support to the Iran-funded Hizballah terrorist network.

"Bayt al-Mal and the Yousser Company function as Hizballah's unofficial treasury, holding and investing its assets and serving as intermediaries between the terrorist group and mainstream banks," said Stuart Levey, Treasury's Under Secretary for Terrorism and Financial Intelligence (TFI). "Institutions considering dealing with these two entities are now on notice as to their true character."

Bayt al-Mal and Yousser Company for Finance and Investment, and Bayt al-Mal head Husayn al-Shami were named as Specially Designated Global Terrorists pursuant to Executive Order 13224, designed to deter financial and material support to terrorists and their facilitators.

Bayt al-Mal is a Hizballah-controlled organization that performs financial services for the terrorist organization. Bayt al-Mal operates under the direct supervision of Hizballah Secretary General Hasan Nasrallah. As Hizballah's main financial body, Bayt al-Mal serves as a bank, creditor, and investment arm for Hizballah. The central headquarters of Bayt al-Mal was located in Hizballah's stronghold in Beirut's southern suburbs.

Bayt al-Mal utilizes the Yousser Company for Finance and Investment to secure loans and finance business deals for Hizballah companies.

Husayn al-Shami, the head of Bayt al-Mal, is a senior Hizballah leader who has served as a member of Hizballah's Shura Council and as the head of several Hizballah-controlled organizations, including the Islamic Resistance Support Organization. Shami is also responsible for foreign donations to Hizballah fundraising organizations.

Today's action prohibits transactions between U.S persons and the designated entities and also freezes any assets those entites may have under U.S. jurisdiction.

Identifying Information

Bayt al-Mal
AKA: Bayt al-Mal Lil Muslimeen
Locations: Harat Hurayk, Beirut, Lebanon
Burj Al-Barajinah, Lebanon
Sidon, Lebanon
Tyre, Lebanon
Al-Nabatiyah, Lebanon
Ba'albak, Lebanon
Hirmil, Lebanon

Yousser Company for Finance and Investment
Location: Lebanon

Husayn al-Shami
Alternate Spellings: Husayn Shaimi

Husayn Shamai
Husayn Shamy
Husayn Al-Shamy
Husayn Ashami
Haj Husayn Al-Shami
DOB: 1948
Alternate DOB: 1954
Alternate DOB: 1960
Location: Lebanon

Background on Hizballah

Hizballah is a Lebanon-based terrorist group. Until September 11, 2001, Hizballah was responsible for more American deaths than any other terrorist organization.

Hizballah is closely allied with Iran and often acts at its behest, but it also can and does act independently. Though Hizballah does not share the Syrian regime's secular orientation, the group has been a strong ally in helping Syria advance its political objectives in the region.

Iran and Syria provide significant support to Hizballah, giving money, weapons and training to the terrorist organization. In turn, Hizballah is closely allied with and has an allegiance to these states. Iran is Hizballah's main source of weapons and uses its Islamic Revolutionary Guards Corps to train Hizballah operatives in Lebanon and Iran. Iran provides hundreds of millions of dollars per year to Hizballah.

The Majlis al-Shura, or Consultative Council, is the group's highest governing body and has been led by Secretary General Hasan Nasrallah since 1992. Hizballah is known or suspected to have been involved in numerous terrorist attacks throughout the world, including the suicide truck bombings of the U.S. Embassy and U.S. Marine Corps barracks in Beirut in 1983 and the U.S. Embassy annex in Beirut in September 1984. Hizballah also executed the 1985 hijacking of TWA Flight 847 en route from Athens to Rome. Most recently, in July 2006 Hizballah fighters precipitated a violent conflict that resulted in scores of civilian casualties in Lebanon and Israel.

On January 25, 1995, the Annex to the Executive Order 12947 listed Hizballah as a Specially Designated Terrorist (SDT). The Department of State designated Hizballah as a Foreign Terrorist Organization (FTO) in 1997. Additionally, on October 31, 2001, Hizballah was designated as a Specially Designated Global Terrorist under Executive Order 13224.

PRESS ROOM

To view or print the Microsoft Word content on this page, download the free Microsoft Word Viewer.

September 7, 2006
HP-84

New Proposed Regulations Issued Under Section 987

WASHINGTON, DC – The Treasury Department and IRS today issued new proposed regulations under section 987 that withdraw and replace proposed regulations that were issued in 1991 and were not finalized. The new proposed regulations generally provide rules for determining items of income or loss of a taxpayer with respect to a "qualified business unit" as well as rules regarding the timing, amount, character, and source of currency gain or loss taken into account upon a remittance from such a unit. As described in Notice 2000-20, IRS experience with the 1991 proposed regulations has shown that some taxpayers sought to exploit conceptual flaws in those regulations to claim substantial noneconomic losses, largely at the taxpayer's discretion. The new proposed regulations employ a revised paradigm that is designed to minimize or eliminate such noneconomic results by taking into account currency gain and loss only with respect to items whose value actually changes with fluctuations in exchange rates

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REPORTS

- REG-208270-86 – Section 987

PRESS ROOM

September 8, 2006
hp-85

Statement of U.S. Treasury Secretary Henry M. Paulson at the APEC Finance Ministers Meeting Hanoi, Vietnam

I would like to thank Finance Minister Ninh for hosting the 13th annual APEC Finance Ministers' meeting. This is an important meeting, and it is fitting that it took place in Hanoi, the capital of one of the world's fastest growing and dynamic economies. My last visit to Vietnam was in the mid-1990s and much has changed since then. My visit today comes as Vietnam is rapidly transforming itself, and as America's relationship with Vietnam is transforming to one of growing friendship and cooperation.

While in Hanoi, I had the opportunity to meet Vietnam's new leaders -- Prime Minister Dung and economic officials. We discussed a range of bilateral issues, including the importance of open trade for both our economies, Vietnam's WTO accession, and achieving Permanent Normal Trade Relations. Yesterday I had the opportunity to discuss the challenges of doing business in a transitioning economy when I met with a group of Vietnam's energetic entrepreneurs. Later this afternoon I will meet with Vietnamese business students. Vietnam's economic success for this and future generations is largely in the hands of these individuals. I encouraged them to have the confidence and courage to continue steadily on the path of economic reform.

In my meetings with APEC finance ministers I encouraged my colleagues to go beyond their traditional finance minister roles and confront the economic challenges we all face. APEC needs to be a relevant and results-oriented organization. I focused on three priority issues where we can make a difference: energizing the chances for multilateral trade liberalization; addressing the orderly adjustment of global imbalances; and preventing the abuse of our financial systems.

We as finance ministers must take an active role in our governments to bring forth enhanced trade liberalizing offers that are necessary for continued progress in lowering global trade barriers. In my discussions I noted that services must be included in this process as it is the largest and fastest growing sector in the world economy. Services account for more than 50% of global GDP but only 20% of world trade. The World Bank estimates that goods and services liberalization could provide income gains in developing countries four and a half times the gains from goods liberalization alone. Financial services liberalization, in particular, is essential for all economies to reach their growth potentials.

To bring about an orderly adjustment of global imbalances, we discussed the actions needed in the United States to increase saving, the need for stronger domestic demand-led growth in Japan, other APEC members and Europe, and the value of flexible exchange rates in China and emerging East Asia.

Finally, I described how financial enforcement tools are valuable to respond to and combat growing threats to our financial systems that include narcotics trafficking, organized criminal activities, terrorism, and weapons of mass destruction (WMD) proliferation. We must act to prevent and combat threats to our security by establishing authorities that will financially isolate those engaged in illicit activities and ensure that they do not access the international financial system.

I look forward to making progress on these issues with my colleagues in APEC, and I thank the Government of Vietnam for hosting these meetings and the warm hospitality of the Vietnamese people.

PRESS ROOM

September 8, 2006
HP-86

Prepared Remarks by Stuart Levey
Under Secretary for Terrorism and Financial Intelligence
Before the American Enterprise Institute for Public Policy Research

Thank you for inviting me to speak today. It is an honor and a pleasure to be here. Policymakers have grown to trust AEI as a valuable source of insightful analysis, honest assessments, and fresh ideas. As we take a moment to assess how far we have come since that pivotal September day in our nation's history just five years ago, we continue to battle terrorism on every front, using every tool at our disposal. I want to thank you and the scholars at AEI for the contributions you have made to this vital effort.

While we can point to progress since 2001, there is no doubt that the world remains a dangerous place. Just since the beginning of the summer, the world has witnessed North Korea launch multiple ballistic missiles, seen a war in the Middle East sparked by Hizballah's aggression, learned of a foiled terrorist plot to blow up ten U.S.-bound aircraft using materials disguised as common household products, and seen the Iranian government's continued defiance of the international community.

If we step back and evaluate the threats we face, terrorism looms large. Not only must we defeat al Qaeda's and other terrorists' plans, we must also address the multifaceted problems and threats posed by state sponsors of terror Iran, Syria, and North Korea. North Korea, the world's foremost proliferator of ballistic missile technology, continues to aggressively pursue greater nuclear weapons capabilities and continues to develop ballistic missiles of increasing sophistication and range. Iran lies at the dangerous intersection of terrorism and weapons of mass destruction, defying the international community in its quest for nuclear weapons and providing financial and material support to terrorist groups, like Hizballah. Syria is a willing partner in Iran's scheme, allowing Iranian weapons to pass through its territory into Lebanon and permitting Hizballah's leaders to operate out of Damascus. And, as the UK terror plot demonstrates, al Qaeda and its sympathizers remain intent on killing innocent civilians, hoping to instill fear throughout our democracies and, in turn, undermine our will to promote democracy in the Middle East and protect our and our allies' vital interests in the region.

We all understand that there is not one approach to dealing with these challenges - North Korea is different from Iran, Iran is different from Syria, Syria is different from loose terrorist networks like al Qaeda - and that tackling them is not by any means an easy task. But addressing each of these challenges requires leadership, persistence, and ingenuity - applying old capabilities and authorities in new ways and, where needed, developing entirely new tools. Today, I want to discuss: 1) the Treasury Department's expanded role in fighting terrorism, weapons of mass destruction proliferation, and other pressing security threats; 2) the power of targeted financial measures, particularly when coupled with government partnership with the private sector, in combating these threats; and 3) how governments and financial institutions can work together to confront the challenge presented by the Iranian regime.

TREASURY'S NEW SECURITY ROLE

Counterterrorism and security policy has traditionally been the province of foreign affairs, defense, intelligence, and law enforcement officials - not Finance Ministers. But finance ministries worldwide are now working closely with the traditional security ministries to meet the government's first responsibility: ensuring the safety of its citizens. Promoting a safe, sound, and secure financial system will enable us to work toward that end.

As our government took stock of all of its tools to combat terrorism and the Executive Branch was reorganized after September 11, President Bush, members of his Cabinet, and the Congress recognized that the Treasury Department had unique authorities that could contribute to the fight. Although many of the Treasury's law enforcement functions were transferred to the Departments of Homeland Security and Justice in 2003, the Treasury quickly assumed a new role in U.S. national security policy as we began to apply these unique authorities in creative ways. This was the genesis of the office I oversee, the Office of Terrorism and Financial Intelligence.

Our mission is to marshal the Treasury Department's policy, enforcement, regulatory, and intelligence functions in order to sever the lines of financial support to international terrorists, WMD proliferators, narcotics traffickers, and other threats to our national security. There are financial networks that underlie all of these threats. Those networks are sources of valuable intelligence; they are also vulnerabilities we can exploit.

While combating terrorism finance is a top priority of my office, we have made progress on other fronts as well. Using a wide range of tools, we have helped shut down the networks of Colombian and other foreign drug kingpins; targeted Iranian, Syrian, and North Korean companies involved in WMD and missile proliferation; financially isolated key Syrian regime members; and struck a deep blow to the North Korean government's illicit financial network.

The intelligence component of our efforts is particularly important. For the first time in U.S. history - and likely the first time worldwide - we set up an intelligence analysis office, the Office of Intelligence and Analysis within the Treasury Department to bring the knowledge of the intelligence community to bear on the evolving threat of illicit finance. Having an intelligence analysis office at the Treasury is a tremendous innovation. Money trails don't lie. Financial intelligence is uniquely reliable; it allows us to track threats, as well as to deter and disrupt them.

The authorities that the Treasury has at its disposal are among the rare tools short of military force that we can use to exert leverage when traditional diplomatic options are exhausted. They allow the U.S. government to bring concentrated pressure to bear on an otherwise unresponsive threat, demonstrating to the world that failure to abide by internationally-accepted norms of behavior bears real consequences. With the Treasury Department's recent actions, the Iranian regime is beginning to see that first-hand

PROGRESS

Our use of these authorities in the financial war on terror is having an impact. The indicators of success are often complex and not readily quantifiable, such as reporting about terrorist cells having difficulty raising money or paying salaries or benefits. Some of the best evidence, of course, is classified. In recent months, we have seen at least one instance of what we look for most - a terrorist organization indicating that it cannot pursue sophisticated attacks because it lacks adequate funding.

In some specific areas, we can however point to concrete indicators of success. For example, we have made dramatic progress in combating terrorist abuse of charities. Prior to 9/11 and even afterwards, terrorists used charities as safe and easy ways to raise and move large sums of money. Al Qaeda and Hamas, in particular, relied on charities to funnel money from wealthier areas to conflict zones with great success. Through a combination of law enforcement and regulatory actions against several corrupt charities, both at home and abroad, we have taken out key organizations and deterred or disrupted others. In tandem, active engagement with the legitimate charitable sector has succeeded in raising transparency and accountability across the board.

We have thus far designated more than 40 charities worldwide as supporters of terrorism, including several U.S. charities such as the Holy Land Foundation, the Global Relief Foundation, the Benevolence International Foundation, the Al Haramain Islamic Foundation, and the Islamic African/American Relief Agency (IARA). The impact of these actions is serious, and sometimes decisive. IARA once provided hundreds of thousands of dollars to Osama bin Laden. More recently, IARA country offices have experienced increased pressure and its leaders have expressed concern about the organization's future.

Just last week, we took action against the Islamic Resistance Support Organization (IRSO), a key Hizballah fundraising organization. Unlike some terrorist-supporting charities, IRSO makes no effort to obscure its support for violence. IRSO fundraising materials present donors with options of sending funds to equip Hizballah fighters or to purchase rockets that Hizballah uses to target civilian populations. Overall, enforcement actions against bad organizations like IRSO, combined with engagement with the charitable sector, have radically altered the dynamic, leaving dirty charities isolated and imperiled.

One of the most effective tools at our disposal was the recently revealed Terrorist Finance Tracking Program. While the details remain classified, I can attest that this program has been instrumental in identifying and capturing terrorists and their financiers, and in attacking terrorist-supporting charities. For example, using subpoenaed data provided by the Society for Worldwide Interbank Financial Telecommunication (SWIFT), the Terrorist Finance Tracking Program played an important role in the investigation that eventually culminated in the capture of Hambali, Jemaah Islamiyya's Operations Chief. Broadly speaking, the Program has helped unravel complex connections and provide leads that were then disseminated to counterterrorism experts to help them track down terrorists. As the Washington Post editorial page aptly put it, "[This program] seems like exactly the sort of aggressive tactic the government should be taking in the war on terrorism."

The public disclosure of this program was regrettable and compromised one of the most valuable tools at our disposal. Tracking terrorist money trails is difficult enough without having our sources and methods reported on the front page of newspapers.

Overall, dedication and hard work across Departments and agencies has yielded critical successes in the financial war on terror. Indeed, the 9/11 Commission's Public Discourse Project awarded its highest grade, an A-, to the U.S. government's efforts to combat terrorist financing.

TARGETING FINANCIAL PRESSURE POINTS

Over the past two years, we have learned a number of lessons about how best to use financial tools to apply financial pressure and isolate terrorists, proliferators, and others whose goal it is to undermine our security. As a result, we are relying more and more on what we call "targeted" measures, aimed at specific actors engaged in illicit conduct. And, as I will describe, we are working in greater partnership with the private sector. Rather than fighting against their interests and tendencies, we have found a way to form somewhat of a natural alliance.

When people think of sanctions, what often comes to mind is a modern-day blockade: an attempt to stop trade or investment altogether in order to weaken the economy of an entire nation. This kind of program is sometimes required. Perhaps one of the best contemporary examples is South Africa under apartheid, a situation where broad, international sanctions made a decisive impact on the course of that nation's history.

But targeted financial measures, directed specifically at individuals, key regime members, front companies, financial institutions, and corrupt charities can be particularly effective. Some of these targeted measures require financial institutions to freeze funds and/or close the accounts of designated actors, denying them access to the traditional financial system. At times, the action includes bans on travel or arms transfers, which only further confine and isolate the target. To maximize the effect, we try to apply these measures in concert with others.

Whenever possible, we act with a partner or a group of allied countries. In some cases, we can designate a target at the United Nations. We also have important new regulatory authorities in the United States, such as Section 311 of the USA PATRIOT Act. Section 311 allows us to designate a foreign financial institution or jurisdiction to be of "primary money laundering concern." The impact of that particular authority - as I will discuss in a moment in the context of North Korea - has been more powerful than many thought possible.

These kinds of measures have several advantages over broad-based sanctions programs. First, because they single out those responsible for supporting terrorism, proliferation, and other criminal activities, rather than an entire country, they are more apt to be accepted by a wider number of international actors and governments. The deterrent and indirect effects of these types of measures are sometimes just as significant as their direct result. The terrorist operative who is willing to strap on a suicide belt is not susceptible to deterrence, but the individual donor who wants to support violent jihad may well be. Terrorist financiers typically live public lives with all that entails: property, occupation, family, and social position. Being publicly identified as a financier of terror threatens an end to that "normal" life. Targeted financial measures also warn innocent people not to deal with the designated target. And those who might still be tempted to deal with targeted high risk actors get the message loud and clear: if they do so, they may be next.

A second powerful lesson we've learned is that -- particularly in the context of "targeted" sanctions -- we share common interests and objectives with the financial community. Financial institutions want to identify and avoid dangerous or risky customers who could harm their reputations and business. And we want to tell them where those risks lie.

Traditionally, the private sector viewed sanctions as obstacles to be worked around, where possible. The extensive abuse of the Oil for Food program in Iraq is just one example of classic "sanctions busting" behavior. As we eventually learned, the companies hurt by that sanctions program were the ones that played by the rules.

But by partnering with the private sector, including by sharing information and concerns with financial institutions, we are increasingly seeing less of a tendency to work around sanctions. As I have traveled and met with bank officials abroad, I have learned that even those institutions that are not formally bound to follow U.S. law pay close attention to these targeted actions and often adjust their business activities accordingly. Why? There are two reasons: First, regardless of the underlying law in any particular country, most bankers truly want to avoid facilitating proliferation, terrorism, or crime. These are responsible corporate citizens. Second, avoiding government-identified risks is simply good business. Banks need to manage risk in order to preserve their corporate reputations. Keeping a few customers that we have identified as terrorists or proliferators is not worth the risk of facing public scrutiny or a regulatory action that may impact on their ability to do business with the United States or the responsible international financial community.

the Power of Targeted Measures - Dealing with state sponsors

In the post-9/11 era, the world faces two unique, but overlapping, problems. We face the threat of the global jihadists, who survive in states but are not always directly supported by them. We also face the threat of regimes dedicated to acquiring weapons of mass destruction, and that, in one fashion or another, also support terrorism. With respect to states, it is a particular challenge to limit or, preferably, halt altogether their ability to use the international financial system to support their threatening behavior. They hide behind a veil of legitimacy, disguising their activities, such as weapons sales or procurement, through the use of front companies and intermediaries. In some cases, they intentionally obscure the nature of their financial activities to evade detection and avoid suspicion.

We have had some important success with North Korea. Confronted with North Korean conduct ranging from WMD proliferation-related activities to counterfeiting of U.S currency and other illicit behavior, the Treasury Department has taken two important steps.

First, we targeted a number of North Korean proliferation firms under a new Executive order, E.O. 13382. That order authorizes the Treasury and State Departments to target key nodes of WMD and missile proliferation networks, including their suppliers and financiers, in the same way we do with terrorists. A designation under this E.O. cuts the target off from access to the U.S. financial and commercial systems and puts the international community on notice about a particular threat.

Second, we took a regulatory action to protect our financial system against Banco Delta Asia (BDA), a Macau-based bank that was handling North Korea's dirty business without any pretense of due diligence or control. BDA was a willing partner, actively helping North Korean agents conduct surreptitious, multimillion dollar cash deposits and withdrawals without questioning the basis of these transactions. Indeed, BDA officials had negotiated a lower standard of due diligence with their North Korean clients. Using an authority provided in Section 311 of the USA PATRIOT Act, Treasury designated Banco Delta Asia as being of "primary money laundering concern." Section 311 enables us to cut off a bank's access to the U.S. financial system following a rule-making process. This tool has had a profound effect, not only in protecting the U.S. financial system from abuse, but also in notifying financial institutions and jurisdictions globally of an illicit finance risk.

As a result of these actions and public revelations about North Korea's criminal conduct, responsible foreign jurisdictions and institutions have taken steps to ensure that North Korean entities engaged in illicit conduct are not receiving financial services. Press reports indicate that some two dozen financial institutions across the globe have voluntarily cut back or terminated their business with North Korea, including institutions in China, Japan, Vietnam, Mongolia, and Singapore. The result of these voluntary actions is that it is becoming very difficult for the Kim Jong-Il regime to benefit from its criminal conduct. U.N. Security Council Resolution 1695 - passed in response to North Korea's launching of seven ballistic missiles in violation of North Korea's 1999 agreement to a moratorium on testing long-range missiles - has accelerated the trend. It requires all countries to prevent the transfer of financial resources in relation to North Korea's WMD and missile programs.

Indeed, the line between North Korea's licit and illicit money is nearly invisible, and the U.S. Government is urging financial institutions around the world to think carefully about the risks of doing any North Korea-related business. If recent press reports are any guide, many seem to be doing just that.

Dealing with Iran - a country that is much further integrated into the international financial system - presents a more complex challenge.

Hizballah's recent aggression in the Middle East has focused international attention to Iran's role in supporting international terrorism. Iran has long been a state sponsor of terrorism. Tehran arms, funds, and advises Hizballah, an organization that has killed more Americans than any terrorist network except al Qaeda. The world witnessed the impact of that Iranian support this summer when Hizballah targeted a civilian population in Israel with sophisticated weaponry. That costs money. Indeed, Iran provides Hizballah with hundreds of millions of dollars each year, which is why I have said that Iran is the central banker of terror. It is remarkable that Iran has a nine-digit line item in its budget to support Hizballah, Hamas, and other terrorist organizations at the expense of investing in the future of its young people.

As we continue to deal with the challenge presented by Iran's pursuit of a nuclear weapons program, we must also confront its support for terrorism. We have taken several steps to do so this week.

First, while Iranian financial institutions are prohibited from directly accessing the U.S. financial system, they are permitted to do so indirectly through a third country bank for payment to another third country bank. Today, we have cut off one of the largest Iranian state-owned banks, Bank Saderat, from the U.S. financial system. Here is why: This bank, which has approximately 3400 branch offices, is used by the Government of Iran to transfer money to terrorist organizations. Iran uses Saderat to transfer money to Hizballah. Iran also uses it to transfer money to E.U.

designated terrorist groups Hamas, the PFLP-GC and the Palestinian Islamic Jihad. For example, since 2001, a Hizballah-controlled organization received $50 million directly from Iran through Saderat. Hizballah uses Saderat to send money to other terrorist organizations as well. Hizballah has used Bank Saderat to transfer funds, sometimes in the millions of dollars, to support the activities of other terrorist organizations such as Hamas in Gaza. We will no longer allow a bank like Saderat to do business in the American financial system, even indirectly.

Second - just yesterday - we took action under our terrorism Executive Order against two financial companies, Bayt al-Mal and the Yousser Company, which function as Hizballah's unofficial treasury, holding and investing its assets and serving as intermediaries between the terrorist group and mainstream banks. Institutions considering dealing with these two entities are now on notice as to their true character.

On the nuclear front, the UN deadline for Iran to suspend its enrichment and reprocessing activities has come and gone, while Iran continues its program without pause. President Bush has made clear that, though we continue to work toward a diplomatic solution, there must be consequences for Iran's continuing defiance. In Iranian President Ahmadinejad, the world faces the dangerous combination of a leader dedicated to developing nuclear weapons and to materially supporting terrorists; a leader that has denied the Holocaust and called for Israel to be "wiped off the map"; a leader that has said of America: "God willing, with the force of God behind it, we shall soon experience a world without the United States."

History's lessons have taught us not to ignore actions and words like these. It is clear why the world should not tolerate a nuclear-armed Iran. The danger is that Ahmadinejad not only has an ideologically extreme vision of the future but that he might develop the weapons that make him believe that vision can be obtained.

Our actions this week are a sign of the costs that Iran's leaders will impose on the Iranian people if the leadership chooses to remain on its current path of defiance. The regime will end up isolating Iran from the world community, with reputable financial institutions becoming increasingly unwilling to handle Iran's business. The Iranian people deserve better than a government willing to sacrifice their economic well-being to pursue weapons they don't need and policies that result in the deaths of innocent civilians. They deserve better than a regime that allows unemployment and poverty to rise, and their basic rights to be tossed aside. Iranians deserve freedom and all it has to offer.

The United Nations is one avenue for imposing pressure on the Iranian regime - an avenue we continue to aggressively pursue - but like-minded states and even the global private sector may well decide to take additional measures outside of that context. We are already seeing private institutions - particularly those in the financial community - responding to this provocative behavior and reassessing their relationships with Iran. Earlier this year, the Swiss bank UBS cut off all dealings with Iran. HSBC and Credit Suisse have also limited their exposure to Iranian business. According to the banks, these were business decisions, pure and simple - handling Iran's accounts was no longer good business. As further evidence of the change in tide, a number of foreign banks are refusing to issue new letters of credit to Iranian businesses. And earlier this year, the OECD raised the risk rating of Iran, reflecting this shift in perceptions and sending a message to those institutions that have not yet reconsidered their stance.

This Sunday, I am traveling to Europe - others will be going to the Middle East and to Asia - to consult with government and private sector leaders on measures we should all be taking to protect ourselves from Iran's use of the international financial system to advance its dangerous policies. The next steps may involve sacrifice, but I think that people are beginning to recognize that the costs we face now pale in comparison to those we might face in the future if Iran does not change course.

CONCLUSION

September 11, 2001 profoundly changed our country. While we in the United States did nothing to deserve that attack or the hatred that gave rise to it, it did awaken us to the very real dangers that were slowly building up around us. Terrorists seeking weapons of mass destruction along with state sponsors of terror that are pursuing them are too dangerous a combination for the civilized world to ignore.

It is critical that the government use every legitimate tool at its disposal. In the past, those tools have been largely located in our military and intelligence services; where they always have and always will continue to play critical and central roles. However, in a world defined by global networks of information and financial services, we at the Department of Treasury also play a vital part in this fight. I am proud of the work my department has done. I am proud to know that as we approach the fifth anniversary of 9/11 that we have shown those engaged in terrorism and weapons proliferation that they will not be able to conduct "business as usual" in the international financial system.

PRESS ROOM

September 8, 2006
HP-87

Treasury Cuts Iran's Bank Saderat Off From U.S. Financial System

Levey: "It is remarkable that Iran has a nine-digit line item in its budget to support terrorism."

In a move to counter Iran's support for terrorism, the U.S. Department of the Treasury today announced that Iran's Bank Saderat is being cut off from all access to the U.S. financial system, direct or indirect.

"Bank Saderat facilitates Iran's transfer of hundreds of millions of dollars to Hizballah and other terrorist organizations each year. We will no longer allow a bank like Saderat to do business in the American financial system, even indirectly," said Stuart Levey, Under Secretary for Terrorism and Financial Intelligence (TFI).

Bank Saderat is one of the largest Iranian-owned banks, with roughly 3400 branch offices. The bank is used by the Government of Iran to transfer money to terrorist organizations, including Hizballah, Hamas, the Popular Front for the Liberation of Palestine-General Command and Palestinian Islamic Jihad. A notable example of this is a Hizballah-controlled organization that has received $50 million directly from Iran through Bank Saderat since 2001.

Under the current Iranian Transactions Regulations (31 CFR Part 560), U.S. banks may process certain funds transfers involving an Iranian bank, such as transfers for authorized or exempt transactions and "U-turn" transactions. U-turn transactions allow U.S. banks to process payments involving Iran that begin and end with a non-Iranian foreign bank. Bank Saderat will not be able to participate in any transfers involving U.S. banks, effective from the date that the amendment to the regulations is filed with the Federal Register early next week.

By prohibiting U-turn and all other transactions with Bank Saderat, the bank is denied all direct and indirect access to the U.S. financial system.

PRESS ROOM

September 8, 2006
HP-88

Treasury Assistant Secretary Fratto to Hold Weekly Press Briefing

Treasury Assistant Secretary for Public Affairs Tony Fratto will hold the weekly media briefing on Monday, September 11 in Main Treasury's Media Room. The event is open to all credentialed media.

Who
Assistant Secretary for Public Affairs Tony Fratto

What
Weekly Briefing to the Press

When
Monday, September 11, 11:30 AM (EDT)

Where
Treasury Department
Media Room (Room 4121)
1500 Pennsylvania Ave., NW
Washington, DC

Note
Media without Treasury press credentials should contact Frances Anderson at (202) 622-2960 or Frances.Anderson@do.treas.gov with the following information: name, Social Security number, and date of birth.

PRESS ROOM

August 31, 2006
HP-89

Treasury Secretary Paulson to Deliver Speech on the International Economy

Treasury Secretary Henry M. Paulson will deliver a speech on Wednesday, September 13, at the Treasury Department. Secretary Paulson will discuss his views on the state of the international economy.

WHAT
Speech on the International Economy

WHEN
Wednesday, September 13, 11:00 a.m. (EDT)

WHERE
Treasury Department
Cash Room
1500 Pennsylvania Ave., NW
Washington, DC

NOTE
Media without Treasury press credentials should contact Frances Anderson at (202) 622-2960 or Frances.Anderson@do.treas.gov with the following information: full name, Social Security number, and date of birth.

M

ber 11, 2006

Treasury Official to Discuss
Disaster Preparedness in US Financial Sector

'reasury Deputy Assistant Secretary D. Scott Parsons will speak about the
:ial sector's preparedness for a disaster or attack tomorrow at 9:00 a.m. at the
cial and Banking Information Infrastructure Committee / Financial Services
ır Coordinating Council meeting. He will give remarks at the City University of
York's Graduate School and University Center.

:
ɹty Assistant Secretary D. Scott Parsons

ıt:
ıarks on Financial Sector Resilience

en:
:s., Sept. 12
) a.m.

ıere:
ɘ City University of New York
ıduate School and University Center
ɔshansky Auditorium
w York, NY

PRESS ROOM

September 11, 2006
HP-90

Treasury Official to Discuss
Disaster Preparedness in US Financial Sector

U.S. Treasury Deputy Assistant Secretary D. Scott Parsons will speak about the financial sector's preparedness for a disaster or attack tomorrow at 9:00 a.m. at the Financial and Banking Information Infrastructure Committee / Financial Services Sector Coordinating Council meeting. He will give remarks at the City University of New York's Graduate School and University Center.

Who:
Deputy Assistant Secretary D. Scott Parsons

What:
Remarks on Financial Sector Resilience

When:
Tues., Sept. 12
9:00 a.m.

Where:
The City University of New York
Graduate School and University Center
Proshansky Auditorium
New York, NY

PRESS ROOM

September 11, 2006
2006-9-11-16-24-49-17593

U.S. International Reserve Position

The Treasury Department today released U.S. reserve assets data for the latest week. As indicated in this table, U.S. reserve assets totaled $66,320 million as of the end of that week, compared to $66,642 million as of the end of the prior week.

I. Official U.S. Reserve Assets *(in US millions)*						
	September 1, 2006			**September 8, 2006**		
TOTAL	**66,642**			**66,320**		
1. Foreign Currency Reserves [1]	**Euro**	**Yen**	**TOTAL**	**Euro**	**Yen**	**TOTAL**
a. Securities	12,082	10,834	22,916	11,922	10,865	22,787
Of which, issuer headquartered in the U.S.			0			0
b. Total deposits with:						
b.i. Other central banks and BIS	11,991	5,278	17,269	11,848	5,293	17,141
b.ii. Banks headquartered in the U.S.			0			0
b.ii. Of which, banks located abroad			0			0
b.iii. Banks headquartered outside the U.S.			0			0
b.iii. Of which, banks located in the U.S.			0			0
2. IMF Reserve Position [2]			6,704			6,676
3. Special Drawing Rights (SDRs) [2]			8,712			8,675
4. Gold Stock [3]			11,041			11,041
5. Other Reserve Assets			0			0

II. Predetermined Short-Term Drains on Foreign Currency Assets						
	September 1, 2006			**September 8, 2006**		
	Euro	**Yen**	**TOTAL**	**Euro**	**Yen**	**TOTAL**
1. Foreign currency loans and securities			0			0
2. Aggregate short and long positions in forwards and futures in foreign currencies vis-à-vis the U.S. dollar:						
2.a. Short positions			0			0
2.b. Long positions			0			0
3. Other			0			0

III. Contingent Short-Term Net Drains on Foreign Currency Assets						
	September 1, 2006			**September 8, 2006**		
	Euro	**Yen**	**TOTAL**	**Euro**	**Yen**	**TOTAL**

1. Contingent liabilities in foreign currency			0			0
1.a. Collateral guarantees on debt due within 1 year						
1.b. Other contingent liabilities						
2. Foreign currency securities with embedded options			0			0
3. Undrawn, unconditional credit lines			0			0
3.a. With other central banks						
3.b. With banks and other financial institutions						
Headquartered in the U.S.						
3.c. With banks and other financial institutions						
Headquartered outside the U.S.						
4. Aggregate short and long positions of options in foreign						
Currencies vis-à-vis the U.S. dollar			0			0
4.a. Short positions						
4.a.1. Bought puts						
4.a.2. Written calls						
4.b. Long positions						
4.b.1. Bought calls						
4.b.2. Written puts						

Notes:

1/ Includes holdings of the Treasury's Exchange Stabilization Fund (ESF) and the Federal Reserve's System Open Market Account (SOMA), valued at current market exchange rates. Foreign currency holdings listed as securities reflect marked-to-market values, and deposits reflect carrying values. Foreign Currency Reserves for the latest week may be subject to revision. Foreign Currency Reserves for the prior week are final.

2/ The items, "2. IMF Reserve Position" and "3. Special Drawing Rights (SDRs)," are based on data provided by the IMF and are valued in dollar terms at the official SDR/dollar exchange rate for the reporting date. The entries for the latest week reflect any necessary adjustments, including revaluation, by the U.S. Treasury to IMF data for the prior month end.

3/ Gold stock is valued monthly at $42.2222 per fine troy ounce.

PRESS ROOM

September 12, 2006
hp-91

Remarks of D. Scott Parsons,
Deputy Assistant Secretary
(Critical Infrastructure Protection and Compliance Policy)
U.S. Department of the Treasury

Before the Financial and Banking Information Infrastructure Committee/ Financial Services Sector Coordinating Council

NEW YORK CITY, NY - Thank you Chris. And thanks to each of you for making the commitment to be here today.

Yesterday marked the fifth anniversary of the terrorist attacks of September 11, 2001. The attacks took the lives of thousands of Americans as well as citizens of 48 other countries. It is important to remember the atrocities of 9-11, the victims of 9-11 and their families, and all those who have suffered at the hands of the enemies of freedom and liberty. It is important to remember on anniversaries such as this because it reminds us all of the cost of freedom here in New York, in Washington, in Pennsylvania, across America--and around the world. Freedom is not free. It reminds me of why I signed up for this job after 9-11, and why we have all committed so much time and to this effort. Working together, we have made the United States a safer, more secure, more resilient place to live and work.

Each of you has made a difference. I commend you for your knowledge, your tenacity, and your team work, and your hard work to improve the security of the American financial services sector. These efforts have involved the strengthening of public-private partnerships, and together we have made great strides since 9-11 towards improving the security and resilience of the financial services sector in this country.

The President has taken historic actions to protect America – our people and our critical infrastructure. Execution of his plan has produced enduring results. President Bush understands the important role of the private sector. In fact, his strategy embraces a public-private partnership.

Since September 11th, President Bush has restructured and reformed the Federal government to focus resources on counterterrorism and to ensure the security of our homeland. Along with creating the Department of Homeland Security, the President established the Homeland Security Council, which is charged with ensuring the coordination of al homeland security-related activities among Executive departments and agencies. The Homeland Security Advisory Council, which includes private sector leaders and their state and local counterparts, was also established to provide recommendations on ways to improve coordination, cooperation, and communication among federal, state and local officials and the private sector.

As the lead sector specific agency for the financial services sector, the Treasury works closely with the Department of Homeland Security and the Homeland Security Council, as well as with the other financial regulators and the private sector to address areas of concern to the industry. Developing and sharing accurate and timely information about threats is critically important. Three organizations essential to these information sharing efforts are the Financial and Banking Information Infrastructure Committee (FBIIC), the Financial Services Sector Coordinating Council for Critical Infrastructure Protection and Homeland Security (FSSCC), and the Financial Services Information Sharing and Analysis Center (FS-

ISAC). Through these organizations, the financial services sector has made dramatic improvements to the security and resiliency of our critical infrastructure.

The FBIIC, a standing committee of the President's Working Group on Financial Markets, is charged with coordinating federal and state financial regulatory efforts to improve the resilience of the U.S. financial system, in the face of man-made attacks or natural disasters. Treasury Assistant Secretary for Financial Institutions Emil W. Henry, Jr. chairs this committee. The FBIIC has developed emergency protocols which are activated when an incident occurs and has redundant communication systems to increase the speed of information flow among agencies.

The FSSCC acts as the private sector group coordinating private sector thinking and actions regarding critical infrastructure resilience. Among its many accomplishments, the FSSCC assists the sector with planning and procedures during crises, testing and simulation exercises, and has coordinated back-up capabilities between the New York Stock Exchange and the NASDAQ Stock Market, allowing each institution to back the other up in case of failure.

The FBIIC and the FSSCC work closely together on a number of key initiatives including conducting outreach meetings such as this one throughout our nation. Additionally, these organizations work together to consider emerging threats and identify preventive measures.

Understanding that financial institutions need to work closely with local and state officials, we have worked to organize and establish regional coalitions. Two examples of these regional coalitions are FloridaFirst and ChicagoFirst. Through these coalitions, we have seen great progress in coordination and planning on a local and regional basis. They also provide us a single point of contact to give the most up-to-date information directly to institutions during crises. For example, during events such as hurricanes Katrina, Wilma and most recently tropical storm Ernesto, we remained in constant contact with FloridaFirst, sharing the latest projections, assessing the condition of the sector, and standing ready to offer resources where needed.

Along with the FBIIC and FSSCC, the FS-ISAC plays a critical role in informing the financial services sector during crises. It is the primary communications mechanism we use to share threat information, and to communicate with the sector during crisis. It currently serves over 8,000 firms nationwide.

We have made many improvements in the resiliency of the financial sector, including:

- Identifying the systemically critical infrastructure and working to remediate any vulnerabilities;
- Arranging for financial institutions to have priority access to telecommunications, both land based and wireless;
- Working closely with the private sector and federal, state, and local officials to coordinate protective efforts for the financial sector;
- Establishing systems and procedures to enable the Federal financial regulators to communicate among themselves and with the private sector during times of crisis as well as promoted industry measures to maintain their own crucial financial communications with each other;
- Conducting numerous drills and exercises to test backup systems and prepare financial professionals;
- Working closely with the private sector to share best practices and improve business continuity plans;
- Created a research and development agenda for the financial sector.

The private sector has made substantial investments to improve its resilience. We have much better geographic diversity with the location of backup operating sites now many hundreds of miles away from the primary operating facility. This enables financial institutions to switch their information technology operations to backup facilities very quickly, which preserves the integrity of data and allows for continuation of orderly transaction processing. This also provides better redundancy for key dependencies, such as telecommunications and electricity. Additionally, regular testing of systems and plans, combined with cross-training of key employees, helps to ensure continuity of operations.

As recent history demonstrates, our efforts to make financial institutions resilient against terrorism helps to improve our sector's stance against all hazards, be they intentional or unintentional, man made or natural. These collective efforts take us far towards ensuring the confidence in the availability of our markets and the strength of our economy remains warranted. Moreover, the resolve and spirit of the employees that work for our institutions is why we are accomplishing our goals.

That said, there are still great threats looming. Looking forward, we must consider the threat of a possible pandemic influenza epidemic as part of our business continuity and risk management planning. The FBIIC and the FSSCC have formed working groups to focus on the potential impact that a pandemic flu may have on the financial services sector. Working together we will meet this challenge as we will continue to fight the war on terrorism.

As we saw on the fateful morning of September 11th 2001, American financial institutions are symbols of our freedom and democracy both at home and throughout the world. To the people of this great nation, these institutions are sources of trust and confidence -- giving life to the great promise of achieving the American dream. Whether it is starting a new business or buying a home or opening a college savings account, our financial institutions embody the American way of life – a way of life that these terrorists want to destroy.

We are not alone as targets of this evil. As we've seen throughout the world in places such as London, Madrid, Bali, Jakarta, Istanbul, Nairobi, and Baghdad, these terrorists will strike innocents wherever they congregate and will use these attacks to recruit greater numbers to their organizations. Nor shall we assume that since there have not been direct attacks on our soil since 9-11 we can become complacent. As recent arrests in London remind us, we remain at war against terrorists that wish to destroy those that embrace our values of freedom.

Five years after 9-11, we remain vigilant and we remain committed to fighting terrorism. In the words of Winston Churchill "One ought never to turn one's back on a threatened danger and try to run away from it. If you do that, you will double the danger. But if you meet it promptly and without flinching, you will reduce the danger by half."

PRESS ROOM

September 12, 2006
HP-92

Testimony of Adam J. Szubin,
Director
(Office of Foreign Assets Control)
U.S. Department of the Treasury
Before the Senate Committee on Banking, Housing and Urban Affairs

Chairman Shelby, Ranking Member Sarbanes and Members of the Committee, thank you for this opportunity to discuss the role that the Office of Foreign Assets Control (OFAC) has been playing to combat terrorism in the five years since September 11.

It is, in a way, fitting that this hearing marks my first public appearance as the Director of OFAC. Combating terrorist financing has been a principal focus of mine almost since that fateful day five years ago. At the time, I was practicing law in the Justice Department's Federal Programs Branch and I looked to discover how I could contribute to our Government's efforts to combat terrorism. It was an OFAC action that provided my entry into the counter-terrorism arena. Shortly after the September 11 attacks, OFAC froze the assets of three Islamic charities in the United States that had been funneling money to al Qaida and Hamas. In combination with law enforcement action by the FBI, OFAC's actions effectively shut down what had been among the more significant conduits of terrorist financing in the United States. When the charities filed lawsuits challenging the government's actions, I joined a team of lawyers representing OFAC and the Treasury Department, as we successfully argued in various court actions why OFAC's actions had been legal and appropriate.

In the years since, I have continued working on terrorist financing and related issues, first as Counsel to the Deputy Attorney General on terrorism financing issues, then as Senior Advisor to Under Secretary Stuart Levey, who oversees the Office of Terrorism and Financial Intelligence (TFI), of which OFAC is a part.

Over the last five years, this Committee has demonstrated its absolute commitment to combating terrorist financing, and ensuring that the Government has all of the tools necessary to do this work aggressively and appropriately. I am therefore particularly pleased to be here today to introduce myself to the members of this committee and thank you for your leadership and support.

OFAC in 2006

My testimony will focus on OFAC's work to combat terrorist organizations and state sponsors of terrorism. I would, however, first like to outline briefly the wide range of national security issues that OFAC confronts today. OFAC is charged with administering and enforcing the U.S. Government's economic and trade sanctions. These sanctions span approximately 25 regimes and countries, and also target international narcotics traffickers, proliferators of weapons of mass destruction, and terrorist support networks.

Crafting these sanctions programs requires meticulous legal and policy analysis to ensure that our sanctions are effective, balanced, and clear. And, before they can be implemented, our targeted programs require persistent and creative investigative work to unravel the hidden financial trails of security threats, be they terrorist or WMD networks or drug kingpins. In recent years, TFI's Office of Intelligence and Analysis has assumed responsibility for researching and investigating the terrorist networks that form the basis for OFAC's actions in this arena, and has done exceptionally fine work. Once our sanctions are in place, however, much of OFAC's work is only beginning. We do extensive outreach to the private financial sector, at home and abroad, to answer questions and ensure that it understands the implications of our sanctions across a range of complex industries. We review and process tens of thousands of license and interpretive guidance requests a year, filed by individuals, firms, and multinational corporations, each of which requires careful consideration, and some of which entail sophisticated transactional analysis. We also investigate possible violations of our sanctions and, in the appropriate case, assess civil penalties or refer the violator for criminal prosecution. All of these efforts are supported by a talented resource management team, which makes continual adjustments to meet shifting priorities. OFAC performs this front-to-end work across all of its 30 sanctions programs, from the Balkans to Zimbabwe. The fact that it has been able to fulfill this mission so ably with a staff of only 125 FTE gives a sense of how dedicated and professional this staff is.

To provide a snapshot of our operations, in just the past three months, OFAC has exposed and targeted the nerve centers of Mexico's notorious Arellano Felix Organization, one of Colombia's most elusive cartels, four Chinese companies facilitating WMD-related activities, two Syrian military leaders, a set of major Hizballah financial entities, and has also cut off from the U.S. financial system an Iranian bank that was supporting Middle East terrorist groups. OFAC has also worked closely with the Departments of State and Justice to help establish and identify targets for three new sanctions programs, including Sudan's Darfur Region, Cote d'Ivoire and Belarus. In nearly every national security issue of the day, OFAC is making a contribution.

On a daily basis, OFAC works hand-in-hand with the other organizations testifying today, the Office of Terrorist Finance and Financial Crime, the Financial Crime Enforcement Network (FinCEN), and the Internal Revenue Service, as well as the Office of Intelligence and Analysis, which is not present. Under the leadership of Under Secretary Stuart Levey's Office of Terrorism and Financial Intelligence, these offices offer a range of powerful financial authorities and influence that can be harnessed to deter, disrupt, or disable threats to our national and economic security.

We also work closely with other federal departments and agencies to ensure that our programs are implemented and enforced effectively. In addition, we engage in regular outreach with the private sector enterprises affected by our programs, ranging from the financial and services sectors to manufacturing and agricultural industries. The cooperation we receive from U.S. corporations in complying with sanctions is generally exceptional.

Against this background, I will focus on OFAC's role in combating terrorism in the five years since the deadly attacks of 9/11.

September 11th Leads to New Sanctions Authorities

Following the horrific events of September 11th, the President issued Executive Order 13224, authorizing the Secretaries of the Treasury and State to wield the President's broad financial authorities against terrorist organizations and their support networks. The Executive Order has proven to be a powerful and flexible tool – it allows us to designate and block the assets of individuals and entities controlled by or acting on behalf of named terrorist organizations, freezing any of the target's assets that are held by U.S. persons and preventing U.S. persons from having any future dealings with them. Violations of the Executive Order are subject to civil and criminal penalties. To date, the U.S. has designated approximately 460 individuals and entities pursuant to E.O. 13224 of which 375 were named by Treasury.

Congress strengthened and reinforced these authorities with the passage of the USA PATRIOT Act in October 2001. The Act clarified OFAC's authority to block the assets of suspect entities in "aid of an investigation," which is an important tool when there is concern about asset flight or when our intelligence leads us to suspect that a dangerous funds transfer is imminent. In addition, the PATRIOT Act made clear that OFAC could use classified information in its designations without risking having to turn this information over to a designated terrorist supporter at a later date. These provisions have enhanced our ability to take swift and meaningful action, while leaving intact a proper balance between effectiveness and fairness.

In cases in which our designation targets are associated with either al Qaida or the Taliban, as has been the case more than two-thirds of the time, we can also propose these names to the United Nations 1267 Sanctions Committee for inclusion on its designation list. When a target is designated by the U.N. Committee, all U.N. member states worldwide are obligated to freeze the target's assets. Thanks to the able work of the State Department, we have made effective use of this international tool, both in using it ourselves to broaden the impact of our own designations and in encouraging other countries to submit their own targets.

The Impact of "Unilateral" Actions

One question frequently posed to OFAC is, how meaningful are OFAC's actions when the U.S. acts by itself to designate a foreign target – whether a terrorist supporter, a narcotics trafficker, or a supporter of WMD proliferation – and that target doesn't hold assets in the United States? Or, to put it more simply, are unilateral actions effective?

As it turns out, even when we initially act alone, we can have a dramatic impact. There are two main reasons for this. First, the United States is the world's leading banking and financial center; to paraphrase an old saying, "all financial roads lead to New York." When a designated party in Afghanistan tries to send money to Southeast Asia, that transfer will often pass through a United States bank, if only for an instant. The result is typically that these funds are frozen and we are notified by a call to our hotline or the filing of a blocking report. In addition, it is important to remember that U.S. persons and U.S. branches situated abroad are subject to U.S. law, and must comply with OFAC's regulations as if they were in the United States.

Our second "force multiplier" is that international financial institutions frequently implement our sanctions voluntarily, even when they are under no legal obligation from their host countries to do so. We have seen this time and again, in countries from Kuwait to Latvia. These financial institutions may do so because they don't want to be hosting the business of terrorist organizations, even if it is legally permissible. They may cooperate because of reputational risk. Or, perhaps they do so because of fears of litigation or U.S. action. Whatever the cause, the "OFAC list," as it is known, is on the computer screens of bank compliance officers the world over. As a result, our "unilateral" actions are anything but and can have a decisive impact against terrorist supporters, narcotraffickers, and WMD proliferators.

Using Targeted Sanctions against Terrorist Financing Networks

The Treasury Department was applying its financial authorities against terrorist organizations long before 2001. OFAC first implemented sanctions against Middle East terrorist groups in January 1995, and then expanded its scope to target Usama bin Laden and al Qaida in 1998. In implementing these programs, OFAC drew on its experience in directing targeted sanctions against narcotraffickers and their financial networks, and its experience – dating back to the 1940s – in administering sanctions against various countries.

As a result, while September 11th prompted a surge in OFAC's counter-terrorism program, the legal framework, institutional knowledge, and connections to the financial community were already in place to allow for the swift and effective use of economic sanctions. The President issued a new Executive Order to address the threat on September 23, 2001, and OFAC moved to block the assets of several al Qaida support organizations before that year's end. OFAC's exceptional institutional capacity and experience in administering sanctions has allowed it to become a model and advisor for other governments in the post-9/11 world.

As I previously noted, in the five years since, OFAC has designated 375 individuals and entities as supporters of terrorism, blocking their assets and – more importantly – cutting them off from the U.S., and frequently the international, financial systems.

In close coordination with colleagues in the Treasury Department, and at the Departments of State and Justice, we have exposed the financial networks of terror groups including al Qaida, Hizballah, Hamas, Jemmah Isalmiyya, and the GSPC, and designated financiers and companies in Southeast Asia, the Persian Gulf, the Horn of Africa, South America's Tri-Border Area, Europe, and the United States.

When we have acted against terrorist supporters in the United States, we have coordinated especially closely with the Federal Bureau of Investigation and other U.S. law enforcement agencies through the Joint Terrorist Task Forces. Indeed, some of our most effective actions have been joint operations, taken in concert with law enforcement. In February 2004, federal agents executed a search warrant on Al Haramain, pursuant to a joint investigation by IRS-CI, the FBI, and DHS/ICE. Simultaneously, Treasury's OFAC blocked the accounts of the organization pending investigation, freezing the organization's assets in place and ensuring that no money would flow through this group during further investigation. A similar coordinated Treasury/law enforcement action was taken in October 2004 against the Islamic African Relief Agency (IARA), and its U.S. alias, the Islamic American Relief Agency. Treasury designated this global network as well as five of its senior officials as Specially Designated Global Terrorists pursuant to E.O. 13224. On the same day, the FBI raided IARA's headquarters in Columbia, Missouri as part of a separate criminal investigation.

Time does not allow for a full review of OFAC's terrorist designations and successes in detail, but I would like to highlight some of our most recent actions.

Last month, we designated two overseas branches of the International Islamic Relief Organization (IIRO), which is headquartered in Saudi Arabia, as well as Abd al Hamid Sulaiman Al-Mujil, the head of IIRO's branch in the Eastern Province of Saudi Arabia. These branch offices, while holding themselves out as purely charitable organizations, were bankrolling the al Qaida network in Southeast Asia. In July, we designated Muhammad Ahmed `Abd Al-Razziq, a Canadian and Sudanese national who provided administrative and logistical support for al Qaida.

We have also taken a string of recent actions to disrupt and undermine Hizballah's financial network. Of course, the U.S. has long recognized Hizballah as a deadly terrorist organization but the recent fighting in Lebanon provided a stark reminder of how dangerous and well-supplied this terrorist organization is.

Two weeks ago, we designated the Islamic Resistance Support Organization (IRSO), a so-called "charity" operated by Hizballah. IRSO offered donors the option of earmarking their donations to equip Hizballah fighters or to purchase rockets. Just last week, OFAC designated Bayt al-Mal and the associated Yousser Company, which together functioned as Hizballah's unofficial treasury, holding and investing its assets and serving as intermediaries between Hizballah and the mainstream banks. At the same time, we designated Husayn al-Shami, a senior Hizballah leader and financial facilitator. These actions, driven by the intelligence work of TFI's Office of Intelligence and Analysis, and coordinated closely with our interagency partners, exposed and attacked some of Hizballah's most prominent financial entities. The world financial community is now on notice as to their true character.

Iran as a State Sponsor of Terrorism

Of course, one cannot hope to apply effective financial pressure against a group like Hizballah so long as it maintains massive inflows of cash from a state sponsor of terrorism, in this case the Iranian Government. OFAC administers a range of sanctions against Iran, the world's leading government sponsor of terrorism, aimed at limiting the regime's financial reach and pressuring it to cease its hostile and destabilizing activities.

In a small exception to this general sanctions program, we have allowed Iranian banks to access the U.S. financial system indirectly, through third-country intermediaries. This past Friday, we took regulatory action to cut off Iran's Bank Saderat from even indirect access to the U.S. financial system. We took this action because Bank Saderat has been a significant facilitator of Hizballah's financial activities and has served as a conduit between the Government of Iran and a range of terrorist groups, including Hizballah, Hamas, the Popular Front for the Liberation of Palestine-General Command (PFLP-GC), and the Palestinian Islamic Jihad (PIJ). As Under Secretary Levey said in announcing this action on Friday, "we will no longer allow a bank like Saderat to do business in the American financial system, even indirectly."

Weapons of Mass Destruction

Recent events involving the nuclear programs of both North Korea and Iran make clear the very serious and real challenges that we and the whole international community face. Recognizing that we must use all of our national authorities to prevent a weapon of mass destruction from falling into the wrong hands, the President issued Executive Order 13382 in June 2005, authorizing the Treasury and State Departments to designate and freeze the assets of proliferation entities and those that facilitate their activities. This authority is a powerful one, as the suppliers, financiers, transporters and other facilitators of WMD networks tend to have commercial presences and accounts around the world that make them vulnerable to exactly this kind of financial action.

In issuing the Executive Order, the President identified eight entities in North Korea, Iran, and Syria, making them immediately subject to the prohibitions set forth in the Order. OFAC's WMD investigation team provided the evidence for these designations, and has continued to track and expose proliferation networks around the world. In the past year, OFAC has designated 19 proliferation entities and one individual under this order. Notable targets have included:

* Sanam Industrial Group and Ya Mahdi Industries Group, both subordinates to Iran's Aerospace Industries Organization (AIO), which manages and coordinates Iran's missile program and oversees all of Iran's missile industries. The Sanam Industrial Group has purchased millions of dollars worth of equipment on behalf of AIO from entities associated with missile proliferation. Ya Mahdi Industries Group also has been involved in international purchases of missile-related technology and goods on behalf of AIO.

* Chinese companies Beijing Alite Technologies Company, Ltd. (ALCO), LIMMT Economic and Trade Company, Ltd., China Great Wall Industry Corporation (CGWIC), and China National Precision Machinery Import/Export Corporation (CPMIEC), as well as a U.S. office of CGWIC located in California. These companies supplied Iran's military and Iranian proliferators with missile-related and dual-use components.

* Swiss company Kohas AG, which acted as a technology broker in Europe for the North Korean military and procured goods with weapons-related applications, and its president, Swiss national Jakob Steiger. Both Kohas and Steiger have been involved in activities of proliferation concern on behalf of North Korea since the late 1980s.

Our actions have cut these entities off from the U.S. financial system and alerted international banks and companies to avoid these designated firms. We have also sent a loud message to any companies that might be considering engaging in proliferation activities that this line of business now comes with severe risks.

Conclusion

Together with my colleagues at this table and throughout the government, we will continue to employ all of our resources and authorities to keep our country safe. We greatly appreciate the continuing interest and oversight of this committee. Thank you for your support.

PRESS ROOM

September 12, 2006
HP-93

**Testimony of Daniel Glaser,
Deputy Assistant Secretary
(Terrorist Financing and Financial Crimes)
U.S. Department of the Treasury
Before the Senate Committee on Banking, Housing and Urban Affairs**

I. Introduction

Chairman Shelby, Ranking Member Sarbanes and distinguished members of the Committee, thank you for the opportunity to speak to you today about the Treasury Department's efforts and achievements in the financial war on terrorism, and to discuss the challenges that lay ahead. This Committee has played an important role in ensuring that we have the authorities to combat terrorist financing. As we take a moment to assess how far we have come since that pivotal September day in our nation's history, we recognize that there is still work to be done. The Treasury Department has been an integral player in the battle against terrorism and we will continue to use every tool at our disposal to stop the flow of illicit money to those who would seek to harm our citizens.

Over the last five years we have increased substantially our understanding of vulnerabilities in the international financial system, and how terrorist and other illicit financial networks exploit those vulnerabilities. At the same time, we have steadily enhanced our skill and sophistication in applying the financial tools that we have at our disposal to close those vulnerabilities, disrupt and dismantle illicit financial networks, and apply pressure on the states that provide terrorists support and comfort. We have begun to understand how – by communicating with the international private sector – we can make the international financial system a hostile environment for terrorist financiers and other illicit actors.

Indeed, over the last five years we have witnessed a revolution in the role that finance ministries can play in international security affairs. Counterterrorism and security policy has traditionally been the province of foreign affairs, defense, intelligence, and law enforcement officials – not Finance Ministers. But we have demonstrated why finance ministries worldwide should become integral components of national security communities.

The U.S. has led the way in this development through the establishment of the Treasury Department's Office of Terrorism and Financial Intelligence (TFI) – the first office of its type in the world. TFI's mission is to marshal the Treasury Department's policy, enforcement, regulatory, and intelligence functions to sever the lines of financial support to international terrorists, WMD proliferators, narcotics traffickers, and other threats to our national security. We seek to meet this responsibility by striving to achieve two overarching goals:

- Identifying and closing vulnerabilities in the U.S. and international financial systems; and
- Identifying, disrupting and dismantling the financial networks that support terrorists, organized criminals, WMD proliferators, and other threats to international security.

In my testimony today, I will: (i) outline how we work to achieve these goals; (ii) articulate some of our successes; and (iii) explain the challenges that we continue to face.

II. Safeguarding the Financial System by Identifying and Closing Vulnerabilities

One of Treasury's core missions is to safeguard the domestic and international financial system from abuse by identifying and closing vulnerabilities that terrorist organizations, WMD proliferators, money launderers, drug kingpins, other international criminals and their support networks exploit. We work with our interagency partners, international counterparts and directly with the private sector to advance this fundamental interest by systematically pursuing the following strategic objectives:

a. identifying typologies of terrorist and illicit financing that present systemic threats to the domestic and international financial system;

b. strengthening and expanding international standards to address these vulnerabilities and to enhance transparency across the international financial system;

c. facilitating compliance with international standards through comprehensive international anti-money laundering/counter-terrorist financing (AML/CFT) assessments and technical assistance;

d. taking appropriate protective actions against those jurisdictions and financial institutions whose AML/CFT and enforcement deficiencies represent substantial threats to the domestic and international financial system; and

e. conducting private sector outreach to the international banking and other financial service industries, as well as to the charitable sector.

This comprehensive strategic approach, described in greater detail below, safeguards the financial system from terrorist and criminal abuse by effectively promoting transparency, particularly across those higher risk elements of the financial system. Such transparency in the financial system is essential in allowing financial institutions, law enforcement, regulatory and other authorities to identify sources and conduits of illicit finance, as well as those individuals and entities that comprise terrorist, WMD and criminal support networks.

Identifying such illicit behavior and terrorist and criminal support networks allows financial institutions and government authorities to adopt appropriate protective measures to prevent these nefarious elements from corroding the financial system. In turn, protective measures deny them access to the financial system, forcing terrorist organizations and criminal interests to adopt alternative financing mechanisms and support structures that present higher costs and greater risks. Finally, the transparency created by our systemic efforts to protect the financial system from abuse is an essential pre-condition for developing and applying targeted financial measures to attack and disrupt specific threats to our national security, foreign policy and criminal justice interests.

A. Identifying Typologies of Abuse and Vulnerabilities to the International Financial System

A critical strategic objective in our mission to safeguard the financial system is identifying systemic vulnerabilities that terrorists and other criminals can exploit to finance their operations and interests. We have collaborated with our partners across the interagency and international community on several projects to identify these vulnerabilities:

- Recently, Treasury worked closely with 16 federal bureaus and offices from across the law enforcement, regulatory, and policy communities to produce the U.S. Governments first-ever Money Laundering Threat Assessment. This working group pulled together arrest and forfeiture statistics, case studies, regulatory filings, private sector and government reports, and field observations. The report analyzes more than a dozen money laundering methods and serves as a first step in a government-wide process to craft strategic ways to counteract the vulnerabilities identified.

- Treasury collaborated with its partners at the Department of Homeland Security's Immigration and Customs Enforcement (ICE) to help produce a comprehensive report on trade-based money laundering, released by the Financial Action Task Force (FATF) in June 2006.
- Treasury is leading an international working group studying the vulnerabilities that new payment products such as stored-value cards and internet-based payment systems introduce to the international financial system. This study includes an initial assessment of the exploitation of these new payment products by criminal organizations.
- Treasury is now working with its partners across the USG to contribute towards the development of international typology studies on money laundering through the real estate industry and casino industries, and terrorist financing more broadly.

We will continue to pursue these and other initiatives to help us identify systemic threats to the international financial system and focus our efforts in developing appropriate policies to protect the financial system from terrorist and criminal abuse.

B. Strengthening and Expanding International AML/CFT Standards

Because of the growing international nature of the financial system, we must work continuously with other financial centers around the world to establish and maintain effective international standards to protect the international financial system from various sources and conduits of illicit financing. In coordination with the interagency community, Treasury primarily advances this strategic objective through the FATF, and also supports the progressive development of international standards against terrorist and illicit financing at the United Nations (UN).

The FATF sets the global standard for combating terrorist financing and money laundering and provides us with a unique opportunity to engage our international counterparts in this effort. Treasury – along with our partners at State, Justice, Homeland Security, the Federal Reserve Board, and the Securities Exchange Commission – continues to assume an active leadership role in the FATF, which articulates standards in the form of recommendations, guidelines, and best practices. These standards aid countries in developing their own specific anti-money laundering and counter-terrorist financing laws and regulations that protect the international financial system from abuse.

Since before the terrorist attacks of September 11, 2001, we have consistently engaged the FATF to expand and strengthen these international standards to address the systemic vulnerabilities that terrorists and other criminals exploit, including through the development of Nine Special Recommendations on Terrorist Financing and the revision and strengthening of the FATF 40 Recommendations. Most recently, we have successfully engaged the FATF to adopt a new international standard to combat the illicit use of cash couriers, and we have enhanced the international standard for combating terrorist abuse of charities. We have also recently finalized a number of technical but critical aspects to the international standard governing the availability and integrity of originator information on cross-border wire transfers. Moving forward, we intend to discuss in the FATF how the existing AML/CFT international standards should be supplemented, amended or applied to address the vulnerabilities associated with trade-based money laundering.

At the UN, Treasury has supported interagency efforts led by the State Department to develop progressive international standards for combating terrorist financing and WMD proliferation. Most recently, these efforts have successfully led to the issuance of UN Security Council resolutions that:

- elaborate expansive criteria for issuing terrorist financing designations against individuals and entities associated with al Qaida or the Taliban (UNSCR 1617); and
- require member states to prevent the transfer of any financial resources in relation to North Korea's missile or WMD programs (UNSCR 1695).

These standard-setting efforts at the FATF and the UN create an international obligation and framework for countries to implement AML/CFT regimes that effectively protect the international financial system from various forms of illicit finance.

C. Facilitating Compliance with International AML/CFT Standards

To give full effect to these international standards, Treasury has worked continuously and closely with interagency partners and international counterparts to establish a comprehensive global system of AML/CFT assessments through the FATF, the various FATF-Style Regional Bodies (FSRBs), and the World Bank and International Monetary Fund. This system has facilitated compliance with the international AML/CFT standards by auditing the AML/CFT regimes of over 150 countries around the world to assess whether these international standards have been effectively implemented.

Most recently, the U.S. underwent such an assessment through the FATF's Mutual Evaluation Review (MER) process. All members of FATF periodically undergo a mutual evaluation and each jurisdiction is subject to the same methodology and set of standards. In all such assessments, the FATF identifies strengths and weaknesses in a jurisdiction's AML/CFT regime and follows up to ensure that significant deficiencies are addressed.

Through the FATF and FSRB mutual evalution process, Treasury has directly participated in the assessments of several strategically important countries in the campaign against terrorist financing, including Saudi Arabia, Pakistan, India and Switzerland. At the moment, a Treasury regional policy advisor is participating in the FATF mutual evaluation of Turkey, another strategically important country in our global counter-terrorist financing efforts.

In recent years, Treasury has worked continuously through a number of channels to globalize this assessment process by facilitating: (i) the development of new FSRBs that now cover all regions around the world, and (ii) a partnership between the FATF and the World Bank/IMF whereby AML/CFT assessments are now incorporated into every financial sector assessment conducted by these international financial institutions. These developments ensure the identification of systemic vulnerabilities created by jurisdictional deficiencies and allow for governmental authorities and the international financial community to take appropriate responsive actions.

One potentially appropriate governmental response to systemic vulnerabilities created by jurisdictional AML/CFT deficiencies is providing technical assistance to facilitate compliance with international standards. Treasury provides significant technical assistance to support the broader USG technical assistance mission in combating terrorist financing and to facilitate the development of transparent and accountable financial systems in strategic countries of concern.

In summary, Treasury's ongoing efforts to globalize AML/CFT assessments, participate in strategically important assessments, and provide meaningful technical assistance collectively advance our core mission of closing down systemic vulnerabilities by promoting compliance with AML/CFT international standards.

D. Taking Protective Action against Systemic Vulnerabilities

Overview of Section 311

In those instances where jurisdictional or institutional deficiencies present ongoing systemic vulnerabilities that create substantial money laundering or terrorist financing threats to the international financial system, Treasury can take appropriate protective action under Section 311 of the USA PATRIOT Act. Section 311 authorizes Treasury to designate a foreign jurisdiction, foreign financial institution, type of account or class of transactions as a primary money laundering concern, thereby enabling Treasury to impose any one or combination of a range of special measures that U.S. financial institutions must take to protect against illicit financing risks associated with the designated target. These special measures range from enhanced due diligence, recordkeeping, and reporting requirements up to and including termination of any and all correspondent accounts or activities with the designated target.

We are grateful to Congress for granting us this powerful and flexible authority. Treasury has utilized Section 311 in a variety of ways to protect the U.S. financial system from money laundering and terrorist financing threats associated with three foreign jurisdictions and eight foreign financial institutions designated as primary money laundering concerns under Section 311. On each of these occasions, our Section 311 designation has had a significant effect in protecting not only the U.S. financial system, but also the international financial system, as international financial markets have taken independent protective financial actions in response to the systemic vulnerabilities associated with the designated target. In some instances, designation under Section 311 has even facilitated the development of rehabilitative measures that effectively addressed the underlying systemic vulnerability such that withdrawal of the 311 designation has been warranted.

Case Study: 311 Actions against Latvian Financial Institutions

Treasury's Section 311 designation of two Latvian financial institutions – Multibanka and VEF Banka – in April 2005 provides an excellent example of the effectiveness of this authority in eliminating systemic vulnerabilities in the financial system. Treasury's designations were grounded in a number of jurisdictional and institutional AML/CFT deficiencies and specific money laundering concerns that created substantial vulnerabilities for the U.S. and international financial systems. Concomitant with these designations, Treasury issued rulemaking notices that proposed prohibiting U.S. financial institutions from opening or maintaining correspondent accounts with the designated Latvian financial institutions.

In reaction, numerous U.S. financial institutions cut off all financial dealings with both Multibanka and VEF Banka and generally exercised greater caution in dealing with Latvian-based transactions, accounts and relationships. Moreover, the international financial community also subjected Latvian-based financial dealings to greater scrutiny in light of the jurisdictional and institutional deficiencies and concerns identified in the 311 actions.

Treasury's 311 designations also spurred various Latvian governmental and financial authorities to cooperate with a broad array of U.S. authorities. Treasury worked together with the State Department, law enforcement and federal banking regulatory authorities to develop a conference series of workshops to discuss AML/CFT concepts and to address a number of the AML/CFT deficiencies identified in the 311 designations. Owing to several significant jurisdictional and institutional remedial steps taken by the Latvian authorities and Multibanka, Treasury subsequently withdrew its finding of primary money laundering concern and its associated notice of propose rulemaking against Multibanka in July 2006. On the other hand, continued institutional deficiencies and ongoing money laundering concerns associated with VEF Banka led Treasury to issue a final rule prohibiting U.S. financial institutions from initiating or maintaining any correspondent relationship with that concern.

Both of these Section 311 designations against Latvian financial institutions succeeded in protecting the financial system from jurisdictional and institutional vulnerabilities, in part by facilitating appropriate remedial actions by the Latvian authorities and Multibanka, and in part by cutting off U.S. financial institutions from ongoing vulnerabilities associated with VEF Banka. These examples help demonstrate the effectiveness of Section 311 in helping Treasury safeguard the financial system by closing down or taking protective action against ongoing systemic vulnerabilities.

E. Conducting Private Sector Outreach

Treasury has also advanced its core mission of safeguarding the financial system and vulnerable industries from abuse by launching comprehensive outreach campaigns with the private sector. Treasury's efforts in this regard are primarily focused on the international banking and financial service industries and the charitable sector.

Outreach to the International Banking Community

In accordance with its international private sector outreach strategy, Treasury has initiated private sector AML/CFT dialogues linking the U.S. banking sector together with those from the Middle East/North Africa (MENA) region and the Latin American region, with the support of relevant financial and regulatory authorities. The purpose of these dialogues is to:

(i) raise awareness of domestic and regional money laundering and terrorist financing risks, international AML/CFT standards and regional developments, and U.S. government policies and private sector measures to combat terrorist financing and money laundering;

(ii) assess the impact of AML/CFT international standards and U.S. law and regulation on AML/CFT development and implementation in the U.S. and foreign banking and financial service industries; and

(iii) strengthen development and implementation of effective AML / CFT measures, particularly in regions of strategic importance and jurisdictions that lack fully-functional AML/CFT regimes.

In collaboration with its interagency and regional partners, Treasury successfully facilitated the launch of the U.S.-MENA Private Sector Dialogue on AML/CFT with an initial AML/CFT Conference in Cairo in March 2006. Bankers and financial and regulatory authorities from the U.S. and the region discussed a range of challenges associated with the development and implementation of effective AML/CFT jurisdictional and institutional measures. We are now collaborating with our partners in this effort to finalize the agenda for a follow-on conference at the Federal Reserve Bank of New York in December 2006.

Treasury has initiated a similar dialogue with the Latin American banking community, hosting a roundtable discussion of U.S. and regional interests at Treasury in June 2006 to help frame this initiative. We are collaborating with these regional interests to plan an initial AML/CFT conference in the region in early 2007.

This direct private sector outreach to the international financial community complements our other work to address vulnerabilities in the international financial system by providing a mechanism to explain our money laundering and terrorist financing concerns, assess and facilitate AML/CFT progress and implementation, and receive feedback on the effectiveness of our efforts from key regional participants in the international financial system.

Outreach to the Charitable Sector

Outreach to the charitable sector represents a fundamental objective for Treasury in its broader campaign to combat terrorist financing. Treasury's ongoing engagement with the charitable community strives to protect charities from terrorist abuse and empower the sector to adopt and implement effective safeguards against terrorist exploitation. I will describe Treasury's protective efforts – advanced largely through designation of those charities that support terrorist organizations and activities – in a few moments.

Treasury's efforts to empower the charitable sector require a sustained interagency outreach campaign to communicate and advance the following fundamental points:

- the U.S. government and the charitable community share common fundamental interests in (i) promoting humanitarian relief and charitable works, and (ii) protecting charitable giving from terrorist abuse;

- Terrorist abuse includes direct support of terrorist activity and broader terrorist exploitation of charitable funds and services to radicalize vulnerable populations and cultivate support for terrorist organizations;
- Terrorist abuse is ongoing, pervasive and particularly difficult in conflict zones where terrorist groups operate and needy populations require humanitarian support;
- Combating terrorist abuse of the charitable sector requires a comprehensive approach, including oversight, outreach, enforcement, and international actions designed to: (i) empower the sector to protect against terrorist abuse, and (ii) identify and disrupt terrorist abuse of the sector;
- Actions to empower the sector include: (i) providing guidance for the sector to consider in developing and applying measures to safeguard operations from terrorist abuse, and (ii) providing information about the nature of the ongoing terrorist exploitation threat to inform the sector in developing and applying appropriate safeguards; and finally
- Actions to disrupt terrorist abuse of the sector include law enforcement investigations and prosecution, as well as financial and economic sanctions such as designations -- these tools are mutually reinforcing but distinct from one another.

Moving forward, Treasury will continue to underscore these fundamental points and provide additional guidance to the charitable community about appropriate protective measures against terrorist abuse. Treasury is currently finalizing the revised version of its Anti-Terrorist Financing Guidelines: Best Practices for U.S.-Based Charities, originally issued in November 2002 and revised and reissued for public comment in December 2005. Treasury will also continue to provide additional information on the risks and typologies of terrorist abuse, such as those discussed in Treasury's paper on the risks associated with terrorist exploitation of post-earthquake relief efforts in Pakistan, available together with other materials on the Treasury website.

III. Disrupt and Dismantle

In addition to identifying and closing vulnerabilities in the financial system, Treasury is working to aggressively disrupt and dismantle the networks that support and facilitate some of the gravest threats the U.S. faces.

The first step in disrupting and dismantling illicit financial networks is identifying those networks. For that reason, the intelligence component of our efforts is particularly important. Recognizing that importance, in close collaboration with Congress we have become the first finance ministry in the world with an internal intelligence analysis office. The Office of Intelligence and Analysis within the Treasury Department brings the knowledge of the intelligence community to bear on the evolving threat of illicit finance. Having an intelligence analysis office at the Treasury is a tremendous innovation. Financial intelligence is uniquely reliable; it allows us to track threats, as well as to deter and disrupt them.

We are learning that the targeted financial measures we have developed since 9/11 to combat terrorist support networks can and should be used to disrupt and dismantle the networks that support other threats. We have shown that these types of financial measures can be quite effective, in part because they unleash market forces by highlighting risks and encouraging prudent and responsible financial institutions to make the right decisions about the business in which they are engaged. As we have seen in the terrorism context, they also give us a concrete way in which to target directly those individuals and entities we know are bad actors and to strike at the heart of their operations.

Today, I would like to highlight Treasury's use of these targeted financial measures to address threats posed by:

a. Terrorists and their support networks;

b. WMD proliferators and their supporters, and

c. State sponsors of terrorism.

Each day, we are working to use financial measures to actively complement broader U.S. strategies to address these threats. We are also focusing on seeking similar actions from our international partners, working collaboratively with other countries and international organizations to develop the multilateral authorities and capabilities that are needed to support the financial actions we are taking. We have seen that these efforts are beginning to reap benefits in the form of growing international recognition of the effectiveness of financial measures. Not only do multiple international organizations such as the Financial Action Task Force, the United Nations, and others recognize that financial measures have an important role to play in the maintenance of global security, multiple UN Security Council resolutions make reference to financial measures in the context of a variety of specific threats.

A. Combating Terrorism with Financial Authorities

Attacking Terrorists Through the Use of Targeted Financial Sanctions

Since September 11, 2001, we have made significant progress in creating and deploying financial tools to identify, disrupt and dismantle the financial networks that facilitate and support terrorism. Through the adoption of UNSCR 1267 and 1373, the U.S. has facilitated the establishment of an effective international framework with obligations to ensure that the international financial system is a hostile working environment for those who support terrorist networks.

Treasury continues to work to refine and focus U.S. implementation of those obligations, predominantly through the application of targeted financial sanctions and our primary financial tool for combating terrorists and their support networks: Executive Order 13224. OFAC Director Szubin will testify to in greater detail this powerful authority freezes the assets of terrorists and terrorist support entities and isolates them from the U.S. financial and commercial systems. This authority also allows Treasury to expose terrorists' true sources of funding, crippling their ability to raise and move money under the guise of legitimate activities, such as charitable fundraising or the provision of financial services.

To date, the U.S. has designated a total of 460 individuals and entities pursuant to E.O. 13224, of which 375 were named by Treasury. Director Szubin will describe some of these designations in greater detail in his testimony. Through mentioning several key actions, he serves to highlight the breadth of terrorist entities that we have been able to expose and disrupt:

- Financial Institutions. Treasury last week designated Bayt al-Mal and Yousser Company, which are financial institutions that functioned as Hizballah's unofficial treasury in Lebanon.
- Charities. Treasury has designated in whole or in part more than 40 charities worldwide as supporters of terrorism, including the designation of the Islamic Resistance Support Organization (IRSO), a key Hizballah fundraising organization, two weeks ago. In August, Treasury designated the Philippine and Indonesian branches of the Saudi-based International Islamic Relief Organization (IIRO) for facilitating fundraising for al Qaida and affiliated terrorist groups.
- Financiers and Fundraisers. Financiers and fundraisers have been significant targets of designation, disrupting their ability to tap into their personal financial reserves and network of donors. Recently designated financiers include al Qaida donor Abd al Hamid Sulaiman Al-Mujil, who has been called the "million dollar man" for supporting Islamic militant groups, and Bilal Mansur Al-Hiyari, who provided financial support to the Zarqawi Network in support of its brutal attacks in Iraq against the Iraqi people, U.S. troops and coalition partners.

Treasury's implementation of targeted financial sanctions against these types of support network individuals and entities achieves multiple objectives, including:

- Deterring entities who might otherwise be willing to finance terrorist activities;
- Exposing "money trails" that may generate leads to previously unknown terrorist cells and financiers;
- Dismantling terrorist support networks by encouraging members of the support network to disassociate themselves from individuals or entities that are the targets of the sanctions;
- Terminating terrorist cash flows by shutting down the pipelines used to move terrorist funds or other assets;
- Forcing terrorists to use more costly and higher risk means of financing their activities, which makes them more susceptible to detection and disruption; and
- Fostering international co-operation and compliance with obligations under relevant UNSCRs, including UNSCR 1267, 1373, and 1617.

Encouraging Multilateral Action

A significant part of Treasury's mission is devoted to U.S. government efforts to secure international support and implementation of targeted financial sanctions actions like those I have described. In the five years since Sept. 11, we have learned all too well that the effectiveness of these authorities is significantly enhanced when other countries support U.S. efforts by freezing terrorist assets in their own jurisdictions, and prohibiting their nationals from dealing with terrorists. In coordination with the Department of State, Treasury facilitates such action through a variety of activities, including by maintaining a dialogue with other countries regarding the financial actions that are needed to disrupt specific terrorist cells or networks. However, we are also working to strengthen other countries' capacity and ability to implement targeted financial sanctions.

Through U.S. government's efforts with the EU, the Financial Action Task Force, the G7 and others, we have succeeded in assisting other countries to develop national sanctions authorities similar to our own and to improve cooperation in implementing asset freezes. In many cases, countries have joined us in imposing sanctions on U.S.-designated individuals and entities, either independently or through action at the United Nations. We have seen an increase in the number of countries approaching the UN Security Council to seek the designation of terrorist supporters. This global designation program, overseen by the UN's 1267 Committee, is a powerful tool for global action against supporters of al Qaida. It envisages 191 UN Member States acting as one to isolate al Qaida's supporters, both physically and financially. In 2005, 18 Member States submitted names for the Committee's consideration, many for the first time, and we will continue to support this process and encourage others to do so as well.

B. Using Financial Authorities to Combat WMD proliferation

Attacking WMD Proliferators Through the Use of Targeted Financial Sanctions

Related to our effort to combat terrorism is the effort to disrupt WMD proliferation, to prevent the possibility that nuclear, chemical or biological weapons could fall into the hands of terrorists. In fact, the financial tools we are using to combat terrorist support networks have proven to be effective in disrupting WMD proliferation as well. The international community also has recognized the need to combat WMD proliferation through financial measures, as reflected in UNSCR 1540, which calls on all states to develop and implement authorities to combat proliferation, including by denying proliferators and their supports access to the financial system. More recently, the UN Security Council adopted resolution 1695 -- passed in response to North Korea's launching of seven ballistic missiles in violation of the September 2005 Joint Statement of the Six-Party Talks, as well as North Korea's 1999 agreement to a moratorium on testing long-range missiles – requiring all member states to prevent the transfer of financial resources associated with North Korean proliferation and missile programs.

We are implementing UNSCR 1540 and UNSCR 1695 obligations through Executive Order 13382, issued by the President in June 2005. E.O. 13382 adds powerful tools similar to those we have in the counter-terrorism realm – a broad-based transactions prohibition and an asset freeze – to the array of options available to the U.S. government to combat WMD trafficking. As part of issuing Executive Order 13382, the President identified and targeted eight entities in North Korea, Iran, and Syria, thereby prohibiting U.S. persons from engaging in transactions with them and requiring any assets of those entities within the control of U.S. persons to be frozen. The President also authorized the Secretary of State and the Secretary of the Treasury to designate additional proliferators of WMD and their supporters under the new authorities provided by the Order.

In addition to the eight entities named in the annex of E.O. 13382, the Treasury Department has designated 19 entities and one individual as WMD proliferators. These actions described in greater detail in Director Szubin's testimony, have exposed some of the front companies, suppliers, financial institutions and individuals that facilitate their WMD proliferation, including:

- Sanam Industrial Group and Ya Mahdi Industries Group, both subordinates to Iran's Aerospace Industries Organization (AIO), which manages and coordinates Iran's missile program and oversees all of Iran's missile industries.
- Chinese companies Beijing Alite Technologies Company, Ltd. (ALCO), LIMMT Economic and Trade Company, Ltd., China Great Wall Industry Corporation (CGWIC), and China National Precision Machinery Import/Export Corporation (CPMIEC), as well as a U.S. office of CGWIC located in California. These companies supplied Iran's military and Iranian proliferators with missile-related and dual-use components.
- Swiss company Kohas AG, which acted as a technology broker in Europe for the North Korean military and procured goods with weapons-related applications, and its president, Swiss national Jakob Steiger.

By prohibiting U.S. persons from engaging in transactions with these front companies and individuals, we can effectively deny proliferators access to the U.S. financial and commercial systems, cutting them off from the benefits of our economy and trade. Our actions also expose their links to proliferation activity, and put unwitting facilitators on notice to cease their dealings with them. Ultimately, we believe that these targeted actions will remove the profit incentive from this dangerous trade and degrade proliferators' ability to conduct business worldwide.

Creating Global Action to Disrupt Financial Underpinnings of Proliferation Networks

Although the U.S. has taken initial steps to implement UNSCR 1540 and UNSCR 1695, many countries have not. Treasury, in conjunction with the State Department and other agencies, has begun outreach initiatives on a variety of fronts to encourage other countries to fulfill these international obligations by developing and utilizing authorities similar to E.O. 13382 in their own jurisdictions. Alternatively, we are urging countries to consider how they may be able to use existing authorities to freeze WMD proliferators' assets and prohibit their nationals from having dealings with them.

- Proliferation Security Initiative. Treasury is working to encourage the more than 70 countries that participate in the Proliferation Security Initiative (PSI) to use financial measures to combat proliferation support networks. This initiative, which was established by the President in May 2003, aims to stop shipments of weapons of mass destruction, their delivery systems, and related materials worldwide. I personally attended the PSI's High Level Proliferation Meeting in Warsaw, Poland in late June and was encouraged by the strong response to the U.S.-led discussion of ways in which countries could address the financial underpinnings of WMD proliferation. We plan to continue to support dialogue on this issue within the PSI's Operational Experts Group, which meets several times annually to discuss practical aspects of combating WMD trafficking.
- Global Initiative. We will also support activities associated with the Global Initiative to Combat Nuclear Terrorism, announced by President Bush and President Putin in July. This initiative goes to the heart of the threat that is most concerning – the possibility that nuclear weapons could fall into the hands of terrorists – and opens up new possibilities for the effective use of

financial authorities.

C. State Sponsors of Terrorism

In the post-9/11 era, the world faces two unique, but overlapping, problems. We face the threat of the global jihadists, who survive in states but are not always directly supported by them. We also face the threat of state sponsors of terrorism dedicated to acquiring weapons of mass destruction. With respect to states, it is a particular challenge to limit or, preferably, halt altogether their ability to use the international financial system to support their threatening behavior. They hide behind a veil of legitimacy, disguising their activities, such as weapons sales or procurement, through the use of front companies and intermediaries. In some cases, they intentionally obscure the nature of their financial activities to avoid suspicion and evade detection. The strategies we have employed to combat the threats posed by North Korea, Iran and Syria are good examples of the ways in which financial authorities are effective in dealing with state sponsors of terrorism.

Iran

As we continue to deal with the challenge presented by Iran's pursuit of a nuclear weapons program, we must also confront its support for terrorism. We have already begun to take steps to do so.

First, while Iranian financial institutions are prohibited from directly accessing the U.S. financial system, they are permitted to do so indirectly through a third country bank for payment to another third country bank. Last week, we took actions to completely cut off one of the largest Iranian state-owned banks, Bank Saderat, from the U.S. financial system. This bank, which has approximately 3400 branch offices worldwide, is used by the Government of Iran to transfer money to terrorist organizations such as Hizballah, as well as Hamas, the Popular Front for the Liberation of Palestine-General Command and Palestinian Islamic Jihad. For example, since 2001, a Hizballah-controlled organization received $50 million directly from Iran through Saderat. Hizballah uses Saderat to send money to other terrorist organizations as well. Hizballah has used Bank Saderat to transfer funds, sometimes in the millions of dollars, to support the activities of other terrorist organization such as Hamas in Gaza. We will no longer allow a bank like Saderat to do business in the American financial system, even indirectly.

Moreover, we have begun to engage with the international financial community to discuss the risks of doing business with Iran. In fact, Treasury Under Secretary Stuart Levey is engaged in precisely such consultations in Europe this week. We are already seeing private institutions – particularly those in the financial community – responding to Iran's provocative behavior and reassessing their relationships with Iran. Earlier this year, the Swiss bank UBS cut off all dealings with Iran. HSBC and Credit Suisse have also limited their exposure to Iranian business. According to the banks, these were business decisions, pure and simple – handling Iran's accounts was no longer good business. As further evidence of the change in tide, a number of foreign banks are refusing to issue new letters of credit to Iranian businesses. And earlier this year, the OECD raised the risk rating of Iran, reflecting this shift in perceptions and sending a message to those institutions that have not yet reconsidered their stance.

North Korea

Treasury has undertaken two broad initiatives to counter illicit North Korean activity. First, we have applied targeted financial sanctions to a number of North Korean proliferation firms under the WMD proliferation Executive Order, E.O. 13382. As I've discussed, a designation under this E.O. cuts the target off from access to the U.S. financial and commercial systems and puts the international community on notice about a particular threat.

Second, we took a regulatory action to protect our financial system against Banco Delta Asia (BDA), a Macau-based bank that was handling North Korea's dirty business without any pretense of due diligence or control. BDA was a willing partner, actively helping North Korean agents conduct surreptitious, multimillion dollar cash deposits and withdrawals without questioning the basis of these transactions. Indeed, BDA officials had negotiated a lower standard of due diligence with their North Korean clients. As I previously discussed, using our Section 311 authorities, Treasury designated Banco Delta Asia as a primary money laundering concern. This action has had a profound effect, not only in protecting the U.S. financial system from abuse, but also in notifying financial institutions and jurisdictions globally of an illicit finance risk.

As a result of these actions and public revelations about North Korea's conduct, responsible foreign jurisdictions and institutions have taken steps to ensure that North Korean entities engaged in illicit conduct are not receiving financial services. Press reports indicate that some two dozen financial institutions across the globe have voluntarily cut back or terminated their business with North Korea, notably including institutions in China, Japan, Vietnam, Mongolia, and Singapore. The result of these voluntary actions is that it is becoming very difficult for the Kim Jong-Il regime to benefit from its criminal conduct. UN Security Council Resolution 1695 has accelerated the trend. It requires all countries to prevent the transfer of financial resources in relation to North Korea's WMD and missile programs.

Indeed, the line between North Korea's licit and illicit money is nearly invisible. Financial institutions around the world should think carefully about the risks of doing North Korea-related business.

Syria

As in North Korea, we have taken a combination of steps to address Syria's problematic behavior and the threats posed by Syria. First, under Executive Orders 13399 and 13338, Treasury is applying targeted financial sanctions that, among other things, freeze the assets of individuals and entities that contribute to Syria's support of international terrorism or were involved in the assassination of the former Lebanese Prime Minister Rafik Hariri. In addition, Syria's Scientific Studies and Research Center (SSRC) is subject to an asset freeze under the WMD proliferation sanctions program, having been named by the President in the annex of Executive Order 13382 establishing the program in June 2005. SSRC is the Syrian government agency responsible for developing and producing non-conventional weapons and the missiles to deliver them. While it has a civilian research function, SSRC's activities focus substantively on the acquisition of biological and chemical weapons.

Second, we took action under Section 311 to protect the U.S. financial system against the Commercial Bank of Syria (CBS), which has been used by criminals and terrorists to facilitate or promote money laundering and terrorist financing, including the laundering of proceeds from the illicit sale of Iraqi oil and the channeling of funds to terrorists and terrorist financiers. In March 2006, Treasury issued a final rule, pursuant to Section 311, designating CBS as a primary money laundering concern and requiring U.S. financial institutions to close correspondent relationships with CBS. Consequently, prominent international financial institutions have begun to reassess their relationships with Syria and a number of Syrian entities.

IV. Conclusion

I am hopeful that my testimony today has provided a broad view of how Treasury's efforts are safeguarding the financial system and helping to advance the overarching efforts of our government to combat terrorism and various other threats. As we review the developments at Treasury since 9/11, it is clear that we have come a long way in reshaping Treasury's role to focus on closing down vulnerabilities to the financial system and applying financial measures to disrupt and dismantle the networks that support terrorists, WMD proliferators and state sponsors of terrorism.

It is also clear that we have considerable challenges ahead of us. We must continue to work with our interagency partners and the private sector to ensure that we are collecting, sharing and applying useful financial information to combat terrorism and other threats. We must also work with our interagency partners and the private sector to advance the effectiveness and efficiency of our financial actions, including our systemic regulatory efforts and our targeted and economic financial measures, in preventing terrorist activity and in disrupting these threats. We must also continue to work with our international counterparts to develop and share meaningful financial information and to achieve broader multilateral capability and support for our financial actions. And we must adjust the development and application of our financial tools as terrorists and other threats adapt their financing methods and as we continue to learn how to improve our efforts. With the comprehensive strategic approach that I have outlined here today, we will move forward to attack these challenges.

Finally, I am grateful for the support that the Congress has provided to us as we have refined our mission under the development of TFI at Treasury. I am honored to be a part of such an important mission at Treasury and am particularly grateful for the support and leadership that our mission continues to receive from across the interagency community and from within Treasury, particularly from Undersecretary Stuart Levey, Assistant Secretary Pat O'Brien, FinCEN Director Werner and OFAC Director Szubin, and others whom I work with every day. Such unwavering support and leadership will ensure that we continue to advance our mission as we tackle the challenges that lie ahead.

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

PRESS ROOM

September 12, 2006
HP-94

Remarks of Anna Escobedo Cabral,
U.S. Treasurer
U.S. Department of the Treasury
Before the Detroit Economic Club

Dearborn, MI- Thanks very much for your warm welcome. It is great to be in Dearborn, Michigan today and to speak before such a distinguished group of community and business leaders. I really do appreciate that the Detroit Economic Club invited me to join you. I particularly want to thank Beth Chapelle, your President and CEO, Steve Grigorian, your COO and Eleanor Josaitis, a Co-founder, for asking me to participate in today's meeting.

You know, today I come to share with you Treasury's commitment to creating an environment that ensures continued economic growth for our whole country and to realize our fullest potential.

Additionally, I also want to share some information about many of the initiatives my Department is continuously working on to help improve the financial literacy skills of all people across the country.

But before I continue with today's discussion, it's important to take a moment to remember all of those who lost their lives in the terrible attacks of September 11 five years ago.

Despite this terrible tragedy, we must truly be thankful for the blessing of living in a free and democratic country – in a country where, no matter the challenge we might face, we know that we have options we can exercise freely, and there are always opportunities to improve our lives, to start all over again, and aspire to achieve greater and better things for ourselves.

We truly can be thankful, that despite the continued threat that still exists, terrorists have failed in their malicious efforts to harm our country and its citizens since then. More importantly, they have failed to divide us as a nation – and we remain united.

President Bush yesterday proclaimed September 11 as "Patriot Day." And I just want to briefly read for you a brief portion of his proclamation. In it the President stated:

"In the face of these unspeakable attacks, we were reminded that the great strength of America is found in the hearts and souls of our citizens. We witnessed firefighters, police officers, other public safety officials, and ordinary Americans demonstrate extraordinary courage, risking their lives to save innocent victims. We saw our country united in compassion as Americans came together to provide relief and bring hope to others.

"Today, America is fighting a war that is testing our Nation's resolve. We are once again answering history's call with confidence, and we know that freedom will prevail. Our brave men and women in uniform have stepped forward to fight our enemies abroad so that we do not have to face them here at home, and we are grateful for the courageous individuals bringing terrorists to justice around the world.

"We are also confronting the extremists in the great ideological struggle of the 21st century. September the 11th made clear that, in the long run, the only way to secure our Nation is to advance liberty and democracy as the great alternatives to repression and radicalism."

Indeed, it is amazing that despite major challenges like the attacks of September 11, on the whole our economy has really shown some significant growth. That is because we've faced our challenges head on.

Despite the fact that we've witnessed continued economic growth in 48 states over the past 12 months and that our national economy has grown at a 4.2 percent annual rate – faster than any other major industrialized country – there is still much work ahead of us.

As I earlier mentioned, it is critical that we remain focused on policies that encourage job growth, investment in businesses and in workers – so that American workers have the means to obtain the skills and qualifications to fill the jobs of the 21st century. In short, we need to stay focused and committed to ensuring we maximize the number of Americans benefiting from the unprecedented national economic growth the country as a whole is experiencing. In essence, we cannot afford to sit on our laurels. It will be important to our survival and well-being to maintain our competitive edge.

In order to ensure continued growth, not just for the majority, but for every state in this great nation of ours, it will be very important to continue advancing the pro-growth economic policies which have helped us remain the most powerful economy in the world.

This Administration has set out a plan to do this. First, the President has a strategy to sustain economic growth and keep the American economy competitive. One important way to do this is by making tax relief permanent for all Americans who pay taxes. When people and businesses are in a position to keep more of the money they earn, there is more money available to invest.

We've already taken important steps in this area – important steps to sustain and increase economic growth.

First, the President worked with Congress to double the child credit, reduce the marriage penalty, cut taxes on capital gains and dividends, and to create new incentives for businesses – particularly small businesses – to invest and expand.

Second, it will be important to exercise fiscal restraint. The President is also working with Congress in this area. In February of this year, he signed the Deficit Reduction Act into law. This legislation will save our nation almost $40 billion over the next five years. He's also urging Congress to pass the line-item veto – a very important tool to target wasteful spending in large bills.

Third, we must focus our efforts in training and education, to ensure we remain a competitive in the global marketplace. The President has developed the American Competitiveness Initiative, which will encourage more aggressive investment by businesses in research and development, increase Federal support for vital basic research, and improve math and science education for America's students.

Additionally, we also have to continue to work on opening markets around the world to American businesses. This will expand opportunities for America's farmers, ranchers, workers and businesses. That is why expanding free trade and lowering trade barriers to the sale of U.S. goods and services is so important.

And finally, we also have to take on the significant challenge of meeting America's energy demands. Developing clean, domestic and affordable supplies of energy is very important, and I know this is an important issue for the automotive industry. While we must safeguard the environment, we must all reduce our foreign energy dependence and help keep prices reasonable for consumers. This Administration continues focused on initiatives like the President's Advanced Energy Initiative, which aims to promote alternatives to oil and seek clean ways to power our homes and our cars.

Now I understand, sometimes the benefits of pro-growth policies, such as more jobs and a higher standard of living for many Americans, are not as immediately obvious in all areas of the country. As Secretary Paulson has said, "Unfortunately the clear benefits . . . sometimes take longer to manifest themselves and are less visible . . . These dislocations are very real and painful . . ."

I agree with the Secretary. We must think more creatively about how we can be more competitive and how we can assist those who face hardships.

I also had a humble beginning when I was growing up. But my parents always set the example that we must learn to take control of our own futures and to seize every opportunity we get.

I carry that message with me today. We must encourage individuals, particularly those in our respective communities, to acquire the necessary skills necessary to manage their money wisely and invest it intelligently.

At the micro level, this Administration and Treasury have also focused on finding ways to help Americans better manage their personal money situations – whether they have more money to keep and invest, or whether they are facing considerable fiscal challenges. I'd like to talk to you now about some of the work we've done at Treasury to improve financial literacy rates across the country.

I often say that education is more than attractive packaging. It must be delivered by trusted sources in the community. And that is why I ask your help, and that of the Detroit Economic Club, to help get the message out about some of the personal finance education resources available to consumers for free.

We're committed to improving financial literacy through the work of a federal commission – The Financial Literacy and Education Commission. The commission has an important role to play in helping citizens gain the knowledge and tools they need to compete and succeed in the 21st century. It recently released a strategy to improve financial education during Financial Literacy Month, in April of 2006.

The Commission, now led by the Secretary of the Treasury Hank Paulson, was created in 2003, and the 20 agencies that form it were tasked with developing a plan to improve the money management skills of people in the U.S. The Commission was also tasked with developing a federal financial education web site and toll-free hotline, which were launched in English and Spanish in October of 2004 – MyMoney.gov and 1-888-MyMoney.

Very soon, the Commission will turn its attention to developing a multimedia campaign addressing financial education needs in the U.S. Since the strategy addressing the campaign has just been completed, the work on this campaign is just in its earliest phase.

The web site and hotline offer quite an array of financial education tools in English and Spanish to help you, your family and your clients obtain basic information to help them make wise personal finance decisions – whether their current interest is in saving, investing, paying for a college education, purchasing a first-time home or even starting a business.

This information is easily accessible in this one-stop shop – these resources and the strategy I mentioned earlier are all accessible at www.mymoney.gov. I encourage you to visit it, and even add the link to your resources list on your web sites!

I also think that given this club's activities, you can help make this information available in your respective communities. And I hope it will help spark some creative thoughts about how groups like this organization and Treasury can partner in future common efforts.

Just to give you a quick overview of the strategy: the strategy looks at a variety of other important topics, such as homeownership, credit management, retirement savings, in addition to "banking the unbanked" – an issue on which my office has been particularly active.

The strategy is really a blue print – it is a first step. However, it is a significant first step toward addressing the issue of tackling the challenge of assisting the more than 10 million individuals that are currently "unbanked" or who do not have a relationship with a traditional financial institution.

It also describes the challenges and guideposts for possible solutions.

The strategy encourages Americans to take advantage of the many tools to help them save money to buy a home, properly plan for retirement or better manage their monthly household income.

It also puts forward examples of financial education programs that community leaders, private companies and volunteers can all look to as they design programs of their own to enhance financial literacy.

Sometimes the solutions come from the Federal government, but often nonprofit organizations, businesses and other private sector players provide important resources for those wishing to learn more about financial matters.

At the end of each chapter in the strategy, you will notice that Calls to Action are highlighted. As a result, Treasury will be coordinating multicultural financial literacy forums to identify the needs of local communities, but also identify some of the best practices in financial education that are quite literally producing positive results.

I hope to hear from all those in the audience, especially those interested and involved in working on these issues. And I look forward to working with each of you in the future.

Thanks again for your attention. Now I believe we have a few minutes for some questions, which I will be happy to take.

PRESS ROOM

September 13, 2006
HP-95

Remarks by Treasury Secretary
Henry M. Paulson
on the International Economy
Treasury Department Cash Room
Washington, D.C.

One week from today, I will be in China to discuss the economic relationship between our two nations. Today I will speak about China, and more broadly about the international economic system.

The prosperity of the United States and China is tied together in the global economy, and how we work together on a host of bilateral and multilateral issues will have a significant impact on the health of the global economy.

Half of all global economic growth in the last five years has come from the United States and China, and our two economies will continue to be the drivers of growth in the future.

Yet many view the growth of China and its increasing importance as the clearest and most tangible threat of globalization. Those who welcome China's growth and integration into the world economy, as I do, should confront this argument directly.

I have spent 32 years working in financial markets, much of that time in economies around the globe, and I have learned a number of important lessons. One lesson is that those nations that reform their economies and open themselves to competition benefit their citizens greatly. They have better jobs, improved living standards, and greater opportunity.

At the same time, those nations that try to close themselves off from competition, hinder free markets, and fail to invest in their people, simply get left behind.

The benefits of competition extend well beyond manufactured goods and agricultural products. Greater efficiencies and advanced technologies in a number of services have a multiplier effect, strengthening the entire economy.

One area where I have personal experience is in financial services where I am a strong advocate of opening up the domestic capital markets and financial systems of our trading partners to international competition. Healthy capital markets are absolutely critical to any nation's long-term economic success. And I don't know of a single example of a nation which has a strong financial system and strong capital markets that has not opened itself up to foreign competition.

The U.S. experience illustrates the benefits of openness and competition. Our economy is by far the world's strongest because it is built on openness – openness to people of all nationalities, openness to new ideas, openness to investment, and openness to competition. It is a model that others strive to emulate. And we aim to keep it that way.

Our proven success has allowed us to effectively advocate free trade and open markets here in the United States and around the world.

A good illustration of the benefits of competition through trade can be found in

Asia. Thirty years ago, economist and author, Gunnar Myrdal, used Asia as a metaphor for global poverty. But Asian nations opened their markets and allowed their businesses to compete in the world market place. What Myrdal referred to as the Asian Drama is now the Asian miracle, with hundreds of millions of people freed from poverty.

Vietnam, where I attended the APEC meetings last week, is a case in point. In 1986, the Vietnamese launched the Doi Moi program of economic reforms that liberalized Vietnam's economy and began to open it to foreign trade and investment. Vietnam's trade has since grown by 20-30% per year, and the country has been second only to China in its rate of real GDP growth. When I visited Vietnam, I spoke to its leaders, but I also spent time with young entrepreneurs and students. They are eager to join the global economy and replicate the success of others in the region.

We must appreciate and reinforce Vietnam's commitment to continuing economic reform, and the rules-based trading system. I will work closely with the President, my colleagues in the Administration, and Congress to bring Vietnam into the World Trade Organization, because it is in the interest of the United States and Vietnam.

Trade is not a zero-sum game. Rapid economic growth in Vietnam and other nations around the world benefits Americans by adding to the growth of the global economy, and over time, creating greater demand for our products and more jobs for our workers.

Our prosperity is linked to the strength of foreign economies. And we are adversely affected by their economic declines and financial shocks. The Asian Financial Crisis of 1997 may have reduced growth by as much as 1 percentage point in the United States and Europe. Financial markets also are global. The Russian default in 1998 led to a sudden widening in credit spreads and a financial shock which contributed to the failure of the hedge fund, Long Term Capital Management, in the United States.

There are no islands of economic stability in today's world. Globalization and interdependence are here to stay. No nation can turn back the clock.

In today's interdependent world, U.S. exports and U.S. employment opportunities are affected by how well our major trading partners are doing. When any major economy does well, its growth benefits the overall global economy. When a major economy falters, it is a drag on global growth. We see this illustrated by Japan, the world's second largest economy, which struggled for a decade with sluggish growth and deflation.

Japan's economic reforms over the past five years have produced an economic recovery, and we all have benefited from the boost to global growth and the increase in Japanese import demand. Japan's reforms are not complete, and they must continue. However, these steps demonstrate the importance of growth-enhancing reforms in major economies as an effective way to increase jobs in the United States and prosperity globally.

Economic integration makes economies more efficient, more productive, and more competitive. Integration gives businesses greater access to markets around the world, and increases their ability to achieve economies of scale. Global markets give consumers more choices. And global competition helps reduce the prices of goods and services – a real benefit to those with lower incomes, whether in the United States or abroad.

Enhanced competition from global integration greatly benefits the international economic system, particularly the United States.

The Institute for International Economics has estimated that the integration of the global economy generates an economic gain of $1 trillion to the U.S. economy, every year. And I know from my previous life at an investment bank that global economic integration also leads to a lower cost of capital, more opportunities for investors to achieve higher returns, and more stable long-term economic growth. This is the foundation of prosperity, jobs, and opportunity.

Yet, despite the benefits of competition and the expansion of world trade, there are many who oppose what is commonly know as "globalization". Ironically, this protectionist sentiment comes from many quarters in those nations – including in the United States and China – which have benefited the most from the economic growth generated by global competition.

This widespread and growing resistance is not surprising, because the benefits of competition, while significant, are not spread evenly and competition can create losers as well as winners.

The short-term problems are more immediately visible in the form of job losses that are very real and painful.

Protectionist policies do not work and the collateral damage from these policies is high. By closing off competition and blocking the forces of change, protectionism reduces the losses of the present by sacrificing the opportunities of the future. Jobs saved in the short term job are off-set by more job losses and a lower standard of living in the future.

I believe it is the responsibility of all nations to search for ways to moderate income disparities and help those who lose their jobs to international competition. We in America must think creatively about how to assist those who fall behind. As the President has repeatedly emphasized, the most effective method for generating new, high-quality jobs, and higher living standards, is to develop the skills and the technologies that promote economic competitiveness. This means helping people of all ages pursue first rate education and training opportunities.

Because I care deeply about the competitiveness of the U.S. economy I will be an outspoken advocate for maintaining – and extending – free and fair trade. The United States wants open markets. We welcome foreign investment. And we seek partners to join us in advancing a global agenda that will help realize the benefits of economic liberalization and competition. We will not heed the siren songs of protectionism and isolationism.

We recognize how important it is to work with our major trading partners to revive the Doha round of trade negotiations. And U.S. Trade Representative Susan Schwab and others are looking for creative ways to do just that.

Trade negotiations are never easy. But the Doha round is just too important to let slip away. We have before us an historic opportunity for the international community to join together to generate economic growth, spark development, and raise living standards across the world like no other action.

The stakes are huge. And they transcend the purely economic. Closer economic ties between nations help promote international peace and prosperity by creating common interests and raising the costs of conflict. In fact, the greatest threat today is not from conflict between states, but from instability within states, and from those states, like North Korea and Iran, which are not prepared to abide by international standards of conduct, including WMD proliferation and terrorism.

It is also true that the hope and opportunity which can come from broad-based economic progress can foster stability within nations, diminishing the appeal of extremists and terrorists. Greater economic freedom and more widely shared prosperity within a nation can lead to greater freedom in the political system as well – a point that has been made persuasively by my friend and author, Fareed Zakaria. Countries that implement market-driven policies which provide their citizens greater economic freedoms, find that those citizens also naturally seek a greater stake in their political system.

The trend towards greater public voice and democratization is clear, for instance, in rapidly growing Asian economies such as Korea, Indonesia, and others.

Does this mean that open markets by themselves will end war, eradicate terrorism, and lead to democratic government everywhere? No. But it does mean that economic liberalization – with the interdependence and the growth that it brings – can play an important role in advancing the cause of peace and stability.

Against this backdrop of interdependence, China has an increasingly important role in today's global economy and its economic relationship with the United States. In many ways, this nation's economic development – which has seen hundreds of millions of its citizens raised from poverty in just a few decades – has to be one of the most dramatic transformations in world economic history. The Chinese people have benefited greatly from China's integration into the global economy. China's GDP has grown 10-fold over the last 27 years, it is now the world's third largest trading nation.

And China's incremental demand is the major factor in determining the price for a number of primary commodities, including oil. We must realize that China is already a global economic leader. China deserves recognition for what it has become, but at the same time, China must be more than a beneficiary of open markets. I agree with former Deputy Secretary of State Bob Zoellick, China should be a responsible stakeholder. As a global economic leader, China should accept its responsibility as a steward of the international system of open trade and investment.

It must recognize its responsibility to maintain the health of the global system. China's remarkable success since market reforms began in 1978 has led many to predict that its meteoric growth will continue indefinitely – that we can extrapolate its future growth from its past performance – as if China has somehow found a way to immunize itself from business cycles and all other economic problems. Some fear that China will soon overtake all other economies to the detriment of the rest of the world. To them, China has become the leading symbol of the threat posed by globalization.

They are concerned about their jobs, and in some cases even the future capability of their nations to compete.

There are others – including many inside China – who argue that China is still a developing nation in transition, and that we must be patient as this transition unfolds. They believe that China must slow or "manage" the transition, and limit foreign access or investment to protect domestic enterprises.

Both these arguments miss the greater truth. Today, China is transitioning from a planned economy to a market-driven economy and there is no doubt that this process will continue for a number of years to come. But, because of its size and its role in world markets, China is, by definition, already a global economic leader and deserves to be recognized as a leader. But with leadership comes responsibility. When I go to the International Monetary Fund meetings in Singapore later this week, I will support China and other nations gaining greater representation at the IMF as part of comprehensive reform of that institution.

In return however, we expect China to be a responsible member adhering to the spirit and letter of the rules and regulations of the IMF. Another area where we look to Chinese leadership is for help reviving the Doha round of trade negotiations. We would like China to be our cooperative partner in encouraging nations to lower barriers to trade.

Because it is a global economic leader, what happens in China will affect the well being of the U.S. and the rest of the world.

China's continued economic progress will strengthen the international economy benefiting people around the world while a hard landing or a significant slow down in the Chinese growth rate will weaken the global economy to our detriment.

Of course, global economic leadership also brings with it responsibilities that go beyond the economic arena, including international laws and conventions on important issues ranging from human rights to non-proliferation.

A big part of being a global economic leader is a commitment to open markets at home. China's record of reform is remarkable by any standard. But much remains to be done. The tasks faced by Beijing are so daunting that the biggest risk we face is not that China will overtake the U.S., but that China won't move ahead with the reforms necessary to sustain its growth and to address the very serious problems facing the nation.

These problems range from modernizing and reforming the rural agriculture economy, to providing an adequate pension system and other safety nets, to developing capital markets that have lagged far behind the needs of China's economy, to freeing up an inflexible currency regime that hinders the efficient allocation of capital and the achievement of balanced sustainable growth. The Chinese economy itself is becoming increasingly difficult to manage as it becomes larger and more complex, but is still only part way between a managed and market economy.

China now faces a difficult but essential phase in its development and the reforms it must continue to pursue will not be easy. Up to now, rapid growth has been achieved by shifting excess labor from agriculture and state-owned enterprises to market-based manufacturing. Today, as the most obvious sources of inefficiency are disappearing, growth will depend on raising productivity which, in my judgment, will require markets to allocate capital as opposed to administrative decisions. The Chinese have an astonishingly high savings rate – 50 percent of GDP – because Chinese households face so many uncertainties.

China needs a more harmonious, more balanced pattern of growth that gives Chinese households more income and the confidence to spend it.

These challenges are made even more difficult by the fact that within China, as in the U.S., there are loud voices espousing anti-reform, protectionist sentiment. In China this resistance stems from a number of factors including that the benefits of this economic expansion have been spread unevenly among its citizens and that some influential people have never fully embraced the need to open up the Chinese economy to competition.

This protectionist sentiment is evidenced by increasing levels of public discontent, demonstrations, and anti-reform articles written by prominent academics.

Yet, it is impossible to overstate the importance of China moving forward with liberalization. First and most importantly, only reform can guarantee the future growth that the Chinese people expect and deserve. Second, liberalization sends a clear signal of China's willingness to assume its role as a global economic leader. And third, reform will do much to ease rising anti-Chinese sentiment.

Over the last couple of years in my prior role, I was struck by the fact that some of the anti-trade sentiment manifesting itself outside our nation is turning into anti-China sentiment as more people in nations around the world are viewing China as a symbol embodying both the real and imagined downsides of global competition. They are increasingly blaming China for economic dislocations in their nations and are increasingly viewing China with apprehension.

Similarly, I've seen that the level of anti-trade and anti-China sentiment in the United States is also significant and growing. I believe that if China doesn't move quickly to continue reforming its economy, it will face a backlash from other international economic stakeholders. This backlash would not benefit any of us.

The United States has its own responsibility to help China continue its structural reforms and its transition to a market-driven economy that welcomes competition.

We also have responsibilities as a stakeholder in the global system. These include keeping our markets open to trade, to foreign investment and maintaining the flexibility and rapid productivity growth that has made us a driving force in the growth of the global economy. We must continue to pursue policies that maintain and enhance international confidence in the U.S. economy, financial markets and U.S. securities.

The U.S. economy and the Chinese economy are highly interdependent, and given this interdependence we have a number of potential areas of cooperation. I want to address two that are very important to me personally – energy, and the environment.

On energy, China, which was self sufficient in oil until 1993, is now the world's second largest oil consumer behind the United States. We clearly share an important interest in energy security with China and other nations, particularly those which are net importers of oil.

That means developing new sources of supply, minimizing supply shocks, increasing conservation, and the developing alternative technologies. Since much of the oil we both need is found in troubled regions of the world, China and the U.S. have common incentives to minimize regional instability while reducing our dependence on foreign oil.

There are also important opportunities to work together to preserve and protect our environment. We only have one planet. Air and water know nothing of national boundaries.

And China's severe environmental hazards not only are harming the health of its people and ecosystems, they are also harming China's long term economic potential. Economic development without regard for environmental protection is not sustainable. A healthy environment and a strong economy are not in conflict but represent opposite sides of the same coin. No one understands the Chinese environmental problem better, or is more concerned about it, than the Chinese people. They have to breathe the air, drink the water, and witness the environmental degradation on a first hand basis.

This point was driven home to me last October when I was in Beijing to co-chair a meeting of a philanthropic organization dedicated to Asian and Chinese environmental and conservation issues. We met for part of a day to share best practices with a group of 100 leading Chinese entrepreneurs who had recently formed their own environmental NGO called Society Entrepreneur Ecology, or SEE. They were so concerned about the quality of air they were breathing in Beijing that they got together to do something about it. This was not a hobby. Their passion and commitment was palpable.

This demonstrated to me in a very tangible way that the U.S. and China share the goal of creating a cleaner China and a cleaner planet.

And we can and should be sharing technologies and best practices to protect our environment as we are through the Asia Pacific Partnership for Clean Development and Climate, along with Australia, India, Japan, and South Korea.

This initiative, which was established last year under Secretary Rice's leadership at the State Department, is an innovative public-private partnership designed to address issues of the environment, energy security, and climate change in ways that promote sustainable development.

While we can work together on these issues and others, China must confront its long-term structural challenges as it makes the transition to a market-driven economy.

Without question, the nation must modernize its financial sector, open up its capital account, and move to a more consumption-based model of growth. A competitive, well-regulated financial system and the free flow of capital will help reduce the extraordinarily high levels of precautionary savings and allocate capital to its most efficient use, which will help raise productivity and living standards. China must also pursue fiscal and regulatory polices that address the investment/savings imbalance.

These changes will help create the millions of jobs that China needs to generate annually, and will help create markets for U.S. exports of goods and services to China.

China faces several critical, immediate challenges. The first is the pressing need to put in place widely-accepted, market-based tools to keep its economy from veering out of control. A much more flexible, market-driven exchange rate along with a more nimble, self-determined monetary policy are key ingredients to stable and sustainable, non-inflationary growth.

Accordingly, maintaining and relying on an overly rigid exchange rate and outdated administrative controls increases the risk of boom and bust cycles. Also, to be under estimated only at China's own peril, is the fact that their currency exchange rate is increasingly being viewed by their critics as a symbol of unfair competition.

Another pressing issue is greater protection for intellectual property rights. China cannot achieve its goal of being a modern economy if it fails to adhere to the rule of law and fair trade and encourage the innovation that is the engine of growth for developed – and developing – economies.

Moreover, U.S. businesses lost billions of dollars in sales last year due to the illegal acquisition and use of their copy-righted ideas and products in China.

When I visit China in the coming days I will discuss these issues with the Chinese leadership, and I will use a Chinese saying indicating that it is for the good of both of our economies that they undertake these changes, for our economic fortunes are interconnected. I will say: We want you to succeed.

Bigger domestic markets and more success for you mean expanded markets, a higher standard of living and more jobs in the U.S. It also means lower prices for U.S. consumers and higher returns for U.S. investors.

The United States has a huge stake in a prosperous, stable China – a China able and willing to play its part as a global economic leader. We are not afraid of Chinese competition. We welcome it.

We want China to assume its rightful place as a responsible member of the international community. The choices you make will affect many things from the air we breathe to price of our farm products. And, of course, of vital importance to you is a United States of America with a healthy, growing economy which believes you are committed to being a responsible global economic leader dedicated to moving forward with your economic reform agenda and fair trade.

These reforms will not be easy, and they will take time. This is why we must take a strategic view of our relationship with China. Both in China and in the United States, we must not allow ourselves to be captured by harmful political rhetoric or those who engage in demagoguery. Instead, we must realize that the U.S./Chinese relationship is truly generational and demands a long-term strategic economic engagement on our common issues of interest.

PRESS ROOM

September 14, 2006
hp-96

Treasury Secretary Paulson to Attend G7-IMF-World Bank Meetings in Singapore, Travel to China

Washington, D.C. –Treasury Secretary Henry M. Paulson will travel to Singapore at the end of this week to attend a G7 finance ministers meeting and annual gatherings of the IMF and World Bank. On Tuesday, September 19, he'll travel to China to meet with government officials, local business leaders and students.

While in Singapore, the Secretary will hold a number of bilateral meetings with his counterparts and participate in a range of discussions with his colleagues around the world. At the conclusion of the G7 meetings on Sept. 16, Secretary Paulson will hold a press conference. (Time and Location TBA.)

In his first trip to China as Treasury Secretary, Paulson will engage Chinese officials in a range of discussions on the importance of trade liberalization – especially in the financial sector, among other issues such as advancing the global agenda with benefits of economic liberalization and competition, and the economic relationship between the two nations. He'll go to Hangzhou on September 19 and spend Sept 20-22 in Beijing before returning the U.S.

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PRESS ROOM

September 14, 2006
HP-97

Testimony of Richard Holcomb
Deputy Chief Financial Officer
U.S. Department of the Treasury
Before the Subcommittee on Federal Financial Management,
Government Information, and International Security
Committee on Homeland Security and Government Affairs

Chairman Coburn and distinguished members of this Committee, thank you for the opportunity to appear before the Committee today. One of the oldest departments in federal government, Treasury has a long and distinguished tradition of serving the American public. The mission of the Department of the Treasury is to promote the conditions for prosperity and stability in the United States and encourage prosperity and stability in the rest of the world. We take our responsibilities in the domestic and international financial arenas very seriously which includes maintaining the day to day fiduciary functions for the nation as a whole.

As the Federal Government's financial manager, we collect United States revenues and disburse eighty-five percent of the federal payments. In addition we manage borrowing and perform central accounting functions. We administer the financial system in such a way as to promote legitimate purposes and prevent the system from being used for purposes that support criminal activity. Our role in executing the Nation's financial sanctions policies and countering money laundering and other financial crimes, particularly terrorist financing, has become increasingly important in recent years.

Communication is the key to our relationship with the individual American taxpayer and the corporate entities that between them provide the bulk of the revenue that supports the business of our government. We incorporate a variety of media to communicate our messages in support of the governmental activities for which we are responsible. For example, we print informational flyers in 33 languages for distribution worldwide when we change the design and look of our paper currency and coinage. We make extensive use of electronic media for providing Internal Revenue Service information, procedures, forms, and policy. Our headquarters and all of our Bureaus make extensive use of websites and online newsletters for general information concerning their functions as well as the specific details of important matters to individual citizens.

We make use of conferences to broadcast and explain matters to individuals as well as corporate bodies that relate to changes in tax law, tax collection, banking and thrift procedures, and commodities regulation. Consequently, the vast majority of the conferences we sponsor are either Internal Revenue Service or Alcohol and Tobacco Tax and Trade Bureau (TTB) events that focus on taxpayer advocacy, small business practitioner forums, or a specific sector such as the wine and alcohol industry.

The Taxpayer Advocacy Panel listens to taxpayers, identifies taxpayers' issues and makes suggestions for improving Internal Revenue Service services and aiding with customer satisfaction. The Taxpayer Advocacy Panel acts as a two-way conduit; serving as a focus group for the Internal Revenue Service providing input on strategic initiatives, as well as providing a venue for raising issues identified by citizens. Structurally, there are seven geographically based Area Boards aligned with the current Taxpayer Advocate Service areas. These Area Boards address local issues and schedule outreach activities. Issue Committees, with nationwide membership, identify and work service-wide issues and are closely linked to the Wage and Investment and Small Business/Self-Employed program owners.

A major part of TTB's mission is to have its industry members voluntarily comply with rules and regulations. Part of this can be accomplished through an increased field presence via tax audits and product integrity investigations. Another very effective tool to reach voluntary compliance is to inform our industry members of what is expected of them. TTB seminars allow us to reach a wide audience and give industry members the instructional tools that are needed to successfully meet the Federal rules that apply to their businesses. These events represent a cross-section of industry producers, wholesalers, and/or importers. They provide outreach to industry members who are geographically dispersed across the country and a platform for sharing information and learning about current issues and trends in the marketplace.

Two of the largest groups of industry members are wineries (4,830 permits) and wholesaler/importers (22,396 permits). Combined, these groups make up 67% of the permits that have been issued by TTB. Thus, winery and wholesaler/importer seminars have been the main focal point of the TTB seminar program.

These seminars attract active permittees, those interested in obtaining permits, industry trade associations, industry lawyers and state regulatory agencies. Attendees are able to obtain relevant information on the Federal rules and regulations that apply to their businesses, ask specific questions that pertain to their daily activities, receive updates on the latest issues that may apply to their activities, obtain information on TTB's electronic initiatives, and important contact information. The end result is a better understanding of their roles as permit holders and increased voluntary compliance with Federal law. It also allows TTB employees to hear first hand the concerns and issues that our industry members have pertaining to the regulation of alcohol & tobacco products.

TTB also attends international meetings and conferences at the request of or invitation from the Office of the United States Trade Representative (USTR) or from other public or private sector individuals representing the alcohol or tobacco regulated industries. At these meetings/conferences, TTB provides technical advice to the USTR on how trade negotiations might impact the administration of US alcohol and tobacco laws and regulations, provides guidance to US industry members, foreign government officials, and the general public on US import/export rules for alcohol and tobacco, and facilitates the import/export trade in alcohol by educating the public on regulatory requirements for both US and foreign markets.

We consider both of these recurring sets of conferences and seminars as vital to the understanding of the rules and regulations pertaining to both individual taxpayers as well as the affected industry. We consider there is nothing more important than an informed public, particularly where it involves taxation and compliance.

Conference participation is closely monitored by the sponsoring offices within the Department. We closely follow travel regulations and our automated travel approval process alerts supervisors to approve necessary travel in the conduct of our conferences and seminars. IRS, in particular, has established rules that delineate identifying low cost locations, numbers of attendees, and approval levels for conferences that cost in excess of $100,000.

We regret the delay in providing the requested information. Our financial data bases do not distinguish between types of business trips and do not cross reference other business expenses. We intend to develop a system that will be more responsive to your needs in the future and will provide us with a positive business tool in safeguarding the money entrusted to us by the taxpayers we serve.

Funding for Department of the Treasury Conferences is as follows:

- Fiscal Year 2001 $1,520,923
- Fiscal Year 2002 $2,017,866
- Fiscal Year 2003 $1,527,519
- Fiscal Year 2004 $2,298,125

- Fiscal Year 2005 $2,986,623
- Fiscal Year 2006 $2,472,925 (as of the end of the 3rd Quarter)

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PRESS ROOM

September 15, 2006
HP-98

Henry to Give Remarks
Before Ntl Assc of Federal Credit Unions

U.S. Treasury Assistant Secretary for Financial Institutions Emil W. Henry, Jr. will speak at the National Association of Federal Credit Unions' 2006 Congressional Caucus on Tues., Sept. 19 in Washington, D.C. He will discuss the role credit unions play in the financial marketplace.

Who
Assistant Secretary for Financial Institutions Emil W. Henry, Jr.

What
Speech before the National Association of Federal Credit Unions

When
Tues., Sept. 19 11:40 a.m. (EDT)

Where
Grand Hyatt Hotel
1000 H Street, NW
Washington, D.C.

-30-

PRESS ROOM

September 16, 2006
hp-99

Statement by U.S. Treasury Secretary Henry M. Paulson following the Meeting of the G7 Finance Ministers and Central Bank Governors Singapore

I was very pleased to attend my first meeting of G7 Finance Ministers and Central Bank Governors here in Singapore. I greatly appreciate the work of our G7 host, especially Japanese Minister Tanigaki, and the country of Singapore.

Fortunately, we are meeting this weekend in the midst of one of the strongest global expansions in memory, and the international institutions are predicting continued strong growth through next year. It is gratifying to see signs of moderate recovery this year in the major economies, particularly Europe and Japan.

We were able to report that U.S. economic growth is settling into ranges more in line with our long term potential. We continue to see solid productivity growth and job growth, and we continue to make progress in bringing down our fiscal deficit. The residential housing market is cooling from record unsustainable growth rates, but growth in the U.S. economy is being supported by other components, including wage growth, strong corporate balance sheets, and increased business capital investment.

In my bilateral discussions and in the G7 meetings, I stressed four areas of importance: global trade liberalization; our cooperative efforts to ensure the safety, soundness and security of the international financial system; IMF reform; and our shared responsibility to address imbalances in the global economy.

As I emphasized the importance of trade liberalization, I noted that global protectionist pressures remain a serious threat. It is crucial that we as finance ministers, with responsibility and interest in strong global growth, work with our governments to breathe new life into trade discussions. As someone who has worked extensively in the international economy, it is clear to me that economies that are open to trade and competition benefit greatly, and economies that restrict open trade and competition impose heavy costs on themselves and the overall economy. I strongly support a renewed commitment to Doha and encouraged my G7 colleagues to work together to achieve an ambitious outcome in the Doha round of negotiations. A successful Doha outcome is particularly important to developing countries since they will reap the vast majority of the benefits.

We discussed our efforts to address global imbalances. These imbalances reflect a wide array of macroeconomic and microeconomic forces and the G7 views their resolution as a shared responsibility, involving participation by economies throughout the world in a manner that maximizes sustained global growth. The United States remains committed to cutting its fiscal deficit and, as I explained, is vigorously doing its part. Europe and Japan need to implement greater structural reform and further raise domestic demand-led growth. China needs greater currency flexibility and stronger domestic consumption as well as financial sector reform. Oil exporters should enhance absorptive capacity for pro-growth investment and, for some, permit greater exchange rate flexibility. Globally, greater economic flexibility and market mechanisms will help reduce global imbalances, smooth economic adjustments, promote sustained strong growth and take advantage of new economic opportunities that develop as patterns of economic activity change.

We also had a substantial discussion of reform of the International Monetary Fund. The IMF needs nothing less than fundamental reform of its quota and governance structure to reflect changes in the global economy. Reform is long overdue, and this plan is the best available route to achieve our goals. In our statement today, the G7 voiced its strong support for the two-step package of reforms put forward by the Managing Director. We must now work together to quickly put in place by this time next year the "second step" reforms such as a revised quota formulas with a predominant weight for GDP, another quota increase to reflect changing economic weights, and an increase in basic votes to ensure that the voice of poor countries is not diminished. I continue to encourage other underweight industrial countries to follow our lead and forgo an increase in their own share in the second stage.

It is equally essential that the IMF strengthen and modernize its surveillance over members' exchange rates. The IMF was founded to keep exchange rate disputes from becoming trade disputes and damaging the global economy. The G7 agreed that the IMF must quickly revise, update, and rigorously implement its 30-year-old guidelines on exchange rate surveillance.

As it is crucial that we improve upon the safety, soundness and security of the international financial system, we should intensify our efforts against terrorist financing, money laundering and illicit finance - including the financial networks supporting WMD proliferation. These efforts should include tackling global financial vulnerabilities, especially in those countries that have failed to recognize international standards. We discussed the need to take action to disrupt terrorist and illicit finance related to specific threats from North Korea and Iran. And we discussed the critical importance of the work of the IMF and the World Bank to foster implementation of the international AML/CFT standards, and we encourage continued deepening of cooperation with the FATF.

I appreciated the deep and thoughtful discussions I had with my colleagues. We have significant challenges ahead of us and I leave these meetings with confidence that we can work together to find creative, effective solutions.

Thank you.

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PRESS ROOM

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September 18, 2006
HP-100

Treasury International Capital Data For July

Treasury International Capital (TIC) data for July are released today and posted on the U.S. Treasury web site (www.treas.gov/tic). The next release date, which will report on data for August, is scheduled for October 17, 2006.

Net foreign purchases of long-term securities were $32.9 billion.

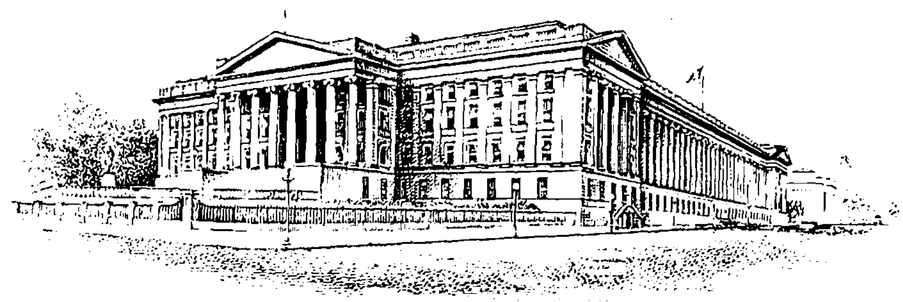
- Net foreign purchases of long-term domestic U.S. securities were $54.5 billion. Of this, net purchases by foreign official institutions were $22.7 billion and net purchases by private foreign investors were $31.8 billion.
- U.S. residents purchased a net $21.6 billion in foreign securities.

Foreigners' Transactions in Long-Term Securities with U.S. Residents

(Billions of dollars, not seasonally adjusted)

REPORTS

- Table



DEPARTMENT OF THE TREASURY
OFFICE OF PUBLIC AFFAIRS

EMBARGOED UNTIL 9:00 AM September 18, 2006
CONTACT Jennifer Zuccarelli (202) 622-8657

TREASURY INTERNATIONAL CAPITAL DATA FOR JULY

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- U.S. residents purchased a net $21.6 billion in foreign securities.

Foreigners' Transactions in Long-Term Securities with U.S. Residents
(Billions of dollars, not seasonally adjusted)

				12 Months Through					
		2004	2005	Jul-05	Jul-06	Apr-06	May-06	Jun-06	Jul-06
1	Gross Purchases of Domestic Securities	15178.9	17175.0	16254.9	18358.5	1372.6	1919.8	1667.4	1453.2
2	Gross Sales of Domestic Securities	14262.4	16164.3	15351.3	17324.9	1310.6	1835.6	1582.7	1398.7
3	**Domestic Securities Purchased, net** (line 1 less line 2) /1	**916.5**	**1010.7**	**903.7**	**1033.6**	**62.0**	**84.2**	**84.7**	**54.5**
4	**Private, net /2**	**680.9**	**889.5**	**738.0**	**907.9**	**40.5**	**85.8**	**82.4**	**31.8**
5	Treasury Bonds & Notes, net	150.9	270.0	163.6	185.7	-7.6	21.8	31.4	-1.7
6	Gov't Agency Bonds, net	205.7	187.8	201.7	203.1	9.6	26.1	18.5	6.6
7	Corporate Bonds, net	298.0	353.1	322.0	410.4	35.2	36.3	37.7	18.0
8	Equities, net	26.2	78.7	50.7	108.6	3.2	1.5	-5.2	8.8
9	**Official, net**	**235.6**	**121.1**	**165.7**	**125.7**	**21.5**	**-1.6**	**2.3**	**22.7**
10	Treasury Bonds & Notes, net	201.1	69.2	119.4	34.4	11.0	-13.6	-4.4	8.2
11	Gov't Agency Bonds, net	20.8	32.0	29.7	55.7	5.5	8.5	4.4	11.8
12	Corporate Bonds, net	11.5	19.0	15.7	24.6	1.7	2.4	1.1	1.0
13	Equities, net	2.2	1.0	0.8	11.0	3.4	1.2	1.3	1.6
14	Gross Purchases of Foreign Securities	3123.1	3681.4	3244.9	4679.7	398.7	537.6	445.6	364.9
15	Gross Sales of Foreign Securities	3276.0	3854.0	3437.5	4858.1	412.8	558.2	455.2	386.5
16	**Foreign Securities Purchased, net** (line 14 less line 15) /3	**-152.8**	**-172.6**	**-192.6**	**-178.3**	**-14.1**	**-20.6**	**-9.6**	**-21.6**
17	Foreign Bonds Purchased, net	-67.9	-45.1	-91.0	-65.6	-6.0	-15.6	-10.3	-18.7
18	Foreign Equities Purchased, net	-85.0	-127.5	-101.5	-112.8	-8.1	-4.9	0.7	-2.9
19	**Net Long-Term Flows** (line 3 plus line 16)	**763.6**	**838.1**	**711.1**	**855.2**	**47.9**	**63.6**	**75.1**	**32.9**

/1 Net foreign purchases of U.S. securities (+) .
/2 Includes International and Regional Organizations
/3 Net U.S. purchases of foreign securities (-)

PRESS ROOM

September 12, 2006
HP-101

Statement of Robert W. Werner
Director, Financial Crimes Enforcement Network
United States Department Of The Treasury
Before The
Senate Banking Committee
September 12, 2006

Chairman Shelby, Senator Sarbanes and distinguished members of the Committee, I appreciate the opportunity to appear before you today to discuss the Financial Crimes Enforcement Network's (FinCEN) ongoing initiatives and efforts to combat money laundering and terrorist financing in the post 9/11 world. This hearing is especially appropriate following yesterday's fifth anniversary of the vicious terrorist attacks against this country. As the Director of FinCEN, which is the agency responsible for administering the Bank Secrecy Act (BSA) – the United States' primary anti-money laundering/counter-terrorist financing regulatory regime, I welcome the opportunity to work with the Members of this Committee in our united fight to safeguard the U.S. financial system against financial crime. I also greatly appreciate all the support and guidance this Committee has provided over the past five years.

I am also pleased to be testifying with my colleagues from other components of Treasury. Each of these offices plays an important role in the global fight against money laundering and terrorist financing, and our collaboration on these issues has greatly improved the effectiveness of our efforts.

As you know, FinCEN's mission is to safeguard the financial system from the abuses of financial crime, including terrorist financing, money laundering, and other illicit activity. FinCEN works to achieve its mission through a broad range of interrelated activities, including:

- Administering the Bank Secrecy Act;
- Supporting law enforcement, intelligence, and regulatory agencies through the sharing and analysis of financial intelligence; and
- Building global cooperation and technical expertise among financial intelligence units throughout the world.

To accomplish these activities, FinCEN utilizes a team comprised of approximately 300 dedicated federal employees, including analysts, regulatory specialists, international specialists, technology experts, administrators, managers, and Federal agents who fall within one of the following areas of expertise at FinCEN:

- **Analysis and Law Enforcement Support** – FinCEN provides federal, state, and local law enforcement and regulatory authorities with different methods of direct access to reports financial institutions file pursuant to the BSA. FinCEN also combines BSA data with all-source information to produce analytic products supporting the needs of law enforcement, intelligence, regulatory, and other financial intelligence unit customers. Products range in complexity from traditional subject-related research performed by contract analysts to more advanced analytic work including geographic assessments of money laundering threats.
- **Global Support** – FinCEN is one of more than 100 recognized national financial intelligence units around the globe that collectively constitute the Egmont Group. FinCEN plays a lead role in fostering international efforts to combat money laundering and terrorist financing among these financial

intelligence units, focusing our efforts on intensifying international cooperation and collaboration, and promoting international best practices to maximize information sharing.

- **Regulatory Policy and Programs** - FinCEN issues regulations, regulatory rulings, and interpretive guidance; assists state and federal regulatory agencies in targeting and consistently applying BSA compliance standards in their examination of financial institutions; and takes enforcement action against financial institutions that demonstrate systemic non-compliance. These activities span the breadth of the financial services industry, including – but not limited to – banks and other depository institutions; money services businesses; securities broker-dealers; futures commission merchants and introducing brokers in securities; dealers in precious metals, stones, or jewels; insurance companies; and casinos.

Tying It All Together

FinCEN's goal is to increase the transparency of the U.S. financial system so that money laundering, terrorist financing and other economic crime can be deterred, detected, investigated, prosecuted – and, ultimately, prevented. Our ability to tie together and integrate our regulatory, international, and law enforcement efforts assists us to achieve consistency across our regulatory regime.

In addition, the BSA data received through Currency Transaction Reports, Suspicious Activity Reports, and other forms have proved to be highly valuable to our law enforcement customers, who use the information on a daily basis as they work to investigate, uncover, and disrupt the vast networks of money launderers, terrorist financiers and other criminals.

Additionally, we strive to use the BSA regulatory regime as an avenue for building partnership between the government and private sector, which is critical in order to achieve the goals of the system. Specifically, we do this in two major ways:

- First, requiring financial institutions subject to the BSA to develop risk-based anti-money laundering programs tailored to their businesses, and provide guidance in this regard. Such programs include the development and implementation of policies, procedures, and internal controls needed to address money laundering, terrorist financing, and other risks posed by that financial institution's products, geographic locations served, and customer base; and,
- Secondly, requiring financial institutions to maintain records and report certain information that is important to the detection, deterrence and investigation of financial crime.

We have learned that in order for this system to work, the government must provide guidance and feedback to the industry in ways that support their understanding of potential vulnerabilities, effective ways to address those vulnerabilities and the benefits derived from information reported by them. The risk-based nature of the regulatory scheme also recognizes that financial institutions are in the best position to design anti-money laundering/counter-terrorist financing programs that address the specific risks that they face. In other words, the success of this regime depends upon the government and financial institutions acting in true partnership – each committed to the goal of taking reasonable steps to ensure that the financial system is protected from criminals and terrorists to the greatest extent possible through the development of appropriate programs and the sharing and dissemination of information.

Ensuring that we strike the right balance between the cost and benefit of this regulatory regime is, in my view, one of FinCEN's central responsibilities. Accordingly, it is vital that we continue to examine how we can more effectively tailor this regime to minimize the costs borne by financial institutions while at the same time ensuring that the law enforcement, intelligence, and regulatory communities receive the information they need.

Recent Accomplishments

Over the past year, we made great strides toward enhancing BSA compliance. For example, we signed a memorandum of understanding (MOU) with the Internal Revenue Service (IRS) to routinely exchange information about BSA examination activities, including the identification of IRS-examined financial institutions with significant BSA compliance deficiencies. We also have similar agreements with the five federal banking agencies and have negotiated 42 memoranda of understanding – or information sharing agreements – with state and territorial supervisory agencies that examine for their own rules on BSA/anti-money laundering compliance. In addition, we collaborated with the federal banking agencies and the Office of Foreign Assets Control to develop and publish an interagency Bank Secrecy Act/Anti-Money Laundering Examination Manual that is designed to ensure the consistent application of the BSA. Further, we extended BSA anti-money laundering program requirements to dealers in precious metals, precious stones, or jewels and certain insurance companies; finalized proposed regulations regarding due diligence requirements in connection with foreign correspondent and private banking accounts; required mutual funds and certain insurance companies to report suspicious activity; and have issued important guidance to the money services businesses industry.

FinCEN is also placing a stronger emphasis on producing more advanced analytic products rather than engaging in basic database queries. For example, analysis of BSA filing patterns enables us to conduct geographic threat assessments that assist law enforcement agencies to allocate limited resources. By identifying increases – or decreases – in filing activities, law enforcement can determine where vulnerabilities may exist and how to adjust their staffing levels accordingly. This proactive data analysis of BSA filings also supports our regulatory rulemaking process. For instance, our regulatory policy specialists are able to use the valuable data provided by financial institutions to identify where additional regulation may be needed and to identify evolving trends in illicit finance.

As the United States' financial intelligence unit (FIU), we collaborate with other FIUs worldwide to exchange information in support of international and terrorist financing cases. To that end, FinCEN developed the Egmont Secure Web to provide a secure system to exchange sensitive information with our foreign counterpart FIUs. FinCEN is currently modernizing this system to enhance its security and increase communication capabilities. FinCEN also plays a significant role in assisting other countries in developing their FIUs by providing technical assistance ranging from analytical training as well as IT and regulatory support. We also sponsor new FIUs for membership in the Egmont Group. In 2005, FinCEN hosted the 13th Plenary of the Egmont Group, which was attended by nearly 300 delegates from more than 90 FIUs from countries and jurisdictions around the world. At the Plenary, seven new FIUs were granted membership, bringing the total to 101. We will continue to work to make this network of FIUs more effective by encouraging information sharing and joint projects.

Lastly, FinCEN continued to strengthen both the policies and technology relating to the information-sharing program authorized under Section 314 of the USA PATRIOT Act. We developed and deployed a secure, web-based system for transmitting information requests from federal law enforcement agencies to financial institutions, and for transmitting the institutions' responses to those requests. Previously, information requests were transmitted via a slower and less secure system of e-mail and faxes.

Cross-Border Wire Feasibility Study

Section 6302 of the Intelligence Reform and Terrorism Prevention Act of 2004 (S.2845, Pub.L.No. 108-458, Dec. 17, 2004) directs the Secretary of the Treasury to prescribe regulations to require the reporting to FinCEN of certain cross-border electronic transmittals of funds to help detect and prevent the proceeds of financial crimes and terrorist financing from flowing across America's borders. The Act requires the Secretary to issue these regulations by December of 2007, if he can certify that the technical capability to receive, store, analyze, and disseminate the information is in place prior to any such regulations taking effect. Finally, the Act also requires that, in preparation for implementing the regulation and data collection system, the Treasury Department study the feasibility of such a program and report its conclusions to Congress.

For the purposes of this study, FinCEN has engaged members of the financial services industry, the federal financial regulatory agencies, and federal law enforcement agencies through the Bank Secrecy Act Advisory Group1, which includes representatives of the U.S. financial services industry, law enforcement, and federal and state financial regulatory agencies. We have also engaged separately with our partners in the law enforcement community, through meetings with their representatives and through the distribution of surveys to those agencies, in order to assess what value might be derived from such reporting in the context of their missions. And we have conducted similar meetings with our regulatory partners.

Canada and Australia already require the reporting of cross-border wire transfers to their Financial Intelligence Units (FINTRAC and AUSTRAC, respectively). In that regard, both FINTRAC and AUSTRAC have provided us with extensive assistance through demonstrations of their respective reporting systems and sharing their views of best practices and lessons learned from the design and implementation of their regimes.

Through these efforts, FinCEN has identified the potential value in collecting cross-border electronic wire transfer information and potential avenues for combining that data with other BSA data. FinCEN has also identified a number of policy-related concerns implicated by the proposed requirement, which arose from feedback FinCEN has received from numerous financial industry representatives and the five federal banking agencies. Chief among these concerns is how to protect the privacy of individuals about whom we collect information. Another significant concern are the costs U.S. financial institutions may incur in complying with such a reporting requirement. Last, there is some concern about the potential impact of the proposed reporting requirement on the day-to-day operations of electronic funds transfer systems in the United States. Our feasibility study will outline these issues and propose an approach for resolving them.

BSA Direct

We have also taken steps to address significant issues that have arisen over the past year. One such matter involved certain aspects of our BSA Direct project. BSA Direct is an overall umbrella project with several components, including: retrieval and sharing, electronic filing, and secure access. The electronic filing and secure access components of BSA Direct have been operational for a number of years. The retrieval and sharing development began conceptually in September of 2003, with a contract awarded on June 30, 2004. The retrieval and sharing (R&S) component of BSA Direct was, in part, aimed at improving authorized users' access and ability to analyze the BSA data. It was designed to apply data warehousing technology to structure the data in a single, integrated, secure web-based environment, and provide sophisticated business intelligence and other analytical tools in a user-friendly web portal. Under this design, law enforcement and regulatory agencies would gain easier, faster data access and enhanced ability to query and analyze the BSA data - improvements that were expected to lead to increased use of the BSA data and enhancements of its utility.

On March 15, 2006, I notified Congress of my intent to issue a temporary 90-day "stop-work" order on this project. This action was necessary due to the project's inability to meet performance milestones. An assessment team, comprised of management, analysts, technology specialists, and independent consultants, was created shortly after the issuance of the stop-work order to assess and refine core requirements for BSA information retrieval, dissemination, sharing, and analysis; to determine whether this component of BSA Direct could be salvaged and/or leveraged by other alternatives; and to define the best path to ensure business continuity.

On July 10, 2006, the assessment team reported its findings and concluded that BSA Direct R&S was a partially built system that integrated a number of best-in-class products that did not, in its present state, function well together. As a result, the system could not be deployed to any of FinCEN's users in the short term.

Moreover, FinCEN, the contractor, and our external consultants could not definitively predict how close the system was to meeting the envisioned requirements or the time, resources, and risks involved in completing the system.

Based on these findings, the assessment team recommended that FinCEN terminate the existing contract, assess immediate needs, and plan for new capabilities. Based on the underlying information and analysis, I supported this recommendation and, therefore, on July 13, 2006, I terminated the BSA Direct R&S contract.

As we move forward, FinCEN will initiate a re-planning effort for BSA Direct R&S, to address strategic, technical, and resource planning issues, as well as stakeholder analysis. In addition, we will continue our efforts with the Internal Revenue Service to implement WebCBRS as an immediate means of meeting internal and customer needs for BSA data query and analysis tools.

Money Services Businesses

Another significant issue that FinCEN has faced and continues to face relates to the money services business industry. There has been mounting concern among FinCEN and others at the Department of the Treasury, various financial regulators, and the money services business industry regarding the ability of money services businesses to establish and maintain banking services. Many banks have expressed an uncertainty with respect to the appropriate steps they should take under the BSA to manage potential money laundering and terrorist financing risks associated with this industry. At the same time, the money services business industry has expressed concern that misperceptions of risk have unfairly led to labeling them as "unbankable."

Individual decisions to terminate account relationships, when compounded across the U.S. banking system, have the potential to result in a serious restriction in available banking services to an entire market segment. The money services business industry provides valuable financial services, especially to individuals who may not have ready access to the formal banking sector.

Consequently, it is important that we maintain the ability of money services businesses that comply with BSA requirements and related state laws to do business through the formal financial system, subject to appropriate anti-money laundering controls. Equally important is ensuring that the money services business industry maintain the same level of transparency, including the implementation of a full range of anti-money laundering controls, as do other financial institutions. The risk of money services business account relationships being terminated on a widespread basis is that many of these businesses could go "underground." This potential loss of transparency would, in our view, significantly damage our collective efforts to protect the U.S. financial system from financial crime – including terrorist financing. Clearly, resolving this issue is critical to safeguarding the financial system.

In March of 2005, the Non-Bank Financial Institutions and the Examination subcommittees of the Bank Secrecy Act Advisory Group jointly hosted a fact-finding meeting to solicit information from banks as well as money services businesses on issues surrounding the provision of banking services to the money services business industry. Subsequently, in April of 2005, FinCEN and the federal banking agencies issued interagency guidance to the banking industry on the provision of banking services to domestic money services businesses. FinCEN issued a companion advisory to money services businesses on what they should expect when obtaining and maintaining banking services.

Currently, based upon what we learned at the March 2005 meeting, and in subsequent discussions with other federal and state regulators, law enforcement, and the industry, we have developed and are implementing a three-point plan for addressing these issues:

1. Guidance -- that outlines with greater specificity BSA compliance expectations

when banks maintain accounts for money services businesses.

2. Education – that provides banks and bank examiners enhanced awareness of the operation of the variety of products and services offered by money services businesses and the range of risks that each may pose.

3. Regulation – that strengthens the existing federal regulatory and examination regime for money services businesses, including coordinating with state regulators to better ensure consistency and leveraging of examination resources.

With respect to the issues surrounding the provision of banking services to money services businesses, we are considering additional actions, guidance, and outreach necessary to address this issue. For example, in March of 2006, we published an advance notice of proposed rulemaking to seek additional information from the banking and money services business industries on this issue. The comment period, which closed in July, provided us a number of insights that we will consider as we move forward on this issue.

In conclusion, Mr. Chairman, we are grateful for your leadership and that of the other Members of this Committee on these issues, and we stand ready to assist in your continuing efforts to ensure the safety and soundness of our financial system. Thank you for the opportunity to appear before you today. I look forward to any questions you have regarding my testimony.

1 Congress established the Bank Secrecy Act Advisory Group (the "BSAAG") in 1992 to enable the financial services industry and law enforcement to advise the Secretary of the Treasury on ways to enhance the usefulness of Bank Secrecy Act reports. Since 1994, the Advisory Group has served as a forum for industry, regulators, and law enforcement to communicate about how law enforcement uses Suspicious Activity Reports, Currency Transaction Reports, and other Bank Secrecy Act reports and how FinCEN can improve the reporting requirements to enhance their utility while minimizing the burden on financial institutions.

PRESS ROOM

September 18, 2006
HP-102

Treasury Officials to Host
Financial Education Commission Meeting

Treasury Deptuy Secretary Robert M. Kimmitt and Assistant Secretary Emil W. Henry, Jr. will host the ninth public meeting of the Financial Literacy and Education Commission in the Treasury Department on Tuesday, Sept. 19.

The meeting is open to the media. Media without Treasury press credentials should contact Frances Anderson at (202)622-2960, or frances.anderson@do.treas.gov with the following information: name, Social Security number, and date of birth.

Who
Deputy Secretary Robert M. Kimmitt
Assistant Secretary Emil W. Henry, Jr.
Deputy Assistant Secretary Dan Iannicola

What
Financial Literacy and Education Commission Meeting

When
Tuesday, Sept. 19   2:00 p.m.

Where
Treasury Department
Cash Room
1500 Pennsylvania Avenue
Washington, DC

PRESS ROOM

September 18, 2006
2006-9-18-16-0-46-3710

U.S. International Reserve Position

The Treasury Department today released U.S. reserve assets data for the latest week. As indicated in this table, U.S. reserve assets totaled $66,342 million as of the end of that week, compared to $66,320 million as of the end of the prior week.

I. Official U.S. Reserve Assets *(in US millions)*						
	September 8, 2006			September 15, 2006		
TOTAL	66,320			66,342		
1. Foreign Currency Reserves [1]	Euro	Yen	TOTAL	Euro	Yen	TOTAL
a. Securities	11,922	10,865	22,787	11,902	10,975	22,877
Of which, issuer headquartered in the U.S.			0			0
b. Total deposits with:						
b.i. Other central banks and BIS	11,848	5,293	17,141	11,832	5,256	17,088
b.ii. Banks headquartered in the U.S.			0			0
b.ii. Of which, banks located abroad			0			0
b.iii. Banks headquartered outside the U.S.			0			0
b.iii. Of which, banks located in the U.S.			0			0
2. IMF Reserve Position [2]			6,676			6,669
3. Special Drawing Rights (SDRs) [2]			8,675			8,667
4. Gold Stock [3]			11,041			11,041
5. Other Reserve Assets			0			0

II. Predetermined Short-Term Drains on Foreign Currency Assets						
	September 8, 2006			September 15, 2006		
	Euro	Yen	TOTAL	Euro	Yen	TOTAL
1. Foreign currency loans and securities			0			0
2. Aggregate short and long positions in forwards and futures in foreign currencies vis-à-vis the U.S. dollar:						
2.a. Short positions			0			0
2.b. Long positions			0			0
3. Other			0			0

III. Contingent Short-Term Net Drains on Foreign Currency Assets						
	September 8, 2006			September 15, 2006		
	Euro	Yen	TOTAL	Euro	Yen	TOTAL

1. Contingent liabilities in foreign currency			0			0
1.a. Collateral guarantees on debt due within 1 year						
1.b. Other contingent liabilities						
2. Foreign currency securities with embedded options			0			0
3. Undrawn, unconditional credit lines			0			0
3.a. With other central banks						
3.b. With banks and other financial institutions						
Headquartered in the U.S.						
3.c. With banks and other financial institutions						
Headquartered outside the U.S.						
4. Aggregate short and long positions of options in foreign						
Currencies vis-à-vis the U.S. dollar			0			0
4.a. Short positions						
4.a.1. Bought puts						
4.a.2. Written calls						
4.b. Long positions						
4.b.1. Bought calls						
4.b.2. Written puts						

Notes:

1/ Includes holdings of the Treasury's Exchange Stabilization Fund (ESF) and the Federal Reserve's System Open Market Account (SOMA), valued at current market exchange rates. Foreign currency holdings listed as securities reflect marked-to-market values, and deposits reflect carrying values. Foreign Currency Reserves for the latest week may be subject to revision. Foreign Currency Reserves for the prior week are final.

2/ The items, "2. IMF Reserve Position" and "3. Special Drawing Rights (SDRs)," are based on data provided by the IMF and are valued in dollar terms at the official SDR/dollar exchange rate for the reporting date. The entries for the latest week reflect any necessary adjustments, including revaluation, by the U.S. Treasury to IMF data for the prior month end.

3/ Gold stock is valued monthly at $42.2222 per fine troy ounce.

PRESS ROOM

September 18, 2006
hp-103

Under Secretary Randal K. Quarles Statement On Record-High Corporate Tax Receipts

Treasury Under Secretary for Domestic Finance Randal K. Quarles issued the following statement today regarding the record-high tax receipts reported Friday, Sept. 15:

"As a continuing demonstration of the strength of the U.S. economy, corporate tax receipts on Friday's quarterly payment date again reached a record high. In fact, Friday's gross receipts were the largest in a single day in the nation's history - 20 percent higher than receipts on the same quarterly tax payment date last year.

"This revenue growth comes in receipts that were already increasing substantially as a result of the President's economic policies. Last year's tax receipts were also a record high, having grown $275 billion, 14.6 percent, from the previous year. At this point in the year, overall tax receipts are running 11.7 percent higher than last year.

"The strength of our tax receipts over an extended period of time reflects the strength of our economy and the results of President Bush's pro-growth policies. These policies have been the framework for an economy that has created more than 1.7 million jobs over the past 12 months and more than 5.7 million jobs since August 2003. Our economy has now added jobs for 36 straight months.

"Strong revenue growth, together with fiscal restraint, is critical to deficit reduction. As today's announcement shows, we are firmly on the path to meeting the President's goal of cutting the deficit in half ahead of schedule."

-30-

PRESS ROOM

September 19, 2006
HP-104

Remarks of Emil Henry,
Assistant Secretary for Financial Institutions
U.S. Department of the Treasury
Before the National Association of Federal Credit Unions

Washington, DC- Good morning and thank you for inviting me to speak to you here today. It is an honor to address the leaders of many of our nation's federal credit unions. You serve a vital role in the financial services industry, and for that I thank you.

Here in Washington, D.C., and at the Treasury Department in particular, these are exciting times. As many of you know, the Treasury has recently undergone a change in leadership. In July, Henry Paulson was sworn in as Secretary of the Treasury. I can tell you, Secretary Paulson is a thoughtful, focused and energetic leader. He is always thinking, and he is always working--even when he is sleeping.

We are all excited that he has taken up the call of public service and he will make a major impact in his time here at the Department. Indeed, many of the issues that I will talk about today are issues in which Secretary Paulson has already taken an active interest.

I would like to spend my time today on a variety of topics including Sarbanes-Oxley, GSE reform, financial literacy and education, a new $1 Coin initiative through the U.S. Mint, and of course, issues that I know are close to your hearts – regulatory burden and National Credit Union Administration's (NCUA) prompt corrective action (PCA) proposal.

But first, let me give you a quick update on the broader economic environment.

General Economic Overview

As we sit here today, I am pleased to say that our economy is robust on so many levels. The overwhelming evidence indicates our economy is firing on all cylinders. Quickly, let me give you some of the facts:

- 128,000 jobs were created in August, more than 1.7 million jobs have been created over the past 12 months, and more than 5.7 million jobs have been created since August 2003.
- Our economy has now added jobs for 36 straight months.
- The unemployment rate is 4.7 percent – below the average of each of the past three decades.
- Employment increased in 48 states over the past 12 months ending in July.
- Over the first half of this year, our economy grew at a strong 4.2 percent annual rate – faster than any other major industrialized country.
- Productivity has grown a strong 2.4 percent over the past four quarters, well ahead of average productivity growth in the last three decades.
- Per capita disposable income has risen 9.2 percent in real terms since the beginning of 2001.
- Total wage and salary income increased in real terms at an annual rate of 3.3 percent in the second quarter. This follows an 11 percent surge in the previous three months.
- Manufacturing production has risen 5.6 percent over the past 12 months.
- Manufacturing productivity has grown 3.8 percent over the past four

quarters.

The numbers tell a compelling story. The president's policies--in particular the tax cuts of 2003--provided the foundation for a dramatic economic expansion

Of note, tax revenues at the Treasury – notwithstanding the lower marginal rates enacted during this administration – are at the highest in the history of our country. Both individual and corporate tax receipts have been very strong this year. Total receipts for FY 2006 are up 11.7% percent over last year. Indeed, individual receipts over the April/May tax period were the second highest in history while corporate receipts on Friday's quarterly payment date again reached a record high. In fact, the Treasury Department announced yesterday that Friday's corporate tax receipts totaled $71.8 billion. Together with other receipts, Friday's gross receipts hit $85.8 billion. These are both records and represent the largest single-day receipts in the nation's history – 20 percent higher than receipts on the same quarterly tax payment date last year. Tax cuts are not placed under a mattress or locked in a safe. They are spent, invested or saved – all of which produces or supports economic activity which, of course, leads to further tax revenue.

Financial Services Issues

As I mentioned earlier, Secretary Paulson was sworn in just two months ago, but he has not wasted any time getting to work. If you happened to catch Secretary Paulson's first speech at Columbia Business School in August or his speech in here in Washington last week, you noticed that the Secretary articulated a few issues on his agenda both domestically and internationally. Key on this agenda is the idea increasing American business and financial market competitiveness around the world. Secretary Paulson has stressed that we need to continue working to open markets abroad, and to keep our own markets open and competitive.

In this vein, one of the key issues we will be working on in Domestic Finance is ensuring that U.S. capital markets remain competitive. One area that certainly deserves our attention is Sarbanes-Oxley.

As you know, Sarbanes-Oxley was enacted in response to the significant corporate scandals that shocked our markets a few years back. It was enacted in the midst of a political and economic crisis and it passed almost unanimously.

As a Wall St. investment banker for 20 years before I came to the Treasury, I experienced the broad market repercussions of the Enron and Worldcom scandals firsthand and it is hard for me to overstate their impact--both in terms of value destruction and a broad loss of confidence. After the Worldcom announcement in 2002, I remember sitting in my office that summer as the equity markets proceeded to collapse. We felt like we had been punched in the stomach.

Sarbanes-Oxley was an important and good law with a much-needed restorative impact. Confidence in senior management, in boards of directors and in financial statements was restored. Investor confidence is obviously a crucial element to properly functioning markets and sustained economic growth. Sarbanes-Oxley strengthened the role of directors as representatives of stockholders and reinforced the role of management as stewards of the stockholders' interest. This was a big step in the right direction.

As corporations have more and more experience in the implementation of this important legislation, it has become clear that there are many concerns about the burdens associated with Sarbanes-Oxley. These concerns largely focus on the compliance burden associated with Section 404. We are also learning of large numbers of IPOs being listed on non-US exchanges and there is concern that Sarbanes-Oxley may be a contributor to the listing decision.

In many cases, the costs in terms of both dollars and human capital are extraordinary, especially for many smaller companies. In fact, the SEC established an Advisory Committee on Smaller Public Companies to examine the impact of the

Act on these companies.

At this point it's unclear where things stand on Sarbanes-Oxley review. Treasury is often called upon to get involved in this debate. Thus far, we have not done so, but it is something that we will follow closely.

Another issue that we are closely following is the effort to reform and strengthen the GSE regulator. As I am sure you know, both houses of Congress have bills pending to impose stricter regulation on the housing GSEs. In July of last year, the Senate Banking Committee approved a bill that has not yet gone to the full Senate, and last October a GSE regulatory reform bill passed the full House.

It is our view at the Treasury that the GSEs via their $1.4 trillion retained mortgage portfolio impose the potential for systemic risk on our financial system in three ways: 1) their large size; 2) their high degree of inter-connectivity with the rest of our financial system; and 3) the lack of market discipline associated with them. We believe that this risk imbedded is substantial and is not necessary for them to carry out their mission.

We have argued strongly that these concerns need to be addressed and that the best way to do so is through a legislative solution. The Treasury will remain engaged on this important, principled issue and is reviewing options in the event there is no legislation before Congress lets out prior to the November elections.

Credit Union Issues

Credit unions occupy a somewhat unique place in the financial institution marketplace by offering access to financial services to millions of Americans based on a cooperative ownership structure. As you know, credit unions have long provided their 86 million members with valuable financial services that help them to achieve financial security and enable them to own their own home, automobile, or business. As a result of strong local ties, credit unions are uniquely situated to meet the financial services needs of our Nation's communities and encourage economic growth, job creation, and savings.

The President recognized the important role that credit unions play and pledged in 2000 to maintain credit unions' tax exempt status. As I stand here today, I can wholeheartedly say that the Administration continues to support credit unions' tax exemption.

Financial Literacy

As you know, credit unions' activities promote economic development and financial education in their local communities. Both your organization and the Treasury Department share a strong commitment to financial education. Treasury is working hard to fulfill the President's vision of an Ownership Society and an important part of that is equipping people with the skills they need to understand their money.

To help make Americans more financially literate, Treasury organized an Office of Financial Education in 2002. I know several of your members have worked with that office. Under the FACT Act, that office got another job in 2003 – leading a Commission of 19 other federal agencies tasked with raising the level of financial literacy nationwide. The Commission launched a federal government web site and hotline in 2004 dedicated to financial education – the web site is located at mymoney.gov and the number is 1-888-mymoney. We encourage you to make use of those resources.

The Treasury's Office of Financial Education has always found the credit union community to be a willing and able partner in spreading financial literacy across the country. We have honored many credit unions for their work, and have collaborated with many others. Earlier this year, along with 19 other agencies, we released the first event *National Strategy for Financial Literacy*. And you will be pleased to know that credit unions were well represented in that document.

Regulatory Relief

Another topic that we have heard from credit unions on is regulatory relief. Two separate regulatory relief bills have passed the House and Senate and both chambers are working toward a single bill. This legislation would eliminate outdated and burdensome regulations on financial institutions. Evaluating the structure of our financial institutions' regulatory oversight is integral for their efficient operations, and I applaud the efforts of both the House and Senate. As I have said before, it is my hope that we can move America's financial services sector forward and leave unnecessary regulatory burdens in the past.

Capital Reform

As you know, the National Credit Union Administration and various portions of the credit union industry have been working on proposals that would modify credit union capital requirements and the corresponding Prompt Corrective Action (PCA) framework. This work has led to a number of positive developments, such as applying a risk-based framework to more credit unions and properly accounting for credit unions' investment in the National Credit Union Share Insurance Fund (NCUSIF).

As you know, credit unions are subject to a higher minimum leverage capital requirement than is required for other insured depository institutions, and the risk-based capital framework that applies to credit unions operates in a slightly different manner than the framework for other insured depository institutions. One common thread in capital requirements across types of financial institutions is that either the leverage or the risk-based requirement is the binding constraint. While the leverage requirement is currently the binding constraint for most credit unions, this is also the case for other insured depository institutions that have a relatively low-risk portfolio of assets.

While often discussed in the context of PCA, the core issue is the minimum capital standards that apply to credit unions. The most challenging aspect of this debate is what to do after the credit unions' investment in the NCUSIF is properly accounted for?

The general rationale for imposing a higher minimum leverage capital requirement on credit unions is that, unlike many other insured depository institutions, credit unions can generally only build capital through increases in retained earnings. Other factors that have been cited for imposing a higher leverage capital requirement surround the proper accounting for credit unions' investment in the NCUSIF and their investments in corporate credit unions.

So, should credit unions be subject to the same minimum leverage capital requirements as other insured depository institutions?

In considering this and other issues related to credit unions, let me make a few observations. There are fundamental differences between credit unions and other depository institutions that lead to different types of treatment across these institutions. Of course, these fundamental differences support the varied tax treatment of credit unions. The Administration's support of credit unions' tax exemption is based firmly on the principle that the business models and organizational structures of credit unions are different from other insured depository institutions.

There are also important differences in the capital structure of credit unions vis a vis other depository institutions. As I mentioned a moment ago, credit unions can only raise equity capital by increasing retained earnings. This is an important feature that is grounded in the cooperative nature of credit unions. Thus, unlike other depository institutions, credit unions do not have access to other sources of capital to build a capital cushion when financial conditions are good. Since the basic goal of a minimum leverage capital requirement is to encourage financial institutions to maintain sufficient capital levels so that the PCA requirements are not triggered, this argues for somewhat differing capital requirements between credit unions and other institutions.

The NCUA has made good progress over the years in refining their capital reform proposal to address these issues. We look forward to continuing our dialogue on this and other credit union issues next year.

Presidential $1 Coin Program

And before I conclude, let me just take a moment to make a quick pitch for a new program that one of Treasury's bureaus, the U. S. Mint, has just unveiled – the Presidential $1 Coin Program.

The Presidential $1 Coin Program is authorized by the Presidential $1 Coin Act of 2005, authored by the House Financial Services Committee and the Senate Banking Committee and signed by President Bush on December 22, 2005. The $1 circulating coins will commemorate the service of American presidents by issuing $1 coins at a rate of four per year, in order of their service. The legislation also provides for one-half ounce pure gold "First Spouse" coins to accompany the release of each presidential coin. The Presidential $1 Coins, as specified by law, are identical in composition to the current Golden Dollar featuring Sacagawea.

The George Washington $1 Coin, will be released around President's Day, 2007. The others for 2007, John Adams, Thomas Jefferson and James Madison, will follow at roughly 3-month intervals. The reverse of these coins will carry a bold and dramatic image of the Statue of Liberty, extending to the coin's rim.

I want to thank NAFCU for participating in the recent coin user's group forum hosted by the United States Mint and the Federal Reserve. The Congress and Administration will be looking to federal credit unions to help make your members aware of and want to use these beautiful new coins as they appear in circulation beginning next year. Your active participation is needed.

Conclusion

As you can see, these are busy and exciting times at the Treasury Department and I'm looking forward to continuing the dialogue with you all. Thank you again for the opportunity to be with you this morning and I would be happy to take any questions you might have at this time.

PRESS ROOM

September 20, 2006
HP-105

The Joint Statement
between the United States of America and The People's Republic of China
on the Inauguration of the U.S.-China Strategic Economic Dialogue

Today, United States and China are pleased to announce the establishment of the U.S.–China Strategic Economic Dialogue, which was proposed by the United States and agreed to by China, implementing an important agreement reached by President Bush and President Hu Jintao. U.S. Treasury Secretary Paulson is visiting China on 19-22 September to discuss the establishment of the Strategic Economic Dialogue. Vice Premier Wu Yi met with him and jointly announced its formation. President Hu and Premier Wen Jiabao will be meeting with Secretary Paulson.

Given growing economic globalization and increasing bilateral economic relations, a high level strategic economic dialogue between the United States and China will promote economic cooperation and the growth of U.S.–China relations. Its establishment will have a positive impact on world economic development as well as global economic stability and security. The dialogue will focus on bilateral and global strategic economic issues of common interests and concerns. Both sides intend to meet twice a year in alternate capitals.

Existing bilateral dialogues and consultation mechanisms, such as the Joint Commission on Commerce and Trade, the Joint Economic Committee, and the Joint Commission on Science and Technology, will remain unchanged and continue to play their positive and important role in promoting U.S.–China economic and trade cooperation.

Both President Bush and President Hu will strongly support and take an active role in the Strategic Economic Dialogue.

PRESS ROOM

September 20, 2006
HP-106

Testimony of Robert J. Carroll
Deputy Assistant Secretary (Tax Analysis)
United States Department of the Treasury
Before the Senate Committee on Finance
United States Senate

Mr. Chairman, Senator Baucus, and Distinguished Members of the Committee.

Thank you for the opportunity to appear before you today to discuss business tax reform. Tax reform is, without question, one of the most important issues facing our economy today. Reform of the federal tax on businesses offers significant opportunities for improving job and wage gains for American workers. A key consideration in evaluating approaches for reform in the business area is the relative efficiency of different policies to encourage investment, or, more accurately, to reduce the extent to which the tax system discourages investment. Also, in today's global economy, tax reform can play an important role in sustaining and improving the competitiveness of U.S. workers and businesses, as well as our ability to continue to attract capital investment from abroad.

Before focusing on business tax reform, I would first like to discuss the problems with our tax system more broadly. Then, I will focus on how the tax system affects investment and the importance of business taxation to the tax burden on investment.

REPORTS

- Testimony of Robert Carroll

TESTIMONY OF ROBERT J. CARROLL
DEPUTY ASSISTANT SECRETARY (TAX ANALYSIS)
UNITED STATES DEPARTMENT OF THE TREASURY
BEFORE THE SENATE COMMITTEE ON FINANCE
UNITED STATES SENATE

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Thank you for the opportunity to appear before you today to discuss business tax reform. Tax reform is, without question, one of the most important issues facing our economy today. Reform of the federal tax on businesses offers significant opportunities for improving job and wage gains for American workers. A key consideration in evaluating approaches for reform in the business area is the relative efficiency of different policies to encourage investment, or, more accurately, to reduce the extent to which the tax system discourages investment. Also, in today's global economy, tax reform can play an important role in sustaining and improving the competitiveness of U.S. workers and businesses, as well as our ability to continue to attract capital investment from abroad.

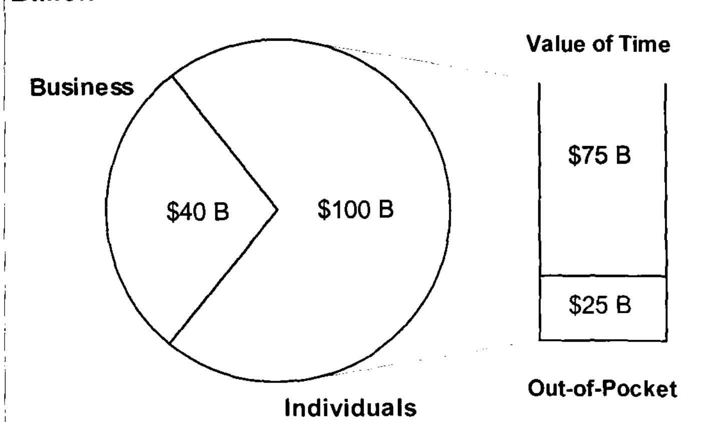
Before focusing on business tax reform, I would first like to discuss the problems with our tax system more broadly. Then, I will focus on how the tax system affects investment and the importance of business taxation to the tax burden on investment.

The Costs of Our Tax System

Our tax system imposes very large costs on our economy. First, our tax system is extremely complex, difficult to comply with, and hard to understand. Individual taxpayers spend over 3.5 billion hours each year to comply with the tax system. To put this into perspective, this is equivalent to hiring another 2 million IRS employees. They spend so much time despite the fact that about 60 percent of taxpayers rely on paid preparers to fill out their tax returns and 25 percent rely on computer software.

The IRS estimates the compliance burden of our tax system to be $140 billion annually, reflecting both the direct out-of-pocket costs – return preparation, tax software, fees for tax professionals, etc. – and the opportunity cost of taxpayers' time to understand the tax system, maintain records, pay their taxes, and otherwise comply with the tax system. About $100 billion of the compliance costs are borne directly

Chart 1: Compliance Cost of Tax System Total $140 Billion



Source: Department of the Treasury, Office of Tax Analysis.

by individuals with the remaining $40 billion borne by businesses (Chart 1).

The tax system also imposes a particularly significant burden on the 31 million small business taxpayers who, because of their limited size, are unable to spread the costs broadly over their business operations. While an individual taxpayer spends on average 26 hours each year to comply with the tax system, taxpayers who report self-employment income spend an average of 45 hours each year to comply with the tax system – more than a full work week away from their business endeavors.

One of the best examples of complexity in our tax system -- and, in many respects, the poster child for tax reform -- is the individual alternative minimum tax (AMT). The minimum tax, enacted in 1969, was initially intended to affect a very small group of higher income taxpayers who paid no income tax by making extraordinary use of a small set of narrowly defined tax provisions. Several major and many minor changes since 1969 have transformed the original minimum tax into the current alternative minimum tax which, for too many taxpayers, is now a second income tax that runs parallel to the regular individual income tax. Today, the AMT affects 4 million taxpayers and, by 2016, without any change in the law, is projected to affect 56 million taxpayers – nearly one-half of all those who owe income tax.

The broad reach and design flaws of the AMT result in a tax system that is unfair and complex. The likelihood of being subject to the AMT rises with family size – creating a penalty for having children. Additional millions of taxpayers must comply with two parallel tax systems – even if they ultimately have no AMT liability.

Complexity also arises from the numerous duplicative and overlapping tax provisions that involve eligibility rules that are difficult-to-understand and are more often than not phased-in or out by income or other taxpayer characteristics. The vast array of provisions available to taxpayers to encourage education spending, retirement savings, and health care, to name but a few, and the associated forms, schedules, and worksheets, present taxpayers with a complex and staggering web of choices.

The complexity of our tax system has also led to the perception by many that the tax system is unfair because it creates opportunities for manipulation to evade paying taxes. Clearly, a tax code that is simpler and more transparent would instill greater confidence in our voluntary tax system.

In addition to these compliance costs, the tax system also imposes large economic costs on our economy. It interferes with and distorts numerous decisions made by individuals and businesses such as whether to participate in the labor force, how much labor to supply, what type of job to take, how much to save and invest, whether to start a small business. These distortions can lead to an inefficient allocation of resources and hinder economic growth.

Some estimates suggest that by reducing these and other economic distortions, reform has the potential ultimately to increase the size of the economy by between 2 percent and 10 percent, depending on the reform. Similarly, the capital stock, which reflects the wealth of the nation, could rise by upwards of 20 percent. This higher capital stock can be thought of as producing an annual annuity, which in today's $13 trillion economy, would translate into an additional $260 billion to $1.3 trillion in output or Gross Domestic Product (GDP). A larger economy means higher real incomes and living standards for Americans – and a larger tax base.

Criteria for a Well Functioning Tax System

In creating the Advisory Panel on Federal Tax Reform, the President outlined three goals: simplicity, growth, and fairness. While there is general agreement on these three broad objectives, there is considerable controversy about the extent to which the details of any reform plan advance these goals. It is useful to consider general principles that can be applied for our tax system.

First, the tax system should raise a given amount of revenue with the least interference in business and household decisions. This requires a tax system that is as simple, transparent and understandable as possible, and has low cost and non-intrusive tax administration.

Second, as a general rule the tax system should have a broad tax base, with low tax rates. Business and household decisions should be based on the tax code as little as possible. This means that there should be a high standard for special tax treatment that is provided only where there is clear and convincing evidence of its benefits. In general, the returns from all activities should be taxed uniformly because this leads to a more efficient allocation of resources within the economy and less economic waste.

Third, the tax system should promote a strong economy. Encouraging saving and investment is essential to promoting economic growth. A tax system that penalizes saving and investment will generally result in lower standards of living.

Fourth, the tax system should be appropriately progressive. It should provide equal tax treatment of similarly situated taxpayers (horizontal equity) and a reasonable degree of progressivity, imposing higher taxes on those with a greater ability to pay (vertical equity).

Fifth, the tax system exists in a world where capital and labor are increasingly mobile and where nations compete for investment and workers. The tax system needs to adapt and change with the increasingly global economy to maintain the competitiveness of the United States and continue to attract investment and highly skilled labor.

Finally, the tax system should be as stable as possible. Frequent changes create uncertainty and make it difficult for taxpayers to plan, while wasting economic resources and increasing compliance burdens.

Tax reform that recognizes and builds upon these principles will also meet the broader goals of simplicity, growth, and fairness as identified by the President and will help serve as a guide as we work to improve our tax system.

Investment and Business Taxes

One key tenet of public economics is that businesses do not pay taxes, people do. Businesses organize capital and labor in the production of goods and services used throughout the economy and consumed by households. Businesses, however, are owned by individual investors, hire individual workers, and sell to individual consumers. While corporations may remit tax to the federal government, it is individuals who bear the burden of business taxes. Investors "pay" business taxes through lower after-tax returns to their investments, workers "pay" business taxes through lower wages, and consumers "pay" business taxes through higher prices.

Business tax reform, the subject of today's hearing, is an issue that can be considered in the broader context of how the tax system taxes investment. Investment adds to the productive capacity of the economy directly by adding to the capital stock, as well as indirectly by integrating new technologies and production processes. Higher investment also raises labor productivity by giving labor more capital with which to work. Policies that encourage investment, increase capital formation, and raise labor productivity are the key to higher living standards.

Business taxation generally reflects only one aspect of the tax on investment. The return to an investment may be subject to several layers of tax under our tax system: business level taxes, investor level taxes, and the estate tax.

Consider, for example, a newly equity-financed investment in the corporate sector. First, corporate tax is paid on the earnings from the investment at the firm level at a top corporate tax rate of 35 percent. Second, for income paid out as dividends, another layer of tax is paid by individual shareholders at a maximum rate of 15 percent. Alternatively, shareholders pay tax at a maximum statutory rate of 15 percent on the realization of appreciation in stock value that arises from corporate earnings that are retained and reinvested in the firm. For corporate income paid out as dividends, the combined corporate and investor level tax rate can be nearly 45 percent (excluding state and local taxes). For corporate income that is retained and reinvested, the combined corporate and investor level tax rate depends on how long the investor holds his stock, but is, on average, upwards of 40 percent.

Such an investment may also be taxed yet again under the estate tax upon the death of the investor. The estate tax can also discourage individuals from saving and investing. To provide some perspective on the estate tax's economic effects, it is useful to translate the estate tax into an equivalent accrual-based income tax for individuals saving for the benefit of their heirs (i.e., bequest motivated saving). This "accrual-based tax rate" on the return to saving is the income tax rate that would leave an individual at death with a net worth exactly equal to the after-tax value of his or her estate under the current estate tax. According to Treasury Department estimates, across all taxpayers the estate tax translates into an additional accrual-based tax on the return to investment of between 5 percent and 10 percent. That is, when the third layer of tax from the estate tax is added, the combined federal tax rate on corporate profits can be over 50 percent.

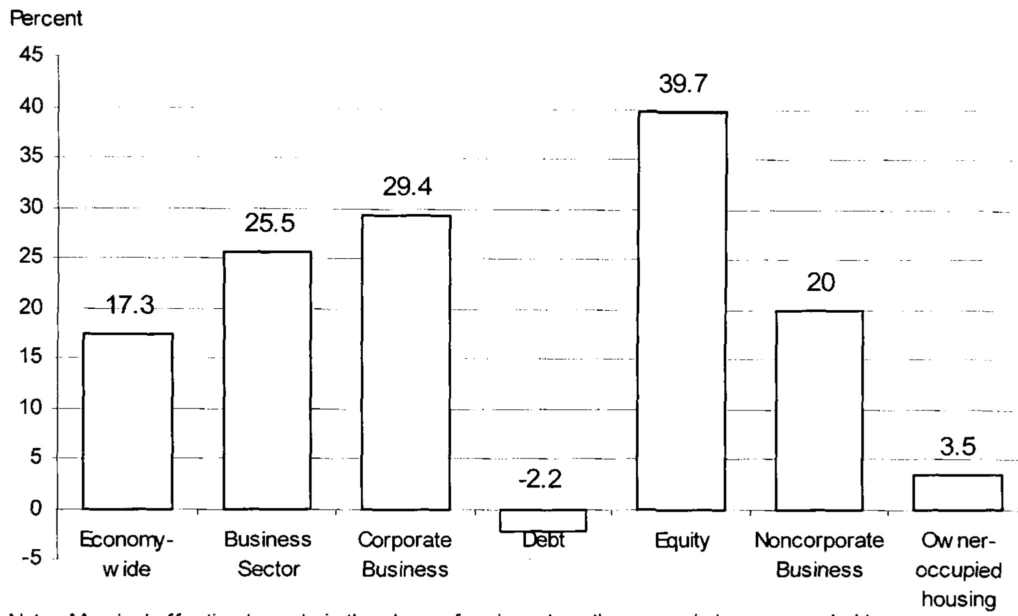
Of course, there are many other dimensions to business taxation. Not all business investment is subject to the statutory tax rate. Tax rules generally allow faster write-off of investment in equipment than economic depreciation, which has the effect of lowering the *effective* tax rate below the *statutory* tax rate. Also, a substantial fraction of business income is not subject to the corporate income tax, but is instead taxed when passed through to owners of S corporations, partnerships and sole proprietorships, many of which are small businesses. According to Treasury Department estimates, roughly one-third of the tax on business income is remitted by owners of such pass-through entities, often at the top individual income tax rate.

Marginal effective tax rates (METR) measure the impact of taxes on investment decisions and summarize how various provisions of the tax code – the statutory tax rate, depreciation deductions, interest deductions, deferral of tax, and both the individual and corporate levels of tax – interact with and affect the after-tax rate of return to a new investment. The METR is the extra share of an investment's economic income that is needed to cover taxes over its lifetime. Because of the double tax on corporate profits, accelerated deprecation on certain investments, and many other provisions taxes can vary sharply from one investment to another. The METR is useful to highlight the effect of these differences, and for focusing attention on the level of tax on investment.

Chart 2 shows the METR on different types of investment by the type of financing and sector under the current tax system. Currently, the estimated overall effective tax rate on all investment in the economy is 17.3 percent, while the marginal effective tax rate on business investment (corporate and non-corporate) is 25.5 percent. Lower tax rates on capital income – the reward to saving and investment -- encourage more of these activities. Investment increases the amount of capital available for each worker and also increases the rate at which new technology embodied in capital can be put to use throughout the economy. More productive capital translates into higher labor productivity, and, ultimately, higher real wages and living standards.

The chart illustrates another key feature of our tax system: Investment can face very disparate tax treatment depending on the sector and financing. Investment in the business sector faces an effective marginal tax rate of 25.5 percent, but because of the double tax on corporate profits the effective marginal tax rate for investment in the corporate sector is 29.4 percent, nearly ten percentage points higher than in the non-corporate sector. Moreover, equity-financed investment in the corporate sector faces an effective tax rate of 39.7 percent, while debt-financed investment is effectively subsidized at a rate of -2.2 percent (which together provide the weighted average METR in the corporate sector).

Chart 2: Effective Marginal Tax Rates on New Investment Current Law



Note: Marginal effective tax rate is the share of an investment's economic income needed to cover taxes over the investment lifetime.

Source: Department of the Treasury, Office of Tax Analysis.

This uneven treatment of investment across sectors and sources of financing leads to an inefficient allocation of capital within the economy, which wastes economic resources, and, ultimately, reduces living standards. The high level of tax on investment in the corporate sector, for example, discourages investment in this sector. This greater tax burden on corporations encourages business owners to choose organizational forms, such as partnerships and other pass-through entities, that face only a single level of taxation, but often at the cost of giving up the benefits of limited liability or centralized management found in the corporate structure.

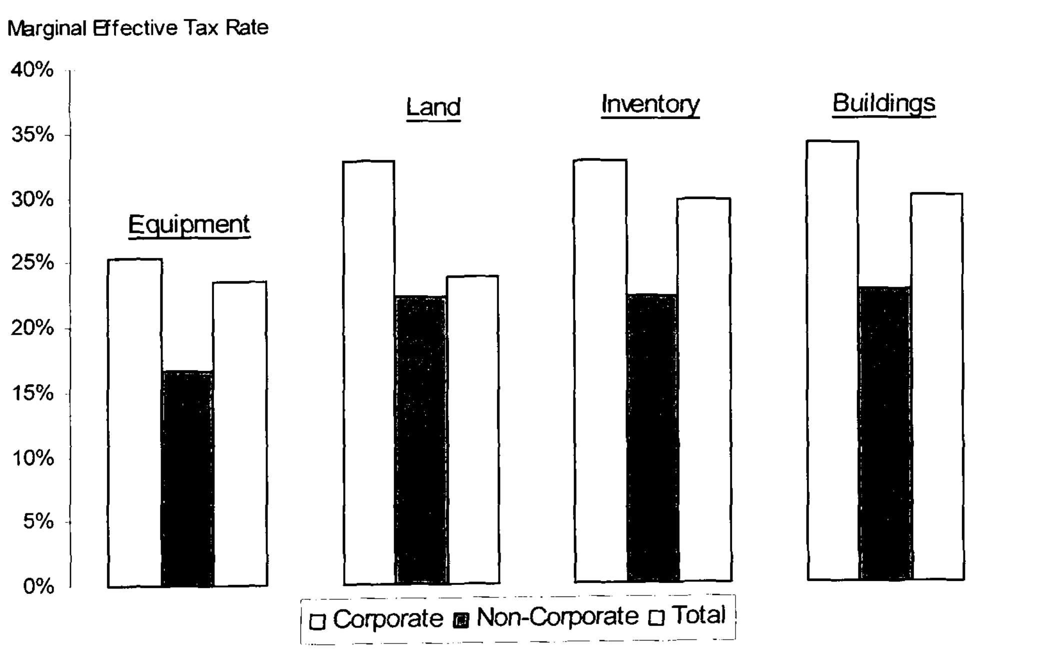
The greater taxation of equity investments leads to an over-reliance on debt finance for corporate investment. A higher debt burden increases a firm's risk of bankruptcy during temporary industry or economy-wide downturns. Business failures generate losses to both shareholders and employees, and the heightened bankruptcy risk can make the entire economy more volatile.

The tax system also discourages corporations from paying out earnings through dividends because dividends are more heavily taxed than capital gains generated through share repurchases or retained earnings. The payment of dividends may improve corporate governance by providing a signal to investors of a company's underlying financial health and profitability. Regular dividend payments also may be one way for shareholders to ensure that managers reinvest only in projects that raise shareholder value.

Also, without the reduction in the double tax on corporate profits enacted in the Jobs and Growth Act of 2003 -- the top 15 percent tax rate on dividends and capital gains now in effect through 2010 -- the uneven treatment of investment reflected in Chart 2 would be even more pronounced. Lower taxes on dividends and capital gains have moved the tax system to more equal treatment of debt and equity, of dividends and capital gains, and of corporate and non-corporate capital. This move increases economic efficiency because it promotes an allocation of capital based on business fundamentals, rather than tax considerations.

The current tax system also taxes the return on investment of some assets much more heavily than the return earned on other assets. This uneven treatment discourages investment in high-taxed activities. As shown in Chart 3, investment in buildings, land and inventories is discouraged relative to investment in equipment. Also, as noted above, business investment, particularly in the corporate sector, is generally taxed more heavily relative to other investment. This uneven tax treatment reduces productivity because tax considerations compete with market fundamentals in guiding investment decisions.

Chart 3: Investment is Taxed Differently by Asset Type and Sector



Note: Marginal effective tax rate is the share of an investment's economic income needed to cover taxes over the investment lifetime.

Source: U.S. Department of the Treasury, Office of Tax Analysis.

A clear theme emerges: The tax on investment income discourages capital formation. Furthermore, the disparate treatment of investment income by the tax system means capital is inefficiently allocated throughout the economy. Business tax reform that focuses on reducing these tax distortions could increase the productive capacity of the economy and increase living standards.

Towards a More Rational Taxation of Investment

There are a number of different policy avenues for influencing the tax on capital and treating different types of investment more uniformly, each with its own set of inherent tradeoffs. The corporate tax rate, the individual tax rate, how quickly investment is written off, the tax on investment returns received by individuals, and the tax treatment of interest all influence the cost of capital. One consideration in evaluating these policy levers is to what extent a particular change provides windfalls to taxpayers because it rewards past decisions. Another consideration is to what extent a change will have large impacts on the market value of assets if new investment is treated differently than existing capital.

Consider, for example, the choice between allowing faster write-off of investment versus lowering the corporate tax rate. Both policies can have a profound effect on effective marginal tax rates and encourage investment. Faster write-off of business investment reduces the role taxes play in investment decisions by reducing the tax on the investment return at the margin. Full expensing of investment (e.g., immediate write-off) completely removes taxes from investment decisions. The value of the deduction in the year the investment is placed in service will exactly offset (in present value) the tax on the expected return to the investment over its life. Consequently, any tax paid on returns above the expected return will have no effect on the decision to make the initial investment. In this way, taxes are removed from the investment decision. One important aspect of expensing is that tax may be paid on higher than expected investment returns, but these taxes will have no effect on the initial decision to make the investment. Another important aspect of expensing is that it is inherently prospective, thus benefiting new investment, but not investment that has already been placed in service.

One difficulty with faster write-off of investment or expensing is the disparate treatment between old and new investment. Because new investment receives more favorable treatment, the market value of existing capital may in some instances fall relative to new investment. This gives rise to the potential need for transition relief to address changes in asset values that result from the disparate treatment of existing capital and new investment. Corporate rate reduction, in contrast, avoids this difficulty because it applies to the return from both existing capital and new investment.

In contrast to faster write-off of business investment or expensing, reducing the corporate tax rate lowers the tax on the full return to investment, regardless of whether it exceeds the expected return. Also, corporate rate reduction benefits old and new investment alike. Thus, prior investments also benefit.

The various policy levers listed above can be contrasted by comparing how much they would encourage investment per dollar of revenue cost. This "bang-for-the-buck" calculation takes into account the extent to which the various policies focus on encouraging new investment, or instead also reward investments that would have been made absent the policy change. Table 1 ranks the policies by their relative "bang-for the-buck". The "bang-for-the-buck" depends on the degree to which investment is responsive to tax changes. But the focus here is on the relative effectiveness of various policies. Thus, the table shows the "bang-for-the-buck" of each policy relative to expensing.

Table 1: Comparison of "Bang for the Buck" of Alternative Investment Incentives

	Effective Marginal Tax Rate on Investment	"Bang for the Buck" Relative to Expensing 1/
Current Law	17%	
Policy Change:		
30% expensing of all investment	13%	100%
Expand tax free savings accounts 1/	12%	65%
Corporate tax rate lowered to 25%	15%	60%
Tax rate on dividends and capital gains lowered to 10%	16%	60%

Source: Department of the Treasury, Office of Tax Analysis.

1/ Reflects the change in the investment incentive divided by the revenue cost of each policy assuming a constant growth rate of investment over time. Estimates presented relative to expensing for ease of presentation.

2/ Replaces existing tax-free savings acounts with the President's Advisory Panel on Federal Tax Reform's proposal for Save for Families and Save for Retirement Accounts (each with a $10,000 contribution limit).

Not surprisingly, expensing of investment provides the largest "bang-for-the-buck" because it focuses the tax benefit on new investment. By contrast, lowering the corporate tax rate has a smaller "bang-for-the-buck" because it reduces taxes on the return from existing or old capital as well as on that from new investment. The expansion of tax preferred savings accounts has a relatively high "bang-for-the-buck" because it also focuses the tax reduction on new savings.[1]

[1]The "bang-for-the-buck" estimates depend importantly on a variety of assumptions. Two assumptions are highlighted here. First, the calculation for the lower tax rate on dividends assumes that dividend taxes reduce the incentive to undertake corporate investment. Under some theories of the firm, dividend taxes

Of course, there are a host of other considerations at play in evaluating these various policies. As discussed above, changes in the market value of existing assets and the possible need for transition relief is one important consideration. Some of the policies also address multiple distortions. As discussed above, the lower tax rate on dividends and capital gains, for example, results in more equal treatment of corporate and non-corporate capital, but can also help improve corporate governance and reduce the economy's exposure to bankruptcy and financial risk during periods of economic weakness.

International Competitiveness

The United States is increasingly linked to the world economy through trade and investment. Domestically based multinational businesses and their foreign investment help bring the benefits of global markets back to the United States by providing jobs and income. Like all firms, multinational corporations choose how much and where to invest. Multinationals also decide where to locate their headquarters, intangible assets, and research and development, and their decisions often affect which countries reap the majority of benefits from the multinational's operations. The tax system can have profound effects on these decisions.

Table 2: Comparison of Statutory Corporate Tax Rates to Among G-7 Countries

	Statutory Corporate Tax Rate		
Country	**2000**	**2006**	**% Change**
Canada	45%	36%	-20%
France	38%	35%	-6%
Germany	52%	39%	-25%
Italy	37%	33%	-11%
Japan	42%	42%	0%
United Kingdom	30%	30%	0%
United States	39%	39%	0%
G7 Average	40%	36%	-10%

Source: Department of the Treasury, Office of Tax Analysis.

Ensuring that our tax system is competitive in the world economy is crucial for the United States to continue to attract capital, create jobs, and further increase living standards. To provide some perspective on how the United States compares to its major trading partners, Tables 2 and 3 compare statutory, average and effective tax rates for the United States with other G-7 countries. The comparison to the G-7 countries is particularly relevant for investment that requires

reduce share values rather than discourage investment. Calculations based on this alternative view of the firm would generate a smaller "bang-for-the-buck."

Second, the "bang-for-the-buck" calculation for the expansion of the contribution limit for retirement accounts assumes that increases in these accounts represent marginal increases in funds available for investment. But contributions to these accounts are capped, so that for some taxpayers the expansion of the contribution limit might have little effect on the incentive to undertake an additional, marginal investment. Once the tax free saving account is fully used, additional, or marginal, saving would be taxable and the "bang-for-the-buck" would be smaller.

higher skilled labor. A comparison to China, India, and other developing economies might be more relevant for investment that is more closely related to low-skilled labor. However, the data for these comparisons is not widely available and, moreover, differentials in the cost of labor, not the tax system, are likely to be more important.

As shown in Table 2, the United States has a high statutory corporate tax rate relative to the G-7 – 39 percent in the United States (including state level taxes) versus 36 percent, on average, among G-7 countries. Also shown in the table are the reductions in corporate tax rates among G-7 countries over the past several years, with the average statutory corporate tax rate falling from 40 percent to 36 percent. Three countries enacted sharp reductions in corporate tax rates during this period Germany lowered its top rate from 40 percent to 25 percent, Italy lowered its top rate from 37 to 33 percent, and Canada lowered its top central rate for service industries from 28 to 21 percent (thereby equalizing it with the manufacturing and production sectors). The corporate tax rates in Japan, the United Kingdom[2], and the United States were largely unchanged, while France's reduction in corporate tax surcharges somewhat lowered their rate somewhat.

While the statutory corporate income tax rate is the headline measure for a country, it does not indicate the breadth of the corporate income tax base, nor does it reflect how heavily corporate income is taxed at the investor level. A country's statutory tax rate, however, is important for determining the incentive for multinational corporations to allocate income and expenses across their subsidiaries for purposes of complying with the U.S. tax system.

Table 3 also shows the effective marginal tax rates, similar in concept to the effective tax rates described earlier, and average tax rates, which show the ratio of corporate-source tax receipts to total corporate income. Both of these measures provide a more complete picture of the tax burden on investment by capturing in different ways the breadth of the tax base. The effective tax rates are more focused on the effect of the tax system on marginal investment decisions, whereas the average tax rates reflect the overall burden of

[2] The United Kingdom enacted successive tax reforms during the 1990s, which brought its corporate rate down from 34 percent in 1990 to 30 percent by 1999.

the tax system on the corporate sector in each country.

Table 3: Comparison of US Corporate Tax Rates to G7 Rates

Country	Statutory CIT	Corporate METR	Integrated METR	Corporate ATR	Integrated ATR
Canada	36%	14%	56%	18%	25%
France	35%	11%	40%	20%	26%
Germany	39%	24%	60%	7%	16%
Italy	33%	-1%	14%	14%	27%
Japan	42%	33%	49%	16%	18%
United Kingdom	30%	15%	47%	27%	38%
United States:					
Current Law	39%	14%	44%	13%	24%
Without the '01/'03 Tax Relief	39%	14%	56%	13%	NA
G7 Average	36%	16%	44%	17%	25%

Source: Department of the Treasury, Office of Tax Analysis.

Notes: CIT = corporate income tax rate, METR = marginal effective tax rate; ATR = average tax rate.

The effective and average tax rates for the United States tend to be close to the average for the G-7 countries whether at the corporate level or "integrated" to reflect both corporate and investor level taxes. Importantly, the "integrated" effective tax rates in the United States would be considerably higher – 56 percent – than the G-7 countries without the lower tax rates on investor level taxes enacted in 2001 and 2003 now in effect through 2010; that is, without the tax relief enacted in 2001 and 2003 the United States would be a relatively less attractive place to invest relative to other G-7 countries.

Thank you again, Mr. Chairman, Senator Baucus, and Members of the Committee for the opportunity to appear before you today. We look forward to working together with this Committee and others in the Congress on this important issue. I would be pleased to answer questions from the Committee.

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PRESS ROOM

September 20, 2006
HP-107

Fact Sheet Creation of the U.S.-China Strategic Economic Dialogue

President George W. Bush and President Hu Jintao have agreed to create a Strategic Economic Dialogue between the United States and China. Reflecting the growing relationship between the U.S. and Chinese economies, this dialogue will occur at the highest official levels and is the first of its kind. Further, it will provide an overarching framework for ongoing productive bilateral economic dialogues and future economic relations. It will examine long-term strategic issues, as well as provide coordination among the specialized continuing dialogues. The Strategic Economic Dialogue will also be a forum for discussing ways the United States and China can work together to address economic challenges and opportunities as responsible stakeholders in the international economic system.

The essential goal of this dialogue is to ensure that the benefits of our growing economic relationship with China are fairly shared by citizens of both countries.

The Strategic Economic Dialogue will convene semi-annually in the United States and China, with the first meeting occurring before the end of 2006. Each of the two Presidents will strongly support and take an active role in the strategic economic dialogue.

President Bush has designated Secretary of the Treasury Henry M. Paulson to lead the U.S. side of the dialogue. National Economic Adviser Al Hubbard and other members of the President's Cabinet will join Secretary Paulson. Additional U.S. agencies will include Commerce, U.S. Trade Representative, State, Health and Human Services, the Environmental Protection Agency, Energy and others. Deborah Lehr will serve as Special Envoy to the Strategic Economic Dialogue to ensure it receives the attention and continuity necessary to produce meaningful results.

President Hu has designated Vice Premier Wu Yi to lead the Chinese side of the dialogue. In that role, she has been given full decision making authority across all aspects of the Chinese economy. To demonstrate the importance of the Dialogue, the Chinese government has created its largest and the highest ranking inter-ministerial working group which Vice Premier Wu Yi will chair, supported by Foreign Minister Li Zhaoxing, Finance Minister Jin Renqing, and Deputy Secretary General of the State Council Xu Shaoshi, as well as the Ministries of Commerce, Agriculture, Health, and Information Industries, the various financial regulators, the National Development and Reform Commission, the People's Bank of China and others.

The Strategic Economic Dialogue will help to ensure leaders of the two countries can address critical economic challenges facing their economies, have a forum for discussing cross-cutting issues, and can make the most productive use of the existing bilateral commissions and dialogues. Likely themes of the discussions will include: building innovative societies, seizing the opportunities of global economic integration to assure sustained growth, and the economics of energy and conservation. The United States will also support China in China's goal of building a consumer-driven economy rooted in open markets. The intent of this dialogue is to discuss long-term strategic challenges, rather than seeking immediate solutions to the issues of the day.

The discussion of long-term structural issues in the Strategic Economic Dialogue will provide a stronger foundation for pursuing concrete results through existing bilateral economic dialogues and ensuring citizens of both countries benefit fairly from the growing bilateral economic relationship. The new strategic dialogue will provide support and guidance for these existing bilateral economic forums, which will remain essential to managing specialized aspects of the interdependent U.S.-China economic relationship. These high level discussions will enhance, not diminish these existing forums. Bilateral issues will continue to receive full attention, including pressing China for floating exchange rates, greater intellectual property rights, and increasing market access. Existing economic and related dialogues include:

- The Joint Commission on Commerce and Trade (JCCT) between the U.S. Department of Commerce, the U.S. Trade Representative, and the Chinese Vice Premier responsible for trade.
- The Joint Economic Committee between the U.S. Department of the Treasury and the Chinese Ministry of Finance.
- Joint Commission on Science and Technology between the U.S. Director of the Office of Science and Technology Policy and the Chinese Ministry of Science and Technology.
- The Economic Development and Reform Dialogue between the U.S. Department of State and China's National Development and Reform Commission.
- The Energy Policy Dialogue between the U.S. Department of Energy and China's National Development and Reform Commission.
- The Global Issues Forum led by the U.S. Department of State and China's Ministry of Foreign Affairs.
- The Healthcare Forum between the U.S. Department of Health and Human Services and the Chinese Ministry of Health.
- The Asia-Pacific Partnership on Clean Development and Climate, which brings together China, the United States, Australia, India, Japan, and Korea.

PRESS ROOM

September 21, 2006
HP-108

Treasury Secretary Henry Paulson Press Briefing
Following the Announcement of
The US-China Strategic Economic Dialogue

Beijing, China

(The following has been edited to remove most unintelligible sections but may contain misunderstood or unintelligible words.)

SECRETARY PAULSON: Good evening, everyone. Sorry to keep you waiting. The banquet went a little longer than expected, but it was a good banquet.

As I said at the press conference that Madame Wu and I had, the relationship between the U.S. and China is the most important bilateral economic relationship in the world today. And that is why we have created this unprecedented dialogue, this unprecedented engagement that has the active, the ongoing support of both President Bush and President Hu. So we start there. The vision is a simple vision, and that is to take a long-term, a strategic view to managing this relationship where we focus on fundamental, long-term issues. We address these issues, talking about identifying areas of mutual benefit and building on those, dealing with the conflicts and the tensions on a long-term basis, and of course, addressing the short-term issues. Because only by addressing the short-term issues can we establish the confidence on both sides that is going to get us keep the relationship on track. So that's going to be very important.

Now, what President Bush asked me to do was to coordinate across the various economic issues. And it's important to do this, because only by doing this will we be able to prioritize it in such a way that I will be able to represent the best interests of the American people as effectively as possible.

And that is very important because as we look forward and as we manage this relationship, it's going to be very important that the benefits that come from economic growth are shared equitably in both countries. And regrettably, there's a sense in the U.S. that the Chinese don't play fair when it comes to trade and economics. And so it's going to be my job to get short-term results at the same time we're keeping our eye on the long-term objective. So with that, why don't I throw it open to questions? Yep. Yeah.

QUESTION: Some people think that on some level, this is like a consolation prize because you're going to leave here without anything concrete on the currency. Can you address that and also can you address what we're hearing from trade groups in the States who are concerned about what they say is a softening line on current trade.

SECRETARY PAULSON: All right. Yeah. Okay. Well, let me take both issues. First of all, in terms of the objective here, I think I've been pretty consistent from day one of saying when you're talking about something as important and fundamental as an economic relationship. I don't think I ever indicated to anybody that I was going to make any first trip to China as the Treasury secretary and bring home a solution to a long-term economic issue or come here and magically negotiate something. So this is -- when you talk about what we've accomplished, let's not confuse process with results. When we met the other day, I think you or someone who was with you -- I think it might have even been you, Peter -- asked the question and said, "Well, how are you going to judge your success?" And I said that I've got two and a half years, and I was going to judge my success by firstly putting in place a process where we had a better, more constructive tone and we've laid the framework for a relationship that's going to have to stand the test of many years.

And secondly, I knew there were going to have to be some results in the short term. And you always have to get through the night if you want to get to the longer term. So again, let's not confuse results with process. I think what we've done here is put a process in place which, based upon my experience, I believe gives us the best chance of getting the results that we're going to need to get over the next two years and for many years in the future. This is, I think, an important step, and it's a step that maximizes our chance of getting results.

To me, the key thing always in working with the Chinese is to be able to get access to all the right people at the right level and have a process where there's a real discipline. And the fact that we will have this dialogue in place and we'll have the big meetings twice a year and a lot of work in between gives us the best chance of maximizing our success. But again, I never expected and I think I've been pretty clear in saying that I never expected anything other than a first set of discussions. Yes?

QUESTION: I have three questions to ask.

SECRETARY PAULSON: Well, I think what we'll do is I may ultimately want you to ask all three questions, but I'm not sure. I may be here for a half an hour or 45 minutes or whatever, but I want to give everybody else a chance to ask questions, too. So I'll let you ask your first question and then I'll come back if we have time for others.

QUESTION: Okay. Which one do you prefer, the weak dollar or the strong dollar, and why?

SECRETARY PAULSON: What did you say?

QUESTION: Which one do you prefer, the weak dollar or the strong dollar, and why?

SECRETARY PAULSON: Okay. Well, I would say to you that – and I think I've been pretty clear on this – a strong dollar is in our nation's interest. And our currency values are always determined – and I believe they should be determined – in a fair, competitive marketplace based upon underlying economic fundamentals. And so what we do in the United States and what I very much advocate is policies that are going to increase confidence, maintain confidence in the U.S. dollar and in our economy. Yes? Right.

QUESTION: What steps have you taken or are you going to take to try to sell this project to Congress?

SECRETARY PAULSON: I don't think I have a need to sell this project to Congress. This is a process. Okay? And I think it's the President's job and it's my job to design a process for working with the Chinese that will give us the best results. And I think Congress is going to judge me by the results that I get and this administration gets over a period of time. I know there's a short-term mentality in the world today, but I don't think many people are going to judge me by what comes out of one visit. And if they do, heaven help this country. Yes...

QUESTION: Thank you. You talk about the need for China to become a flexible exchange rate regime. In your view, what do you think is a more flexible exchange rate regime? For example, would it be expanding the daily band or what would that be?

SECRETARY PAULSON: The -- of course in the longer term, we all know what it is. Okay? In the long term it is an exchange rate that is where the currency's value is set in the competitive marketplace. We're not going to be able to get there until we get China to get to the point where they have capital markets that are really competitive in an open financial system. That isn't achievable right away. I would say right now I, when I'm looking at something short of the perfect outcome, which is a freely tradable currency, I'm not going to get all concerned about what technique they use to get flexibility. I'm going to know flexibility when I see it and so are you. Yes?

QUESTION: Mr. Secretary, could you address the recent events in Thailand, the military takeover, and whether you fear that this could lead to instability both in the Thai economy and more further afield, in the regional economy as a whole?

SECRETARY PAULSON: I would say I've been traveling so I'm not on top of this on a minute-by-minute basis, but I would note that there's been very little dislocation in the Thai capital markets. No spill over in the global capital markets. So it's always very regrettable when you see a change take place this way in a democracy. From that standpoint it's something we've all got to look at with regret. But in terms of the economic impact – and I don't mean to say that an adverse development isn't possible – but if I'm thinking about the top five or six things I'm worrying about today, that isn't on the list. Yes?

QUESTION: Thank you. I'm from China Business News. I wonder, Citibank tried to merge with Guangdong Development bank, but they faced a lot of problems from China --

(Translated from Chinese) There are many restrictions from the Chinese government on the potential deal of Citigroup to acquire Guangdong Development Bank. How do you comment on this as the former Chairman and CEO of Goldman Sachs? In addition, can you update the status on the issue of possibly cutting off financial connections with Iran? Thank you.

SECRETARY PAULSON: Okay. Remember, I said one question, but I'm going to, just for you, do two questions, but that's the only one. From now on we're going to do one question. Now, in terms of the Citigroup transaction, which I haven't followed closely on a day-to-day basis, I will just say to you that I am a very strong advocate of this country opening up its capital markets to foreign investment. I believe when they open up and let foreign competition in, the biggest beneficiary will be China and it will mean more jobs in the financial services industry for Chinese people. It will mean better training. It will mean a more competitive capital market that will have all sorts of other benefits for the economy. And I've noticed as I've spent time in markets around the world that those economies that have healthy capital markets are stronger and it really takes a healthy capital market for long-term success. I can't think of a single example anywhere of a situation where a country has a strong capital market system and they haven't opened themselves up to competition. So that one, I see pretty clearly.

Now, in terms of the Iranian situation, I have nothing new to report other than what I said the other day, which is I'm a big believer in the fact that the role of the Treasury Secretary of the U.S. and financial ministers around the world is to keep our financial system safe, sound, and secure. And you can't have a secure financial system, you can't preserve the reputation of a financial system if you let people come in and abuse it and abuse it for illegal activities of any kind, whether WMD proliferation or terrorism. Iran is abusing the financial system.

Now as far as the effort I think you're referring to, there are two efforts and they're related, but they are different. Bank Saudara has been sanctioned. Separate and apart from that we had noticed that the Iranians were using a series of devices that were very misleading to infiltrate the system and trick a number of banks around the world. And so we went around and we talked to those banks and we talked to them as part of an educational program to help them understand the risks. And as far as I know, they all were very grateful for the assistance. A number of them learned things, and I think that that will be an important step in helping maintain the integrity of our banking system around the world. Yes?

QUESTION: Mr. Secretary, you alluded to voices in the U.S. who see China as an unfair trader, and you're trying to discourage people from expecting immediate results. But when would it be appropriate for people in the U.S. to expect some concrete results from this new channel that you've opened up today?

SECRETARY PAULSON: I wouldn't want to predict when there should be the concrete results, but I'm not famous for being very patient. Okay? Check with anybody who's worked with me. But I really don't believe it is appropriate to carry on negotiations in a public forum. Behind closed doors I'm pretty aggressive as a persuader, as an advocate. But I've spent my career doing negotiations, and where I come from, it's appropriate to do negotiations in private. Yes, the man at the back.

QUESTION: I'm from [inaudible] TV from Korea. My question is a little bit out of out of theme, but I'll ask something else about the -- is there any specific time frame, timetable for investigation into the Banco Delta Asia case as a sanction on the DPRK. And when you are --

SECRETARY PAULSON: I missed your question. Is there a time frame for -- for what case?

QUESTION: As a sanction on the DPRK, but was there any specific timetable for investigation into Banco Delta Asia? And when you met Korean President Mr. Roh, was there a request from Mr. Roh to hasten the speed of investigation on Banco Delta Asia?

SECRETARY PAULSON: Let me say that I met with President Roh. It was a very good meeting, but it was a confidential meeting. And again, it would be inappropriate for me to divulge publicly what I'm talking about when I'm meeting with an important head of state or when I'm meeting with anyone in private. That's number one. But to your question, no, there is no prescribed time frame. This is a law enforcement matter, and it will take as long as it takes to resolve it appropriately. Thank you. Yes, the woman in the farthest back.

QUESTION: Okay. Thank you. I'm from Xinhua News Agency. I know that you have met with Minister Ma Kai this afternoon.

SECRETARY PAULSON: Yes.

QUESTION: Yes. And later you will meet with the Chinese top leaders Hu Jintao and Wen Jiabao. So we just want to know that China has to do a lot of work to push forward its reforms. So what kind of message do you want to deliver to the Chinese top leaders, and how do you judge China's efforts to push forward its reforms? Thank you.

SECRETARY PAULSON: Yeah. Well, thank you for that question, because I think the one thing I have said that I'm going to talk about, because I don't think it's divulging any confidences and it's pretty clear how I feel, I'm going to encourage them to move ahead with all of their reforms and the things they said they were going to do and move forward even more quickly. And when I look at China and their reforms, what they've done is remarkable, and they move very quickly. I noticed it years ago in my former job when we'd work on a privatization in China. Something that historically would have taken well over a year in another country, we would sometimes get done in six months here.

The pace of change has been quick and it's been remarkable. But my view is that the biggest danger that China faces is not that they will go ahead too quickly with the reforms, but that they won't go ahead quickly enough. Because the economy is so big and complex that it's becoming, in my judgment, increasingly difficult to run it with administrative procedures, and particularly when they are partway between the planned economy and a market-driven economy. So the biggest message I would give is congratulations on what you've accomplished, and it will be in our benefit and your benefit if you move ahead even more quickly, because then you will do better. And when you do better, we in the U.S. will do better because our two economies are very interdependent. Okay? You're going to get your question in a minute. But I'll let this man behind you -- okay.

QUESTION: Yes, thank you. I'm from *China Business Newspaper*. I want to ask you some questions in Chinese.

SECRETARY PAULSON: Okay. Let me just see if I can figure out -- I'm not great at these high-tech things here, but I think I'll figure it out.

QUESTION: (Translated from Chinese) Thank you. I notice from your news documents that neither People's Bank of China nor China Securities Regulatory Commission nor China Banking Regulatory Commission is included in the dialogue mechanism. Before your trip to China, the Chinese government released some new regulations on foreign financial institutions that hope to enter China and on joint ventures in the investment banking sector. These new regulations raise the entrance criteria for foreign companies that hope to invest in China. What do you think is the most imperative issue that needs to be solved in China's opening of the banking sector? Why aren't Chinese financial regulatory bodies included in the dialogue mechanism? Another question is what was the result of your Hangzhou trip? Thank you.

SECRETARY PAULSON: Well, I got your question. The financial supervisors who are looking at the markets in China have a big and a complex job. I've got to begin by saying that it took the United States many, many years to establish the capital markets we have in the United States. So I know this isn't easy. But the -- in order to get the Chinese capital markets where they're going to need to get, I'd said that I really do believe they'll get there quicker if they let in foreign investors and let foreign firms come in and establish businesses there.

But to get more specifically to your question, the issues they confront are a domestic market that is really an equity market that is quite small relative to the size of the country. There's very little of an institutional market to speak of. It's largely a retail market. Most of the equities that have been issued in this market are state-owned enterprises where there's still the big overhang. Many of the best offerings have been sold outside of China, and there hasn't been enough high-quality equity issuance in China. The quality of the local firms is by and large not strong. Many of them have -- don't have strong financial positions. Many of them aren't well managed. So it is an equity capital market that's underdeveloped relative to the size of the Chinese economy. And the domestic bond market is even more primitive in its development. But it could be very important to develop a bond market because that will take some of the pressures off of the banks. Yes?

QUESTION: Thanks. Some members of Congress have promised to put through their legislation imposing some sanctions on Chinese products. If your visit doesn't give them what they want, what do you think the possible action is?

SECRETARY PAULSON: Well, I don't want to speculate about actions others may take. I know you're talking about Senators Schumer and Graham. They are knowledgeable about China. They share many objectives that I share. I don't agree with the tactics. You'll never have me favoring protectionist legislation and I will try to talk them out of it. Whether I'll be successful or not, I don't know. Yes?

QUESTION: Thank you. I'll speak Chinese. Can we...? (Translated from Chinese) Thank you. From your answers to the questions, I can see that you are very familiar with the current Chinese economic situation and economic development. As far as I know, you have visited China about 70 times. My question is what is your source of knowledge on China's economic situation? What's your personal impression of China's current situation after your 70 or so visits to China? Thank you.

SECRETARY PAULSON: Well, my source of knowledge is talking to a lot of people, reading a lot of things, but the best knowledge comes from being right here and having done business, having, as an investment banker, worked with the government on privatizations, worked with the private companies in the marketplace and experienced it on a firsthand basis. And I am a – like everyone else I know who has spent time here – I'm a huge proponent of and believer in the Chinese economy. And to me it starts with the people, the great human resource for quality and the talent and the commercial talent of the people. And then you get to a group of leaders who are very smart and knowledgeable, pragmatic, results-oriented, looking everywhere for best practices, finding things that will work and implementing them. And so it is a strong and growing economy.

My own view is, though, that you can't take the past success and automatically extrapolate it and just assume it's going to keep growing like this and pass all the other economies in the world, because this economy still needs to make the transition from being based on low-cost labor and assembling and manufacturing well-value-added products to developing a more complex economy. And I have every confidence that will happen. But in my judgment, for that to happen, you'll have to continue to make the transition to using market-based devices as opposed to administrative. And that means speeding up the reforms. It doesn't take any magic. Your leaders have already identified what needs to be done. They stated what needs to be done. I believe they're right. They just have to do it.

MODERATOR: Last question.

SECRETARY PAULSON: Okay. Last question. Who hasn't asked a question? Only put your hand up if you haven't asked one. Yes?

QUESTION: Secretary Paulson, you and Madame Wu have each been nominated to represent the U.S. and China to have the strategic talks. What do you think about the fact that she is not exactly your counterpart in terms of government hierarchy? I mean, she is a vice premier above the ministerial level. What do you think this says about the Chinese government's attitude towards this strategic topic? Thank you.

SECRETARY PAULSON: First of all, let me say I have got huge confidence in Madame Wu. She knows how to get things done. She's pragmatic. She's aggressive. As we say in the U.S., she comes to play every day. And so she wants results. That's number one. And number two, Madame Wu and I are just two parts of this, of a process – a process that begins with our presidents and a process where our presidents are going to be involved. It is a process where I am going to have access and going to be having substantive conversations on Friday with your premier, Wen Jiabao, and with President Hu Jintao. And where we're going to have a ministerial group, an inter-ministerial group in China that is at a very senior level. And again, it's been my experience in China that to get things done, you just don't go to one person to get it done; you go to a number of people. And so to me, the important part of this process was not to have different parts of our economic relationship "siloed" but to be able to have broad access to senior people where we could talk about issues that are all interrelated in a more complex way.

And so again, I'm very enthused about the process. But you're not going to get me declaring a victory because we set up a process. A process is only a process. It's a means to the end, and this process will be judged by the results it achieves.

Thank you all very much for staying here so late and have a good evening.

MODERATOR: Thank you.

PRESS ROOM

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September 22, 2006
HP-109

Treasury and IRS Announce Regulations To Be Issued With Respect to Certain Triangular Reorganizations Under Section 368(a) Involving Foreign Corporations

The Department of the Treasury today issued a notice that announced that the Treasury Department and the Internal Revenue Service will issue regulations under section 367(b) of the Internal Revenue Code (Code) to address certain triangular reorganizations under section 368(a) involving foreign corporations.

The notice states responds to comments and requests for guidance regarding certain triangular reorganizations that are designed to avoid U.S. tax, including tax on the repatriation of a subsidiary's earnings. The notice describes the transactions as involving a parent corporation (P) and a subsidiary corporation (S) where S transfers property to P in exchange for stock of P and then uses the P stock as consideration in an exchange to acquire the stock or assets of another corporation in a triangular reorganization. Taxpayers take the position that S's transfer of property to P for P's stock is treated as the purchase of P stock, and not a distribution from S to P, thereby effecting, in most cases, a tax-free transfer of S's earnings to P without U.S. income tax.

The notice provides that the regulations that will be issued will apply only where P or S (or both) is a foreign corporation. Further, the regulations will make adjustments with respect to P and S such that the property transferred from S to P in exchange for P stock will have the effect of a separate distribution of property from S to P. When issued, the regulations will apply to transactions occurring on or after the date the notice was released for publication. The regulations will not, however, apply to a transaction that was completed on or after the date the notice was released for publication, provided the transaction was entered into pursuant to a written agreement which was binding before the publication of the notice and all times thereafter.

The notice also requests comments with respect to the rules announced in the notice, including appropriate exceptions.

REPORTS

- Treatment Under Section 367(b) of Property Used to Purchase Parent Stock in Certain Triangular Reorganizations

Part III - Administrative, Procedural, and Miscellaneous

Treatment Under Section 367(b) of Property Used to Purchase Parent Stock in Certain Triangular Reorganizations

Notice 2006-85

SECTION 1. OVERVIEW

This notice announces that the Internal Revenue Service (IRS) and the Treasury Department (Treasury) will issue regulations under section 367(b) of the Internal Revenue Code that address certain triangular reorganizations under section 368(a) involving one or more foreign corporations. This notice is issued in response to comments and specific requests for guidance regarding certain transactions that are designed to avoid U.S. income tax, including tax on the repatriation of a subsidiary's earnings. The transactions generally involve a subsidiary purchasing its parent's stock for property and then transferring the stock in exchange for the stock or assets of a corporation in a triangular reorganization under section 368(a). In general, and as described below, the regulations issued pursuant to this notice will apply to transactions occurring on or after September 22, 2006.

The IRS and Treasury recently finalized §1.367(b)-4(b)(1)(ii), which may apply to certain (but not all) of the triangular reorganizations described in this notice. That final regulation under section 367(b) appropriately addressed the treatment of the majority of relevant triangular reorganizations. While the IRS and Treasury were aware of the transactions covered by this notice at that time, the decision was made to address these transactions comprehensively in separate guidance.

The following definitions apply for purposes of this notice. A "triangular reorganization" is a forward triangular merger, a triangular C reorganization, a reverse triangular merger, or a triangular B reorganization, as those terms are defined in §1.358-6(b)(2)(i) through (iv), respectively, or a reorganization described in section 368(a)(1)(G) and (a)(2)(D). In addition, P, S, and T are corporations described in §1.358-6(b)(1)(i) through (iii), respectively. Finally, the term "property" means money, securities, and any other property, except that the term does not include stock in S.

SECTION 2. TRANSACTIONS AT ISSUE

The IRS and Treasury are aware that certain taxpayers are engaging in triangular reorganizations involving foreign corporations that result in a tax-advantaged transfer of property from S to P. The transaction is often structured as a triangular B reorganization, but could also be structured as a triangular C reorganization or another type of triangular reorganization. For example, assume P, a domestic corporation, owns 100 percent of S, a foreign corporation, and S1, a domestic corporation. S1 owns 100 percent of T, a foreign corporation. S purchases P stock for either cash or a note, and provides the P stock to S1 in exchange for all the T stock in a triangular B reorganization.

Taxpayers take the position that (i) when P sells its stock to S for cash or a note, P recognizes no gain or loss on the sale under section 1032, (ii) S takes a cost basis in the P shares under section 1012, and (iii) S recognizes no gain under §1.1032-2(c) upon the transfer of the P shares immediately thereafter because the basis and fair market value of the shares are equal. Thus, taxpayers take the position that the cash or note used by S to acquire the P stock does not result in a distribution under section 301. Furthermore, taxpayers do not include in income amounts under section 951(a)(1)(B) because S acquires and disposes of the P stock before the close of a quarter of the taxable year, which is the time at which to measure P's share of the average amount of United States property held by S. *See* section 956(a)(1)(A). Finally, under §1.367(b)-4(b)(1)(ii), S1 does not include in income as a deemed dividend the section 1248 amount attributable to the T stock that S1 exchanges.

The IRS and Treasury believe that the taxpayers' characterization of these transactions raises significant policy concerns, particularly when either P or S (or both) is a foreign corporation (regardless of whether T is related to P and S before the transaction). For example, when P is domestic and S is foreign, as in the example described above, the transaction could have the effect of repatriating foreign earnings of S to P without a corresponding dividend to P that would be subject to U.S. income tax. Similarly, where P is foreign and S is domestic, the transaction could have the effect of repatriating S's U.S. earnings to its foreign parent in a manner that is not subject to U.S. withholding tax. This variation of the transaction also raises U.S. earnings stripping issues where S uses a note to purchase all or a portion of the P stock. Moreover, where both P and S are foreign, the transactions may have the effect of avoiding income inclusions to certain U.S. shareholders of P that would be subject to U.S.

income tax under the subpart F provisions, absent the application of an exception, such as under section 954(c)(6). In addition, foreign-to-foreign transactions of this type can be used to facilitate the subsequent repatriation of foreign earnings to U.S. shareholders without U.S. income tax.

SECTION 3. BACKGROUND

.01 Triangular reorganizations

Section 368 defines the term "reorganization." Sections 368(a)(1)(B), 368(a)(1)(C), 368(a)(1)(G), 368(a)(2)(D), and 368(a)(2)(E) describe certain reorganizations in which P stock may be used by S as the consideration issued in exchange for T's stock or assets, as applicable.

Section 1032 provides that no gain or loss will be recognized to a corporation on the receipt of money or other property in exchange for stock of such corporation. Section 1.1032-2(b) provides that in the case of a forward triangular merger, a triangular C reorganization, or a triangular B reorganization, P stock provided by P to S, or directly to T or T's shareholders on behalf of S, pursuant to the plan of reorganization is treated as a disposition by P of shares of its own stock. However, §1.1032-2(c) provides that S must recognize gain or loss in the above transactions on its exchange of P stock for T stock or assets if S did not receive the P stock from P pursuant to the plan of reorganization. Section 361 provides that S does not recognize gain or loss on the P stock that it exchanges for T stock in a reverse triangular merger.

Section 361(a) provides that no gain or loss shall be recognized by T if it exchanges property in pursuance of the plan of reorganization solely for stock or securities in P. Section 361(c) provides that no gain or loss shall be recognized to T on the distribution to its shareholders of P stock received from P in pursuance of the plan of reorganization.

Section 354 provides that no gain or loss shall be recognized by T shareholders if stock or securities in T are, in pursuance of the plan of reorganization, exchanged solely for stock or securities of P. Section 356 applies to T shareholders in cases where they receive other property in addition to the property permitted to be received under section 354.

Section 358 provides rules for determining the T shareholders' bases in their P stock following triangular reorganizations. Sections 1.358-6 and 1.367(b)-13 provide rules for determining P's basis in its S or T stock, as applicable. If P files a consolidated return with S or T, other basis rules apply. *See* Treas. Reg. §1.1502-30 or 1.1502-31.

.02 Section 367

Section 367(a)(1) provides that if, in connection with any exchange described in section 332, 351, 354, 356, or 361, a United States person transfers property to a foreign corporation, such foreign corporation shall not, for purposes of determining the extent to which gain shall be recognized on such transfer, be considered to be a corporation. The Secretary has broad authority under section 367(a)(2), (3), and (6) to provide that section 367(a)(1) will not apply to certain transfers described therein.

In the case of any exchange described in section 332, 351, 354, 355, 356, or 361 in connection with which there is no transfer of property described in section 367(a)(1), section 367(b)(1) provides that a foreign corporation shall be considered to be a corporation except to the extent provided in regulations prescribed by the Secretary which are necessary or appropriate to prevent the avoidance of Federal income taxes.

Section 367(b)(2) provides that the regulations prescribed pursuant to section 367(b)(1) shall include (but shall not be limited to) regulations dealing with the sale or exchange of stock or securities in a foreign corporation by a United States person, including regulations providing, among other things, the circumstances under which gain is recognized, amounts are included in gross income as a dividend, adjustments are made to earnings and profits, or adjustments are made to basis of stock or securities.

.03 Distributions of property

Section 301(c)(1) provides that a distribution of property by a corporation to its shareholder with respect to its stock is included in the shareholder's gross income to the extent the distribution constitutes a dividend under section 316. Section 316 defines a dividend as a distribution out of a corporation's current and accumulated earnings and profits. To the extent the distribution is not a dividend, the shareholder reduces basis in the distributing corporation's stock, and any amount of the distribution in excess of the shareholder's basis is treated as gain from the sale or exchange of the corporation's stock. *See* section 301(c)(2) and (3).

Certain transactions that are exchanges in form can be treated as distributions for tax purposes. Section 304 generally provides that when a shareholder transfers stock of a controlled corporation to another controlled corporation in exchange for property, the two legs of the exchange are bifurcated and the receipt of the property by the shareholder is treated as a distribution. Section 304, by its terms, does not apply to the transfer by a shareholder of its own stock to a controlled corporation in exchange for property, even though the economic effect of that transaction is essentially identical.

Other transactions may result in deemed distribution treatment in certain circumstances. For example, a shareholder that exchanges common stock of a corporation for common stock and property pursuant to a recapitalization will be treated as receiving a distribution of property with respect to its stock under section 301 if in substance the distribution is a separate transaction. *See* Treas. Reg. §1.301-1(l); *see also*, *Bazley v. Comm'r*, 331 U.S. 737 (1947).

.04 Distributions involving foreign corporations or foreign shareholders

The treatment of a distribution varies depending upon whether the corporation or shareholder is domestic or foreign. A distribution from a foreign corporation to a shareholder that is a U.S. person resulting in a dividend under sections 301(c)(1) and 316, or gain from the sale or exchange of property under section 301(c)(3), generally is subject to U.S. income tax, with potential offset by foreign tax credits.

A distribution from a domestic corporation to a shareholder that is not a U.S. person resulting in a dividend is generally taxable under section 871 or 881 at a rate of 30 percent, subject to reduction under an applicable treaty, and the domestic corporation is responsible for withholding tax under section 1441 or 1442. To the extent such a distribution results in gain from the sale or exchange of property to the foreign shareholder under section 301(c)(3), such amounts are subject to U.S. income tax under section 897(a) if the distributing corporation had been a United States real property holding corporation (as defined in section 897(c)(2)) within the past five years.

n such a case, the gain is subject to U.S. income tax as income effectively connected with the conduct of a trade or business within the United States.

Finally, a distribution from a foreign corporation to a shareholder that is a controlled foreign corporation, within the meaning of section 957, resulting in a dividend or gain from the sale or exchange of property to the foreign shareholder under section 301(c)(3) may also be subject to U.S. income tax. For example, such amounts may constitute subpart F income and therefore result in an income inclusion under section 951(a)(1)(A) to U.S. shareholders, within the meaning of section 951(b), of the controlled foreign corporation, subject to certain exceptions. *See*, *e.g.*, section 954(c)(6).

SECTION 4. APPLICATION OF SECTION 367(b)

Congress enacted section 367(b) to ensure that international tax considerations are adequately addressed when the subchapter C provisions apply to certain nonrecognition exchanges involving foreign corporations. This provision was necessary because the subchapter C provisions were enacted largely to address transactions involving domestic corporations and shareholders that are United States persons. As a result, the subchapter C provisions do not fully account for international tax concerns that arise when the provisions apply to transactions involving foreign corporations or shareholders that are not U.S. persons.

In enacting section 367(b), Congress noted that "it is essential to protect against tax avoidance in transfers to foreign corporations and upon the repatriation of previously untaxed foreign earnings…." H.R. Rep. No. 658, 94th Cong., 1st Sess. 241 (1975). In addition, because determining the proper interaction of the Code's international and subchapter C provisions is "necessarily highly technical," Congress granted the Secretary broad regulatory authority to provide the "necessary or appropriate" rules to prevent the avoidance of Federal income taxes, rather than enacting a more comprehensive statutory regime. *Id.* This broad grant of authority has been exercised on numerous occasions to address a wide range of international policy concerns. *See, e.g.*, Treas. Reg. §§1.367(b)-4(b)(1) (preserving section 1248 amounts), (b)(2) (addressing trafficking in foreign tax credits by use of preferred stock), -5(b)(1)(ii) (ensuring section 311(b) gain is recognized by a domestic corporation when it distributes stock of a controlled foreign corporation to an individual distributee under section 355), and -7 (addressing the carryover of tax attributes in a foreign-to-foreign section 381 transaction).

In a triangular reorganization, the exchange by the T shareholders of their T stock for P stock is described in section 354 or 356. As a result, a triangular reorganization involving a foreign corporation is described in section 367(b) and, therefore, may be subject to regulations issued under the broad regulatory authority granted therein. It is on this basis that regulations will be issued to address the triangular reorganizations covered by this notice.

SECTION 5. REGULATIONS TO BE ISSUED UNDER SECTION 367(b)

The IRS and Treasury will issue regulations under section 367(b) to address certain triangular reorganizations involving foreign corporations. The regulations will apply to triangular reorganizations where P or S (or both) is foreign and, pursuant to the reorganization, S acquires from P, in exchange for property, all or a portion of the P stock that is used to acquire the stock or assets of T (T could be either related or unrelated to P and S before the transaction). In such a case, the regulations under section 367(b) will make adjustments with respect to P and S such that the property transferred from S to P in exchange for P stock will have the effect of a distribution of property from S to P under section 301(c) that is treated as separate from the transfer by P of the P stock to S pursuant to the reorganization. The adjustments will be made notwithstanding the fact that section 1032 otherwise applies to the reorganization. Therefore, the regulations will require, as appropriate, an inclusion in P's gross income as a dividend, a reduction in P's basis in its S or T stock, and the recognition of gain by P from the sale or exchange of property. The regulations will also provide for appropriate corresponding adjustments to be made, such as a reduction of S's earnings and profits as a result of the distribution (consistent with the principles of section 312). The regulations will also address similar transactions in which S acquires the P stock used in the reorganization from a related party that purchased the P stock in a related transaction.

SECTION 6. EFFECTIVE DATE

In general, the regulations to be issued under section 367(b) that are described in section 5 of this notice will apply to transactions occurring on or after September 22, 2006. The regulations described in this notice will not, however, apply to a transaction that was completed on or after September 22, 2006, provided the transaction was entered into pursuant to a written agreement which was (subject to customary conditions) binding before September 22, 2006 and all times thereafter.

No inference is intended as to the treatment of transactions described herein under current law, and the IRS may, where appropriate, challenge such transactions under applicable provisions or judicial doctrines.

SECTION 7. COMMENTS

The IRS and Treasury request comments on the regulations to be issued under this notice. Specifically, comments are requested as to whether in certain cases it is appropriate to provide an exception from the treatment described in this notice. In addition, comments are requested as to the source and timing of the adjustments to be made with respect to P and S under the regulations to be issued.

The IRS and Treasury also request comments regarding transactions that are not described in section 5 of this notice. For example, comments are requested on transactions where S or P is foreign and S purchases P stock from a person unrelated to P (for example, from the public on the open market), or where S acquires the P stock in a transaction that is unrelated to the triangular reorganization. Finally, the IRS and Treasury request comments on the treatment of transactions similar to those described in this notice that do not qualify as reorganizations (for example, because S issues minimal consideration to T in a transaction that would otherwise qualify as a reorganization under section 368(a)(1)(B)). Any regulations issued to address transactions that are not described in section 5 of this notice will apply prospectively.

SECTION 8. DRAFTING INFORMATION

The principal authors of this notice are Daniel McCall of the Office of Associate

Chief Counsel (International) and Sean McKeever of the Office of Associate Chief Counsel (Corporate). However, other personnel from the IRS and Treasury participated in its development. For further information regarding this notice contact Mr. McCall at (202) 622-3860 (not a toll-free call). For comments or questions regarding subchapter C issues, contact Mr. McKeever at (202) 622-7750.

PRESS ROOM

September 25, 2006
HP-110

Treasury Official to Discuss Surveillance of US Treasury Market

Deputy Assistant Secretary for Federal Finance James Clouse will speak with the Government Securities and Funding Divisions of the Bond Market Association Wed., Sept. 27 in New York City. He will discuss market surveillance and related issues in the U.S. Treasury market.

Who
Deputy Assistant Secretary for Federal Finance James Clouse

What
Remarks on Market Surveillance,
Related Issues in the U.S. Treasury Market

When
Wed. , Sept. 27, 12:00 p.m. (EDT)

Where
Bond Market Association
360 Madison Ave.
New York City, NY

PRESS ROOM

To view or print the PDF content on this page, download the free Adobe® Acrobat® Reader®.

September 26, 2006
HP-111

A Comprehensive Strategy for Reducing the Tax Gap
U.S. Department of the Treasury
Office of Tax Policy
September 26, 2006

Executive Summary

In fiscal year 2005, Federal receipts totaled over $2.2 trillion. More than 95 percent of net receipts were collected by the Internal Revenue Service (IRS) through its administration of the income, transfer and excise tax provisions of the Internal Revenue Code. The vast majority of these receipts is collected through our voluntary compliance system, under which taxpayers report and pay their taxes with no direct enforcement and minimal interaction with the government. The overall compliance rate achieved under this system is quite high. In 2001, the compliance rate was over 86 percent, after including late payments and recoveries from IRS enforcement activities. Nevertheless, an unacceptably large amount of the tax that should be paid every year is not, requiring compliant taxpayers to make up for the shortfall and giving rise to the "tax gap."

The Administration is committed to working with Congress to reduce the tax gap. This document outlines the Administration's aggressive strategy for addressing the tax gap. The strategy builds upon the current efforts of the Treasury Department and the IRS to improve compliance. As part of the deliberations in preparing the Administration's fiscal year 2008 budget request to Congress, the Treasury Department and the IRS are working
with the Office of Management and Budget to further develop this strategy to reduce the tax gap. This document is intended to provide a broad base on which to build. The more detailed elements of the tax gap strategy are, in part, contingent upon the budget process for fiscal year 2008 and beyond. Accordingly, the Treasury Department and the IRS will provide a more detailed outline of steps they will take to address the tax gap following
release of the Administration's fiscal year 2008 budget request early next year.

Four key principles guided the development of this strategy:

- First, unintentional taxpayer errors and intentional taxpayer evasion should both be addressed.
- Second, sources of noncompliance should be targeted with specificity.
- Third, enforcement activities should be combined with a commitment to taxpayer service.
- Fourth, policy positions and compliance proposals should be sensitive to taxpayer rights and maintain an appropriate balance between enforcement activity and imposition of taxpayer burden.

REPORTS

- Treasury Comprehensive Strategy for Addressing the Tax Gap

A Comprehensive Strategy for Reducing the Tax Gap

U.S. Department of the Treasury

Office of Tax Policy

September 26, 2006

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- Second, sources of noncompliance should be targeted with specificity.

- Third, enforcement activities should be combined with a commitment to taxpayer service.

- Fourth, policy positions and compliance proposals should be sensitive to taxpayer rights and maintain an appropriate balance between enforcement activity and imposition of taxpayer burden.

These principles point to the need for a comprehensive, integrated, multi-year strategy to reduce the tax gap. Our practical and effective overall strategy includes the following seven components:

1. Reduce Opportunities for Evasion. The Administration's fiscal year 2007 budget includes five legislative proposals to reduce evasion opportunities and improve the efficiency of the IRS. The Treasury Department's Office of Tax Policy is working with the IRS to develop additional legislative proposals for consideration as part of the fiscal year 2008 budget process. The Treasury Department and the IRS will also continue to

use the regulatory guidance process to address both procedural and substantive issues to improve compliance and reduce the tax gap.

2. Make a Multi-Year Commitment to Research. Research is essential to identify sources of noncompliance so that IRS resources can be properly targeted. Regularly updating compliance research ensures that the IRS is aware of vulnerabilities as they emerge. New research is needed on the relationship between taxpayer burden and compliance and the impact of customer service on voluntary compliance. Research is also essential to establish accurate benchmarks and to measure the effectiveness of IRS efforts, including the effectiveness of this comprehensive strategy to reduce the tax gap.

3. Continue Improvements in Information Technology. Continued improvements to technology would provide the IRS with better tools to improve compliance through early detection, better case selection, and better case management.

4. Improve Compliance Activities. By improving document matching, examination, and collection activities, the IRS would be better able to prevent, detect, and remedy noncompliance. These activities would increase compliance not only among those directly contacted by the IRS, but also among those who would be deterred from noncompliant behavior as a consequence of a more visible IRS enforcement presence. The IRS continues to reengineer examination and collection procedures and invest in technology, resulting in efficiency gains and better targeting of examination efforts. These efficiency gains translate into higher audit yields, expanded examination coverage, and reduced burden on compliant taxpayers.

5. Enhance Taxpayer Service. Service is especially important to help taxpayers avoid unintentional errors. Given the increasing complexity of the tax code, providing taxpayers with assistance and clear and accurate information before they file their tax returns reduces unnecessary contacts afterwards, allowing the IRS to focus enforcement resources on taxpayers who intentionally evade their tax obligations. The statutorily mandated Taxpayer Assistance Blueprint, the next phase of which is expected to be delivered in January, will include a process for assessing the needs and preferences of taxpayers and will develop a decision model to prioritize service initiatives and funding. The IRS is also working to provide service more efficiently and effectively through new and existing tools, such as the IRS web site.

6. Reform and Simplify the Tax Law. Simplifying the tax law would reduce unintentional errors caused by a lack of understanding. Simplification would also reduce the opportunities for intentional evasion and make it easier for the IRS to administer the tax laws. For example, the Administration's fiscal year 2007 budget includes six proposals to simplify the tax treatment of savings and families by consolidating existing programs and clarifying eligibility requirements. The Office of Tax Policy is developing other simplification proposals for consideration in the Administration's fiscal year 2008 budget request. In addition, the Treasury Department is evaluating the report of the President's Advisory Panel on Federal Tax Reform and is considering options for reform. These initiatives will continue to be supplemented by IRS efforts to reduce taxpayer burden by simplifying forms and procedures.

7. Coordinate with Partners and Stakeholders. Closer coordination is needed between the IRS and state and foreign governments to share information and compliance strategies. Closer coordination is also needed with practitioner organizations, including bar and accounting associations, to maintain and improve mechanisms to ensure that advisors provide appropriate tax advice. Through contacts with practitioner organizations, the Treasury Department and the IRS learn about recent developments in tax practice and hear directly from practitioners about taxpayer concerns and potentially abusive practices. Similarly, contacts with taxpayers and their representatives, including small business representatives and low-income taxpayer advocates, provide the Treasury Department and the IRS with needed insight on ways to protect taxpayer rights and minimize the potential burdens of compliance strategies.

The success of this comprehensive strategy will depend, in significant part, on IRS resources and the agency's efficient and effective use of such resources. The IRS has made significant progress toward improving the efficient use of its allocated resources, especially in targeting enforcement efforts to areas where they will have the greatest direct and indirect impact on compliance. The IRS will continue to seek ways to make its operations more efficient and thus free resources to fund new compliance initiatives. In implementing this strategy, the Treasury Department and the IRS recognize that it will be important to establish benchmarks against which progress on each element of the strategy can be measured.

I. The Size and Source of the Tax Gap

The "gross tax gap" is the difference between the amount of tax that taxpayers should pay under the tax law and the amount they actually pay on time. In February 2006, the IRS released updated compliance estimates, showing that the gross tax gap was $345 billion in tax year 2001.[1] As a percentage of tax liability for tax year 2001, this represents a compliance rate of about 83.7 percent.

This estimate, however, does not take into account taxes that were paid voluntarily but paid late, or recoveries from IRS enforcement activities. Taking these factors into account, the "net tax gap" was an estimated $290 billion in tax year 2001, which represents a net compliance rate of 86.3 percent.

There are three key characteristics of the tax gap:

- Over 70 percent of the gross tax gap is attributable to the individual income tax, which is the largest single source of Federal receipts.
- Over 80 percent of the gross tax gap is caused by underreporting of tax (i.e., by underreporting income or overstating deductions and credits), with roughly half this amount (including self-employment tax) attributable to underreporting of net business income by individuals. Eighteen percent of the gross tax gap is attributable to underpayments of taxes or failure to file tax returns.
- Noncompliance is highest among taxpayers whose income is not subject to third-party information reporting or withholding requirements.

These characteristics suggest a targeted response designed to address the most significant areas of noncompliance. The following overview discusses these characteristics in more detail.

<u>**Type of Tax**</u>

As indicated above, the IRS estimates that over 70 percent of the gross tax gap is attributable to the individual income tax. As Table 1 below shows, the remainder of the tax gap is associated with employment taxes (chiefly self-employment taxes), corporate income taxes, and estate taxes.

[1] The estimates of underreporting of individual income and self-employment taxes were derived from analysis of the 2001 National Research Program (NRP). Most of the other estimates are projections derived from older compliance studies.

Table 1 Gross Tax Gap by Type of Tax		
Type of Tax	**Gross Tax Gap ($ Billions)**	**Share of Gross Tax Gap (%)** [1]
Individual Income	245	71
Corporate Income	32	9
Employment	59	17
Estate	8	2
Excise	Not Available	
TOTAL	**345**	**100**

[1] Totals may not add up to 100 percent due to rounding.

Type of Error

The IRS estimates that over 80 percent of the gross tax gap is caused by underreporting of tax (i.e., underreporting of income or overstating deductions and credits). Over 40 percent of the gross tax gap is attributable to underreporting of net business income by individuals (affecting both income and self-employment taxes). (See Table 2).

The remainder of the gross tax gap is split between two sources of errors:

- Roughly 10 percent of the gross tax gap is attributable to underpayments, a significant portion of which is due to employer failures to deposit withheld income and employment taxes.

- The remainder of the tax gap is due to failure to file tax returns, mostly for individual income taxes.

Table 2 Gross Tax Gap by Type of Error				
Type of Error			**Gross Tax Gap ($ Billions)**	**Share of Gross Tax Gap (%)[1]**
Underreporting[2]	**Individual Income Tax**			
		Non-Business Income	*56*	*16*
		Business Income	*109*	*32*
		Adjustments, Deductions, Exemptions, and Credits	*32*	*9*
		Total	**197**	**57**
	Corporation Income Tax		**30**	**9**
	Employment Tax			
		FICA	*14*	*4*
		Self-Employment Income Tax	*39*	*11*
		Total	**54**	**16**
	Estate Tax		**4**	**1**
	Total Underreporting		**285**	**83**
Underpayments[3]	*Individual Income Tax*		23	7
	Employment Tax		5	1
	Other		5	3
	Total Underpayments		**34**	**10**
Nonfiling[4]	*Individual Income Tax*		25	7
	Estate		2	1
	Total Nonfiling		**27**	**8**

[1] Totals may not add up to 100 percent due to rounding.
[2] Information regarding underreporting of excise taxes is not available.
[3] Underpayments include employer failures to deposit withheld income and employment taxes.
[4] Information regarding the nonfiling gap associated with corporate income taxes, employment taxes, or excise taxes is not available.

Level of Transparency

Tax compliance is greatest for income subject to mandatory withholding by the payer. Only one percent of the tax due on wage income (reported by employers) was not reported to the IRS by return filers in 2001.

Noncompliance rates are higher for income that is not subject to withholding, but that is reported separately to the IRS by a third party when payments are made. The net misreporting percentage is about 4.5 percent for interest income, dividends, social security benefits, pensions, and unemployment insurance, all of which are generally subject to third-party reporting. The net misreporting percentage is somewhat higher for income items that are subject to some, but not substantial, information reporting. For partnership and S corporation income, alimony, reportable exemptions and deductions, and capital gains, the net misreporting percentage is 8.6 percent.

Noncompliance rates are highest for income that is not subject to either withholding or third-party reporting requirements. About 54 percent of net income from proprietors (including farms), rents, and royalties is misreported. Underreporting of self-employment income also results in high noncompliance for self-employment taxes for social security and Medicare.

Intentional Versus Unintentional Errors

A common question is the extent to which the tax gap results from intentional evasion rather than unintentional errors by confused taxpayers. Determining taxpayer intent under a regular examination is very difficult. For obvious reasons, taxpayers do not concede that their erroneous reporting is intentional, and any analysis of the nature of the error by IRS examiners is inherently subjective. Some researchers have applied econometric techniques to compliance data to measure intentional evasion, but the results have been inconclusive. In all events, complexity provides those taxpayers who are predisposed to taking aggressive reporting positions the opportunity to argue that their errors are unintentional.

It is safe to conclude that both intentional and unintentional errors contribute to the tax gap and that any strategy to reduce the gap must address both intentional evasion as well as taxpayer confusion due to the complexity of the code.

II. Challenges to Reducing the Tax Gap

Addressing the tax gap involves improving voluntary compliance, reducing opportunities for evasion, and making it easier for the IRS to administer the tax laws. We must, however, have realistic expectations about the magnitude and timing of the impact of any reasonable strategy to reduce the tax gap, particularly if it is not accompanied by broader simplification and reform of the tax code, or significant advances in compliance technology.

Implementing a strategy to reduce the tax gap will take time. As a result, it will take time to realize the anticipated benefits. As part of this strategy, the IRS will, for example, acquire and analyze new data, improve document matching programs, refine examination selection criteria, purchase and test new technology, and train employees to handle new enforcement and customer service responsibilities.

Moreover, while it may be possible to develop a comprehensive strategy that reduces the tax gap, it is not possible to implement a policy that would come close to eliminating the tax gap without an unacceptable change in the fundamental nature of our tax compliance system.

III. A Comprehensive Strategy to Reduce the Tax Gap

With an estimated net tax gap of $290 billion, no single approach will be successful at substantially reducing noncompliance. A comprehensive, integrated, multi-year strategy is necessary, within the context of an annual budget process.

1. Reduce Opportunities for Evasion

Without reliable third-party data, the IRS cannot easily detect errors in the absence of expensive and intrusive audits. The IRS receives over 1.5 billion information returns a year, reporting income from employers, financial institutions, third party payers, and state and Federal governments. However, the IRS still lacks reliable information on certain types of income, most notably income earned by the self-employed.

Penalties can deter noncompliance, but they may be set at the wrong level. Some penalties may be too low under current law to change behavior. Other penalties may be so high that examiners have been unable or unwilling to assert them, particularly when they believe that taxpayers may have made inadvertent errors.

The Administration's fiscal year 2007 budget contains five legislative proposals that would reduce evasion opportunities by focusing on employment taxes, information reporting, streamlining collection procedures, and problem return preparers. The legislative proposals in the Administration's fiscal year 2007 budget are an important step in reducing the tax gap. The Treasury Department is developing other proposals for consideration during the deliberations on the fiscal year 2008 budget, which would further reduce opportunities for evasion without unduly burdening honest taxpayers.

During these deliberations, we are exploring a number of different options including ways to:

- Strengthen reporting requirements;
- Expand IRS access to reliable data;
- Enhance examination and collections authority;
- Enable the IRS to detect and prevent multi-year noncompliance; and
- Set penalties at more appropriate levels.

The issuance of regulations and administrative guidance by the Treasury Department and the IRS will also continue to play an important role in effectively administering the tax law and responding to the tax gap problem. Guidance clarifies ambiguous areas of the law, increasing voluntary compliance. Guidance also targets specific areas of noncompliance, and prevents abusive behavior, such as tax shelters. Each year, the Treasury Department and the IRS publish a Priority Guidance Plan. The 2006-2007 plan includes 264 guidance projects scheduled for completion between July 2006 and June 2007. Many of the 264 guidance items included in this year's plan address potential areas of noncompliance. A representative sample of these items includes:

- Guidance regarding transfer-pricing arrangements involving cost-sharing under section 482;
- Guidance under section 671 regarding information reporting by widely-held fixed investment trusts (WHFITs);
- Final regulations under section 860G(b) regarding withholding obligations of partnerships allocating income from real estate mortgage investment conduit (REMIC) residual interests to foreign persons; and
- Final regulations under section 6655 regarding estimated tax payments by corporations.

The Treasury Department and the IRS have also successfully used the guidance process to help curb the involvement of taxpayers and practitioners in abusive tax avoidance transactions. For example, following enactment of the American Jobs Creation Act of 2004 ("AJCA"), the Treasury Department and the IRS released eleven separate guidance items to put into effect new reportable transaction disclosure and penalty rules. A major guidance project is currently underway to incorporate these rules into regulations. In addition, building on provisions in the AJCA, the Treasury Department and the IRS have taken significant steps to tighten and enforce the ethical rules that apply to tax practitioners, targeting improper tax advice as a significant contributor to noncompliance and the tax gap.

The publication of instructions and forms also contributes to increased efficiencies in tax administration. For example, the IRS and the Treasury Department developed the Schedule M-3 for large business taxpayers to disclose and reconcile book-tax differences. The Schedule M-3 increases the transparency of book-tax differences, resulting in a material increase in the IRS's ability to detect sources of noncompliance. The Treasury Department and the IRS are expanding Schedule M-3 coverage to S corporations and partnerships.

Following release of the Administration's fiscal year 2008 budget request, the Treasury Department and the IRS will issue a more detailed outline of the steps we will take to reduce opportunities for evasion and address the tax gap. In addition, the Treasury Department and the IRS will continue to identify guidance projects targeted to compliance and include them in regular updates to the Priority Guidance Plan.

2. Make a Multi-Year Commitment to Research

Research enables the IRS to develop strategies to combat specific areas of noncompliance, improve voluntary compliance, allocate resources more effectively, and reduce the tax gap.

The National Research Program (NRP) demonstrates the importance of comprehensive compliance data. As part of the NRP, the IRS reviewed approximately 46,000 randomly sampled individual income tax returns from tax year 2001 – the first comprehensive compliance study for individual income tax returns since 1988. Returns for which reported information could not be independently verified were audited. An NRP reporting compliance study of 5,000 S corporation tax returns filed in 2003 and 2004 is currently underway.

Data from the NRP reporting compliance study have been used to estimate the individual income tax component of the tax gap and to identify sources of noncompliance. Accurate NRP data provides a critical benchmark for determining the sources of noncompliance and for measuring changes in compliance rates over time. The IRS is also using the findings from the NRP to target examinations and other compliance activities better, thus increasing the dollar-per-case yield and reducing "no change" audits of compliant taxpayers. Innovations in audit techniques to reduce taxpayer burden, pioneered during the 2001 NRP, have been adopted in regular operational audits.

More compliance research is needed. Without new reporting compliance studies, the IRS is forced to rely on old studies, conducted over 20 years ago, to estimate compliance for areas other than individual income tax or S corporations. Moreover, with each passing year, the data from the 2001 study on individual income tax compliance becomes more outdated. Without up-to-date studies in all areas, the IRS is hampered in its ability to respond rapidly to emerging vulnerabilities in the tax system. A multi-year commitment to research would ensure that the IRS can efficiently target its resources and effectively respond to new sources of noncompliance as they emerge. Compliant taxpayers benefit when the IRS uses the most up-to-date research to improve workload selection formulas because this reduces the burden of unnecessary taxpayer contacts. Research is also critical in helping the IRS to establish benchmarks against which to measure progress in improving compliance.

The IRS is considering new research projects in the following areas:

- *Regularly update NRP reporting compliance studies.* NRP studies (such as the 2001 reporting compliance study of individual taxpayers) must be regularly and frequently scheduled to ensure that the IRS has the most up-to-date compliance data.

- *Initiate new NRP reporting compliance studies.* To provide the IRS with more comprehensive data on the magnitude and sources of noncompliance, NRP studies could extend to partnerships, other business entities, employment taxes, exempt organizations, and government entities.

- *Supplement NRP reporting compliance studies with smaller and more targeted compliance studies.* By focusing on specific areas of noncompliance, smaller studies can yield more information about the sources of noncompliance. Targeted studies can also provide insight into the effectiveness of different types of compliance strategies.

- *Examine the linkages between taxpayer services and compliance.* Research would provide a better understanding of the relationship between taxpayer burdens and compliance and the impact of taxpayer service on voluntary compliance, two areas where there has been limited work to date. Understanding the link between taxpayer service and voluntary compliance could help the IRS better target taxpayer services as well as develop programs that would both ease taxpayer burden and improve voluntary compliance.

- *Develop new tools to uncover patterns of noncompliance.* Research must be done to understand the changing patterns of noncompliance and to develop tools to discover and address it. Improved abilities to link data sets and to recognize similarities in abusive tax reduction strategies allow the IRS to target examination resources on the most egregious cases.

- *Improve the allocation of resources.* Research could help the IRS better match enforcement and service resources with the types of noncompliance, thereby maximizing the overall impact on compliance.

3. Continue Improvements in Information Technology

Tax administration in the 21st century requires improved IRS information technology (IT). The IRS is committed to continuing to make improvements in technology, including:

- Replacing antiquated core account management systems and technology. The Customer Account Data Engine (CADE) is the technological foundation that will enable the IRS to manage its tax accounts better and provide the data for a modernized IRS. Over time, the existing data base (the Individual Master File) and retrieval system (the Integrated Data Retrieval System) will be replaced with new technologies, new data bases, and new applications.

- Expanding and enhancing compliance activities through early detection, better case selection, and better case management.

- Delivering effective customer service, including E-File systems and web services, at reduced cost.

- Investing in infrastructure necessary to perform operations more efficiently, thus freeing up resources for enforcement and taxpayer service projects.

Upon release of the Administration's fiscal year 2008 budget request, the IRS will report on specific steps that will be taken to continue to improve its information technology.

4. Improve Compliance Activities

The IRS has an annual budget of roughly $10.5 billion for fiscal year 2006 to process roughly 140 million individual, partnership, and corporate income tax returns and 1.5

billion information returns, provide guidance to taxpayers and their preparers, enforce the tax law, and collect over $2 trillion of taxes. The IRS can address only a small part of the tax gap each year through its enforcement activities. In 2005 taxpayer contacts by the IRS included: 3.2 million notices sent to individual taxpayers who made mathematical or clerical errors on their 2004 tax returns, 3.5 million notices sent to taxpayers who underreported income on their tax returns or did not file returns, and 1.2 million examinations of individual income tax returns.

The IRS is continuing to improve efficiency and productivity through process changes, investments in technology, and streamlined business practices. For example, to combat abusive tax avoidance transactions, the IRS is expanding its front-line enforcement activities by redirecting employees. As detailed in the following section, the IRS continues to take advantage of technological advances, such as the Internet, to improve taxpayer services. Not only do these technological advances ease taxpayer burden, but they free valuable IRS resources to be devoted to enforcement activities.

The IRS will continue to reengineer its examination and collection procedures to reduce time, increase yield, and expand coverage. As part of its regular examination program, the IRS is expanding the use of cost-efficient audit techniques first pioneered in the NRP. By increasing its use of reliable third-party data to verify information reported by taxpayers, the IRS can better target its audit resources. The IRS is expanding its efforts to shift to agency-wide strategies, which maximize efficiency by better aligning problems (such as non-filers and other areas of noncompliance) and their solutions within the organization. The IRS is committed to improving the efficiency of its audit process, measured by audit change rates and other appropriate benchmarks.

However, efficiency gains in existing programs alone will not significantly reduce the tax gap. Some of the new steps described elsewhere in this strategy, such as providing the IRS with access to more third-party data and simplifying the tax code, would also help make compliance activities more effective.

To reduce the tax gap further, new initiatives, such as the following, are needed:

- *Expand information reporting.* If legislation were enacted to strengthen reporting requirements, the IRS could use the new information to increase and better target its enforcement activities. Voluntary compliance would also improve, freeing IRS resources to focus on more questionable returns.

- *Improve document matching program.* Increasing the number of inquiries to taxpayers when there are discrepancies between amounts reported on tax returns and third-party information returns would improve compliance.

- *Refine detection programs.* Refining and expanding detection programs to target enforcement efforts on noncompliant taxpayers would ensure that IRS resources are used effectively.

- *Increase examinations in selected areas.* Some types of noncompliance (such as the large amount of noncompliance attributable to unreported business income) can only be detected and prevented through labor-intensive, expensive examinations. Reducing the tax gap will require more examinations in areas where they are most cost-effective in recovering amounts attributable to past noncompliance and deterring future noncompliance. As noted above, the IRS is continuing to reengineer the examination process, allowing for some increase in coverage.

Implementation of these initiatives would have both direct and indirect benefits. Improving compliance activities would result in an increase in enforcement revenues as more noncompliant taxpayers are contacted and examined (the direct benefit). In addition, a more visible IRS enforcement presence would deter other taxpayers from evading their tax obligations, thus leading to an increase in voluntary compliance (the indirect benefit).

5. Enhance Taxpayer Service

Taxpayer service is especially important to help taxpayers avoid making unintentional errors. The IRS provides year-round assistance to millions of taxpayers through many sources, including outreach and education programs, tax forms and publications, rulings and regulations, toll-free call centers, the Internet, taxpayer assistance centers, and volunteer income tax assistance (VITA) and tax counseling for the elderly (TCE) sites. Assisting taxpayers with their tax questions before they file their returns reduces burdensome notices and other correspondence from the IRS after returns are filed and reduces inadvertent noncompliance overall.

Since the enactment of the IRS Restructuring and Reform Act of 1998, the IRS has significantly improved customer service. For example: (1) in the 2006 filing season, over 56 percent of all individual taxpayers filed electronically (more than double the number who filed electronically in fiscal year 1999); (2) Low-Income Taxpayer Clinics have been established to provide free or nominal charge representation for low-income taxpayers in Federal tax disputes, and to provide tax education and outreach for taxpayers who speak English as a second language; (3) the number of hits on the IRS web site ("IRS.gov"), which enables taxpayers to more easily obtain forms, track refunds, and get answers to their questions, grew to over 135 million during 2006, up nearly 8 percent from 2005; (4) other services, including the provision of transcripts of tax returns and matching of taxpayer identification numbers for third-party payers, are now being provided on-line; and (5) a pilot Compliance Assurance Process (CAP) program, which allows large corporations to work with the IRS to determine tax return accuracy prior to filing, provides these corporations with greater accuracy on their tax returns and greater certainty about their tax liability at an earlier date.

In report language accompanying the fiscal year 2006 Appropriations bill for the Treasury Department, the Senate Committee on Appropriations requested that the IRS develop a five-year plan to improve taxpayer services. The Taxpayer Assistance Blueprint, the next phase of which will be delivered in January, will include a process for assessing taxpayer needs and preferences, develop a decision model to prioritize service initiatives and funding, recommend service improvement initiatives, create customer-centric performance and outcome measures, and outline a multi-year research plan. The

Taxpayer Assistance Blueprint will also provide an important tool to help establish benchmarks against which improvements in customer service can be measured.

6. Reform and Simplify the Tax Law

The current tax code is too complicated. The complexity of the tax code makes the tax law too difficult for taxpayers to understand and for the IRS to administer. Special rules and subtle distinctions in the tax law foster a sense of unfairness in our tax system, discouraging compliance and increasing the tax gap.

Taxpayers who want to comply with the tax code often make unintentional errors on their returns, as they struggle to understand complicated rules and forms. Complexity also provides opportunities for those who are willing to exploit the system. Furthermore, complexity makes it difficult for the IRS to detect noncompliance. Simplifying the tax code will reduce unintentional errors by well-meaning taxpayers and reduce opportunities for evasion. A simpler tax code will also be easier for the IRS to administer.

The complexity of the tax law also contributes to the tax gap because limited IRS resources are increasingly committed to administering a wide array of targeted tax provisions created to meet social policy goals. These targeted provisions, which themselves are growing increasingly complicated, divert IRS resources from basic compliance efforts.

The Administration's fiscal year 2007 budget contains six proposals that would simplify the tax treatment of savings and families. The Treasury Department will continue to develop additional legislative proposals to simplify the tax code in ways that will reduce the tax gap. In addition, the Treasury Department is studying the report of the President's Advisory Panel on Tax Reform and is considering options for reform. Simplification proposals aimed at reducing the tax gap would be part of a reform proposal.

Legislative initiatives will continue to be supplemented by administrative efforts to reduce taxpayer burdens. In recent years, the IRS has taken a number of steps to reduce taxpayer burden, including the establishment of the Office of Taxpayer Burden Reduction (TBR). Recent improvements in IRS forms, processes and procedures include simplifying the filing requirements for Form 944 (Employer's Annual Federal Tax Return), eliminating the need for filing Form 2688 (Application for Additional Extension of Time to File U.S. Individual Income Tax Return) by allowing the taxpayer to get an automatic six month extension to file, and the creation of the EITC Assistant, an on-line tool that helps taxpayers determine their eligibility for the earned income tax credit (EITC) and the estimated EITC amount. Additional projects to simplify tax forms and processes are currently under review by TBR.

7. Coordinate with Partners and Stakeholders

The Treasury Department and the IRS extensively coordinate with state and foreign governments, taxpayer representative groups and practitioners to increase compliance, gain efficiencies in tax administration, improve taxpayer services and minimize taxpayer burden. Increasing the level of such coordination activities will be an important part of a successful effort to reduce the tax gap.

- *International Exchange of Information.* Through tax treaties and tax information exchange agreements, the United States is able to obtain from foreign tax authorities information needed to enforce U.S. tax laws. In addition, the United States participates in information sharing regarding broader, non-taxpayer-specific information. For example, through the Joint International Tax Shelter Information Centre (JITSIC), the IRS and tax authorities in other participating countries will continue to share information regarding abusive tax avoidance transactions.

- *Federal-State Partnerships.* The IRS continues to work with state governments to develop strategies to address trends in noncompliance. For example, combined Federal-state employment tax reporting allows extensive coordination between the IRS and state governments with respect to employer noncompliance with employment tax obligations. In addition, the Treasury Department's Financial Management Service and the IRS will launch a pilot program with two states in January 2007 to enable taxpayers to pay all their Federal and certain state taxes online by means of the Treasury's Electronic Federal Tax Payment System (EFTPS). This initiative will provide one stop for taxpayers to make their Federal and state tax payments. Additional actions to address the tax gap in the next 18 months will include:

    - Exploring the use of state data-mining capabilities, designed to utilize proprietary state data, to refine further and prioritize IRS audit leads;
    - Testing the use of state Department of Revenue audit reports as an efficient basis for IRS audit assessments;
    - Testing the use of State Workforce Agency employment tax audit reports as an efficient basis for similar IRS audit assessments;
    - Expanding coordination with other Federal agencies with the goal of leveraging their resources and securing data pertinent to IRS compliance programs;
    - Identifying state and Federal resources and programs that can be used to communicate tax gap messages; and
    - Identifying non-traditional methods utilizing state and Federal resources to communicate the societal impact of the tax gap.

- *Practitioner Liaison and Education.* The Treasury Department and the IRS conduct liaison and education activities with practitioners in order to learn about developments in tax return preparation and to ensure that advisors provide appropriate tax advice. The IRS maintains active relationships with several national practitioner groups, small business representatives, and industry organizations to provide information related to the most current IRS positions and guidance. The creation of the Office of Professional Responsibility has helped restore credibility to enforcement of professional standards. Over the next 12 months, the IRS will enhance outreach efforts with these practitioner and industry stakeholders to engage in a discussion of key components of the tax gap including:

    - Proper reporting of gross receipts;
    - Correct computation of business deductions such as cost of goods sold, depreciation, travel and entertainment expenses, and motor vehicle expenses; and
    - Third party information reporting.

- *Taxpayer Representatives.* The Treasury Department and the IRS often communicate with taxpayer representative groups to learn about taxpayer concerns, including issues regarding taxpayer rights in administering the tax code. For example, comments received from organizations representing low-income taxpayers significantly improved new EITC procedures that are currently being tested by the IRS. Recent meetings with representatives of small businesses have focused on the importance of balancing the IRS's need for action in areas of noncompliance with taxpayer concerns about increased burdens. Ongoing interaction with these groups is an integral part of this tax gap strategy.

Conclusion

The Administration is committed to reducing the tax gap. In doing so, the Administration recognizes that the most effective way to reduce the tax gap is to increase compliance rates through a combination of initiatives (including targeted legislative and administrative changes, taxpayer service, and enforcement efforts) that are sensitive to taxpayer rights and minimize taxpayer burden. Simplification of the tax law is also critically important to this effort. This document provides a broad strategy for reducing the tax gap. The Administration is committed to working with Congress to further refine and implement it.

Tax Gap Strategy Timeline for Fiscal Year 2007

2006

September	• Initial tax gap strategy
October	• Stakeholder meetings to review initial tax gap strategy
November	• Development of Administration legislative proposals for inclusion in fiscal year 2008 budget request • Development of Administration's budget request for the IRS for fiscal year 2008
December	• Proposal for next NRP Reporting Compliance Study

2007

January	• Taxpayer Advocate's Annual Report to Congress • Update of 2006-2007 Treasury Department/IRS Priority Guidance Plan • Launch of Federal/State Electronic Federal Tax Payment System (EFTPS). • Deliver Taxpayer Assistance Blueprint Phase II Report to Congress
February	• Administration's fiscal year 2008 budget request, including anticipated legislative proposals for compliance initiatives, tax code simplification and IRS funding
March/April	• Detailed outline of IRS tax gap strategy reflecting provisions in Administration's fiscal year 2008 budget request o Outline steps to reduce opportunities for evasion o Outline IRS research initiatives o Outline IRS information technology initiatives o Outline IRS compliance initiatives o Outline IRS taxpayer service initiatives o Outline steps to reform and simplify the tax law
May	• Stakeholder meetings to discuss Administration's fiscal year 2008 budget request
June	• Treasury Department review of practitioner compliance initiatives
July	• 2007-2008 Treasury Department/IRS Priority Guidance Plan.

PRESS ROOM

September 26, 2006
HP-112

Prepared Remarks by Adam Szubin, Director
Office of Foreign Assets Control

Today's agreements represent government at its best. By combining the financial sanctions powers of the Treasury Department with the law enforcement and criminal authorities of those on this stage, and working closely with our partners in Colombia, we have crippled what was one of the most notorious and dangerous drug cartels in the world.

Today's agreement also brings into sharp relief the power of financial sanctions. Since 1995, Treasury's Office of Foreign Assets Control, or "OFAC," has relentlessly pursued Colombian drug cartels, using Executive Order 12978 to designate and freeze the U.S.-controlled assets of over 1,200 companies and individuals. We have focused in particular on the notorious Cali cartel, designating over 700 entities and people that were operating as fronts for Gilberto and Miguel Rodriguez Orejuela. The heart of this financial network was the Colombian drugstore chain Drogas La Rebaja, as well as pharmaceutical laboratories like Farmacoop, which allowed the Rodriguez Orejuelas to launder their narcotics proceeds while providing an ostensibly legitimate source of income for family members and associates.

For ten years, OFAC investigators pursued the Rodriguez Orejuela's dirty assets around the world, uncovering new front companies in Colombia, Ecuador, Spain and six other countries, as the family attempted to mask its financial trails and circumvent our sanctions.

The impact of these sanctions has been dramatic. When OFAC designates a person or company, any assets held by a U.S. person or bank, anywhere in the world, must be frozen. Trade with or through the United States is cut off. Even more importantly, Colombian businesses and banks follow suit, severing all ties with entities that OFAC has listed. Time and again, U.S.-designated narcotics traffickers have been barred from opening bank accounts in Colombia or conducting business. And Colombian authorities have frequently been able to act against designated companies or properties, as they did in a massive forfeiture action against Drogas La Rebaja.

Indeed, in Colombia, being designated by OFAC is referred to as "muerte civil," or civil death.

This unrelenting pressure was a key cause of today's agreements. In a separate agreement, 28 designated family members of the Rodriguez Orejuela family have today agreed to forfeit their interests in all narcotics-related entities worldwide, including the hundreds of entities designated by OFAC since 1995. They have also committed to assist U.S. and Colombian governments in any future forfeiture actions. If the 28 Rodriguez Orejuela family members fully comply with the terms of the agreement and meet all terms of removal, we will work to remove them from OFAC's list. Any future dealings with narcotics traffickers, including on behalf of the two still-designated Rodriguez Orejuela brothers, will land them back on the list.

Today's outcome is a success - two dangerous drug lords are headed to prison and their once-powerful financial empire has been dismantled. This result is a team effort in every sense of the word, and we extend our deep appreciation to our dedicated colleagues in the U.S. Attorney's Offices in Miami and New York, the Drug Enforcement Administration, the Departments of Homeland Security and

State, and in the Colombian government. And I want to extend a special thanks to our exceptional narcotics team at OFAC.

PRESS ROOM

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September 26, 2006
HP-113

Testimony of Robert J. Carroll
Deputy Assistant Secretary (Tax Analysis)
United States Department of the Treasury
br>Hearing on Health Savings Accounts: The Experience So Far
Senate Finance Subcommittee on Health
September 26, 2006

Chairman Hatch, Ranking Member Rockefeller, and distinguished Members of the Subcommittee, I appreciate the opportunity to discuss with you today the health savings accounts (HSAs) and the health care initiative included in the President's FY 2007 Budget. I will focus my remarks on both the problems in health care and how the President's proposals to expand HSAs help address these problems.

The Experience So Far with HSAs

The growth in high deductible health plans (HDHPs) since their inception has been dramatic. Enrollment in HSA-qualified HDHPs has grown to nearly 3.2 million individuals in January 2006, according to the latest estimates from America's Health Insurance Plans (AHIP). As shown in Chart 1, this is triple the number reported in 2005, which in turn was double the number reported in 2004, the first full year in which HSAs were available.

REPORTS

- Testimony: Dep. Asst. Sec. Carroll on Health Savings Accounts

TESTIMONY OF ROBERT J. CARROLL
DEPUTY ASSISTANT SECRETARY (TAX ANALYSIS)
UNITED STATES DEPARTMENT OF THE TREASURY

HEARING ON HEALTH SAVINGS ACCOUNTS: THE EXPERIENCE SO FAR
SENATE FINANCE SUBCOMMITTEE ON HEALTH
SEPTEMBER 26, 2006

Chairman Hatch, Ranking Member Rockefeller, and distinguished Members of the Subcommittee, I appreciate the opportunity to discuss with you today the health savings accounts (HSAs) and the health care initiative included in the President's FY 2007 Budget. I will focus my remarks on both the problems in health care and how the President's proposals to expand HSAs help address these problems.

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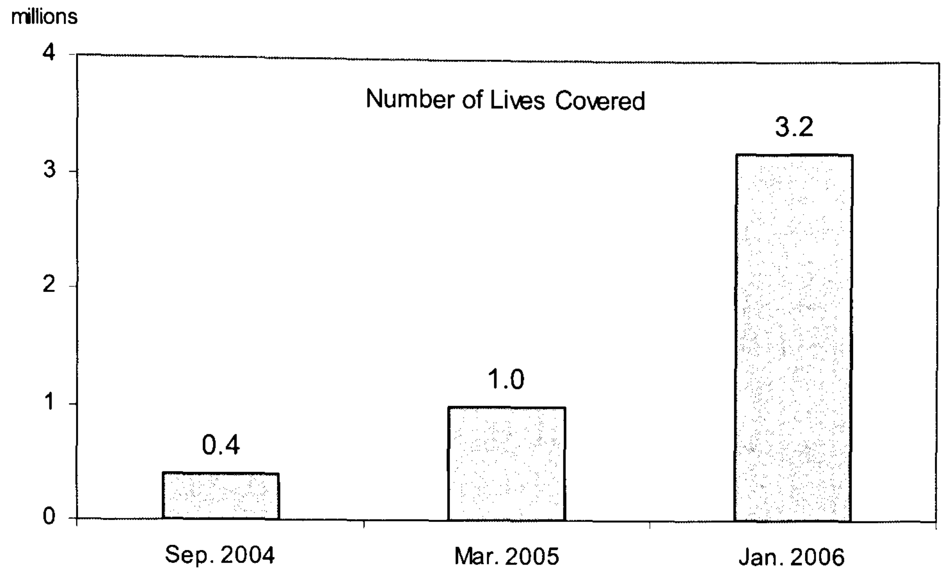
Chart 1: The number of HDHP/HSA-type plans has grown rapidly



Source: America's Health Insurance Plans, Center for Policy Research

Importantly, HSAs appear to have helped the uninsured and are being used by many lower income and older Americans. AHIP data also show roughly one-third of those who purchased HSA-eligible HDHPs in the non-group market were previously uninsured, and about 50 percent are age 40 or over. Other research shows that over 40 percent of those who purchased HSA-eligible plans in 2005 have incomes below $50,000. HSAs provide an additional option to individuals, which helps reduce the number of uninsured and helps lower income and older individuals.

<u>The Broad Objectives of the President's Health Care Initiative</u>

The President's initiative on health care is aimed at making health care more accessible, affordable, and portable, thus better enabling Americans to obtain health care and to retain their health care when they change employment.

Health insurance should be more accessible, regardless of where people work. Individuals and families should have access to a variety of health plans from which they can choose based on their individual needs and preferences.

Ideally, health insurance options at a reasonable cost would be available in all types of employment settings , not just for those who work at large firms that are capable of offering economical group health coverage to all of their employees. Employees of smaller firms, the self-employed, and those outside of the workforce should have similar choices at similar prices. One goal of the President's health care initiative is to remove the tax disincentive for individuals to purchase health care directly. It is simply unfair for individuals without access to health care through their employer to be denied the tax advantages given to those with access to employer-provided health insurance.

A key focus of the President's health care initiative is to put the consumer at the center of his or her own health care decisions. Empowering consumers is essential to improving value and affordability in American health care. When individuals are allowed to take greater control of their own health care decisions, we can expect those decisions to be better ones. Removing the tax disincentive against high deductible health plans (HDHPs) will help encourage the more efficient use of health care resources. Information about the range, price, and quality of health care options should also be readily available and easy to use. Purchasing decisions should be made by consumers, rather than surrogates, such as employers, insurers, or the government.

The President's health care initiative also recognizes that health insurance should be more affordable. The government has a responsibility to promote access to high quality and affordable health care for the poor. Our federal government also can provide financial assistance to low-income Americans and encourage the states and employers to help the chronically ill to obtain affordable health coverage.

Health insurance should be portable. Individuals should be able to take their health insurance with them when they change jobs, move, become self-employed, or leave the labor force. They should not have to worry about changing doctors, learning a new insurance company bureaucracy, having their premiums go up, or losing their insurance tax advantage when they move between employment opportunities.

The tax system should not impose a relative tax penalty on small employers that makes it difficult to recruit and retain workers.

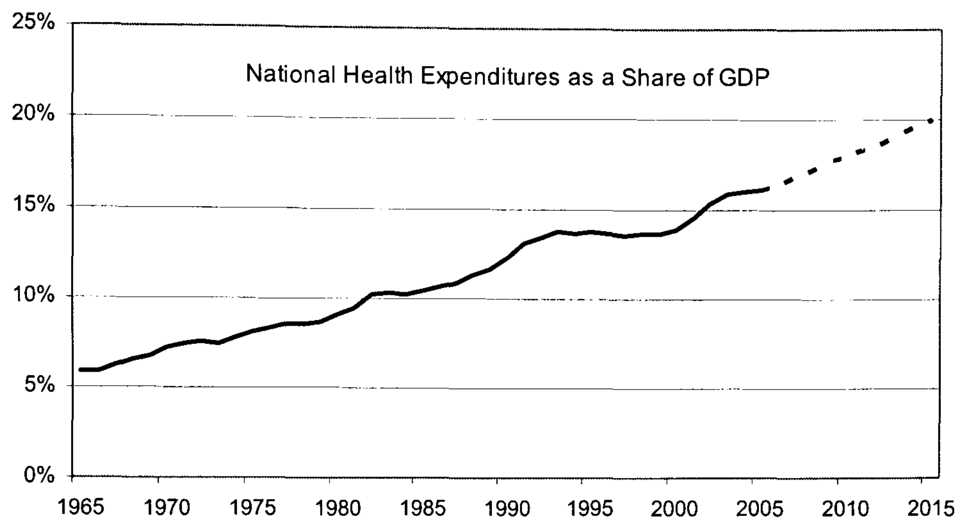
Americans enjoy the best health care facilities and medical professionals in the world, but Americans are concerned about the rising cost of health care, losing their health insurance if they change jobs, and a lack of information about price and quality. These concerns are based on real world observation and are valid. The President's health care initiative attempts to address the root problems that underlie these concerns.

Problems in Health Care

Rising Costs

Health care costs continue to rise rapidly. Growth in health care costs have been exceeding GDP growth by two percentage points annually since 1940. Chart 2 shows both actual and projected growth of national health expenditures as a percentage of GDP from 1965 through 2015. Most recently, growth of national health expenditures as a percentage of GDP rose from 13.8 percent in 2000 to 16 percent in 2004 and is expected to rise to nearly 20 percent by 2015. These rising costs impose a burden on the U.S. economy. Higher spending on public programs like Medicare and Medicaid strains state and Federal budgets. Higher insurance premiums pose a challenge for employers and burden workers with higher health costs and lower wage increases.

Chart 2: National health expenditures continue to rise as a share of GDP



Source: Department of Health and Human Services, Centers for Medicare and Medicaid Services.

The burden of rising health care costs is particularly problematic for small businesses, which often choose not to offer any health insurance to employees. According to the Kaiser Family Foundation's annual survey, nearly 100 percent of firms with 200 or more workers offer health insurance to their employees. Yet only 59 percent of firms with between 3 and 199 workers offer insurance to their employees, a decline of 9 percentage points from 2000.

The Uninsured

At the same time health care costs are rising, the number of uninsured also continues to grow. As health care costs grow faster than incomes, an increasing number of individuals are unable to purchase health insurance. Regardless of how the number of uninsured is measured, millions of Americans are currently uninsured.

Removal of Market Forces from Health Care Purchase Decisions

A substantial portion of rising health care costs is due to the effects of our insurance system itself. Health insurance gives people valuable protection and peace of mind that they will have help paying their medical bills should a major illness arise.

However, because third parties such as insurance companies, employers, and the government finance the vast majority of health care spending, most insured Americans do not know or feel the full cost of the health care services they consume.

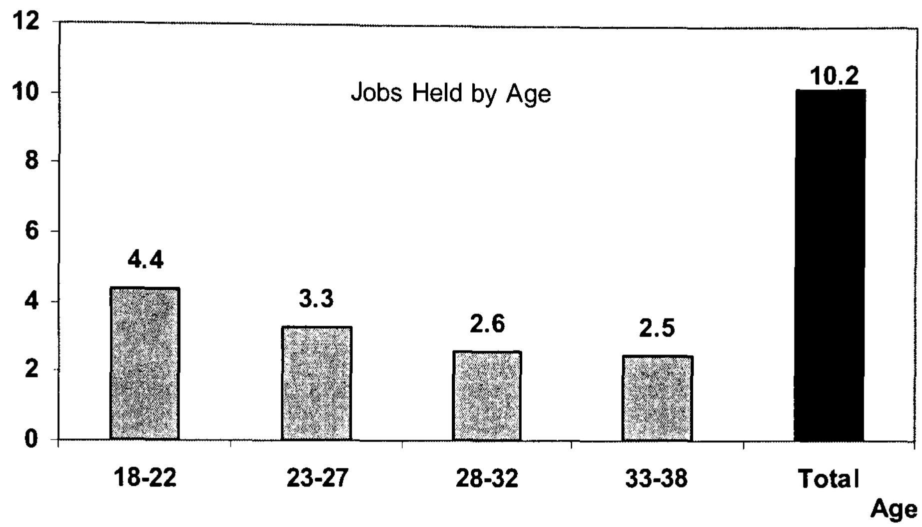
The direct expenditure for health care by an insured person may be only a small portion of his or her total health care costs. This is characteristic of low deductible and first dollar health insurance and the prevalence of this type of insurance is rooted in the tax treatment of health care generally. The tax code reduces the cost of health care when it is "pre-paid" or purchased in advance through employer-provided insurance. This has resulted in health care markets dominated by low deductibles, low coinsurance rates, and pre-paid coverage, all of which dull consumers' incentives to be cost conscious and may lead to the over-consumption of medical care. This over-consumption is the rational response of consumers who do not have to directly pay the entire cost of the medical services they use. A change in the portion of the cost of medical services faced by the consumer so that he or she faces something closer to the true market cost of medical services – the marginal cost of health care – would encourage him or her to make better decisions and examine information on lower-cost alternative treatments. This may slow the steady increase in national health expenditures.

Health Insurance Is Not Directed Towards Today's Dynamic Labor Markets

In today's economy employees frequently change jobs. These changes are often for the better. The dynamism of U.S. labor markets provides important economic benefits by allowing our economy to adapt more quickly to changing economic circumstances. The fluidity and flexibility of our labor markets may generally lead to a better matching of workers to jobs and contribute to skill development and wage growth. Workers might change jobs in pursuit of better pay, to gain more work experience or broaden their skills, or possibly to attain more flexible work arrangements.

According to the Bureau of Labor Statistics' Job Openings and Labor Turnover Survey, in 2005, some 56.1 million employees were hired to fill jobs, while 53.1 million employees left their former positions, and this was a typical year for labor turnover. As shown in Chart 3, the

Chart 3: Job turnover is an important part of dynamic labor markets in the U.S.

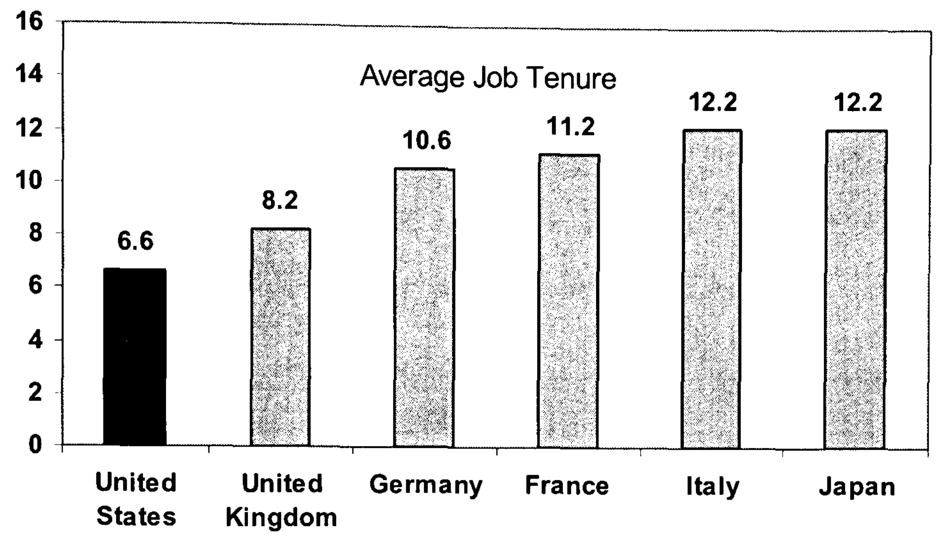


Source: Bureau of Labor Statistics, "Number of Jobs Held, Labor Market Activity, and Earnings Growth among Younger Baby Boomers: Recent Results from a Longitudinal Survey," August 25, 2004.

average American between the ages of 18 and 38 has held 10.2 jobs and the young are more apt to change jobs than those who are older. About two-thirds of lifetime wage growth occurs within the first 10 years of labor market experience. Seeking out and testing different jobs appears to be an important aspect of our labor markets and an important component of the economic progress for younger workers.

The high degree of job mobility and its role in building labor market experience and skills undoubtedly contributes to our economic vitality. As shown in Chart 4, Americans tend to change jobs much more frequently than workers in other major industrialized nations, in some cases nearly twice as often. The better matching of workers to jobs associated with the high degree of labor force dynamics contributes to economic growth and living standards by increasing the productivity of labor.

Chart 4: Labor markets in the U.S. are characterized by greater flexibility than our major trading partners



Source: International Labor Organization, "World Employment Report 2004-05," December 2004.

Tying employees' health insurance to their workplace, however, is an impediment to a dynamic labor market. Approximately 73 percent of insured Americans obtain their insurance in whole or in part through their employers. Employer-based health insurance is usually not portable when employees change jobs or stop working. People changing jobs usually must change insurance policies to receive any health benefits from their new employer. Lack of portability results in "job lock" – if anyone in the family is in poor or questionable health status, workers become hesitant to leave their jobs to work for an employer who does not offer insurance, work for themselves, or retire. Job lock has the effect of reducing the fluidity and flexibility of our labor markets and is a drag on economic growth.

How Does The President's Health Care Initiative Address the Problems

Major Parts of the Initiative

With the appropriate reforms, the U.S. health care system can become more efficient at supplying cost-effective health care to consumers while continuing to lead in innovation and the development of cutting edge medicines.

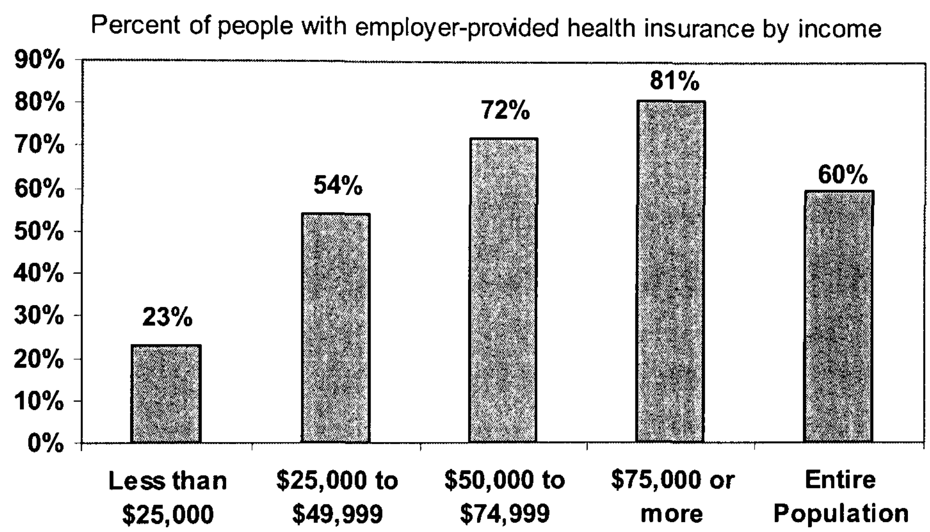
The President's initiative would address the rising costs of health care spending through a series of initiatives designed to encourage more efficient use of health care resources by improving consumer incentives. At the core of this initiative is a set of tax proposals that remove the tax disincentives to purchase high deductible health plans (HDHPs) and purchase health care directly. These changes put the health care consumer more in control of his or her health care and could result in lower health expenditures and lower health insurance premiums.

Currently, health insurance purchased through an employer is subject to neither income nor payroll taxes. While an individual purchasing health care on his or her own might pay one dollar for a dollar's worth of health care, an individual who obtains health care through an employer-provided insurance plan pays considerably less. Consider, for example, a taxpayer who is in the 15 percent income tax bracket and also pays 15.3 percent in Social Security and Medicare taxes (including both the employee and employer shares). For the last dollar of wages received, this taxpayer would pay 30.3 cents in income and payroll taxes. Thus, for every dollar of wages received, this individual could purchase only 69.7 cents of most consumption items. In the case of health care financed through an employer, however, the individual can purchase a dollar of "pre-paid" health care through a health insurance policy for every dollar of wages received. Thus, the current tax system builds in a large tax subsidy for "pre-paid" health care in the form of employer-provided health insurance.

Smaller firms are comparatively disadvantaged by this system. As already mentioned, many small businesses cannot afford to offer insurance and their workers are often among the uninsured. But those who work for larger companies currently receive a significant tax advantage: they pay neither income taxes nor payroll taxes on their health insurance premiums. In contrast, those who purchase insurance directly – perhaps because they work for a small business that does not offer insurance – pay for insurance after paying income and payroll taxes.

The President's proposals would also reduce the possibility of job lock. HSAs are owned by individuals regardless of their employer. When workers change jobs, they take their HSAs with them, reducing the possibility of job lock. An individual could seek the best job possible regardless of whether the employer offers insurance coverage, or become self-employed and still have the opportunity to take advantage of the tax benefits provided by the President's proposals.

Chart 5: Low-income families often aren't covered by employer-provided health insurance.



Source: U.S. Department of Commerce, Bureau of the Census, Current Population Survey, March 2005

Moreover, as shown in Chart 5, lower income individuals are less likely to be covered by employer-provided insurance. Policies that make health insurance more accessible and affordable to all Americans by extending the tax advantages enjoyed by those receiving their insurance through their employers would be particularly helpful to these lower income individuals.

There are several parts to the proposal. First, all taxpayers could either deduct or exclude for income tax purposes health insurance premiums for high deductible health care plans (HDHP). In addition, individuals would receive a refundable income tax credit for payroll taxes paid on those premiums.

These two provisions effectively place insurance purchased directly by individuals on an equal footing with insurance purchased through an employer, provided the insurance purchased is an HDHP.

Next, all taxpayers that have an HDHP could deduct a higher level of out-of-pocket expenses for income tax purposes through the use of an HSA than under current law. Also, taxpayers could claim a tax credit for payroll taxes paid on out-of-pocket expenses through the use of that same HSA. The amount of out-of-pocket expenses that could be deducted would be equal to the amount of out-of pocket exposure allowed for a qualifying HDHP. These two proposals have the effect of placing out-of-pocket expenses for those with an HDHP on an equal footing with "pre-paid" health insurance.

Once a taxpayer decides to purchase an HDHP, he or she would effectively receive the same tax advantages on his or her health care expenditures -- insurance and out-of-pocket -- as those who finance all their health care through an employer-provided health plan. The initiative eliminates the current tax disincentive to purchase of HDHPs and removes the tax bias that makes health care cheaper when purchased through pre-paid insurance, more attractive, than out-of-pocket payments.

The third major piece of the initiative is a refundable health insurance tax credit (HITC) for lower-income individuals for the purchase of an HDHP. The credit would be refundable and cover up to 90 percent of the cost of the health insurance up to $1,000 for singles and up to $3,000 for families. This provision would make health care more affordable to lower-income individuals and encourage those currently uncovered to obtain health insurance.

Giving Consumers a Greater Stake in Health Care Decisions – Slowing the Growth in Health Care Costs

An HDHP gives consumers a greater stake in their health care decisions.

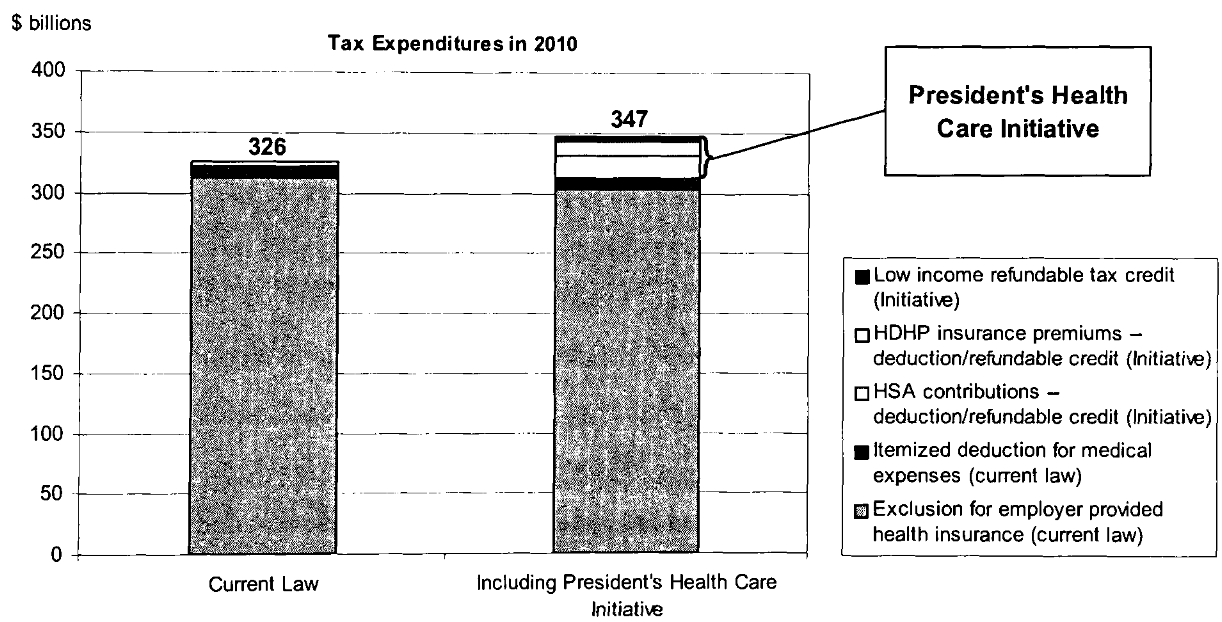
There is considerable evidence that the consumption of health care is sensitive to prices and that removing the tax bias for first dollar coverage can have an effect on health care spending. Currently, an insured individual with an HDHP has responsibility for payment of at least the first $1,050 (with no more than a total $5,250 out-of-pocket exposure) of medical costs. The President's initiative, by increasing the HSA contribution limits to the out-of-pocket maximum ($10,500 for families) ensures that individuals purchasing health care via an HSA-eligible HDHP receive the same tax treatment as employer-provided coverage up to the limits of their potential out-of-pocket costs. . It has been estimated that individuals who switch from traditional first dollar insurance to HSAs with spending below the out-of-pocket maximum would reduce their spending by 21 percent. Overall, it has been estimated health care spending would fall by 1.2 percent because of the greater exposure people who switch from traditional health insurance to HSAs would face under the President's initiative

Health care spending also has the potential to grow more slowly over time as individuals become more cost-conscious and bear a larger share of the financial responsibility for their health care decisions. In health care markets where market forces are prevalent, health care costs have grown more slowly or, in some cases, even decreased. Markets such as the laser eye surgery market and the in vitro fertilization markets, where there is significant competition, have experienced price decreases. To put this into perspective, if greater cost consciousness through the President's initiative were able to lower the growth in health care costs by just 0.5 percent, the effects on health care spending over time could be dramatic. In just ten years, this decline in the growth rate would lower health care spending by 5 percent and would be an entire percent point lower as a fraction of GDP in 2015 (e.g., $162 billion).

What is the Cost of the President's Initiative?

Chart 6 shows the health care tax expenditures under current law and under the President's health care initiatives for fiscal year 2010 for both income and payroll taxes. As can be seen, the current tax subsidy for the employee exclusion for employer-provided health insurance constitutes the major portion of the health care tax expenditure, either currently or under the President's initiative. As a result of the President's health care initiative, total health tax expenditures would increase by about $21 billion or somewhat over 6 percent in 2010.

Chart 6: President's Health Care Initiative complements already existing health care tax expenditures



Note: The estimates include the tax expenditure related to both income and payroll taxes. The estimates also include the effects on outlays.

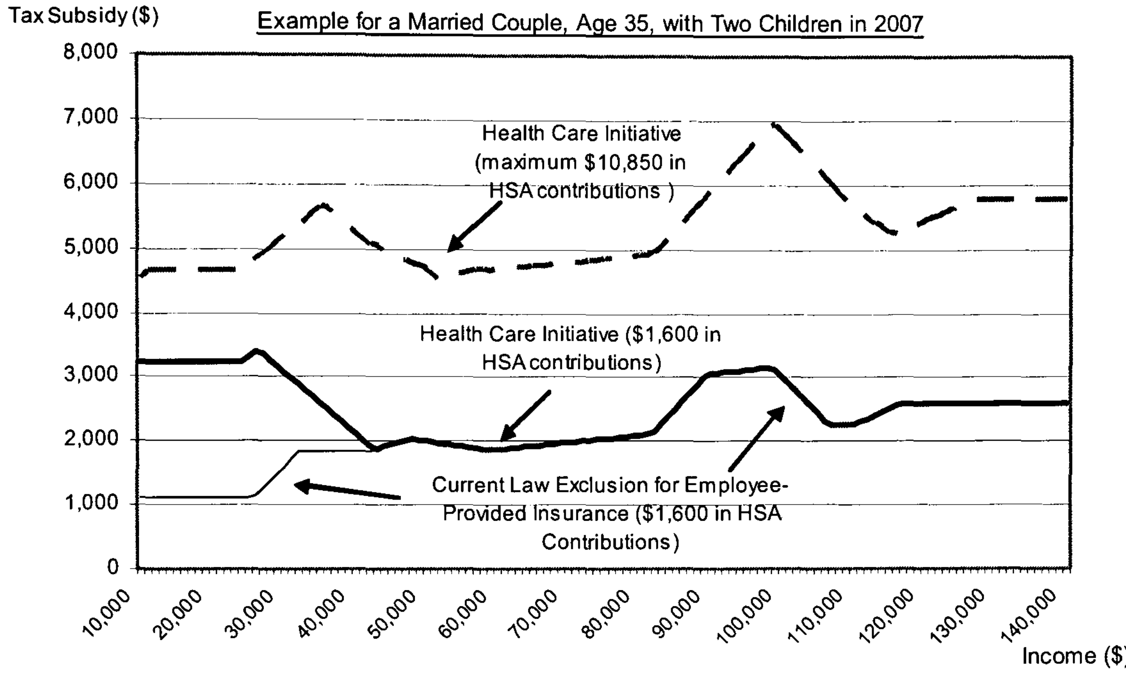
Source: U.S. Department of the Treasury, Office of Tax Analysis.

Where Does the Presidents Health Care Initiative Take Us?

The President's health care initiative levels the playing field between employer-provided insurance and HDHP insurance purchased directly by an individual and also levels the playing field between out-of pocket expenditures and insurance premiums for those with an HDHP. A key benefit of the initiative is that it reduces the tax bias towards lower deductible and first dollar health insurance. As discussed above, first dollar insurance dulls the incentives for consumers to shop carefully for cost-effective health care. Placing the consumer at the center of health care decisions helps slow the growth in health care spending. Greater reliance on health insurance purchased directly by individuals, and on HSAs generally, will also increase portability and reduce the harmful effects of job lock.

The initiative also makes HSAs more progressive. Lower income Americans receive a larger tax subsidy through the refundable health insurance tax credit targeted to low income individuals and through the set of refundable tax credits for Social Security and Medicare taxes. The latter set of credits is reduced once an individual reaches the taxable wage cap for Social Security taxes. Chart 7 compares the tax subsidy from the health care tax provisions under current law to those received under the President's health care initiative for a couple at age 35 with two children. When the family's income exceeds roughly $45,000, the President's health care initiative provides the same tax subsidy for a family purchasing health care directly as it does for a family purchasing their insurance through their employer under current law. Also, the tax subsidy under the President's health care initiative is higher for lower income families than under current law. For those with the lowest incomes, the President's initiative would provide a subsidy for more than half of a family's insurance premiums.

Chart 7: Health Care Tax Subsidy Under Current Law and the President's Health Care Initiative



Note: The family is assumed to pay a health insurance premium of $6,200 and make an HSA contribution of $1,600, except as noted above. The maximum HSA contribution under the proposal is $10,850 (in 2007). The taxpayer is assumed to receive all income from wages.

Source: U.S. Department of the Treasury, Office of Tax Analysis.

As shown in Chart 7, there is a significant tax benefit from contributing the maximum amount to an HSA under the President's initiative, with the tax subsidy initially increasing with income because of the graduated income tax rates. The tax subsidy declines once the taxable wage cap for Social Security taxes is reached. Thus, there is a limit on the tax benefit from the payroll tax credit for higher-income earners.

The maximum tax benefit provided by the HITC targeted to lower income individuals is available for single individuals with incomes below $15,000 and is completely phased out when a single individual's income reaches $25,000. For families, the maximum tax benefit provided by the HITC is available for incomes below $25,000 and completely phased out when a family's income reaches $60,000.

The President's initiative makes HSAs significantly more attractive to both the uninsured and to lower-income individuals. The Treasury Department estimates that the President's initiative would increase the number of HSAs by some 50 percent by 2010. This initiative would also help control the growth in national health expenditures by encouraging the use of HSAs and HDHPs.

Conclusion

It is also important to consider these tax provisions as part of the President's broader initiative. The broader initiative outlined by the President includes: new national Portable HSA insurance plans; a proposal to permit the purchase of health insurance policies across state lines; a proposal to allow associations of small businesses to band together to purchase health insurance; medical liability reform; and a series of health information technology actions.

I thank you for the opportunity to testify before the Subcommittee and look forward to your questions.

PRESS ROOM

September 16, 2006
HP-114

Statement by G-7 Finance Ministers and Central Bank Governors
Singapore, September 16th 2006

We, Finance Ministers and Central Bank Governors, met today to evaluate global economic outlook and discussed the ways to promote continued prosperity by addressing the opportunities and challenges lying ahead. In our economies, performance remains strong amid moderating growth in the United States, growth in the euro zone after accelerating should remain strong and more-balanced in the second half of the year, growth in the UK is becoming stronger and more-balanced, Canada remains on a strong balanced growth path, and Japan has exited the zero-interest rate policy and its recovery is now broadly-based. More widely, thanks partly to benign international financial conditions, emerging economies are broadly enjoying robust growth. The positive outlook, however, is not without potential downside risks, e.g., tight and volatile energy markets, rising inflation expectations in some economies, and the spread of protectionist tendencies. We will remain vigilant to these developments. We reaffirm our strong commitment to pursuing sound policies, and call on others to join us to meet the shared responsibility for orderly adjustment of global imbalances.

We are of the view that high energy prices reflect both rising demand from strong global expansion and concerns about current and future supplies, though the prices have eased recently. In addition to promoting greater transparency and reliability in energy market data, including through development of a global common standard for reporting oil reserves, we thus encourage investment in exploration, production, transportation and refinery capacity. At the same time we call for renewed efforts by consumers towards energy efficiency, conservation and diversification, and continued dialogue between the consumers and the producers. We stand ready to provide, in co-operation with the IFIs, technical assistance for this purpose to emerging economies and developing countries, and welcome the work on the Clean Energy Investment Framework.

We stress the importance of advancing multilateral trade liberalization, which is essential to enhancing global growth and reducing poverty. We urge all parties to show political will and flexibility necessary to resume the Doha Development Round as soon as possible, in order to achieve a comprehensive package in agriculture, industrial products, services, including financial services, intellectual property and WTO trade rules. This must address the concerns of developing countries, in particular the least developed countries. We also emphasize the importance of delivering aid for trade to low-income countries, consistent with the principle of aid-effectiveness. We underline the need to combat counterfeiting and piracy.

We reaffirm that exchange rates should reflect economic fundamentals. Excess volatility and disorderly movements in exchange rates are undesirable for economic growth. We continue to monitor exchange markets closely and cooperate as appropriate. Greater exchange rate flexibility is desirable in emerging economies with large current account surpluses, especially China, for necessary adjustments to occur.

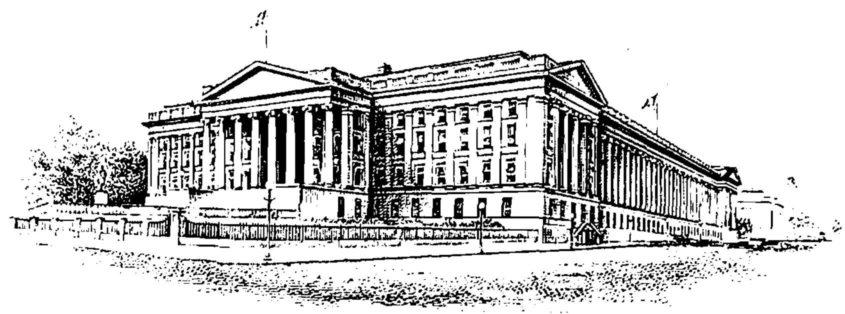
We reaffirm our strong belief, in line with the IMF Managing Director's progress report, that fundamental reform is necessary for the IMF to maintain its legitimacy, relevancy, and credibility in the changing global economy. We welcome the resolution on quota and voice reform now being considered by IMF Governors, and urge all members to support it. We endorse the objectives of making IMF quota and voting shares more responsive to changes in global economic realities in the future, and enhancing the participation and voice for low-income countries. We will work intensively with all members of the IMF to ensure these objectives are met equitably. The adoption of the resolution will increase the quotas of four particularly underrepresented economies. It will also trigger the work to achieve a significant further alignment of members' quotas with their relative positions in the world economy based on a revised quota formula, as well as at least a doubling of the basic votes at a minimum to preserve the existing voting share of low-income countries. We underscore the importance of honoring the resolution's two-year timeframe, and urge the Executive Board and the Managing Director to carry out necessary work accordingly.

We also stress the importance of enhancing the effectiveness of IMF surveillance, both by further strengthening analytical capacity and modernizing its framework. We welcome the on-going Board discussion about how best to re-state members' existing obligations to the IMF and to each other. In this context, we support the IMF's comprehensive review of its thirty-year-old guidelines on exchange rate policies. The IMF should make appropriate revisions to the guidelines so that they better define its surveillance framework for fiscal, financial sector, exchange rate and monetary policies and their collective spillovers on other countries. Together with a remit to set priorities and enhance accountability, this will improve surveillance. We look forward to the completion of this work by the 2007 Spring Meetings. We also welcome the additional perspective provided by the multilateral consultation process that was set in motion recently. On the question of a new instrument that allows economies with market access to forestall sudden disruption in capital flows, we ask the Managing Director to present a concrete proposal that is deemed effective and realistic, as well as adequately safeguarding IMF resources, by the 2007 Spring Meetings.

While welcoming the increasing role of new donor countries, we believe it is imperative that all donors share information and take account of debt sustainability issues in their lending practices. The IFIs should also enhance capacity building in the area of debt management and more closely monitor fiscal and financial situations in post-MDRI countries, so that these countries will not accumulate new debts beyond sustainable levels. We look forward to further discussions on strengthening the debt sustainability framework in the coming months, taking into account, e.g., IDA's recently-adopted policy. In order to secure the full delivery of debt relief under the HIPC initiative, the IFIs should redouble their efforts to encourage non-Paris Club official bilateral and commercial creditor participation in the Initiative. We welcome the progress towards the launch of a pilot AMC for pneumococcus by interested parties by the end of this year, including the recent formation of the working group including non-G7 members. We also welcome the World Bank's Progress Report for the Education for All-Fast Track Initiative and look forward to a further progress on education outcomes. We call on the FTI to produce a specific action plan setting out concrete recommendations on its future direction.

The international community has a stake in achieving long-term political and economic stability in the Middle East. In this light we support the Government of Lebanon's efforts towards reconstruction, development, and economic reform. We welcome donors' commitments to help Lebanon, and look forward to a deeper involvement of the IFIs. We discussed economic prospects in the West Bank and Gaza Strip and agreed to keep this under review. We also welcome the launch of the international Iraq compact.

We agreed to intensify our efforts to combat money laundering; proliferation network as well as terrorist and illicit financing by addressing global financial vulnerabilities particularly those associated with jurisdictions that have failed to recognize international standards. We urge the FATF to focus on identifying and adopting appropriate measures within its mandate. We ask the IMF and the World Bank to work closely with the FATF to foster implementation of the relevant international standards. We also encourage all countries to publish their full evaluations.



DEPARTMENT OF THE TREASURY
OFFICE OF PUBLIC AFFAIRS

EMBARGOED UNTIL 9:00 AM September 18, 2006
CONTACT Jennifer Zuccarelli (202) 622-8657

TREASURY INTERNATIONAL CAPITAL DATA FOR JULY

Treasury International Capital (TIC) data for July are released today and posted on the U.S. Treasury web site (www.treas.gov/tic). The next release date, which will report on data for August, is scheduled for October 17, 2006.

Net foreign purchases of long-term securities were $32.9 billion.

- Net foreign purchases of long-term domestic U.S. securities were $54.5 billion. Of this, net purchases by foreign official institutions were $22.7 billion and net purchases by private foreign investors were $31.8 billion.
- U.S. residents purchased a net $21.6 billion in foreign securities.

Foreigners' Transactions in Long-Term Securities with U.S. Residents
(Billions of dollars, not seasonally adjusted)

				12 Months Through					
		2004	2005	Jul-05	Jul-06	Apr-06	May-06	Jun-06	Jul-06
1	Gross Purchases of Domestic Securities	15178.9	17175.0	16254.9	18358.5	1372.6	1919.8	1667.4	1453.2
2	Gross Sales of Domestic Securities	14262.4	16164.3	15351.3	17324.9	1310.6	1835.6	1582.7	1398.7
3	**Domestic Securities Purchased, net** (line 1 less line 2) /1	**916.5**	**1010.7**	**903.7**	**1033.6**	**62.0**	**84.2**	**84.7**	**54.5**
4	**Private, net /2**	**680.9**	**889.5**	**738.0**	**907.9**	**40.5**	**85.8**	**82.4**	**31.8**
5	Treasury Bonds & Notes, net	150.9	270.0	163.6	185.7	-7.6	21.8	31.4	-1.7
6	Gov't Agency Bonds, net	205.7	187.8	201.7	203.1	9.6	26.1	18.5	6.6
7	Corporate Bonds, net	298.0	353.1	322.0	410.4	35.2	36.3	37.7	18.0
8	Equities, net	26.2	78.7	50.7	108.6	3.2	1.5	-5.2	8.8
9	**Official, net**	**235.6**	**121.1**	**165.7**	**125.7**	**21.5**	**-1.6**	**2.3**	**22.7**
10	Treasury Bonds & Notes, net	201.1	69.2	119.4	34.4	11.0	-13.6	-4.4	8.2
11	Gov't Agency Bonds, net	20.8	32.0	29.7	55.7	5.5	8.5	4.4	11.8
12	Corporate Bonds, net	11.5	19.0	15.7	24.6	1.7	2.4	1.1	1.0
13	Equities, net	2.2	1.0	0.8	11.0	3.4	1.2	1.3	1.6
14	Gross Purchases of Foreign Securities	3123.1	3681.4	3244.9	4679.7	398.7	537.6	445.6	364.9
15	Gross Sales of Foreign Securities	3276.0	3854.0	3437.5	4858.1	412.8	558.2	455.2	386.5
16	**Foreign Securities Purchased, net** (line 14 less line 15) /3	**-152.8**	**-172.6**	**-192.6**	**-178.3**	**-14.1**	**-20.6**	**-9.6**	**-21.6**
17	Foreign Bonds Purchased, net	-67.9	-45.1	-91.0	-65.6	-6.0	-15.6	-10.3	-18.7
18	Foreign Equities Purchased, net	-85.0	-127.5	-101.5	-112.8	-8.1	-4.9	0.7	-2.9
19	**Net Long-Term Flows** (line 3 plus line 16)	**763.6**	**838.1**	**711.1**	**855.2**	**47.9**	**63.6**	**75.1**	**32.9**

/1 Net foreign purchases of U.S. securities (+)
/2 Includes International and Regional Organizations
/3 Net U.S. purchases of foreign securities (-)

PRESS ROOM

September 26, 2006
HP-115

Statement by Treasury Deputy Secretary Robert Kimmitt on the Signing of the U.S.–Afghan Bilateral Debt Agreement
Treasury Department – Diplomatic Room
Washington, D.C.

I was pleased and honored to welcome Afghan Finance Minister Ahady to the Treasury Department today to sign the U.S.-Afghan bilateral debt rescheduling agreement.

By signing this bilateral agreement, the United States implements the terms of the Paris Club agreement of July 19, 2006, which reduces Afghanistan's debts to its three Paris Club creditors -- the United States, Russia and Germany -- by approximately $10.4 billion, or 92 percent.

The Paris Club agreement and the U.S.-Afghan bilateral agreement are the first steps towards 100 percent forgiveness of Afghanistan's debts, which we expect will be granted within the framework of the enhanced Heavily Indebted Poor Countries Initiative.

Today's action is another step in Afghanistan's road toward creating the conditions for more sustainable economic growth. We urge Afghanistan's other bilateral creditors to join us by committing to 100 percent debt reduction.

PRESS ROOM

September 19, 2006
HP-116

Treasury Assistant Secretary Clay Lowery
IMF-World Bank Plenary Remarks

Singapore – Chairmen, Governors, Managing Director de Rato, President Wolfowitz, on behalf of Secretary Paulson who had to depart early, I wanted to provide the U.S. perspective on this weekend. While the setting of Singapore and this weekend bring out many lessons in the world of international economics, I wanted to mention three in particular that stand out.

I. The Central Importance of Liberalization

The impressive rise in Asia's living standards is a reminder of what we all have to gain--more jobs, greater opportunities, less poverty--in pressing forward on a global trade agreement that reduces trade barriers.

Setbacks in the Doha round reflect uneasiness about the impact of globalization, even among countries that stand to gain the most from a new global trade deal. We need to address such concerns head-on, by being attentive to the impact of trade opening on different groups and ensuring that benefits are widely spread. Finance officials have special responsibility to halt rising protectionist pressures while at the same time promoting the opportunities that open trade and investment regimes bring.

There is hard and important work ahead in building a broad coalition to bring the Doha round to a successful conclusion. The rewards of trade liberalization, growth and development, however, make this work imperative and we must seize the chances before us.

II. The Growing Weight of Emerging Markets

Emerging economies with sound policies and institutions have become increasingly important actors in the global economy. They should have a greater role, and assume increased responsibilities for the management of the international financial system. At these meetings, we have begun this process by reordering the governance of the IMF so that it reflects the new realities of the 21st century.

We are pleased to have the first small step in quota reform behind us and want to thank Managing Director de Rato for his leadership. We came to the view awhile ago that if we do not take action to recognize the growing role of emerging economies, the IMF will become less relevant and we will all be worse off. We have much work to do in the coming months and we should get started on it as soon as possible.

III. Updating the Work of the International Financial Institutions

To remain relevant, the IFIs need to evaluate continually whether they are achieving their core missions--and accordingly--adjust their work programs to maintain their focus. While there have been great changes in the international monetary system over the last half-century, the encouragement of appropriate exchange rate policies to facilitate international trade and global growth remains the IMF's most fundamental responsibility. This entails rigorous assessment of members' exchange rate regimes and their consistency with domestic policies and the international system. If the IMF as a multilateral institution does not strengthen its exchange rate surveillance, the burden will inevitably fall upon bilateral mechanisms--frankly, to the potential detriment of us all.

The Asian setting for our meetings also reminds us that development efforts can succeed, as demonstrated by the role now played in the world by former World Bank borrowers like Singapore and South Korea. However, we must not let the World Bank become stale and this weekend has suggested three ways to avoid that:

First, as more countries gain market access and no longer need to rely on the Bank to finance development needs, the Bank should recognize this as success and find new ways other than lending to engage with such countries.

Second, where deep-seated corruption exists, genuine development that lifts people out of poverty simply cannot take place. Under President Wolfowitz's leadership, we have taken the first steps on a strategy that strengthens the Bank's engagement on governance and corruption issues. It is imperative that we follow through to implement this robust approach in the months ahead.

Third, and together with the IMF, the World Bank must find ways to prevent a return to unsustainable debt levels. This will mean creating the right incentives so that borrowers and lenders, join together to break the lend-and-forgive cycle once and for all.

Speaking on behalf of the U.S., we appreciate these lessons and we look forward to working with you to make them a reality. Thank you.

PRESS ROOM

September 18, 2006
HP-117

Remarks by
Treasury Assistant Secretary for International Affairs
Clay Lowery
before the Institute of International Bankers
Breakfast Dialogue Singapore
Promoting a More Open Global Financial System

Promoting financial sector reform and liberalization throughout the globe is one of the Treasury Department's foremost objectives. I see three main benefits from reform and liberalization: increased growth, greater financial stability and better opportunities for foreign financial institutions to compete in local markets.

- Economic Growth: A World Bank study shows that countries with open financial services sectors grow, on average, one percentage point faster than others, with the incremental growth rates being even somewhat higher for developing countries.
- Financial Stability: A WTO study of 27 emerging market countries found that allowing foreign financial institutions to establish locally and engage in a broad spectrum of financial activities contributed to greater stability. A more developed and competitive financial system puts pressure on policy makers to make regulatory and supervisory structures more predictable and transparent and to follow sound macro policies, which are beneficial to economic growth and financial stability.
- U.S. Investment: Financial services represents one of the most dynamic sectors of our economy. Improving access helps our exporters to expand and develop new markets, building on U.S. competitive advantages. This investment also brings benefits to the foreign markets as our financial services companies provide fresh capital, enhanced risk management and a broader array of financial products.

Today, I want to describe three key methods by which Treasury engages on financial sector reform and liberalization. These include trade negotiations, technical assistance, and bilateral regulatory policy dialogues.

Financial Services Negotiations

The first method involves formal negotiations, such as the World Trade Organization's Doha Round of negotiations on trade and financial services, and negotiations to establish Free Trade Agreements (FTAs) with individual foreign countries. The United States remains fully committed to restarting the Doha talks and achieving an ambitious outcome, but we cannot do it alone.

Treasury has a special responsibility for the financial service talks in the Doha Round. We are working with other countries to identify specific ways in which they could improve offers. Among the types of barriers we address in the WTO are limitations on new licenses, caps on foreign ownership of new or existing financial institutions, and measures that discriminate against foreign-owned financial institutions, such as those affecting the scope of business activities and geographic expansion of these institutions. At the moment, our efforts in financial services are stalled until the overall WTO negotiations are put back on track.

In 2000, the U.S. had comprehensive Free Trade Agreements with three countries, today we have implemented or concluded negotiations for 18 countries, including Singapore. The level of commitments we achieve in these agreements for services, including financial services, is high and provides our industries with greater opportunities and opens countries up to competition. For instance, right here in Singapore as of about a year ago, U.S. banks were able to obtain licenses for full service banks that were restricted prior to our FTA. These FTAs also provide protections for the transfer of capital associated with investments, so that emerging markets can attract funds to expand the productive potential of their economies.

Treasury TA

A lesser- known area of engagement is the technical assistance Treasury provides in banking supervision, capital market development and debt management. Experts are hired from the private sector and we place them in central banks and finance ministries in countries around Africa, Asia, Eastern Europe, and the former Soviet Union.

One example of our engagement is the Broader Middle East Initiative and its Partnership for Financial Excellence. Through this program, we provide technical assistance in the development of respective financial sectors to countries in the Middle East and Northern Africa region, including through training by U.S. regulators and Treasury long- and short-term advisors.

Bilateral Regulatory Dialogues

In addition, Treasury – working with its counterparts – brings together finance ministries and financial regulators in a series of financial sector policy dialogues. We hold these dialogues with Australia, Canada-Mexico, China, the European Union, India and Japan. In support of these dialogues and our ongoing work on financial services liberalization, we routinely reach out to U.S. private sector financial officials and trade associations for their input and expertise. Let me touch on a few highlights.

China

Last October, we created the U.S.-China Financial Sector Working Group. It has met twice and another meeting will take place in the coming months. The Working Group brings together U.S. and Chinese financial regulators at a technical level for discussions about regulatory issues in the banking, securities, and insurance areas, as well as cross-sectoral issues such as regulatory transparency, capital requirements, and anti-money laundering policy. Because the talks are held at the technical level, the discussion tends to be detailed and frank. Our teams candidly discuss the health of our respective banking systems, including NPLs, risk management, branching and capital issues, payments systems, and the state of the equities and bond markets. We have also raised our agenda for opening up China's financial sector, especially lifting caps on foreign investment in the financial sector and taking additional measures to open up the securities and insurance sectors to foreign investment.

These discussions have anchored widespread exchanges and technical assistance between U.S. and Chinese financial experts. A great example is the FDIC's work in helping China understand the U.S. deposit insurance system.

At the end of this year, Chinese commitments in joining the World Trade Organization will take effect in the financial arena. We have stressed that China must deliver on all of its commitments, including provision of national treatment to foreign banks.

India

In the U.S.-Indian Financial and Economic Forum, Treasury officials and senior U.S. regulators engage in technical and policy dialogue with their Indian counterparts on banking, capital markets, insurance and AML/CFT.

Treasury officials stress the benefits of liberalization of financial institutions, markets, and cross-border capital flows in order to deepen financial intermediation and capital markets. Accelerating such measures would help India meet its goals of economic growth and poverty reduction, expanded access to financial services, and infrastructure development. Specifically, we have pressed them to lift investment caps in banking, insurance, and pensions; remove quotas on the number of foreign bank branches; and eliminate restrictions on foreign institutional investors.

In our meeting, both the U.S. and Indian side engaged in a constructive discussion of capital markets development noting that India needs a more active, more efficient corporate debt market to counterbalance the current undue dependence of Indian firms on bank financing for domestic investment. The SEC and CFTC discussed the U.S. corporate debt and commodities markets, as well as progress and developments in their regulation and oversight, both key areas of interest for India. Treasury officials also argued that eliminating caps on foreign investment in insurance and pensions sector, would enable institutional investors to help deepen India's capital markets.

European Union

The U.S. and EU are the world's two largest economies and their financial markets are closely linked. The EU is in the midst of a 10-year program to integrate its 25 member state financial markets into a single market. This will enhance the efficiency of Europe's financial sector, and help sustain higher European economic growth.

The U.S.-EU Financial Markets Regulatory Dialogue was born four years ago to address a wide range of financial and regulatory issues arising on both sides of the Atlantic. Initially we managed spillover effects from legislation and regulation arising in one another's market. We succeeded for example in mitigating such effects with the Financial Conglomerates Directive in Europe and the Sarbanes-Oxley Act in the U.S.

We also work together to anticipate other issues arising in the medium term which, if not addressed, could cause other spillover effects. A clear example is accounting equivalence. Right now, the SEC and EU are working on a roadmap that by 2009 would allow EU public companies to list in the U.S. markets using financial statements based on International Financial and Reporting Standards. The EU is also seeking to defer its finding on U.S. GAAP's equivalency to IFRS for listings in Europe until 2009 in order to allow continued listings by U.S. issuers. We have also discussed issues such as Basel II and re-insurance regulation.

Japan

Our long history of engagement with the Japanese government on financial sector issues has evolved from barriers to market access, to technical and regulatory issues. The Financial Services Working Group meets annually and is jointly chaired by Treasury and the Finance Ministry and FSA. Financial regulators from both countries participate in wide-ranging discussions of financial sector issues. Current issues include privatizing Japan Post's financial institutions so that there is a level playing field, strengthening market forces and competition in the consumer finance market, and improving regulatory transparency and predictability.

Conclusion

This has been a broad-brush presentation on Treasury's international engagement to promote liberalization and reform. But I hope you will take away that our work is wide-ranging and that it is one of Treasury's highest international priorities. Let me conclude by saying that the doors of the Treasury Department are open. We want to hear your views and concerns regarding financial services issues. Your input is critical to our work.

PRESS ROOM

September 26, 2006
2006-9-26-17-27-3-2514

U.S. International Reserve Position

The Treasury Department today released U.S. reserve assets data for the latest week. As indicated in this table, U.S. reserve assets totaled $66,747 million as of the end of that week, compared to $66,342 million as of the end of the prior week.

I. Official U.S. Reserve Assets *(in US millions)*

	September 15, 2006			September 22, 2006		
TOTAL	66,342			66,747		
1. Foreign Currency Reserves [1]	Euro	Yen	TOTAL	Euro	Yen	TOTAL
a. Securities	11,902	10,975	22,877	12,065	10,918	22,983
Of which, issuer headquartered in the U.S.			0			0
b. Total deposits with:						
b.i. Other central banks and BIS	11,832	5,256	17,088	11,977	5,313	17,290
b.ii. Banks headquartered in the U.S.			0			0
b.ii. Of which, banks located abroad			0			0
b.iii. Banks headquartered outside the U.S.			0			0
b.iii. Of which, banks located in the U.S.			0			0
2. IMF Reserve Position [2]			6,669			6,711
3. Special Drawing Rights (SDRs) [2]			8,667			8,722
4. Gold Stock [3]			11,041			11,041
5. Other Reserve Assets			0			0

II. Predetermined Short-Term Drains on Foreign Currency Assets

	September 15, 2006			September 22, 2006		
	Euro	Yen	TOTAL	Euro	Yen	TOTAL
1. Foreign currency loans and securities			0			0
2. Aggregate short and long positions in forwards and futures in foreign currencies vis-à-vis the U.S. dollar:						
2.a. Short positions			0			0
2.b. Long positions			0			0
3. Other			0			0

III. Contingent Short-Term Net Drains on Foreign Currency Assets

	September 15, 2006			September 22, 2006		
	Euro	Yen	TOTAL	Euro	Yen	TOTAL

1. Contingent liabilities in foreign currency			0			0
1.a. Collateral guarantees on debt due within 1 year						
1.b. Other contingent liabilities						
2. Foreign currency securities with embedded options			0			0
3. Undrawn, unconditional credit lines			0			0
3.a. With other central banks						
3.b. With banks and other financial institutions						
Headquartered in the U.S.						
3.c. With banks and other financial institutions						
Headquartered outside the U.S.						
4. Aggregate short and long positions of options in foreign						
Currencies vis-à-vis the U.S. dollar			0			0
4.a. Short positions						
4.a.1. Bought puts						
4.a.2. Written calls						
4.b. Long positions						
4.b.1. Bought calls						
4.b.2. Written puts						

Notes:

1/ Includes holdings of the Treasury's Exchange Stabilization Fund (ESF) and the Federal Reserve's System Open Market Account (SOMA), valued at current market exchange rates. Foreign currency holdings listed as securities reflect marked-to-market values, and deposits reflect carrying values. Foreign Currency Reserves for the latest week may be subject to revision. Foreign Currency Reserves for the prior week are final.

2/ The items, "2. IMF Reserve Position" and "3. Special Drawing Rights (SDRs)," are based on data provided by the IMF and are valued in dollar terms at the official SDR/dollar exchange rate for the reporting date. The entries for the latest week reflect any necessary adjustments, including revaluation, by the U.S. Treasury to IMF data for the prior month end.

3/ Gold stock is valued monthly at $42.2222 per fine troy ounce.

PRESS ROOM

September 27, 2006
HP-118

**Remarks of Deputy Assistant Secretary for Federal Finance
James Clouse
U.S. Department of the Treasury**

**Before the Bond Market Association,
Government Securities and Funding Division**

New York City, NY - Thank you very much. It is a great pleasure for me to be here today to address this distinguished audience. Before turning to my prepared remarks, let me just take a moment first to thank the Bond Market Association for organizing this event and second to thank all of you for taking time out of your busy schedules to be here today.

I would like to take this opportunity to elaborate on one of the themes that Under Secretary Quarles raised in his speech before the annual meeting of the Bond Market Association in May--in particular, the recent developments in the secondary market for U.S. Treasury securities. Over the last two years, we have witnessed an increase in trading practices in the cash, repo, and futures markets for U.S. Treasury securities that have raised questions for the U.S. Treasury and the regulatory agencies that monitor these markets. Simply put, we have observed instances in which firms appeared to gain a significant degree of control over highly sought after Treasury issues and seemed to use that market power to their advantage. In the process, prices in the cash, repo and futures markets appear to have been distorted to varying degrees.

There are a number of factors that may account for the upturn in the number of observations of questionable trading activity in the Treasury market. Trading volumes in the Treasury market over recent years have risen sharply relative to the amounts of individual Treasury issues outstanding, perhaps allowing firms to acquire a controlling position in a particular issue more readily than in the past. In addition, the financial incentives to manipulate or "squeeze" an issue have risen markedly since mid-2004. The potential gain for any would-be manipulator in the Treasury market is often a function of the degree and the duration of the "specialness" that a firm can induce for a given security. Specialness is an inelegant term often used to refer to the spread between the general collateral repo rate and the rate for a particular security in the specials repo market. In 2003 and the first half of 2004, the general collateral repo rate stood at historically low levels close to 1 percent. With a lower bound for the specials rate of essentially zero, the potential gain from squeezing an issue over this period was a rather modest 1 percentage point. Of course, the general collateral repo rate is now much higher, implying that an effective squeeze in the Treasury market can be substantially more rewarding--a fact that has not gone unnoticed in some market circles.

In some quarters, these observations meet with a certain ambivalence. Strategic behavior in the Treasury market is viewed by some as an integral part of the "game" in the Treasury market, and the potential to gain control over an issue is simply part of the reward that dealers and others reap as a return for assuming risks and making markets. Moreover, this game and its consequences are often viewed as largely contained within the universe of dealers and other sophisticated professional investors, with few if any implications for smaller investors or the economy at large.

In contrast, the Treasury and other federal regulatory agencies regard market manipulation as a serious impediment to efficient and competitive financial markets. I'm sure that the compliance professionals in this audience have similar concerns about market manipulation, and we certainly would like to enlist your help in conveying the message that manipulative or otherwise questionable trading behavior undermines the integrity of the Treasury market and can also result in quite serious consequences for the persons and the firms engaged in that behavior.

Ensuring the integrity of the Treasury market is essential. The U.S. Treasury market is the deepest and most liquid market in the world. Average daily trading volumes currently fluctuate in the neighborhood of $600 billion--many times the average daily trading volumes in the U.S. equity and corporate bond markets--and dealers operate with very thin bid-ask spreads. The liquidity and depth of the Treasury market have made it a critical national asset: It affords the U.S. government unparalleled access to funding at the lowest possible cost over time; it is the primary market employed by the Federal Reserve in conducting open market operations and implementing monetary policy; and it conveys important so-called public good benefits to investors around the globe. Active and continuous trading in the Treasury market provides market participants with real-time readings on the "risk-free" rate that, in turn, is both a key benchmark in pricing a broad array of private instruments and a cornerstone for efficient financial portfolios. Finally, the liquidity of the Treasury market has made Treasury securities the instrument of choice for many market participants in managing interest rate risk.

Of course, no one in this audience really needs to be reminded of these special attributes of Treasury securities and the Treasury market, but these basic observations provide an important backdrop for regulators' concerns about recent questionable trading practices. Manipulative or otherwise questionable trading behavior in the Treasury market has the potential to affect virtually every individual and firm in the United States and around the world that interact with credit and other financial markets in some capacity. Moreover, the extraordinary liquidity that we observe in the Treasury market involves an element of so-called network externalities--investors trade and take positions in the Treasury market, in part, because many other investors are doing so as well. This is a self-reinforcing process in which increasing numbers of potential counterparties tend to reduce trading costs, which in turn tends to draw in more investors and lead to further reductions in trading costs. These sorts of network externalities can work in reverse as well. If the integrity of the secondary market were to be compromised by manipulative trading behavior, many investors could well migrate away from Treasuries in favor of other instruments. Left unchecked, that process could impair many of the special attributes of the Treasury market and raise the Treasury's cost of borrowing over time.

These and other adverse effects of market manipulation have long been recognized as a threat to the efficient functioning of our financial system. It is no surprise then that prohibitions against market manipulation are a core element of U.S. securities law. After the case of improper bids at Treasury auctions in the early 1990s, the 1934 Securities Exchange Act was amended to specifically prohibit government securities brokers and dealers from employing "any fraudulent, deceptive, or manipulative act or practice."

Generally, there is a presumption that private markets are efficient until proven otherwise. That said, the recent incidents in the Treasury market have certainly raised questions. I would emphasize, however, that I am not expressing an official view on any specific matters or on any matters that may be enforced by other regulators. Indeed, I would remind you that the SEC, not the Treasury, is charged with enforcing the anti-manipulation prohibitions in federal securities laws. And the CFTC is the relevant enforcement agency on matters pertaining to futures markets.

There is though a strong sense of history repeating itself in the recent instances of questionable trading practices. Over the last twenty years, there have been occasions in which firms have employed various tactics to first gain control over a highly sought-after Treasury issue and then to intentionally constrain the availability of the sought-after issue in the market so as to benefit their overall trading positions. In the so-called "futures squeeze," for example, a firm acquires control in the repo market or cash market over a security that is cheapest-to-deliver into a Treasury futures contract. In addition, the firm establishes a position in the futures market in which it is due to receive securities at settlement. Ordinarily, firms close out their open positions in an expiring Treasury futures contract and roll into the subsequent contract. But a firm attempting a futures squeeze instead insists on taking delivery at settlement with the intent of using its control over the cheapest-to-deliver security to force other market participants to settle their futures obligations by delivering more expensive securities. The futures squeeze is a stratagem that has been observed in a number of countries over the years. [1] In the United States, the Fenchurch Capital Management case in 1993 is perhaps the most noteworthy and notorious example of this particular ploy.

Another common strategy is the "repo squeeze" in which firms reverse in very large positions in highly-sought after securities in the term repo market. At the same time, they limit the availability of the security to other market participants by financing only a portion of their term repo position in the specials market. The balance of their position is financed at higher rates in tri-party repo or similar arrangements. In tri-party repo, the custodian ensures that the collateral pledged by a firm borrowing cash is immobilized and thus not available to be recirculated in the market. This is a very effective arrangement for general collateral transactions, but one might wonder why a firm would intentionally finance a large portion of a position in a scarce security in a tri-party arrangement at the general collateral rate rather than obtaining low-cost funding in the specials market. While there may be legitimate reasons for this behavior, the firm may also be engaging in a well known artifice, choosing the portions of its total position to finance in the specials market and the tri-party market so as to minimize its blended cost of funds. Essentially, this strategy can be an exercise in monopoly pricing.[2]

The market implications of these various schemes are a serious matter. As Under Secretary Quarles noted in May, the Treasury along with colleagues at the SEC, CFTC, the Federal Reserve Bank of New York, and the Board of Governors of the Federal Reserve System conduct an ongoing program of "Treasury market surveillance." This program was established following the improper bidding at Treasury auctions in the early 1990s. The surveillance group holds a biweekly call to review developments in the Treasury cash, repo and futures markets. That effort is supported by weekly data from primary dealers on transactions, positions, and financing arrangements in Treasury securities. Data on positions in specific issues is collected as well. When the group identifies situations that raise questions, there may be conversations with the market participants involved. If the situation warrants, cases may be forwarded to the appropriate agency for enforcement action or criminal investigation.

At this point, a word about transparency in the surveillance program is in order. Often market participants would like to have some specific parameters to help guide their risk management and compliance programs. And in the past, officials have offered some general guidance by suggesting that firms keep a close watch on the size of their position in specific issues relative to the total amount outstanding, the size of their trading volume in a particular issue relative to the total market volume in the issue, and any tendency for the specials rate for a particular security to trade at persistently low levels.[3] Concerns on the last point might be amplified still further if there are significant volumes of fails to deliver the scarce security.

These are helpful suggestions, but they are not necessarily definitive. For that reason, it may be appropriate for the risk management and compliance functions of financial firms to also focus broadly on questions that may bear on potentially manipulative practices.

For example, is the trading area able to exercise significant control over the floating supply of a scarce security in the market? The size of a firm's position in a particular security is certainly an important element in this regard. Historically, cases of market manipulation have often involved firms that have amassed very large positions in specific issues. We recognize, of course, that large positions may be quite benign. Indeed, large matched book positions can enhance market liquidity and efficiency. Conversely, it may also be worth noting that even comparatively modest positions could, in principle, become a vehicle for market manipulation. If the demand for a security is particularly inelastic, for example, even a modest constraint on supply could substantially affect market pricing.

Another fundamental question concerns whether a trading desk is *intentionally* exercising significant control over the floating supply of a scarce security in an effort to influence pricing in the Treasury cash, repo or futures markets. An especially important issue here may involve the means by which scarce securities are financed. In particular, it seems prudent for compliance officers to pay close attention to situations in which the trading desk is financing a significant portion of its holdings of a scarce security in tri-party repo or other arrangements that limit the availability of the security to the market. Again, reliance on tri-party financing for scarce securities is not a perfect indicator of manipulative intent; there may be legitimate reasons for a trading desk to finance a portion of its holdings of a scarce security via tri-party or similar means. However, when a trading desk continuously finances a large portion of its holdings of a scarce security in the tri-party market at a rate well above that prevailing in the specials market, compliance officers might want to review the factors that are giving rise to this funding choice. In a similar vein, it seems appropriate for compliance programs to note when Treasury trading desks are generating abnormally high profits on a position in an issue in which it is exercising significant control over the floating supply. Once again, there are many factors that can potentially explain elevated profits apart from manipulation--skill and serendipity among them. But one also has to recognize that there generally are no free lunches in a highly competitive and efficient financial market--so profits booked by a Treasury desk that are well outside the norm ought to at least trigger some measure of additional scrutiny.

Let me just close by saying that I recognize the topic that I have discussed today is an uncomfortable one in some respects. And I don't want to leave anyone with a false impression that regulators in Washington are embarked on a heavy-handed regulatory intrusion in the Treasury market. Far from it. As I noted at the outset, the Treasury market is highly efficient almost all the time. But it is also incumbent upon all of us in both the public sector and the private sector to exercise due diligence in guarding against developments that could pose a serious threat to the integrity of the Treasury market. The market surveillance program conducted by the regulatory agencies is one important vehicle for doing so. But this program by itself is only part of an overall approach. We also are working to raise the awareness of these issues at the highest levels of financial firms; the discussion of market surveillance issues with the Treasury Borrowing Advisory Committee in August was part of this overall effort. We would hope that greater awareness of these issues among top management will strengthen the support for regulatory and compliance officers in meeting their very important responsibilities.

The role of compliance functions at financial firms is absolutely crucial in stemming potential problems before they become serious enough to warrant the attention of federal regulators. In addition, the Treasury and other regulators would very much welcome a continuing dialogue with market participants on these issues. We look forward to working cooperatively on any steps that can help safeguard the integrity and efficiency of the Treasury market--an outcome that serves all of our interests. Thank you very much.

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[1] For an excellent discussion of a futures market squeeze in the U.K., see the paper by John J. Merrick Jr., Narayan Y. Naik, Pradeep K. Yadap, "Strategic Trading Behavior and Price Distortion in a Manipulated Market: Anatomy of a Squeeze," *Journal of Financial Economics*, 2005.

[2] See the discussion on short squeezes in Appendix B of the Joint Report on the Government Securities Market, published by the Department of the Treasury, Securities and Exchange Commission, and Board of Governors of the Federal Reserve, January 1992. See also the lucid discussion in the paper by Mark Fisher, "Special Repo Rates: An Introduction," Federal Reserve Bank of Atlanta Economic Review, second quarter of 2002, pp. 27-43.

[3] See remarks by Peter R. Fisher, October 8, 1996 before the Money Marketeers of New York University.

PRESS ROOM

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September 28, 2006
hp-119

Treasury Designation Targets Nine Leaders and Key Figures of the FARC

The U.S. Department of the Treasury's Office of Foreign Assets Control (OFAC) today designated nine leaders and key figures of the Colombian narco-terrorist organization, the Revolutionary Armed Forces of Colombia (*Fuerzas Armadas Revolucionarias de Colombia* or FARC).

"Today's action exposes key figures in the violent underworld of the FARC, one of the world's largest suppliers of cocaine and a notorious Colombian terrorist organization," said Adam J. Szubin, Director of OFAC. "We will continue to expose and financially isolate key individuals of the FARC who operate at the dangerous cross-section of terrorism and narcotics trafficking."

The nine individuals, named pursuant to the authority of the Foreign Narcotics Kingpin Designation Act (Kingpin Act), include eight FARC leaders and a key international representative of the FARC. These persons are subject to the economic sanctions imposed against foreign drug cartels under the Kingpin Act, including the blocking of transactions between U.S. persons and the designees, as well as the freezing of any designees' assets found within U.S. jurisdiction.

Six of the nine individuals named today were indicted as part of a narcotics conspiracy along with other high ranking members of the FARC in March 2006 in the U.S. District Court for the District of Columbia: Jose Juvenal Velandia ("Ivan Rios"), Jose Lisandro Lascarro ("Pastor Alape"), Alvaro Alfonso Serpa Diaz ("Felipe Rincon"), Gener Garcia Molina ("John 40"), Gerardo Antonio Aguilar Ramirez ("Cesar") and Gentil Alvis Patino ("Chiguiro"). Also designated today is Ferney Tovar Parra, a FARC member and right hand man to previously designated FARC commander "Fabian Ramirez." Tovar Parra has been indicted on federal drug trafficking charges in the Southern District of Florida. U.S. authorities are seeking the extradition of Gentil Alvis Patino and Ferney Tovar Parra, who are currently in Colombian custody. Also designated today are Rodrigo Granda Escobar and Jesus Emilio Carvajalino. Rodrigo Granda Escobar, an international representative for the FARC, is also in Colombian custody. Jesus Emilio Carvajalino, a member of the FARC Secretariat, is one of Colombia's most wanted terrorists.

On February 19, 2004, OFAC designated 19 individuals that included leaders of the FARC Secretariat (its governing body), certain key FARC commanders, international representatives of the FARC, and key FARC members engaged in narcotics trafficking or crimes against U.S. persons.

Background on the FARC

The FARC was designated by President Bush as a Significant Foreign Narcotics Trafficker or drug kingpin pursuant to the Kingpin Act on May 29, 2003. Previously, the Secretary of State named the FARC as a Foreign Terrorist Organization under the Antiterrorism and Effective Death Penalty Act in October 1997, and on November 2, 2001, the FARC was designated as a Specially Designated Global Terrorist pursuant to Executive Order 13224.

This action is part of an ongoing U.S. Government effort under the Kingpin Act, to apply financial measures against foreign narcotics trafficking kingpins worldwide.

This effort involves close inter-agency coordination. A total of 284 organizations, individuals and businesses in 16 foreign countries have been designated under the Kingpin Act.

Penalties for violations of the Kingpin Act range from civil penalties of up to $1,075,000 per violation to more severe criminal penalties. Criminal penalties for corporate officers may include up to 30 years in prison and fines of up to $5,000,000. Criminal fines for corporations may reach $10,000,000. Other individuals face up to 10 years in prison for criminal violations of the Kingpin Act.

For a complete list of the individuals and entities designated today, please visit: http://www.treasury.gov/offices/enforcement/ofac/actions/index.shtml.

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REPORTS

- Chart of Today's Designation

Revolutionary Armed Forces of Colombia (FARC)

September 2006

U.S. Department of the Treasury
Office of Foreign Assets Control

Foreign Narcotics Kingpin Designation Act

FARC-EP

FARC Designated by the President as a Significant Foreign Narcotics Trafficker on May 29, 2003

FARC Secretariat or Central High Command

Jesus Emilio CARVAJALINO
"Andres Paris"
DOB 15 Mar 1955
CC 3228737 (Colombia)

Jose JUVENAL VELANDIA
a.k.a. Manuel Jesus MUNOZ ORTIZ
"Ivan Rios"
DOB 19 Dec 1961
CC 71613902 (Colombia)

U.S. Indictment
March 2006

Jose LISANDRO LASCARRO
"Pastor Alape"
DOB 4 Jun 1959
CC 71180715 (Colombia)

U.S. Indictment
March 2006

Alvaro Alfonso SERPA DIAZ
"Felipe Rincon"
DOB 9 Oct 1956
CC 6877656 (Colombia)

U.S. Indictment
March 2006

FARC Commanders

Gener GARCIA MOLINA
"John 40"
43rd Front Commander
DOB 23 Aug 1963
CC 17353242 (Colombia)

U.S. Indictment
March 2006

Gerardo Antonio AGUILAR RAMIREZ
"Cesar"
1st Front Commander
DOB 20 Sep 1962
CC 16148998 (Colombia)

U.S. Indictment
March 2006

FARC International Representative

Rodrigo GRANDA ESCOBAR
DOB 9 Apr 1949
CC 19104578 (Colombia)
CC 171493523-4 (Ecuador)
Electoral Registry No. 22942118 (Venezuela)

In Colombian
Custody

Key FARC Members

Ferney TOVAR PARRA
"Fercho"
DOB 17 Nov 1966
CC 17640605 (Colombia)

U.S. Indictment
2005; 2006

In Colombian
Custody

Gentil ALVIS PATINO
"Chiguiro"
DOB 4 Jun 1961
CC 17669391 (Colombia)

U.S. Indictment
March 2006

In Colombian
Custody

PRESS ROOM

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September 28, 2006
hp-120

Treasury Exposes Fronts for the Arellano Felix Drug Kingpin Organization

The U.S. Department of the Treasury's Office of Foreign Assets Control (OFAC) today identified five companies and six individuals that have acted as fronts for Manuel Aguirre Galindo, a key leader of the Arellano Felix Organization (AFO). On June 1, 2004, the President named the AFO as a drug kingpin pursuant to the Foreign Narcotics Kingpin Designation Act ("Kingpin Act").

"Manuel Aguirre Galindo, a fugitive from U.S. justice, has used a network of financial associates and real estate companies to hide and launder his drug monies," said Adam J. Szubin, Director of OFAC. "Today's action exposes his accomplices and front companies and cuts them off from the United States and its financial institutions."

This action targets long-term financial associates of Aguirre Galindo, including Alberto Alfredo Valencia Martinez, Urbano Hernandez Somero, and Aguirre Galindo's son, Manuel Francisco Aguirre Ramos. Aguirre Galindo advanced his criminal enterprise with the help of these individuals, who were used to incorporate, administer, and hold front companies on his behalf. Notable among these companies are the Tijuana real estate firms being named today – *Playa Mar S.A. de C.V., Inmobiliaria Esparta S.A. de C.V., Inmobiliaria La Provincia S.A. de C.V., Inmobiliaria Estado 29 S.A. de C.V.,* and *Inmobiliaria Tijuana Costa S.A. de C.V.*. A number of the Aguirre Galindo associates named in today's designation participated in all facets of Manuel Aguirre Galindo's illicit business dealings.

Manuel Aguirre Galindo is a fugitive wanted by the Drug Enforcement Administration (DEA) and the U.S. State Department has issued a $2 million dollar reward for information leading to his arrest. Aguirre Galindo has a long criminal history as a major Mexican drug trafficker and has been associated with the Arellano Felix Organization for over 15 years. In January 2002, Aguirre Galindo was designated by OFAC pursuant to the Kingpin Act. In July 2003, he and other senior members of the AFO were indicted for narcotics trafficking, money laundering and conducting the affairs of an illegal enterprise through a pattern of racketeering activity (RICO).

Today's action is part of an ongoing U.S. Government effort under the Kingpin Act to apply financial measures against foreign narcotics trafficking kingpins worldwide. This effort involves close inter-agency coordination. In particular, this OFAC action would not have been possible without key support from the DEA. A total of 284 organizations, individuals and businesses in 16 foreign countries have been designated under the Kingpin Act.

Today's designation blocks any assets of the 11 designees found within U.S. jurisdiction and prohibits U.S. persons from doing business with these individuals and entities. Penalties for violations of the Kingpin Act range from civil penalties of up to $1,075,000 per violation to more severe criminal penalties. Criminal penalties for corporate officers may include up to 30 years in prison and fines of up to $5,000,000. Criminal fines for corporations may reach $10,000,000. Other individuals face up to 10 years in prison for criminal violations of the Kingpin Act.

For a complete list of the individuals and entities designated today, please visit: http://www.treasury.gov/offices/enforcement/ofac/actions/index.shtml.

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REPORTS

- Chart of Today's Designation

ARELLANO FELIX ORGANIZATION (AFO)

AGUIRRE GALINDO Financial Network

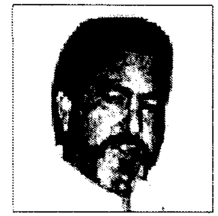
U.S. Department of the Treasury
Office of Foreign Assets Control

Foreign Narcotics Kingpin Designation Act

September 2006

All individuals depicted in this chart are Mexican nationals.

Names in red text were previously designated in January 2002



Manuel AGUIRRE-GALINDO
DOB 2 Nov 1950
R.F.C. # AUGM-501102-PM3

Mother / Business Partner

Esperanza GALINDO LEYVA
DOB 16 Aug 1920
R.F.C. GALE-200816-6IA (Mexico)

Key Front Person

Urbano HERNANDEZ SOMERO
DOB 25 May 1943
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PRESS ROOM

September 28, 2006
hp-121

Treasury Announces Negotiation of Bilateral Income Tax treaty with Iceland

The Treasury Department today announced the conclusion of the negotiation of a proposed new bilateral income tax treaty with the Government of Iceland to replace the existing tax treaty from 1975 between the two countries.

The proposed treaty modernizes the tax treaty relationship between the United States and Iceland by taking into account many changes in the law and policies of both countries since the current treaty was signed. For example, to conform to Iceland's current tax treaty policy, the proposed treaty provides for a positive rate of withholding on certain cross-border royalty payments. To conform to the current tax treaty policy of the United States, the proposed treaty contains a comprehensive limitation on benefits provision that aims to ensure that only residents that satisfy the conditions of that paragraph shall enjoy the benefits of the treaty.

The Treasury Department and the Government of Iceland hope that the proposed new tax treaty will be signed and brought into force as soon as possible

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PRESS ROOM

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September 29, 2006
HP-122

Treasury Updates Anti-Terrorist Financing Guidelines for Charitable Sector

The U.S. Department of the Treasury today issued updated *Anti-Terrorist Financing Guidelines: Voluntary Best Practices for U.S.-based Charities (Guidelines)*, taking into consideration the comments and suggestions provided by the public to assist the charitable community in efforts to safeguard itself from the threat of abuse and exploitation by terrorist organizations.

The updated *Guidelines* issued today follow a public comment period that opened in December 2005. Additionally, Treasury also issued today a response to the comments submitted on the *Guidelines* to further detail the public comment and finalization process.

"Throughout the comment period, we welcomed ideas and suggestions by the charitable sector, and took steps to strengthen areas of concern and fortify areas of support," said Pat O'Brien, Assistant Secretary for the Treasury's Office of Terrorist Financing and Financial Crime.

The Treasury, in November 2002, issued an original set of *Guidelines* to aid the charitable sector in protecting against potential abuse and exploitation by terrorist groups and their support networks. This guidance was based on the ongoing threat to well-intentioned charitable works globally. The Treasury has maintained an open and robust dialogue with the charitable community, notably the Arab-American and Islamic-American community, on how to best safeguard charitable giving from misuse by terrorists and increase awareness of the very real threat terrorist groups pose to the sector.

"The *Guidelines* reinforce the need to keep the communication channels between the government and the sector open and ongoing and demonstrate the need for continued outreach between the two. Given the importance of charitable work to people in need and the multiple ways terrorist groups exploit such work, outreach and dialogue are truly crucial components to our overall counter-terrorist financing strategy," O'Brien continued.

These *Guidelines* take into account areas of major concern, clarifying that the *Guidelines* are voluntary, not mandatory, and they do not amend or supersede existing statutes and regulations governing charities. The *Guidelines* provide recommended best practices, which are intended to help charities develop, reevaluate, and build upon pre-existing internal controls and protective measures.

The *Guidelines* urge charities to take a proactive risk-based approach to protecting against illicit abuse and are intended to be applied by those charities vulnerable to such abuse in a matter that is commensurate with the risks they face and the resources with which they work. As requested by the charitable sector, the *Guidelines* contain extensive anti-terrorist financing guidance, as well as guidance on sound governance and financial practices that helps to prevent exploitation of charities.

"The abuse of charities by terrorist organizations is a serious and urgent matter, and the *Guidelines* reinforce the need for both the U.S. Government and the charitable sector alike to keep this challenge at the forefront of our complementary efforts. The Treasury Department is committed to protecting and enabling legitimate and vital charity worldwide, and will continue to work with the sector to advance our mutual goals," said O'Brien.

REPORTS

- Updated Anti-Terrorist Financing Guidelines: Voluntary Best Practices for U.S.-based Charities
- Response to Comments Submitted on the U.S. Department of the Treasury Anti-Terrorist Financing Guidelines: Voluntary Best Practices for U.S.-Based Charities

U.S. DEPARTMENT OF THE TREASURY ANTI-TERRORIST FINANCING GUIDELINES: VOLUNTARY BEST PRACTICES FOR U.S.-BASED CHARITIES[1]

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[1] This document is a revised version of the original *Anti-Terrorist Financing Guidelines: Voluntary Best Practices for U.S.-Based Charities* released by the U.S. Department of the Treasury in November 2002. This revised version incorporates comments received in response to the issuance of the draft revised Guidelines released for public comment in December 2005.

These Guidelines are designed to assist charities that attempt in good faith to protect themselves from terrorist abuse and are not intended to address the problem of organizations that use the cover of charitable work, whether real or perceived, to provide support to terrorist groups or fronts operating on behalf of terrorist groups. Non-adherence to these Guidelines, in and of itself, does not constitute a violation of existing U.S. law. Conversely, adherence to these Guidelines does not excuse any person (individual or entity) from compliance with any local, state, or federal law or regulation, nor does it release any person from or constitute a legal defense against any civil or criminal liability for violating any such law or regulation. In particular, adherence to these Guidelines shall not be construed to preclude any criminal charge, civil fine, or other action by Treasury or the Department of Justice against persons who engage in prohibited transactions with persons designated pursuant to the Antiterrorism and Effective Death Penalty Act of 1996, as amended, or with those that are designated under the criteria defining prohibited persons in the relevant Executive orders issued pursuant to statute, such as the International Emergency Economic Powers Act, as amended. Please see Footnote 12 for an explanation of the master list of Specially Designated Nationals (the "SDN List"), which includes all such designated persons. These Guidelines are also separate and apart from requirements that apply to charitable organizations under the Internal Revenue Code ("IRC").

I. Introduction

Upon issuance of Executive Order 13224, President George W. Bush directed the U.S. Department of the Treasury ("Treasury") to work with other elements of the federal government and the international community to develop a comprehensive and sustained campaign against the sources and conduits of terrorist financing. Investigations have revealed terrorist abuse of charitable organizations, both in the United States and worldwide, to raise and move funds, provide logistical support, encourage terrorist recruitment or otherwise cultivate support for terrorist organizations and operations. This abuse threatens to undermine donor confidence and jeopardizes the integrity of the charitable sector, whose services are indispensable to both national and world communities.

In response to this threat, Treasury first released the *Anti-Terrorist Financing Guidelines: Voluntary Best Practices for U.S.-Based Charities* ("Guidelines") in November 2002. In December 2005, based on extensive review and comment by public and private sector interested parties, Treasury revised and released the Guidelines in draft form for further public comment. Based on the comments received, Treasury has further amended the Guidelines to improve their utility to the charitable sector in adopting practices that can better protect it from terrorists and their support networks.

The Guidelines are designed to enhance awareness in the donor and charitable communities of the kinds of practices that charities may adopt to reduce the risk of terrorist financing or abuse. These Guidelines are voluntary and do not create, supersede, or modify current or future legal requirements applicable to U.S. persons, including U.S. non-profit institutions. Adherence to these guidelines does not constitute a legal defense against any civil or criminal liability for violating any local, state, or federal law or regulations. In addition, these Guidelines do not represent an exhaustive or comprehensive compilation of best practices. Many charities, through their extensive experience and expertise in delivering international aid, have already developed effective internal controls and practices that lessen the risk of terrorist financing or abuse. In view of this fact, Treasury does not want charities to abandon proven internal controls and practices. Rather, the Guidelines are intended to assist charities in developing, re-evaluating, or strengthening a risk-based approach to guard against the threat of diversion of charitable funds or exploitation of charitable activity by terrorist organizations and their support networks.

In addition, these Guidelines are intended to assist charities in understanding and facilitating compliance with preexisting U.S. legal requirements related to combating terrorist financing, which include, but are not limited to, various sanctions programs administered by the Office of Foreign Assets Control ("OFAC"). These preexisting legal requirements are clearly marked in the text of the Guidelines.

The risk-based nature of these Guidelines reflects Treasury's recognition that a "one-size-fits-all" approach is untenable and inappropriate due to the diversity of the charitable sector and its operations. Accordingly, certain aspects of the Guidelines will not be applicable to every charity, charitable activity, or circumstance. Moreover, Treasury acknowledges that certain exigent circumstances (such as catastrophic disasters) may make application of the Guidelines difficult. In such cases, charities should maintain a risk-based approach that includes all prudent and reasonable measures that are feasible under the circumstances. Charities and donors are encouraged to consult these Guidelines when considering protective measures to prevent infiltration, exploitation, or abuse by terrorists. Although adherence to these Guidelines does not guarantee protection from terrorist abuse, effective internal controls which incorporate the principles and practices set forth in these Guidelines can prevent the diversion of charitable resources from their proper uses, as well as identify situations involving terrorist financing or abuse.

Treasury recognizes the vital importance of the charitable community in providing essential services around the world. Treasury also understands the difficulty of providing assistance to those in need, often in remote and inaccessible regions, and applauds the efforts of the charitable community to meet such needs. The goal of these Guidelines is to facilitate legitimate charitable efforts and protect the integrity of the charitable sector and good faith donors by offering the sector ways to prevent terrorist organizations from exploiting charitable activities for their own benefit.

II. Fundamental Principles of Good Charitable Practice

A. Charities are independent entities and are not part of the U.S. Government. Like all U.S. persons, charitable organizations must comply with the laws of the United States, which include, but are not limited to, all OFAC-administered sanctions programs.[2]

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[2] OFAC sanctions programs include those relating to particular countries or regimes (country-based programs), as well as those relating to groups, individuals, or entities engaged in specific activities (list-based programs). Sanctions programs normally: (i) prohibit U.S. persons from engaging in certain transactions, such as trade in goods and services and financial transactions, and/or (ii) require U.S. persons to block the assets and property of persons designated under the relevant Executive order or law. The particular prohibitions and/or obligations of U.S. persons vary by program. OFAC can issue licenses to U.S. persons to engage in transactions that would otherwise be prohibited, if there is a policy-permissible reason to do so, and if permitted by statute. Further information on how to apply for specific licenses is available at http://www.treas.gov/offices/enforcement/ofac/faq/index.shtml#license.

For further information on OFAC-administered sanctions programs and general licensing under these programs, please see http://www.treas.gov/offices/enforcement/ofac.

OFAC guidelines for non-governmental organizations wishing to undertake humanitarian activities in sanctioned countries are available at http://www.treas.gov/offices/enforcement/ofac/regulations/ngo_reg.pdf.

Other helpful guidance materials for charities relating to protection from terrorist abuse may be found at http://www.treas.gov/offices/enforcement/key-issues/protecting/index.shtml.

The United States relies on a wide array of federal criminal statutes in fighting the threat of terrorist financing. Charities should be particularly aware that in its efforts against the financing of terrorism, the U.S. relies on, among others, the federal statutes that prohibit:

- the financing of terrorism (18 U.S.C. § 2339C),
- providing material support or resources to terrorists (18 U.S.C. § 2339A), and
- providing material support or resources to designated terrorist organizations (18 U.S.C. § 2339B).

In that effort, the U.S. also particularly relies upon the federal statutes which criminalize:

B. Charitable organizations are encouraged to adopt practices in addition to those required by law that provide additional assurances that all assets[3] are used exclusively for charitable or other legitimate purposes.[4]

C. Individuals acting in a fiduciary capacity for any charitable organization should exercise due care in the performance of their responsibilities, consistent with applicable common law as well as local, state, and federal statutes and regulations.

D. Governance, fiscal and programmatic responsibility and accountability are essential components of charitable work and must be reflected at every level of a charitable organization and its operations.

III. Governance Accountability and Transparency

A. Governing Instruments: Charitable organizations should operate in accordance with governing instruments, *e.g.*, charter, articles of incorporation, bylaws, *etc.* The governing instruments should:

1. delineate the charity's basic goal(s) and purpose(s);

2. define the structure of the charity, including the composition of its governing body, how such body is selected and replaced, and the authority and responsibilities of the body;

3. set forth requirements concerning financial reporting, accountability, and practices for solicitation and distribution of funds; and

4. state that the charity shall comply with all applicable local, state, and federal laws and regulations.

B. Independent Oversight: It is important for charitable organizations to have independent oversight of charitable operations, and each charitable organization should determine what oversight structure best suits that organization and will provide for unbiased scrutiny of its operations. The following provisions set forth

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- the laundering of monetary instruments (18 U.S.C. § 1956), and
- engaging in monetary transactions in property derived from specified unlawful activity (18 U.S.C. § 1957).

[3] An asset is any item of value, including, but not limited to, services, resources, business, equitable holdings, real estate, stocks, bonds, mutual funds, currency, certificates of deposit, bank accounts, trust funds, and the property and investments placed therein.

[4] A charitable organization may never use charitable assets for illegal purposes; however, a charitable organization may accrue unrelated business taxable income in the course of legitimately doing business as a charitable organization. Even though an organization is recognized as tax exempt, it still may be liable for tax on its unrelated business taxable income.

basic principles for the creation of a transparent and accountable oversight body (the "governing board").

1. Members of the governing board ordinarily should not have an active role in the day-to-day management of the charitable organization.[5] The charity should establish a conflict of interest policy for both members of the governing board and employees. That policy should establish procedures to be followed if a member of the governing board or employee has a conflict of interest or a perceived conflict of interest relating to the management or operations of the charity.

2. The governing board should be responsible for the charitable organization's compliance with relevant laws, its finances and accounting practices and for the adoption, implementation, and oversight of practices, including financial recordkeeping that will safeguard charitable assets effectively.

3. The governing board should maintain records of its decisions.

4. Charities should maintain and make publicly available a current list of members of the governing board, their salaries and their affiliation with any subsidiary or affiliate of the charitable organization.

5. While fully respecting individual privacy rights, charities should maintain records of additional identifying information about the members of the governing board, such as available home, email and URL addresses, social security number, citizenship, *etc.*

6. While fully respecting individual privacy rights, charities should maintain records of identifying information for the members of the governing boards of any subsidiaries or affiliates[6] receiving funds from them.

7. When served with process or when other appropriate authorization exists, charities should produce requested records maintained in accordance with these Guidelines to the appropriate regulatory/supervisory and law enforcement authorities in a timely fashion.

C. Key Employees[7]

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[5] Certain charitable organizations, such as houses of worship, certain trusts, and corporations sole, may not be able to apply this practice due to their varying organizational and operational structures.

[6] Subsidiaries or affiliates are organizations that are subject to the general supervision or control of a parent or central organization.

[7] Key employees include not only highly compensated employees but employees who have responsibilities, powers, or influence similar to those of officials, directors, or trustees. Key employees also include chief management and administrative officials of a charitable organization, including those involved in the disbursement of funds.

1. Charities should maintain and make publicly available a current list of their five highest paid or most influential employees (the key employees) and the salaries and direct or indirect benefits they receive.

2. While fully respecting individual privacy rights, charities should maintain records containing identifying information (such as available home, email and URL addresses, social security or other identification number – *e.g.*, taxpayer identification number, national identity, or passport number – citizenship, *etc.*) about their key, non-U.S. employees working abroad. Such information should be similar to that maintained by charities in the normal course of operations about all U.S. employees, wherever employed, and foreign employees working in the United States.

3. While fully respecting individual privacy rights, charities should maintain records containing identifying information for the key employees of any subsidiaries or affiliates receiving funds from them.

IV. Financial Accountability and Transparency

A. The charity should have a budget, adopted in advance on an annual basis and approved and overseen by the governing board.

B. The governing board should appoint one individual to serve as the financial/accounting officer who should be responsible for day-to-day control over the charity's assets.

C. If the charity's total annual gross income exceeds $250,000,[8] the governing board should select an independent certified public accounting firm to audit the finances of the charity and to issue a publicly available, audited financial statement on an annual basis.

D. Solicitations for Funds

1. The charity should clearly state its goals for and purposes of soliciting funds so that anyone examining the charity's disbursement of funds can determine whether the charity is adhering to those goals.

2. Solicitations for donations should accurately and transparently tell donors how and where their donations are going to be expended.

3. The charity should substantiate on request that solicitations and

[8] The $250,000 figure is drawn from the June 2005 final report to Congress of the Panel on the Nonprofit Sector, convened by Independent Sector. This report, which offers a comprehensive approach to improving oversight and governance of charitable organizations, recommends independent financial audits for charities that have more than $250,000 in total annual revenue. This report is available at http://www.nonprofitpanel.org/final/.

informational materials, distributed by any means, are accurate, truthful, and not misleading, in whole or in part.

4. The charity should fully, immediately, and publicly disclose if it makes a determination that circumstances justify applying funds for a charitable purpose different from the purpose for which such funds were contributed or solicited.

E. Receipt and Disbursement of Funds

1. The charity should account for all funds received and disbursed in accordance with generally accepted accounting principles and the requirements of the Internal Revenue Code. The charity should maintain records of the salaries it pays and the expenses it incurs (domestically and internationally).

2. The charity should include in its accounting of all charitable disbursements the name of each grantee,[9] the amount disbursed, the date, and form of payment for each disbursement.

3. The charity, after recording, should promptly deposit all received funds into an account maintained by the charity at a financial institution. In particular, all currency donated should be promptly deposited into the charity's financial institution account.

4. The charity should make disbursements by check or wire transfer rather than in currency whenever such financial arrangements are reasonably available. Where these financial services do not exist or other exigencies require making disbursements in currency (as in the case of humanitarian assistance provided in rural areas of many developing countries, or in remote areas afflicted by natural disasters), the charity should disburse the currency in the smallest increments sufficient to meet immediate and short-term needs or specific projects/initiatives rather than in large sums intended to cover needs over an extended time frame, and it should exercise oversight regarding the use of the currency for the intended charitable purposes, including keeping detailed internal records of such currency disbursements.

F. Mechanisms for Public Disclosure of Distribution of Resources and Services

[9] The term "grantee," as it is used throughout these Guidelines, means an immediate grantee of charitable resources or services. To the extent reasonably practicable, charitable organizations should also apply or ensure the existence of applicable safeguards (as described in Sections III, IV, V, and VI) in any downstream sub-grantees or recipients to protect charitable resources from exploitation by terrorists, terrorist organizations, or terrorist supporters. Charities should not enter into a relationship with a grantee where any doubts exist about the grantee's ability to ensure safe delivery of charitable resources independent of influence by or association with any terrorist organization.

1. The charity should maintain and make publicly available a current list of any branches, subsidiaries, and/or affiliates that receive resources and/or services from the charity.

2. The charity should make publicly available or provide to any member of the general public, upon request, an annual report. The annual report should describe the charity's purpose(s), programs, activities, tax exempt status, the structure and responsibility of the governing board of the charity, and financial information.

3. The charity should make publicly available or provide to any member of the general public, upon request, complete annual financial statements, including a summary of the results of the charity's most recent audit. The financial statements should present the overall financial condition of the charity and its financial activities in accordance with generally accepted accounting principles and reporting practices.

V. Programmatic Verification

A. Supplying Resources

When supplying charitable *resources* (monetary and in-kind contributions), fiscal responsibility on the part of a charity should include:

1. determining that the potential grantee of monetary or in-kind contributions has the ability to both accomplish the charitable purpose of the grant and protect the resources from diversion to non-charitable purposes or exploitation by terrorist organizations and/or their support networks;

2. reducing the terms of the grant to a written agreement signed by both the charity and the grantee;

3. ongoing monitoring of the grantee and the activities funded under the grant for the term of the grant; and

4. correcting any misuse of resources by the grantee and terminating the relationship should misuse continue.

B. Supplying Services

When supplying charitable *services*, fiscal responsibility on the part of a charity should include:

1. appropriate measures to reduce the risk that its assets would be used for non-charitable purposes or exploitation by terrorist organizations and/or their support networks; and

2. sufficient auditing or accounting controls to trace services or commodities between delivery by the charity and/or service provider and use by the grantee.

C. Programmatic Review

The charity should review the programmatic and financial operations of each grantee as follows:

1. The charity should require periodic reports from grantees on their operational activities and their use of the disbursed funds;

2. The charity should require grantees to take reasonable steps to ensure that funds provided by the charity are neither distributed to terrorists or their support networks nor used for activities that support terrorism or terrorist organizations. Periodically, a grantee should apprise the charity of the steps it has taken to meet this goal; and

3. The charity should perform routine, on-site audits of grantees to the extent reasonable – consistent with the size of the disbursement, the cost of the audit, and the risks of diversion or abuse of charitable resources – to ensure that the grantee has taken adequate measures to protect its charitable resources from diversion to, or abuse or influence by, terrorists or their support networks.

VI. Anti-Terrorist Financing Best Practices

Charities should consider taking the following steps before distributing any charitable funds (and in-kind contributions). As explained in Section I, these suggested steps are voluntary. The purpose of these steps is to enable charities to better protect themselves from the risk of terrorist abuse and to facilitate compliance with U.S. laws, statutes, and regulations, with which all U.S. persons, including U.S. charities, must comply. Depending upon the risk profile of an individual charitable organization, adopting all of these steps may not be applicable or appropriate. When taking these steps, charities should apply a risk-based approach, particularly with respect to engagement with foreign grantees due to the increased risks associated with overseas charitable activity.

A. The charity should collect the following basic information about grantees:

1. The grantee's name in English, in the language of origin, and any acronym or other names used to identify the grantee;[10]

[10] Charities should also be mindful of the possibility that a grantee may have changed its name or transformed its organizational structure to avoid being associated with prior questionable activity. If a charity has any reason to believe that the grantee is operating under a different identity or has used a different name in the past, the charity should undertake reasonable efforts to uncover any such prior identity or name.

2. The jurisdictions in which a grantee maintains a physical presence;

3. Any reasonably available historical information about the grantee that assures the charity of the grantee's identity and integrity, including: (i) the jurisdiction in which a grantee organization is incorporated or formed; (ii) copies of incorporating or other governing instruments; (iii) information on the individuals who formed and operate the organization; and (iv) information relating to the grantee's operating history;

4. The available postal, email and URL addresses and phone number of each place of business of a grantee;

5. A statement of the principal purpose of the grantee, including a detailed report of the grantee's projects and goals;

6. The names and available postal, email and URL addresses of individuals, entities, or organizations to which the grantee currently provides or proposes to provide funding, services, or material support, to the extent reasonably discoverable;

7. The names and available postal, email and URL addresses of any subcontracting organizations utilized by the grantee;

8. Copies of any public filings or releases made by the grantee, including the most recent official registry documents, annual reports, and annual filings with the pertinent government, as applicable; and

9. The grantee's sources of income, such as official grants, private endowments, and commercial activities.

B. The charity should conduct basic vetting of grantees as follows:

1. The charity should conduct a reasonable search of publicly available information to determine whether the grantee is suspected of activity relating to terrorism, including terrorist financing or other support. Charities should not enter into a relationship with a grantee where any terrorist-related suspicions exist;[11]

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[11] List-checking alone (as described throughout this section) does not guarantee the safe and secure delivery of charitable funds and services in high-risk areas. For this reason, the Guidelines encourage charities to employ all reasonably available resources both when determining the level of risk in a particular charitable operation and when engaging in appropriate vetting procedures. One example of publicly available information of which charities should be aware is the Terrorist Exclusion List (the "TEL"). The TEL was created pursuant to the USA PATRIOT Act, which authorizes the Secretary of State to designate organizations or groups for inclusion on the TEL in consultation with or upon the request of the Attorney General. Inclusion on the TEL allows the U.S. Government to exclude or deport aliens who provide material assistance to, or solicit assistance for, designated TEL organizations. Although many of the organizations included on the TEL are also included on the Office of Foreign Assets Control ("OFAC") SDN List, several TEL organizations are not listed on the SDN List because of the different purposes and legal criteria associated with these lists.

2. The charity should assure itself that grantees do not appear on OFAC's master list of Specially Designated Nationals (the "SDN List"), maintained on OFAC's website at www.treas.gov/offices/enforcement/ofac/sdn/,[12] and are not otherwise subject to OFAC sanctions.[13]

3. With respect to key employees, members of the governing board, or other senior management at a grantee's principal place of business, and for key employees at the grantee's other business locations, the charity should, to the extent reasonable, obtain the full name in English, in the language of origin, and any acronym or other names used; nationality; citizenship;

TEL designations do not trigger any legal obligations for U.S. persons; however, the TEL does provide charities with additional terrorist-related information that may assist charities in making well-informed decisions on how best to protect themselves from terrorist abuse or association. For further information regarding the TEL, including access to the list containing all TEL designees, please refer to the U.S. Department of State's website at http://www.state.gov/s/ct/rls/fs/2004/32678.htm.

[12] The master SDN List is an integrated listing of designated parties with whom U.S. persons are prohibited from providing services or conducting transactions and whose assets are blocked. OFAC's designations are available in a variety of formats and can easily be broken down into subsets of the master list by program, by country of residency, individuals vs. entities, and other variations for appropriate use in a charity's risk-based approach. Each charity should determine which OFAC listings align with the specific risks the charity faces in its operations and should check grantees accordingly.

OFAC routinely updates information on its targets, including persons designated under country-based and list-based economic sanctions programs, such as individuals and entities designated under the various Executive orders and statutes aimed at terrorism. OFAC offers a free email subscription service that enables subscribers to keep current with these updates. With respect to terrorism-related OFAC sanctions programs, SDN listings include persons designated under Executive Order 13224, Executive Order 12947, or the Antiterrorism and Effective Death Penalty Act of 1996, as amended; such persons are called "Specially Designated Global Terrorists" or "SDGTs", "Specially Designated Terrorists" or "SDTs", or "Foreign Terrorist Organizations" or "FTOs", respectively. SDN listings also include parties subject to OFAC sanctions pursuant to other list-based programs (such as counter-WMD proliferation and counter-narcotics) and country-based programs.

In addition to checking appropriate SDN listings, charities should consult OFAC's website for other information relating to sanctioned activities or countries that may implicate their operations.

[13] As discussed in Footnote 12, the SDN List is an integrated list of individuals, organizations, and entities that the U.S. Government has designated pursuant to both country-based and list-based OFAC administered sanctions programs. U.S. persons, including U.S.-based charities, are prohibited from dealing with any of the parties included on the SDN List. A charity wishing to engage in activity in a country subject to economic sanctions should contact OFAC directly about any authorizations necessary to engage in such activity. Although the SDN List includes persons meeting the criteria established in the authorities or Executive orders that define certain OFAC sanctions programs, transactions with actors not named on the SDN List may nevertheless violate U.S. sanctions due to interests of designated parties in such transactions or prohibitions owing to country-based OFAC administered sanctions programs. For example, if a charity engages in a particular transaction with a party not on the SDN List that involves the property or interests in property of a designated actor, the transaction may be subject to OFAC sanctions. This underscores the importance of charities knowing their grantees and monitoring their programs and transactions through the use of appropriate due diligence measures. Therefore, while the SDN List is a critically important compliance tool that can assist charities in meeting their legal obligations under the variety of sanctions programs that OFAC administers, it should only form one part of a charitable organization's broader risk-based approach to protect against the risks of terrorist abuse.

current country of residence; and place and date of birth. The charity should assure itself that none of these individuals is subject to OFAC sanctions.

4. Charities should be aware that other nations may have their own lists of designated terrorist-related individuals, entities, or organizations pursuant to national obligations arising from United Nations Security Council Resolution 1373 (2001).[14]

5. With respect to the key employees, members of the governing board, or other senior management described in the preceding paragraph, the charity should also consider consulting publicly available information to ensure that such parties are not reasonably suspected of activity relating to terrorism, including terrorist financing or other support; and

6. As a pre-condition to the issuance of a charitable grant, the charity should require grantees to certify that they are in compliance with all laws, statutes, and regulations restricting U.S. persons from dealing with any individuals, entities, or groups subject to OFAC sanctions, or, in the case of foreign grantees, that they do not deal with any individuals, entities, or groups subject to OFAC sanctions or any other persons known to the foreign grantee to support terrorism or to have violated OFAC sanctions.

C. The charity should conduct basic vetting of its own key employees as follows:

1. The charity should conduct a reasonable search of publicly available information to determine whether any of its key employees is suspected of activity relating to terrorism, including terrorist financing or other support. Charities should not employ a person where any terrorist-related suspicions exist; and

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[14] Under United Nations Security Council Resolution 1373 (2001) (UNSCR 1373), UN Member States must generally freeze without delay the funds and other financial assets or economic resources of persons financing or otherwise supporting terrorist activity or terrorist-related individuals, entities, or organizations. In addition, UN Member States must generally prohibit their nationals from engaging in transactions with such parties. In order to implement these obligations under UNSCR 1373, each UN member state should, as a practical matter, develop its own list of parties sanctioned under the criteria of UNSCR 1373. For example, the SDN List incorporates those parties designated by the United States pursuant to its national obligations under UNSCR 1373.

The Guidelines do not legitimize or endorse the UNSCR 1373 lists adopted by foreign jurisdictions. Rather, this information is intended to assist charities in developing their own risk-based programs based upon a full understanding of the law in those jurisdictions in which they may operate. Charities operating in a foreign jurisdiction may choose to take the additional precautionary measures of determining whether that jurisdiction maintains a national list under UNSCR 1373 and screening the identities of grantee organizations (including their directors and key employees) against any such list. Such precautionary measures may protect charities from potential sanctions or other consequences to which they might be subject from foreign jurisdictions as a result of engaging in transactions with individuals, entities, or organizations deemed to be financing or otherwise supportive of terrorist activity under the laws of those jurisdictions.

2. The charity should assure itself that none of its key employees is subject to OFAC sanctions or have violated OFAC sanctions.

D. Should a charity's vetting practices lead to a finding that any of its own key employees, any of its grantees, or any of the key employees, members of the governing board, or other senior management of its grantees is suspected of activity relating to terrorism, including terrorist financing or other support, there are a number of available mechanisms and resources that a charity may utilize:

1. If the charity believes there is a match between the name of one of the individuals or organizations listed above and a name on the SDN List, the charity should take appropriate due diligence steps to ascertain whether the match is valid. These steps and further guidance are available on OFAC's Web site at http://www.treas.gov/offices/enforcement/ofac/faq/answer.shtml#hotline; and

2. The charity should provide information on any suspicious activity relating to terrorism, including terrorist financing or other support, which does not directly involve an OFAC match, through a referral form available on Treasury's Web site at http://www.treas.gov/offices/enforcement/key-issues/protecting/index.shtml. In addition, the Federal Bureau of Investigation maintains local field offices to which charities should provide such suspicious information. A list of the locations and phone numbers of the FBI's field offices is available at http://www.fbi.gov/contact/fo/fo.htm.

ANNEX TO GUIDELINES

The risk of terrorist abuse facing charitable organizations is ongoing and significant and cannot be measured from the important but relatively narrow perspective of terrorist diversion of charitable funds to support terrorist acts. Rather, terrorist abuse also includes the exploitation of charitable services and activities to radicalize vulnerable populations and cultivate support for terrorist organizations and activities. As reported through a wide range of media sources, terrorist organizations deliberately establish, infiltrate, or otherwise exploit charitable organizations to build terrorist support networks.[15] Recent developments – such as the exploitation by Lashkar e Tayyiba (a.k.a. Jamaat-ud-Dawa) and other terrorist entities/charitable fronts of relief efforts following the October 2005 earthquake in South Asia, the critical role of Hamas-associated charities in building popular support in the Palestinian territories for the terrorist organization, and Hezbollah's substantial control of charitable distribution networks in southern Lebanon – demonstrate the ongoing intent and effectiveness of terrorist organizations in exploiting charitable organizations and relief efforts.

Treasury, together with other Departments across the U.S. Government, is continuing to combat such terrorist abuse of the charitable sector by: (i) administratively sanctioning terrorist-related charities and charitable officials through terrorist financing designations; (ii) contributing financial information and investigative resources and expertise to advance criminal investigations and prosecutions of charities and charitable officials providing material support for designated terrorist organizations or activities; (iii) facilitating international action to address these abuses; and (iv) conducting comprehensive outreach to the charitable sector to raise awareness of terrorist exploitation and the steps charities can take protect themselves from such abuse.

U.S. designations of charities and charitable officials demonstrate the breadth of the problem of terrorist infiltration and exploitation of the charitable sector. To date, the United States has designated forty-three charities worldwide and twenty-nine associated individuals for their support of terrorist organizations and operations. These seventy-two charities and individuals

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[15] *See, e.g.*, Matthew Levitt, HAMAS: Politics, Charity and Terrorism in the Service of Jihad; New Haven, CT: Yale Univ. Press, 2006 (documenting the logistical and financial support Hamas charities provide for the group's political and terrorist activities); Heather Timmons, *British Study Charitable Organizations for Links to Plot*, N.Y. TIMES, Aug. 25, 2006 (describing the risks inherent in delivering charitable aid and resources to high-risk areas where terrorist organizations are known to operate); Robert F. Worth & Hassan M. Fattah, *Relief Agencies Find Hezbollah Hard to Avoid*, N.Y. TIMES, Aug. 23, 2006 (describing Hezbollah's efforts to cultivate support by controlling the provision of charitable resources and services across southern Lebanon); Laila Bokhair, *Political Struggle Over Earthquake Victims*, Norwegian Defense Research Establishment, Nov. 23, 2005 (documenting terrorist organizations such as Lashkar-e-Taiba and Jaish-e-Mohammed efforts to provide humanitarian aid to affected areas in the months following the earthquake in South Asia); Christopher Kremmer, *Charities Linked to Extremists Lead Quake Relief*, Age, Nov. 21, 2005 (reporting that in addition to providing relief in South Asia, terrorist organizations are recruiting and indoctrinating orphan children in their extensive network of orphanages); Evan Kohlmann, *The Role of Islamic Charities in International Terrorist Recruitment and Financing* (2006), Danish Institute for International Studies: available at http://www.diis.dk/graphics/Publications/WP2006/DIIS%20WP%202006-7.web.pdf (tracing the historical link between charitable organizations and terrorist activities from the Soviet-Afghan war through to the present); BBC News, *Faith, hate and charity: Transcript*, BBC One, Recorded from Transmission, July 30, 2006 (reporting on one of Britain's leading Islamic charities, Interpal, and illustrating Interpal's use of a network of charities in Gaza and the West Bank to support and fund Hamas, a terrorist organization designated by the U.S. Government and the European Union).

comprise over fifteen percent of all U.S.-designated terrorist supporters or financiers, indicating the primary importance of charities as a critical means of support for terrorist organizations and activities. Treasury maintains a summary of all designated charities, including unclassified background information summarizing the basis of each designation, to assist the donor and charitable communities in identifying those charities associated with terrorist financing and support. Further information and press releases relating to these designations are available on the Treasury Web site at http://www.treas.gov/offices/enforcement/key-issues/protecting/charities_exec-orders.shtml.

In addition to these ongoing efforts by Treasury and the U.S. Government, other countries and organizations from around the world have recognized and helped curb abuse of the charitable sector by terrorist organizations. The Financial Action Task Force (FATF) – the premier inter-governmental organization responsible for developing and promoting global policies to combat money laundering and terrorist financing – has studied the problem of terrorist financing and abuse across the charitable sector globally and has published typologies of such abuse. The FATF has also published Best Practices for Non-Profit Organizations and more recently issued interpretive guidance strengthening the international standard for combating terrorist abuse of non-profit organizations. Additionally, FATF style regional bodies (FSRBs) such as the Asia Pacific Group (APG), Eurasian Group (EAG) and the Middle East and North Africa Financial Action Task Force (MENA FATF) are developing typologies and studies on the active threat of terrorist financing and support through charities that operate within their regions.[16] These organizations and their member countries are implementing measures to actively combat this threat through the development and application of supervisory, investigative, and financial authorities to identify and dismantle charities engaged in terrorist financing or support. Many of these documents, which underscore the threat that terrorist organizations and operations pose to the charitable sector, are available on the Treasury Web site at http://www.treas.gov/offices/enforcement/key-issues/protecting/index.shtml.

Treasury continually engages in outreach and updates its Web site to communicate useful information regarding: (i) the ongoing risks of terrorist abuse in the charitable sector; (ii) ongoing U.S. and other governmental efforts to mitigate these risks and combat terrorist abuse, and (iii) steps the sector can take to protect against such abuse. Treasury's Guidelines represent one essential component and product of the ongoing outreach that Treasury is conducting with the charitable sector to empower and protect the sector from terrorist abuse. Another example of available resources is Treasury's December 2005 advisory paper, which provides information to charities delivering relief in areas affected by the 2005 South Asia earthquake by detailing typologies of terrorist abuse of charities and reports on activity by militant and terrorist groups in those areas. This paper also shows, through media reports, the extent to which terrorist organizations pose a risk to charities trying to deliver aid in unstable areas, where terrorist

[16] The efforts of the MENA FATF are particularly exemplary of international efforts to combat terrorist abuse of charities. MENA FATF Member States have issued a best practices paper, based on the FATF's international standard for combating terrorist abuse of the non-profit sector, tailored to the specific religious, social, and economic values of the region. The comprehensive framework, crafted by the MENA FATF, outlines legislative, regulatory, and procedural measures to ensure that the charitable sector is not misused or abused by terrorist financiers. The MENA FATF charities best practices paper is an indispensable tool for the Middle East and North Africa region in helping to protect against terrorist abuse of charities by offering guidance to promote transparency and accountability in the charitable sector.

organizations themselves and/or their charitable fronts are often engaged in delivering relief as an effective recruitment mechanism in building broader support for their organizations.

Treasury will continue its outreach and informational efforts as part of its larger mission to combat terrorist financing and safeguard the charitable sector from terrorist abuse.

Response to Comments Submitted on the *U.S. Department of the Treasury Anti-Terrorist Financing Guidelines: Voluntary Best Practices for U.S.-Based Charities*

In response to the threat of terrorist financing in the charitable sector and to assist charities in protecting themselves from such abuse, Treasury initially released its *Anti-Terrorist Financing Guidelines: Voluntary Best Practices for U.S.-Based Charities* (Guidelines) in November 2002. After receiving numerous comments from the sector regarding these Guidelines, Treasury hosted an Initial Outreach Event in April 2004, at which time Secretary Snow committed that Treasury would continue to work with the sector to amend and revise the Guidelines to improve their utility for the sector in protecting against terrorist abuse. On December 5, 2005, after extensive discussions with other government authorities and the charitable sector, Treasury released a draft revised version of the Guidelines and invited public comment on the revisions.

Treasury received a total of nine submissions during the comment period from a wide range of organizations. A number of organizations prefaced their comments with a general recommendation that Treasury withdraw the Guidelines based on their perception that the Guidelines are potentially harmful to the charitable sector given existing regulations governing the operations of charities. We do not believe that the voluntary adoption of the Guidelines-whereby charities with a higher risk of vulnerability to terrorist financing should consider adopting the best practices to better defend against that risk-would adversely affect the financial health, or obstruct the day-to-day operations, of the charitable sector.

Treasury is uniquely positioned to provide recommended measures to the charitable sector that are particularly relevant for combating the ongoing and pervasive terrorist abuse and exploitation of charities. Such voluntary measures are intended to assist charities build upon pre-existing controls and protective measures by adopting and applying appropriate counter-terrorist financing safeguards. Treasury also believes the sector is better served through ongoing dialogue regarding the evolving nature of the terrorist threat, particularly with respect to the charitable sector, and effective voluntary protective measures that the sector can adopt to combat this threat.

Treasury initially conceived the Guidelines as a direct response to requests from the sector for policies and practices to protect against potential terrorist abuse and assist in compliance with new terrorist financing authorities, including Executive Order 13224. The Guidelines not only provide such measures in the form of voluntary "best practices," but their release initiated a strong and ongoing dialogue with the charitable sector. This dialogue has led to a greater awareness of the risks of terrorist abuse in the charitable sector, and as a result, charities have adopted more proactive approaches to protect their assets and the integrity of their operations. Treasury's engagement with the sector has also resulted in the evolution of the Guidelines into a more effective, relevant, and applicable resource for the sector. In addition, we encourage charities to consult other available publications or materials on good governance and sound charitable practices. We hope that the adoption of the policies and procedures contained in the Guidelines serve to strengthen donor confidence and contribute to the charitable sector's continued vitality.

For the above reasons, Treasury has not withdrawn the Guidelines. Instead, after careful consideration of all comments and recommendations, Treasury has further amended the Guidelines to enhance their usefulness for the charitable sector in adopting practices that better protect it from the risks of terrorist abuse. The purpose of this document is to summarize the content of the comments received and describe our response, including any changes to the Guidelines and the reasoning supporting those changes. The summary of the comment submissions has been organized according to the layout of the Guidelines.

1) Title

Comments: Many commenters indicated that part of the title of the Guidelines, "*Voluntary Best Practices*," is a misrepresentation for two reasons. First, the commenters stressed that it is inaccurate to suggest that the Guidelines are a compilation of the charitable sector's best practices. Due to the diversity within the charitable sector, there is not a commonly agreed upon set of best practices that applies to all charities. Second, many commenters expressed the belief that the Guidelines are not voluntary. Their concern is based primarily upon the recent incorporation of the Guidelines into the memorandum accompanying the regulations for the 2006 Combined Federal Campaign (CFC), issued by the Office of Personnel Management (OPM). Moreover, concern exists that other federal agencies will adopt the recommendations included in the Guidelines as requirements, thus conferring upon the Guidelines de facto legal authority. A few commenters suggested that Treasury should change the title of the Guidelines to "*Suggestions for Complying with Anti-Terrorist Financing Laws.*"

Treasury Response: Although we acknowledge the concerns of the commenters, the title of the Guidelines remains unchanged, because it does not misrepresent the purpose and intent of the Guidelines. We believe the Guidelines represent sound best practices that help to prevent terrorist abuse of charitable organizations, and were, in fact, conceived after reviewing a wide spectrum of existing due diligence best practices employed by the sector. To address the concerns of the commenters, we have revised the Introduction to the Guidelines to state more clearly that these best practices are neither exhaustive nor comprehensive. Rather, the Guidelines represent one set of best practices specifically aimed at combating terrorist financing. Other best practices may exist that would be more suitable for combating other abuses that charities may face, but which may also be relevant or helpful in protecting charities from terrorist abuse. Nonetheless, the Guidelines contain many best practices that will help charities in adopting an appropriate risk-based approach to protect their assets and operations from terrorist financing abuse and facilitate their compliance with existing U.S. legal obligations, including the Office of Foreign Assets Control (OFAC) administered sanctions programs.

Similarly, we disagree that the Guidelines may become de facto legal requirements. We have been clear both in the Introduction to the Guidelines, as well in our public discourse regarding the Guidelines, that they are voluntary and do not create, modify, or supersede any existing U.S. legal requirements. In addition to the title, their voluntary nature is reiterated throughout the text of the Guidelines. We have also amended Footnote 1 (formerly Footnote 3) to make clear that non-adherence to the Guidelines does not, in and of itself, constitute a violation of existing U.S. law. Moreover, the incorporation of the Guidelines into the CFC commentary does not indicate the evolution of the Guidelines from a voluntary undertaking to a legal requirement, but, in fact, speaks to their usefulness as practical advice to protect charities from abuse. The incorporation of the Guidelines by other federal agencies encourages consistency across the U.S. Government and signals the acceptance of the central tenet of the Guidelines – charities should apply a risk-based approach in adopting appropriate measures to protect themselves against the threat of terrorist abuse. For these reasons, we have not changed the title to the Guidelines.

2) Introduction

Comments: Many commenters expressed concern that the introductory paragraphs broadly overstate the extent of diversion of charitable assets to terrorist organizations and their support networks. In particular, several comments singled out the following sentence: "Investigations have revealed terrorist abuse of charitable organizations, both in the United States and worldwide, often through the diversion of donations intended for humanitarian purposes but funneled instead to terrorists, their support networks, and their operations." The commenters recommended that Treasury include data and other information to support these statements.

Treasury Response: We have taken this comment under advisement and have revised the sentence quoted above by including an Annex that describes and references the various indicators of terrorist financing in the charitable sector. There exists a large library of open source information describing the use of charities by terrorists and their supporters that is available to the public. Terrorist financing risk in the sector is evidenced by: i) open source media reports; ii) designations of charities; iii) results of investigations and prosecutions of charities and individuals associated with charities; and iv) international actions. The Annex also notes that much of the information evidencing the terrorist financing risk in the charitable sector is available on Treasury's Web site at http://www.treas.gov/offices/enforcement/key-issues/protecting/index.shtml.

3) Fundamental Principles

Comments: Several commenters noted that the Guidelines do not include two principles from *Principles of International Charity*, which was developed by the Treasury Guidelines Working Group of Charitable Sector Organizations and Advisors and released in March 2005. The first principle asserts that charitable organizations are non-governmental entities and are not agents for enforcement of U.S. or foreign laws or their policies. The second principle states that each charity "must safeguard its relationship with the communities it serves in order to deliver effective programs. This relationship is founded on local understanding and acceptance of the independence of the charitable organization."

Treasury Response: We agree with both of these principles. Therefore, we have revised the first principle in Fundamental Principles to state: "Charities are independent entities and are not part of the U.S. Government. Like all U.S. persons, charitable organizations must comply with the laws of the United States, which include, but are not limited to, all OFAC administered sanctions programs." With this revision, we recognize the necessity of independence for charities to perform their work effectively. We also acknowledge that charities, by virtue of their separation from the government, are not agents for the enforcement of U.S. or foreign laws or their respective policies. Moreover, we do not believe that charities become agents of the government by virtue of their obligation to abide by U.S. law, or by applying any of the best practices within the Guidelines. Based on this revision, we do not think it is necessary to revise the Fundamental Principles further to include the second principle, because our revision captures the meaning, and is consistent with, the second principle. The recognition of the independence of charities ensures that the foundation forming a charity's relationship with the community it serves will not be shaken.

4) <u>Governance, Financial Practice, and Disclosure/Transparency</u>

Comments: This section will group together comments falling under the sections for Governance, Financial Practice, and Disclosure/Transparency in Governance and Finances, due to the interrelated nature of those comments. Several commenters suggested combining the Financial Practice section with the Disclosure/Transparency section into one section, entitled "Accountability." The commenters felt that such a section, dealing only with financial practices, would be more applicable to Treasury's expertise.

In the event that Treasury should choose to keep the practices pertaining to governance in the Guidelines, the commenters recommended the following specific changes:

- <u>Section III.B</u>: A few commenters noted the need for an appropriate exception to the suggestion that the governing board of a charity consist of at least three members. They explained that this provision does not take into account certain trusts, religious organizations, and corporation soles, which may not be able to have more than one member on the board.

- <u>Section III.B.4</u>: Many commenters expressed concern with the provision recommending that governing board records be immediately turned over to appropriate law enforcement authorities, stating that such a provision goes beyond federal and state disclosure laws and constitutional protections.

- <u>Section V.B</u>: Two commenters noted that the definition of "key employees" expands on the definition contained in Form 990 from the Internal Revenue Service (IRS), and it could be interpreted to include people who exert influence over charitable activities, but who are not directly related to the charitable projects.

- <u>Section V.A.3</u>: One commenter remarked on the lack of a definition for subsidiaries or affiliates and cited the need for clarification.

- <u>Section IV.C</u>: One commenter stated that the provision in the Guidelines recommending independent audits for charitable organizations if the charity's annual gross income exceeds $250,000 is inconsistent with the auditing standards issued by OMB Circular A-133.

Treasury Response: Based on the comments received, we extensively reorganized these three sections to clarify the objectives of each section:

- We changed the original section, "Governance," to "Governance Accountability and Transparency." Within this section, we incorporated all provisions relating to governance from the original "Disclosure/Transparency" section.

- We renamed the original "Financial Practice/Accountability" section to "Financial Accountability and Transparency" and incorporated all provisions relating to financial practice from the original "Disclosure/Transparency" section.

- We revised the original "Disclosure/Transparency" section and renamed it "Programmatic Verification," which conveys the purpose of its remaining provisions more clearly, and aligns more closely with existing international best practices for non-profit organizations. It also incorporates the provisions on how charities should best review the programmatic operations of their grantees, which were originally located in the final section on anti-terrorist financing best practices.

We also considered the specific comments received on these three sections and made the following revisions (the section numbers correspond with the current sections in the Guidelines).

- Section III.B: We deleted the provision calling for a minimum of three members on the governing board of a charity. We agreed with the commenters that this provision did not adequately take into account the existence of certain types of organizations that would not be able to meet this recommendation. Thus, we revised the section that originally discussed best practices for a charity's board of directors, renaming it, "Independent Oversight." Within this section, we added a preamble conveying the importance of both independent oversight of charitable organizations and flexibility for an organization to choose the oversight structure that best fits its needs. We have also included the acknowledgement that independent oversight may be unfeasible for certain charitable organizations, such as houses of worship and corporation soles. The remaining provisions within this oversight section merely highlight certain basic principles that are hallmarks of good governance: i) independence of the governing board; ii) development of conflict of interest policies and procedures; iii) accountability of the governing board; and iv) record-keeping.

- Section III.B.2: We agreed with one commenter's concern about the confusion caused by a governance provision calling for the board to adopt, implement, and oversee practices consistent with the principles contained in the Guidelines. We understand that some may interpret the provision to mean that the best practices provided in the Guidelines are either mandatory or represent a comprehensive list of best practices to protect against terrorist financing in the charitable sector. As stated earlier, the Guidelines do not purport to be an exhaustive compilation of best practices, and are voluntary. Therefore, we have changed this provision to clarify that members of a charity's governing board are responsible for the oversight of practices that will effectively safeguard charitable assets.

- Section III.B.6: We have added a footnote (Footnote 6) defining subsidiaries and affiliates, as the terms are used in the Guidelines. The definition is similar to the one used by Form 990: "Subsidiaries or affiliates are organizations that are subject to the general supervision or control of a parent or central organization."

- Section III.B.7: In response to some commenters' concern with the provision governing the disclosure of records, we revised the provision to state the following: "When served with process or when other appropriate authorization exists, charities should produce requested records maintained in accordance with these Guidelines to the appropriate regulatory/supervisory and law enforcement authorities in a timely fashion."

- Section III.C: We agreed with the commenters who noted the difference between the definition of key employees in the Guidelines and the definition used by the IRS. We amended the definition of key employees to mirror the definition used by the IRS in Form 990.

- Section IV.C: We disagree that the Guidelines are inconsistent with the audit standards set forth by OMB Circular A-133. First, OMB Circular A-133 only applies to audits performed on expenditures of federal grants or awards. While many charities may receive federal grants, the Guidelines are intended to provide best practices that charities may apply regardless of whether they receive federal funds or private donations. Second, while Circular A-133 sets standards among federal and state governments regarding the audits of non-profit organizations expending federal awards, it does not preclude charities from having additional independent audits performed if they wish. Third, as stated in the eighth footnote of the Guidelines, the $250,000 threshold figure is drawn from the June 2005 final report to Congress of the Panel on the Nonprofit Sector, convened by Independent Sector, and is thereby consistent with industry's suggested threshold. Finally, the Guidelines are not obligatory, but voluntary steps that charities may choose to take as additional protective measures. Thus, the provision on financial audits remains unchanged in the Guidelines.

5) Anti-Terrorist Financing Best Practices

Comments: The majority of the comment submissions expressed concerns with various provisions in this section. The following summarizes the specific comments:

- Section VI: One commenter noted the difficulty of assessing risk pursuant to the Guidelines' risk-based approach without any corresponding advice.

- Sections VI.A and B: Several comments focused on the amount of information-collection provisions, regarding them as onerous, unrealistic, and having limited value in protecting against terrorist financing.

- Sections VI.B.1 and 4: Many commenters objected to the inclusion of the publicly available information, including the Internet, as a means to vet grantees or employees. They argued that Internet searches would yield widely varying and unverified information about certain organizations or individuals.

- Section VI.B.3: A few commenters objected to the incorporation of other government lists of designated parties created pursuant to UNSCR 1373. They claimed that Treasury is inadvertently legitimizing these other lists by citing to them.

- Section VI.B.5: A few comments focused on the provision suggesting that charities request certifications from grantees with whom they contract or work. They suggested deleting the provision or at least revising the certification to adopt the approach of the 2006 CFC. This approach would involve a grantee certifying its compliance with U.S. law, as opposed to certifying that it has checked certain lists.

- Section VI.D: Some commenters recommended deleting the voluntary reporting provision in its entirety, arguing that it creates the impression that charitable organizations are agents of the U.S. Government.

- One commenter suggested the Guidelines should explicitly state that it is permissible for a charity to engage in normally prohibited transactions with a group, entity, or individual on the Specially Designated Nationals and Blocked Persons List (SDN List) if OFAC issues a license to charities for such transactions.

Treasury Response: We have made the following revisions to the anti-terrorist financing best practices section based on the comments (the section numbers correspond with the current sections in the Guidelines):

- Section VI: In response to the comment requesting further assistance in assessing the risk of terrorist abuse or exploitation, Treasury continues to produce information and engage in outreach to assist charities in understanding the nature of ongoing terrorist abuse. Such materials and outreach are available on or through the Treasury Web site and are further described or referenced in the Annex to the Guidelines.

- Sections VI.A and B: We disagree with the comment that the information-collection procedures are burdensome and of little utility. We recognize that the information-collection practices are expansive and are purposefully designed so that a charity can gather as much information as possible to ensure the greatest transparency and accountability over charitable operations. This type of information-gathering is essential for the charity to know its grantees and to be assured that its assets will not be diverted to terrorist organizations or their support networks. Moreover, the general risk-based approach governing the Guidelines affords charities the opportunity to tailor the scope of these information-collection procedures to the terrorist financing risk they face. A charity should perform its own terrorist financing risk assessment based on its particular operations and projects. Depending on its particular risk profile, a charity should then choose appropriate protective measures that will adequately safeguard its assets from terrorist financing abuse and ensure their delivery to legitimate beneficiaries. As stated above, the best practices of the Guidelines are not a comprehensive or exhaustive listing of all best practices. Charities are free to apply other measures that they believe will protect their assets from diversion.

  In order to lessen any perceived administrative burden on charities, we have amended the Guidelines by replacing the word "recipient" with "grantee" throughout the document and defining "grantee". This revision is intended to clarify the information-collection recommendations by explaining what charities should do for immediate grantees versus downstream grantees. "Grantee" is defined as an immediate grantee of charitable resources or services. To the extent reasonably practicable, charitable organizations should also apply or ensure the existence of applicable safeguards in any downstream sub-grantees or recipients to protect charitable resources from diversion. Finally, we caution charities against entering into a relationship with a grantee where any doubts exist about the grantee's ability to ensure safe delivery of charitable resources.

- Sections VI.B.1 and 5: We agree with commenters that the Internet often provides information that may be false or unverified. For this reason, we have removed the clause suggesting that charities look to the Internet for further information about potential grantees or employees. However, the Guidelines still encourage charities to employ all reasonably available means, including publicly available information, to determine the level of risk accompanying a particular charitable operation or when engaging in appropriate vetting procedures. List-checking alone does not guarantee the safe delivery of charitable assets to intended beneficiaries. Properly using publicly available resources, such as open source media reports or other federal agency lists and information, can provide a charity with adequate and comprehensive information from which to make informed decisions about the kinds of protective measures it should take.

- Section VI.B.4: We do not agree with commenters that Treasury is legitimizing the UNSCR 1373 lists adopted by other governments by merely providing information that such lists exist. The purpose of including information on UNSCR 1373 lists in the Guidelines is not to endorse such lists, but to provide charities with an understanding of the varying laws under which they may operate in other jurisdictions. However, in response to the objections raised in some comments and to clarify the purpose of the information, we have added the following sentence to Footnote 14: "The Guidelines do not legitimize or endorse the UNSCR 1373 lists adopted by foreign jurisdictions."

- Section VI.B.6: We agree with the importance of carrying a consistent message throughout the U.S. Government. For that reason, we have accepted the suggestion of one commenter to align the certification more closely with the one adopted in the 2006 CFC. The new provision also delineates different certifications for U.S. and foreign grantees. Instead of having grantees certify that they checked the SDN List, the new certification suggests that U.S. grantees certify that they are in compliance with all laws restricting U.S. persons from dealing with parties subject to OFAC sanctions. With regard to foreign grantees, they should certify that they do not deal with parties subject to OFAC sanctions or anyone else known to support terrorism.

- Section VI.D: We disagree with the notion that the voluntary reporting provision creates the impression that charities are agents of the U.S. Government. As with all parts of the Guidelines, this provision is voluntary and charities are not under any obligation to report any information. This provision is also consistent with U.S. guidance to other sectors regarding terrorist financing or other illicit finance risks. In addition, we have clearly acknowledged in the Fundamental Principles of the Guidelines that charitable organizations are independent entities and are not a part of the U.S. Government. The voluntary reporting measure explains what steps a charity may proactively take to assist in protecting itself from abuse by terrorists and their support networks. Since charities occasionally have direct access to evidence of terrorist activities in the course of their operations, voluntarily reporting such evidence provides the appropriate authorities with the opportunity to conduct further investigations, and helps reduce the threat that terrorist financing poses to the charitable sector. Thus, the provision is an important component of anti-terrorist financing best practices, and it remains in the Guidelines with only minor changes.

- While the comment regarding OFAC's licensing authority is accurate, we believe that the Guidelines make sufficient reference to this authority in Footnote 2 (formerly Footnote 8), which states: "OFAC can issue licenses to U.S. persons to engage in transactions that would otherwise be prohibited, if there is a policy-permissible reason to do so, and if permitted by statute." In addition, the footnote refers to further information, available on OFAC's Web site, regarding licensing procedures for non-profit organizations wishing to undertake humanitarian activities in sanctioned countries. To provide more information on licensing, we have added the link to OFAC's Web site, which has information about the types of available licenses and the process for requesting a license.

Conclusion

As the Annex to the Guidelines illustrates, the risk of terrorist abuse of the charitable sector is both ongoing and significant. Recognition of this reality is the first step in finding ways to protect both donors and charities.

Treasury is sensitive to the concerns raised by the charitable sector and appreciates the insightful comments submitted. The release of these revised Guidelines reflects a further positive development in the ongoing dialogue between the charitable sector and Treasury. Treasury believes that the Guidelines offer a framework of voluntary best practices that is attuned to the unique challenges and risks facing charities. These best practices provide the necessary framework to safeguard against terrorist abuse of the charitable sector by offering protective measures to help ensure that the vital services provided by charities are not exploited by terrorists or their organizations.

Treasury remains deeply committed to working with the charitable community on future initiatives to combat terrorist abuses. While Treasury believes that the Guidelines represent a positive step in combating terrorist abuse of the charitable sector, the Guidelines also underscore the need for continued public outreach as a critical element of our comprehensive approach to combating terrorist abuse of the charitable sector.

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Treasury Participates
In World Financial Literacy Leaders
Conference

Warsaw, Poland- Treasury Deputy Assistant Secretary for Financial Education Dan Iannicola, Jr. visited Warsaw, Poland this week to discuss financial literacy issues with international economic leaders. Iannicola delivered remarks and moderated a panel at a conference hosted by the National Bank of Poland, the Federal Reserve Bank of New York and the European Central Bank in Warsaw.

"More and more countries are recognizing the importance of financial literacy for their citizens. Free markets and free enterprise are giving people more financial choices," Mr. Iannicola said. "But as our choices increase so must our knowledge, so we can make the right financial decisions for ourselves and our families."

The conference provided a forum for the exchange of experience and ideas from more than 200 recognized central bankers, government officials, academic and international educators.

"By meeting with the global leaders in financial education today, we can share our thoughts and all bring back valuable insights to our respective nations," he said.

The Treasury Department is the head of the 20-agency Financial Literacy Commission that recently released the first U.S. national strategy to improve financial literacy in America. The plan, titled Taking Ownership of the Future: The National Strategy for Financial Literacy, is available at MyMoney.gov.

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Preliminary Annual Report on U.S. Holdings of Foreign Securities

Preliminary data from the annual survey of U.S. portfolio holdings of foreign securities at year-end 2005 are released today and posted on the U.S. Treasury web site at http://www.treas.gov/tic/fpis.html. Final survey results, which will include additional detail as well as revisions to the data, will be published on December 29, 2006.

The survey was undertaken jointly by the U.S. Treasury, the Federal Reserve Bank of New York, and the Board of Governors of the Federal Reserve System.

A complementary survey measuring foreign holdings of U.S. securities also is conducted annually. Data from the most recent such survey, which reports on securities held on June 30, 2006, are currently being processed. Preliminary results are expected to be reported on March 30, 2007.

Overall Preliminary Results

The survey measured U.S. holdings at year-end 2005 of approximately $4.6 trillion, with $3.3 trillion held in foreign equities, $1.0 trillion in foreign long-term debt securities (original term-to-maturity in excess of one year), and $0.3 trillion in foreign short-term debt securities. The previous such survey, conducted as of year-end 2004, measured U.S. holdings of approximately $3.8 trillion, with $2.6 trillion held in foreign equities, $1.0 trillion in foreign long-term debt securities, and $0.2 trillion in foreign short-term debt securities.

REPORTS

- Foreign Holdings of U.S. Securities Tables

Table 1. U.S. holdings of foreign securities, by type of security, as of survey dates[1]
(Billions of dollars, except as noted)

Type of Security	Dec. 31, 2004	Dec. 31, 2005
Long-term Securities	3,553	4,346
Equity	2,560	3,318
Long-term debt	993	1,028
Short-term debt securities	233	263
Total	3,787	4,609

U.S. Portfolio Investment by Country

Table 2. U.S. holdings of foreign securities, by country and type of security, for the countries attracting the most U.S. investment, as of December 31, 2005
(Billions of dollars)

		Total	Equity	LT Debt	ST Debt
1	United Kingdom	815	538	185	92
2	Japan	531	493	35	2
3	Canada	419	248	158	14
4	France	274	205	48	21
5	Cayman Islands	249	103	118	28
6	Germany	217	158	49	10
7	Switzerland	196	192	2	2
8	Netherlands	192	133	52	7
9	Bermuda	187	174	11	2
10	Australia	128	71	49	9
11	South Korea	119	110	8	0
12	Brazil	90	69	22	0
13	Mexico	86	58	28	0
14	Italy	79	64	12	3
15	Ireland	75	33	17	25
16	Sweden	75	41	16	18
17	Spain	70	64	6	1
18	Taiwan	58	57	1	*
19	Finland	49	44	4	*
20	Netherlands Antilles	47	45	2	*
21	Luxembourg	46	11	29	6
22	Hong Kong	46	44	2	*
23	Israel	44	29	15	*
24	Singapore	36	29	7	*
25	Norway	36	22	9	5
	Rest of world	445	283	143	19
	Total	4,609	3,318	1,028	263

[1] The stock of foreign securities for December 31, 2005 reported in this survey may not, for a number or reasons, correspond to the stock of foreign securities on December 31, 2004, plus cumulative net flows reported in Treasury's transactions reporting system. The final report on U.S. holdings of foreign securities as of end-year 2005 will contain an analysis of the relation between the stock and flow data.

* Greater than zero but less than $500 million.