Department of the Treasury

PRESS RELEASES

Numbers not used: HP-527, 532, and 537

PRESS ROOM

August 1, 2007
HP-521

UPDATE
Treasury Secretary Paulson to Visit Montana Next Week

Washington --Treasury Secretary Henry M. Paulson, Jr. will travel to Billings, Montana on Tuesday, August 7 to discuss the importance of trade and the economy in rural America.

While in Billings, the Secretary will participate in a public forum on keeping rural areas competitive in the global economy. He will also tour MRL Equipment, a local manufacturer focused on domestic and international production of pavement marking application and removal equipment, and give remarks to MRL employees.

The following events are open to credentialed media:

Who
Treasury Secretary Henry M. Paulson, Jr.
Senate Finance Committee Chairman Max Baucus
What
Tour of MRL Equipment and Remarks to Employees
When
Tuesday, August 7, 9:20 a.m. MDT
Where
5379 Southgate Drive
Billings, MT

Who
Treasury Secretary Henry M. Paulson, Jr.
Senate Finance Committee Chairman Max Baucus
What
Press Availability with Local Media
When
Tuesday, August 7, 11:15 a.m. MDT
Where
Montana State University
Cisel Hall
Band Room
27th Street between Poly Drive and Rimrock Road
Billings, MT

Who
Treasury Secretary Henry M. Paulson, Jr.
Senate Finance Committee Chairman Max Baucus
What
Community Jobs Forum
When
Tuesday, August 7, 11:30 a.m. MDT
Where
Montana State University
Cisel Hall
Auditorium
27th Street between Poly Drive and Rimrock Road
Billings, MT

PRESS ROOM

August 1, 2007
hp-522

Asst Sec Nason Statement on House TRIA Bill

Washington- Treasury Assistant Secretary for Financial Institutions David G. Nason issued the following statement today regarding the House Financial Services Committee mark up of H.R. 2761 to extend the Terrorism Risk Insurance Act:

"The Administration has frequently stated the need for three critical elements in TRIA reauthorization: the program should remain temporary and short-term, with no expansion and a continued increase of private sector retention. Today's effort to extend TRIA does not meet these standards for an improved market and we strongly oppose this bill.

"We are particularly disappointed with the Committee's decision to extend the program for 15 additional years. This extension runs counter to the public policy goal of reducing and eventually eliminating the federal government's role in the terrorism insurance market, and it sends the wrong message to the marketplace for a program that was intended to be temporary.

"As the bill moves through the legislative process, the Administration looks forward to working with the Congress to pursue an improved TRIA."

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PRESS ROOM

August 2, 2007
hp-523

Testimony of Treasury Deputy Assistant Secretary
Mark Sobel
Before the Committee on Ways & Means,
Subcommittee on Trade
Hearing on Legislation Related to Trade with China

Washington, D.C.--Chairman Levin, Representative Herger, and members of the Sub-committee on Trade, thank you for the opportunity to appear before the subcommittee to speak to you on our views on legislation related to international currency issues.

The Congress is currently considering legislation to counter perceived unfair currency practices. While the bills are wide-ranging, many focus on the concept of "fundamental misalignment" against the background of very legitimate concerns over China's exchange rate management. Let me share with you our perspectives on these proposals and their implications for U.S. international monetary policy.

Engagement with China

Secretary Paulson is engaging China forcefully through the Strategic Economic Dialogue (SED). He frequently observes that, given China's economic size and importance, ensuring a productive U.S.-Chinese relationship is essential to managing the challenges of the 21st Century.

Last night, Secretary Paulson returned from a trip to China, where he saw President Hu and China's financial officials. He conveyed a strong message about the need for far more vigorous action by China to correct the undervaluation of the renminbi (RMB), take immediate action to lift the RMB's value, and achieve far greater currency flexibility.

Our discussions with China in the SED focus on the imperative for China to rebalance its economy away from exports and investment toward more consumption, to promote better balanced and more sustainable growth and to reduce the country's enormous and excessive external surpluses. A more effective monetary policy, made possible by greater currency flexibility, is also key. It would enable China to better control domestic inflation, dampen swings in the investment cycle, liberalize interest rates and improve credit allocation.

In contrast, heavy foreign exchange market intervention by China's central bank to manage the currency is leading to excess reserve accumulation and rapid increases in domestic liquidity. This heightens the risk of overheating, a build-up of non-performing loans leading to further banking sector stress, and asset bubbles. RMB undervaluation encourages production of exports at the expense of domestic consumption of goods and services. These trends increase the risk of a renewed boom-bust cycle, which would significantly harm first and foremost China, but also the world economy. Chinese currency adjustment is a matter of international responsibility, with significant implications for the smooth functioning of the international monetary and trading systems.

RMB appreciation also would to some extent reduce the U.S. bilateral trade deficit with China. But Chinese and U.S. global imbalances are rooted in the structures of our economies. That is why the SED process is focused not only on increasing currency flexibility but also more broadly on the overall rebalancing of the sources of growth of the Chinese economy.

While we are not satisfied with the pace of change in China, there has been important progress. China's currency is no longer fixed; it has appreciated by nearly

10 percent against the dollar in the last two years and the rate of appreciation has accelerated lately. China also is taking steps to reform its financial sector and to improve market access for U.S. and other foreign firms. Yet, there is still a long way to go.

We must continue to work hard for greater progress in our engagement. We appreciate the frustrations of Congress with the slow pace of Chinese reform. Indeed, we strongly share those frustrations. Yet, we continue to believe that direct, robust engagement with China is the best means of achieving progress. We do not believe that legislation would strengthen the United States' hand in achieving the goal, which the Administration and Congress share, of promoting faster Chinese economic reform. Indeed, we believe legislation would be counterproductive and could lead to unintended adverse consequences.

Multilateral Engagement

While strong bilateral engagement is a vital part of U.S. financial diplomacy, experience has taught us that multilateralism is essential to accomplish our objectives. Experience also teaches us that China responds defensively to bilateral pressure and is more open to multilateral engagement. Through multilateralism, the United States can win the high ground. But perceived unilateral actions would run the risk of weakening our effectiveness and fostering unwarranted perceptions that we are an isolationist nation.

That is precisely why we have worked through both diplomacy and multilateral fora to enhance global understanding of the adverse impact of China's currency practices and build a multilateral consensus to persuade China to alter its exchange rate regime. The G7 has repeatedly called for greater currency flexibility in China. The President of the European Central Bank recently reaffirmed this position. French President Sarkozy, soon after assuming office, spoke out about Chinese currency practices. Brazil's Finance Minister also recently made similar comments, as have many in Southeast Asia.

The United States has also worked hard to strengthen the IMF's focus on currency surveillance. Last month, the IMF – the only multilateral institution with a mandate for exchange rate surveillance – modernized its thirty-year old operational rules for carrying out this responsibility. Under the new Executive Board decision, the IMF will scrutinize much more closely countries' currency policies and their impact on the stability of the country and the world economy. This decision was adopted by an overwhelming consensus of the IMF's membership. Twenty-two of the twenty-four IMF Board chairs, accounting for 94 percent of the IMF's voting power, supported the decision. Only China and the Iranian-led chair opposed.

Critically, the new decision sends a strong and welcome message that the IMF is putting exchange rate surveillance back at the core of its duties.

U.S. Economy

The performance of the global economy in recent years has been the strongest in three decades. Much of this owes to the soundness of our economy. But China's unparalleled growth has also been a hugely positive factor. The United States and China together account for over 40 percent of global growth over the past five years.

The global economic landscape is changing rapidly. Technological innovation, trade and globalization are potent drivers of change. The United States benefits enormously from openness. Change, however, creates uncomfortable dislocations and angst, and we have sympathy for American workers affected by these powerful forces. China has become the face on the poster of rapid global economic change, and the RMB its symbol. China needs to play by the rules of the game. But neither RMB appreciation nor currency legislation will alter the underlying forces of globalization and technological change.

If the United States adopts currency legislation that is perceived abroad as unilateralist, investors' confidence in the openness of our economy could be dampened, diminishing capital inflows into the United States, and potentially putting upward pressure on interest rates and prices. Further, if we adopt legislation targeted at one country, we must be mindful of the risk that we will create a retaliatory precedent that others might use, including against the United States. This could have serious adverse effects for the smooth functioning of the international monetary system.

Currency Misalignment

Many of the proposals under consideration mandate determination of whether currencies are in "fundamental misalignment" as a basis for remedial measures. Fundamental misalignment is a useful concept. Indeed, the IMF included "fundamental misalignment" as a foundation of its new currency surveillance decision, stressing that it must be thoroughly analyzed and reviewed in IMF surveillance work.

In assessing currency misalignment, economists typically rely on models first to compute "real equilibrium exchange rates" and then to compute misalignment -- or the over- or under-valuation -- as deviations from these computed real equilibrium exchange rates. There are many approaches to these calculations – some rely on a "macroeconomic balance" approach, others on "behavioral equilibrium exchange rate models", and others simply on "purchasing power parity" calculations, to name a few.

The models make various assumptions. Among others, should a sustainable external position mean a country has a balanced trade account, or is a deficit of a given size consistent with external sustainability? What is the underlying saving and investment balance in a country? Should one assume trading partners are growing at potential, and if so, what is that potential? How do trade balances respond to exchange rate changes? What price index should be used in deflating nominal prices? What is the proper goods basket for measuring purchasing power? What are the key variables influencing the behavior of exchange rates and their proper weights?

Depending on the answers to these questions, a wide range of results is yielded. One study on China, collating academic research, found an extremely large range of estimates, from as little as zero to as much as 50 percent undervaluation of the renminbi. The GAO echoed this finding in an April 2005 report.

It is difficult for models to describe fully and accurately all the features of a modern economy relevant to exchange rate determination. In particular, most models do not take into account the world's enormous private financial markets and their impact on currency valuations. Yet, the volume of global foreign exchange transactions in one week exceeds all trade transactions that take place over an entire year. Currencies can be substantially "under-valued" as defined by a model, yet this undervaluation may result from purely market phenomena. This is especially the case for Japan and Switzerland, countries with floating currencies integrated into the global financial system, yet experiencing large capital outflows in view of very low domestic interest rates. Failure to take financial market effects into account could result in currencies whose exchange rates are wholly market determined being assessed as fundamentally misaligned.

Most approaches focus on multilateral real exchange rates – or indexes of a country's currency valuation against its trading partners adjusted for relative price differences and trade shares of each partner. Economists view bilateral equilibrium exchange rates as a less robust concept. Practically speaking, computing a bilateral equilibrium exchange rate implies that one knows the appropriate amounts of bilateral trade, investment, and other financial activity with another country. To be sure, many financial institutions compute such bilateral rates, but they are interested in assessing the direction in which a currency may move for the purpose of maximizing trading profits.

Equilibrium exchange rate analysis is a worthwhile undertaking. If many multilateral exchange rate models yield similar directional conclusions and project a broadly similar range of misalignment, that is valuable information. But while exchange rate models yield valuable insights, there is no reliable or precise method for estimating the proper value of an economy's foreign exchange rate or measuring accurately a currency's undervaluation. As Sam Cross, one of the distinguished architects of U.S. post-Bretton Woods financial diplomacy put it: "Most of the approaches to exchange rate determination tell only part of the story – like the several blindfolded men touching different parts of the elephant's body."

Using the concept of fundamental misalignment to drive a bilateral exchange rate calculation for the purpose of imposing trade penalties goes well beyond the IMF approach to fundamental misalignment. On matters pertaining to the WTO, the Treasury defers to colleagues at USTR and Commerce. But using currency calculations that admittedly lack precision and reliability to determine trade remedies, which appear to raise serious concerns with respect to U.S. compliance with WTO rules, underscores the weakness of some of the legislative approaches.

Other Issues

Some of the bills include provisions requiring the Treasury to oppose any change in International Financial Institution governance arrangements if a country with a currency designated for action were to receive a higher voting share. Such provisions are detrimental to U.S. interests. The IMF's current voting structure is out of touch with today's global economy and the growing weight of many emerging market economies. IMF members are currently discussing governance reforms aimed at shifting voting power from over-represented countries to under-represented, dynamic emerging market economies. The United States has led this modernization process, seeking to keep emerging market economies from drifting away from the multilateral system from which we strongly benefit.

Such legislative provisions could prevent many emerging markets from increasing their weight in the IMF, presumably in order to keep China from seeing an increase in its share. Yet even if China's voting share will rise as a result of governance reform, given the current state of discussions, it will likely still be at a level far less than China's true weight in the world economy. China already has its own Board seat in the IMF. On balance, this provision would likely be ineffective in influencing Chinese behavior, but harm U.S. relations with many fast-growing emerging market countries around the world and thwart highly necessary modernization of the IMF.

Proposals to consider "remedial intervention" in the foreign exchange markets as a counter-weight to currency misalignment are ill-advised. It would be enormously difficult to intervene in a currency that is not traded internationally, as in the case of the RMB, which is traded only in China. Even if we could intervene in the Chinese market by buying RMB, China at the same time might be in its own market selling RMB. In the final analysis, the proposal could detract from our efforts to work with China to correct the RMB's undervaluation, immediately raise the RMB's value and achieve far greater flexibility in the currency regime.

Thank you.

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PRESS ROOM

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August 2, 2007
HP-524

Treasury, IRS Release Report on Improving Voluntary Compliance

Washington, D.C.--The Treasury Department and the Internal Revenue Service (IRS) released today an IRS report addressing the agency's implementation of the 2006 strategy to improve voluntary compliance with federal tax laws. A copy of the report is attached.

The IRS report, "Reducing the Federal Tax Gap: A Report on Improving Voluntary Compliance," details steps currently being taken by the IRS, as well as those under development, to address key elements of the "tax gap." The report builds on the seven components of the "Comprehensive Strategy for Reducing the Tax Gap," which the Treasury Department released in September 2006. Those components are:

1. Reducing Opportunities for Evasion
2. Making a Multi-Year Commitment to Research
3. Continuing Improvements in Information Technology
4. Improving Compliance Activities
5. Enhancing Taxpayer Service
6. Reforming and Simplifying the Tax Law
7. Coordinating with Partners and Stakeholders

In each of these areas, the report sets out compliance objectives and initiatives, along with targeted completion dates, that the IRS is implementing to improve tax compliance over the next several years.

Detailed information is provided on each step currently being taken to reduce opportunities for tax evasion, leverage technology, and support legislative proposals that, as implemented, will improve compliance. At the same time, the report reaffirms that taxpayer rights must be respected and burdens on compliant taxpayers must be minimized. The report also presents an outreach approach to ensure all taxpayers understand their tax obligations. Additionally, it recognizes the importance of having a multi-year research program that will assist in understanding both the scope of and reasons for noncompliance.

Full implementation of the initiatives outlined in the report will have a positive effect on the rate of voluntary compliance. The report reflects the commitment of the IRS to apply its resources where they are of most value in reducing noncompliance while ensuring fairness, observing taxpayer rights, and minimizing the burden on taxpayers who comply.

The overall compliance rate achieved under the U.S. revenue system is quite high. For the 2001 tax year, the IRS estimates that over 86 percent of tax liabilities were collected, after factoring in late payments and recoveries from IRS enforcement activities. Nevertheless, an unacceptable amount of the tax that should be paid every year is not, short-changing the vast majority of Americans who pay their taxes accurately and giving rise to the tax gap. The gross tax gap was estimated to be $345 billion in 2001. After enforcement effects and late payments, this number was reduced to a net tax gap of approximately $290 billion.

A copy of the Treasury Department's 2006 strategy is available at:
http://www.treas.gov/press/releases/reports/otptaxgapstrategy%20final.pdf.

REPORTS

- IRS Report on Improving Voluntary Compliance

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.

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. <u>Reduce Opportunities for Evasion</u>. 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.

Type of Tax

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.

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[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
  - Outline steps to reduce opportunities for evasion
  - Outline IRS research initiatives
  - Outline IRS information technology initiatives
  - Outline IRS compliance initiatives
  - Outline IRS taxpayer service initiatives
  - 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

August 2, 2007
hp-525

Transcript of Secretary Paulson's Press Roundtable
Beijing, China,
August 1, 2007

Secretary Paulson: As I look around, since a number of you have heard me talk about this trip and put it in perspective, what I'm going to do is just be pretty brief, give you a few comments on the trip overall, then talk about some of the meetings, and then take your questions. So we'll have plenty of time for questions.

I think you all know that the SED is not just about two meetings a year, two big meetings. We have constant dialogue, accomplishments, steps toward reform. I came here to follow up on some of the accomplishments coming out of SED II and to plan for our upcoming meeting in December.

I think just as a general rule, I've just learned this over the years, that you can do a lot on the telephone but you're better off if you can sit down face to face and have a candid discussion. I found that the meetings with the Chinese leaders are particularly useful because they're pragmatic, there's a give and take, candid discussion. We learn, they learn. So they're just generally very useful.

As a general matter the topics we talked about most were currency reform, appreciation, energy and the environment and consumer product safety, food safety.

We had good individual meetings. Why don't I run through some of those meetings quickly.

I had a lunch with Governor Zhou Xiaochuan. We talked about a wide variety of economic issues, talked in some depth about currency, talked about investment issues, talked about sovereign wealth fund issues, talked about our work together to keep the financial system free from abuse and illicit behavior.

I had a meeting with Liu Mingkang, CBRC, and there the conversation was mainly about expanding market access, greater market access for foreign banks.

The meeting with Shang Fulin, CSRC, largely following up on things coming out of SED II and talking about financial sector reform. I was pleased to learn that they were moving forward to the date that we'd agreed to, we're moving it forward to lift the moratorium on joint venture security, joint ventures, and they're also broadening the scope of these joint ventures.

I met with, had lunch with Ma Kai at the NDRC. We talked about a number of things. Probably the one we talked about the most was climate change. We talked about President Bush's initiative, their upcoming meeting in the fall and the importance of engaging major countries, developed and developing, and also that to really solve this issue it's going to take a concerted effort. It's not going to be possible unless economies remain strong and competitive and healthy and it's going to take a big emphasis on low carbon technologies.

I talked with the SFA, the State Forestry Administration. The topics there were sustainable logging which is fighting illicit logging, sustainable logging, either one, but it really is very important in terms of climate change and dealing with that issue. We also talked about conservation initiatives.

And good substantive meetings with Wu Yi and with President Hu. Probably on these meetings I'd never tell you as much as you'd like to hear because the real value of these meetings is they're private and if we go into a lot of detail then they lose their meaning. That destroys confidence.

But good discussions. I obviously talked about currency reform.

First of all we were talking about the SED. Let me step back even before that and say one of the things that I had an opportunity to spend time with Minister of Finance Jin, who was involved in a number of the meetings. He and I agreed to convene a meeting of the JEC in late October, around the time of the IMF World Bank meetings. What we'll talk about there are global imbalances, so that will lead to discussions on currency reform, open investment policies, and financial sector reform.

I might add that as we think about the SED, the purpose is to manage this very important economic relationship between our two countries. To take a strategic, forward-looking focus to deal with the most important issues at any one time.

Now every economic issue, even before we established the SED, was being talked about in some form. The JCCT, the JEC, we had multiple dialogues going on in the energy side, environmental, all of the whole range of economic issues. The purpose of the SED was never to replace those, it was to provide guidance to those initiatives, help prioritize and always deal with the most important issues at any one time. Again, the WTO compliance is very important. We have mechanisms to deal with that. We have mechanisms in the JCCT, USTR. What is always most interesting to me was reform and the pace of reform. WTO compliance. WTO, what China agreed to to gain admissions to the WTO was to me represented a minimum level. The interesting thing was when you reform beyond that.

Again, I look forward to a JEC meeting in late October.

Now back to the various meetings with Wu Yi and President Hu focused on the SED, the importance of the SED. I talked about public sentiment in the U.S.; talked about sentiment in Congress; talked about a number of the congressional legislative initiatives; and then obviously talked about currency reform; talked about product safety; consumer safety; and energy and the environment.

Why don't I end it there and take your questions.

Question: You mentioned sovereign wealth funds. I was wondering if you could tell us what you told them and if you're worried about that hurting the Treasury market.

Secretary Paulson: The conversation about investment was with Zhou Xiaochuan, and we made the point that I've made often publicly but I will say it again. First of all, I emphasized how committed we, the United States, are. This administration has open investment. I mentioned that the President recently signed CFIUS legislation which I believe is a step forward, a better CFIUS bill. It's focused on national security and the relatively few investments that involve national security every year. When we talk about sovereign wealth funds. I separate the sources from the uses. In other words, you can have discussions about what are the policies that lead to the imbalances and the buildup of reserves, but then once countries have reserves we expect them to naturally invest them in ways that make sense economically, to get risk-adjusted returns. We welcome foreign investment in the United States from sovereign wealth funds or any direct foreign investment. I believe that that's the highest vote of confidence anyone can pay to our economy or any economy is to make a direct investment.

We emphasized, and it's not just with China, sovereign wealth funds around the world, but the importance of transparency.

Question: You don't think there's a fear that they might be shifting to [inaudible]?

Secretary Paulson: I can tell you what I said. I think foreign direct investment is a good thing.

Question: Can I ask about your discussions about the [inaudible]. Your previous trip would suggest that China might be [inaudible].

Secretary Paulson: Let me say on currency, and this is the case with many of the areas of reform. The positive, and we should never lose sight of the positive, is there's not a difference as to principle. I heard from everyone right up at the top, they are committed to currency flexibility, they're committed to currency reform. I would just say to you as an aside, as someone who watches this carefully, that the rate of apreciation has increased over the last year and over the last six years. It's increased. I don't believe it is fast enough. I make the case that they and the whole world economy would be better off and they would have greater financial security and greater stability if they increased the pace in the short term and worked toward the measures that would let them have a market-determined currency in the intermediate term. That is why I emphasize so much financial sector reform.

I believe that competitive, efficient capital markets are a key to more balanced, higher quality economic growth on China's behalf and toward a market determined exchange rate.

Question: [Inaudible] some concern that the stock market [inaudible] generally quite strong. They're reluctant [inaudible] financial reforms that [inaudible]. The best example [inaudible]. Do you have any --

Secretary Paulson: I would say that the biggest reforms, the significant ones I'm talking about, would increase the financial security and the stability because I believe a competitive, efficient capital market that had sophisticated institutional investors, had a well developed bond market, would provide more financial security. And so the reforms I'm talking about are greater access by the best of class foreign firms.

As I emphasized to the Chinese, there are two issues. One is their regulatory structure and the range of products they allow and the rate at which they open up the markets. The other is what is the quality of competition they allow. For the life of me I cannot understand why competition and letting strong firms in that are regulated by the Chinese would endanger the stability. As a matter of fact that would promote the stability of the market.

I think the resistance, it's easy to say stability, but I think resistance comes from entrenched domestic competition with an interest which every market-driven firm has and every economy. They all like competition in areas other than their own. Everyone would like to have a little bit of protectionism. That's my view on stability.

Question: You mentioned sentiments in Congress. What can you go back and tell, for instance, the Trade Representative in Washington about this meeting that's going to make them want to postpone drastic action?

Secretary Paulson: In terms of what they will or won't do, I can't speculate. I can just say several things about this.

I talk with many leaders in Congress. I understand their frustrations. I share a similar objective with many of them of wanting quicker reform of the currency and China to move quicker to open up their markets. They know that I don't believe legislation is the right way to proceed. They know I believe that the right way to make progress is through direct engagement bilateral and a multilateral basis. They know I believe we're making progress. They know I believe we should make quicker progress.

I think legislation would be counter-productive and undermine what we're trying to accomplish here.

Having said that, I have explained to leaders of Congress why I'm going here, just as I've explained to you, so I don't need to repeat it. This is to follow up on the last SED, to plan for the next one.

I also will tell them when I come back that I explained also to the Chinese, the Chinese had an opportunity to hear directly from the leadership of Congress and from the Senate Finance and the Ways and Means Committee when they're over here. I have updated them on developments in Congress. I've told them of the views of a number of congressional leaders. I've obviously communicated that. I don't think anyone that I know of in Congress is expecting me to come back with some deal on the currency. They know what the SED is trying to accomplish. Everyone talking to me directly has been very respectful about that. Some of them have, just as I've respectfully said I don't think legislation is the way to go, I think direct engagement; they respectfully said continue with your direct engagement, Mr. Secretary, but we have a different plan. So I've got more work to do with Congress.

Question: Mr. Secretary, with markets tumbling around the world over the last 24 hours, we're obliged to ask for a comment or observation on what may be going on there. You stated clearly in recent weeks and months that you think the housing market's near a bottom, that the collapse of the sub-prime markets is contained. Yet markets continue to fall, companies report their profits are shrinking because of the effects from the housing market.

Have you seen anything that's changed your view on what's going on?

Secretary Paulson: No. Kevin, let me be pretty clear about what I've said before. When I said the housing market, that there had been a major correction and the housing market was at or near the bottom, I also have said that I thought this would not resolve itself any time soon, and that it would take a reasonably good period of time for the sub-prime issues to move through the economy as mortgages reset. But that as, even though this, and it is a cause of concern, the impact on individual homeowners, and we care a lot about that, but I said as an economic matter I believe this was largely contained because we have a diverse and healthy economy.

I also said I thought in an economy as diverse and healthy as this that losses may occur in a number of institutions, but that overall this is contained and we have a healthy economy.

Now to talk about what's going on in the markets, my comments -- and let me say that in my career at Goldman Sachs, I traveled a lot, and I stayed very close to the markets. In today's world, it's quite easy to stay close to the markets, and it's my job to be vigilant and stay close to the markets.

I've also, in watching markets for a long time, I'm never surprised by volatility or adjustments. My starting point is what is the state of the economy? We have the strongest global economy I've seen in my business lifetime today. We have a healthy economy in the U.S. So what is going on in my judgment is a reassessment of risk. There are adjustments and market adjustments going on as risk is being repriced. Again, when we have the benign markets and strong economies for extended periods of time you tend to see excesses.

We talked about the sub-prime. There are some excesses there. We've also seen excesses in terms of other lending behavior. Some of the loans to fund leveraged buy-outs. These loans have not had traditional covenants. So now the market is focused on this. There's a wakeup call and there's a, as I've said, an adjustment to this repricing of risk. But I see the underlying economies being very healthy.

Question: On the [inaudible], did they give you a timeframe for which [inaudible]?

Secretary Paulson: We originally talked about getting that done by December. Shang Fulin now said he's going to be able to move that forward and do it earlier in the fall.

Question: For the meeting in October or --

Secretary Paulson: I don't want to be that specific. But it was meaningfully earlier. And I'm always glad to hear that news as opposed to something slipping.

Question: On the currency issue again, in your meetings and discussions with the Chinese [inaudible], did he give a sense of frustration on the part of them maybe not being able to feel like they ever satisfy the Members of Congress or [inaudible]?

Secretary Paulson: Let me say this. We agree on the principle. They emphasize that they're committed to reform but they believe financial stability is every bit as important, China's financial stability is very important to China, but very important to the U.S. and the rest of the world.

I have also been quoted often frequently as saying the same thing. So many of the people that have concern about China are worried about the wrong thing. They're worried that China's going to out-compete and overtake every other economy, as opposed to worrying about a financial problem in China which would impact us all negatively.

So I do believe the Chinese are patient, and I believe they ask themselves, they say we're moving the currency quicker. Our stability is important to you as well as to us. They also make the point, which we agree with, which is as important as the currency, is it is not the key driver toward dealing with the economic imbalances and the trade imbalances. It is a factor but the biggest issues are the structural issues in the various economies. With China it's their very high savings rate and so on.

So they're too polite to say they're frustrated, but I do believe they're asking themselves will they ever be able to satisfy us. But again, the case I make is that the rate of appreciation so far, there's no evidence it's hurt the Chinese economy, and if they accelerate the pace I believe they will make it easier to use more traditional monetary policy, to dampen overheating, and they will be able to hasten their development of the economy toward higher value-added products.

The Chinese economy, much of what they export to the U.S. is assembled in China. And they are the last point in a manufacturing chain, an integrated chain throughout Asia where they import commodities, components, and assemble them, and that their value-added is often relatively low.

So as they seek to develop their economy, if they have a currency that gives market signals it will be better for them.

In any event, you don't need to hear all that.

Thank you for your time.

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PRESS ROOM

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August 3, 2007
HP-526

Treasury, IRS Issue New Proposed Cafeteria Plan Regulations

Washington, D.C.--The Treasury Department and the IRS issued today new proposed regulations for employee benefit plans under Section 125 of the Internal Revenue Code. The plans, called "cafeteria plans," allow employees to make a choice between receiving taxable cash compensation or tax-free employee benefits, such as health care, dependent care, and other fringe benefits.

The new proposed regulations generally preserve the rules of the existing proposed regulations, while adding clarifications relating to statutory changes and administrative guidance changes since the previous regulations were published. The new regulations also address many issues on which the IRS has previously provided informal guidance.

The proposed regulations will assist employers, employees, and plan administrators in utilizing cafeteria plans.

The new proposed regulations:

- Clarify that cafeteria plans are generally the sole method of preserving the nontaxable nature of employer-provided benefits where employees are allowed to elect between taxable compensation and nontaxable benefits.
- Include new rules for determining if a cafeteria plan improperly discriminates in favor of highly compensated employees, including definitions of key terms. The new rules are generally consistent with the rules for qualified retirement plans. Also, the rules provide an objective test to determine if the actual election of benefits is discriminatory.
- Incorporate guidance previously issued relating to debit cards and grace periods for using health Flexible Spending Arrangements (health FSAs) money after the end of a plan year.
- Generally retain the rules in the prior regulations for health FSAs, including a 12-month plan year, requirements that the full reimbursement be available at anytime during the plan year, restrictions on changing elections in mid-plan year, and the requirement that unused amounts at plan year end are forfeited (the "use-or-lose" rule).

The IRS requests comments on the proposed regulations and will hold hearings on the proposed regulations on November 15, 2007. Taxpayers may rely on the proposed regulations for guidance pending the issuance of final regulations.

REPORTS

- Proposed Regulations for Cafeteria Plans

PRESS ROOM

August 3, 2007
HP-528

Remarks by Secretary Henry M. Paulson, Jr. at Idaho Quarter Celebration

Boise, ID – It is a pleasure to be here to celebrate the Idaho quarter, the 43rd quarter of the 50 State Quarters Program. The Idaho quarter design includes a striking image of the peregrine falcon. When this spectacular bird was listed as an endangered species in 1970, its population had been reduced to just 324 known nesting pairs. While it may not seem that the minting of a quarter and the conservation of a species have much in common, in fact, they do. Both represent successful models of government and citizen cooperation.

The Idaho quarter is number 43, because the quarters are being unveiled in the same order as a state's admission to the Union. The first quarter for the first state, Delaware, was issued in January of 1999. The Idaho quarter follows Washington State, and the next state to unveil its quarter is also your neighbor - Wyoming.

The 50 State Quarters Program, authorized by Congress in 1997, has been very successful. More than 140 million Americans are collecting the 50 state quarters. The state quarters program isn't just for coin collectors, however. Many citizens have had the opportunity to participate in the quarter design process. Thousands of Americans have suggested designs that represent their state's unique, positive features. The final designs are selected from these submissions. In 2005, the Idaho Commission on the Arts solicited concepts from the public and received over 1,200 submissions. Each state's quarter is minted for only ten weeks, and then will never be minted again.

The peregrine falcon is the chosen design for the Idaho quarter, and the people of Idaho can be rightfully proud of their role in helping to protect this charismatic species.

The peregrine falcon's recovery is a true success story. When the peregrine was listed as endangered in 1970, the outlook was grim. The species had completely vanished in eastern America, and nearly 90 percent of the population in the American west had disappeared. But over the next thirty years, the visionary work in captive breeding and release coordinated by The Peregrine Fund, working in cooperation with scientists, several universities, and many state and federal agencies, led to the falcon's recovery and removal from the endangered species list in 1999. I know of no more dramatic example of conservation groups working cooperatively, and with the government, to take a bird that was essentially extinct in the continental United States and bring it back to normal population levels.

It is fun for me to talk with you today about these two successful, cooperative public and governmental efforts --- the U.S. Mint's 50 State Quarters Program, and the restoration of the peregrine falcon. I look forward to the rest of today's program and, remember, spend your Idaho quarters wisely.

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PRESS ROOM

August 3, 2007
hp-529

Treasury Economic Update 8.3.07

"The U.S. economy and the job market are healthy, with sustained job growth, low unemployment, and rising wages. Solid fundamentals will support continued growth in household spending and business investment."

Assistant Secretary Phillip Swagel, August 3, 2007

Job Creation Continues:

Job Growth: 92,000 new jobs were created in July and nearly 2 million new jobs have been created in the past 12 months. The U.S. has added 8.3 million jobs since August 2003 – more than all the other major industrialized countries combined. Our economy has seen job gains for 47 straight months. Employment has increased in 48 states and the District of Columbia within the past year. *(Last updated: August 3, 2007)*

Low Unemployment: The unemployment rate of 4.6 percent is close to the lowest reading in 6 years. Unemployment rates have decreased or held steady in 32 states and the District of Columbia over the past year. *(Last updated: August 3, 2007)*

U.S. Economic Fundamentals Remain Solid:

Economic Growth: Real GDP growth was 3.4 percent in the second quarter of 2007, supported by strong gains in business investment and exports. *(Last updated: July 27, 2007)*

Household Spending: Consumer spending has been affected by increased energy and food prices and weakness in the housing sector, but the job market is healthy and should continue to boost incomes and support household consumption. *(Last updated: July 27, 2007)*

Business Investment: Business spending on commercial structures and equipment strengthened in the second quarter. *(Last updated: July 27, 2007)*

Exports: U.S. exports grew by 6.8 percent over the past 4 quarters. *(Last updated: July 27, 2007)*

Tax Revenues: Tax receipts rose 11.8 percent in fiscal year 2006 (FY06) on top of FY05's 14.6 percent increase. As a share of GDP, FY07 receipts are projected to be above their 40-year average. *(Last updated: July 13, 2007)*

Americans Are Keeping More of Their Hard-Earned Money:

Real Wages Increased 1.3 percent Over the Past 12 Months (ending in June). This translates into an additional $444 above inflation for the average full-time production worker.

Pro-Growth Policies will Enhance Long-Term U.S. Economic Strength:

We are on track to balance the budget by 2012. The Mid-Session Review of the FY 2008 Budget shows that we are on track to achieve a small surplus in 2012. This year, the deficit is projected to be down to 1.5 percent of GDP. Much of the improvement in the deficit reflects strong revenue growth, which in turn reflects the continued strength of the U.S. economy. Looking ahead, higher spending on entitlement programs dominates the future fiscal situation; we must squarely face up to the challenge of reforming these programs. The time has come for both political parties to work to achieve comprehensive earmark reform that yields greater transparency and accountability to the congressional budget process, including full disclosure for each earmark and cutting the number and cost of all earmarks by half.

www.treas.gov/economic-plan

PRESS ROOM

August 7, 2007
hp-530

Remarks by Secretary Henry M. Paulson, Jr. at Community Jobs Forum

Billings, MT – Thank you for the opportunity to be with you this morning. I am pleased to be in Billings, with Senator Baucus. We have had a chance to talk since I arrived, and first I would like to express my shared concern about the wildfires and thanks to those who are doing a great job getting them contained, and keeping people and homes as safe as possible.

The Montana landscape reminds me a bit of the Illinois prairie, where I grew up. At an early age, I developed an appreciation for wide, open spaces. Although I spent thirty years of my career in investment banking, whenever we could, my wife Wendy and I would escape the cities and travel to places like Montana - where we could hike and fish. I like to spend lots of time in wild, beautiful places and Montana is certainly one of those. Several years ago, we spent time at the Matador Ranch in North Central Montana, just north of the Missouri River; two years ago we enjoyed the Bozeman area. And today it's Billings!

I know that wide, open spaces are a foundation of your economy. But agriculture isn't the only thriving industry in Montana – your economy is expanding, and taking advantage of the opportunities created by technology and trade. I look forward to talking with you today about important issues for the people of Montana and for all Americans – what are the key factors that will continue our economic leadership and create new jobs in rapidly changing world markets? And what is the role of a rural economy, such as Montana's, in those markets?

The good news is that Montana is already very much a part of the global economy. In the five years between 2002 and 2006, total exports from Montana more than doubled to $1.4 billion. Agricultural exports were a big part of this increase; they grew from about $300 million in 2002 to almost $600 million in 2006. Your wheat, livestock and vegetables are being shipped around the world, and the overall export increase reflects an economy that is diversifying.

Montana, like the overall American economy, is growing. From 2005 to 2006, Montana's gross domestic product grew 4.6 percent --- higher than the overall U.S. average of 2.9 percent during the same time period.

There is also additional good news in the rate of growth in non-agricultural jobs – a sign that while Montana retains its historical leadership in agriculture, it is also broadening its economic base. Since January 2001, approximately 55 thousand non-agriculture related jobs have been created. As new technologies and industries develop, Montana is keeping pace with the changing economy.

As Montana diversifies and produces more goods, the global economy will provide expanding opportunities if we remain committed to free trade, to promoting foreign investment, and to a business tax system that will help our companies and workers successfully compete.

Proven economic principles show that nations that open themselves up to competition - in trade, finance, and investment – benefit while those that don't are left behind. Openness to trade and competition fuels innovation and creates good-paying jobs that raise productivity and standards of living in both rural and urban economies.

Despite this, more and more Americans seem to doubt that trade brings greater benefits than costs. This increase in protectionism is a worrisome trend. Trade is one of the cornerstones of our economic success as a nation. Retreating to economic isolationism would mean fewer jobs and lower incomes in Montana, in the U.S., and around the world. If we arbitrarily protect our markets, other nations will surely protect theirs. When farmers and companies have fewer options for exporting their goods, the impact will be felt by workers throughout Montana.

At every opportunity, this Administration presses our trading partners and other nations to keep their markets open, and to open them further. I recently returned from a trip to China where I had candid discussions with Chinese officials about a wide variety of economic issues, including the need for the Chinese to move more quickly to adopt market-oriented reforms which would reduce their trade imbalance with the United States.

In our rapidly changing economy, we see job losses and dislocations in particular companies, industries, and even regions – just as there are new opportunities in others. But making trade a scapegoat and enacting protectionist policies would make us worse off. We should recognize the hardships and work to alleviate them, while keeping in sight the higher living standards Americans enjoy as a result of economic dynamism. The global economy is here to stay. To keep growing and leading the world in innovation and opportunity, the U.S. must trade freely, openly, and according to the principles of the global marketplace.

Four Free Trade Agreements – with Peru, Colombia, Panama and South Korea – are awaiting Congressional action. Approval of these FTAs is critical. Such agreements are a key element to continued U.S. economic growth. They also demonstrate our support for democratic countries that are working to develop greater opportunities for their citizens, which will in turn create new markets for goods from Montana and the rest of the United States.

To keep America competitive in a global economy, we must also welcome foreign investment. Foreign investment in the United States is the ultimate vote of confidence in our economy. It creates high-quality jobs, spurs innovation, and gives American consumers a wider variety of choices and lower prices on everything from food to clothes to cars. When we encourage open investment, foreign money supports local communities across a wide span of industries. In fact, U.S. subsidiaries of foreign companies play an important role in supporting jobs in Montana, supplying $3 billion in plant and equipment investment, and providing the livelihood for over 6,500 of Montana's workers.

The American economy today is healthy and we have low unemployment. However, we can not rest. Enhancing our future competitiveness, which means new and better-paying jobs and higher living standards for American workers, requires making sure that our policies respond to changes in the global marketplace. This includes a tax regime that does not burden our companies with complexity or put us at a competitive disadvantage when compared to other nations.

In the 1980's, we reformed and simplified the tax code. We closed loopholes and lowered individual and corporate rates. These tax reforms set the stage for "The American Miracle," twenty years of remarkable economic performance in the U.S. and around the world. Yet, since then we have moved in the opposite direction. Over the past two decades, U.S. tax law has grown more complicated and our statutory corporate income tax rate has increased, while other nations have been reducing their rates. In comparison to our major trading partners, the U.S. has moved from a country with below-average corporate tax rates to one with above-average rates. Instead of encouraging economic growth by reducing the tax burden on additional investments, the current tax code distorts capital flows, hurting productivity, job creation and our global competitiveness.

We have made great strides in the last few years. Tax law changes in 2001 and 2003 have helped flow-through businesses flourish and create jobs. These changes will help fuel future prosperity in Montana. Over 100,000 Montana small businesses, including a lot of farmers, will pay lower taxes this year. They will have more money to invest in growing their businesses and creating jobs.

Let me say again how glad I am to be here with Senator Baucus. We share the goals of a free, dynamic marketplace, where government does not pick economic winners or losers, and business men and women are able to make decisions based on what is best for their companies and their workers. The benefits of free trade and economic openness are as compelling in Montana as they are anywhere in the country.

Thank you. I look forward to hearing your questions and your insights on the Montana economy.

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PRESS ROOM

August 7, 2007
HP-531

Treasury Designates Al-Salah Society
Key Support Node for Hamas

The U.S. Department of the Treasury today designated the Al-Salah Society, one of the largest and best-funded Hamas charitable organizations in the Palestinian territories. Al-Salah Society's director, Ahmad Al-Kurd, was also designated today.

"Hamas has used the Al-Salah Society, as it has many other charitable fronts, to finance its terrorist agenda," said Adam Szubin, Director of Treasury's Office of Foreign Assets Control (OFAC). "Today's action alerts the world to the true nature of Al-Salah and cuts it off from the U.S. financial system."

The Al-Salah Society supported Hamas-affiliated combatants during the first Intifada and recruited and indoctrinated youth to support Hamas's activities. It also financed commercial stores, kindergartens, and the purchase of land for Hamas. One of the most senior Gaza-based Hamas leaders and founders, Ismail Abu Shanab, openly identified the Al-Salah Society as "one of the three Islamic charities that form Hamas' welfare arm." The Al-Salah Society has received substantial funding from Persian Gulf countries, including at least hundreds of thousands of dollars from Kuwaiti donors.

The Al-Salah Society is directed by Ahmad Al-Kurd, a recognized high-ranking Hamas leader in Gaza. Al-Kurd's affiliation with Hamas goes back over a decade. During the first Intifada, Al-Kurd served as a Hamas Shura Council member in Gaza. As of late 2003, Al-Kurd was allegedly the top Hamas leader in Deir Al-Balah, Gaza. Since mid-2005, he has served as the mayor of Deir Al-Balah, elected as a Hamas candidate.

The Al-Salah Society has employed a number of Hamas military wing members. In late 2002, an official of the Al-Salah Society in Gaza was the principal leader of a Hamas military wing structure in the Al-Maghazi refugee camp in Gaza. The founder and former director of the Al-Salah Society's Al-Maghazi branch reportedly also operated as a member of the Hamas military wing structure in Al-Maghazi, participated in weapons deals, and served as a liaison to the rest of the Hamas structure in Al-Maghazi. At least four other Hamas military wing members in the Al-Maghazi refugee camp in Gaza were tied to the Al-Salah Society.

The Al-Salah Society was included on a list of suspected Hamas and Palestinian Islamic Jihad-affiliated NGOs whose accounts were frozen by the Palestinian Authority as of late August 2003. After freezing the bank accounts, PA officials confirmed that the Al-Salah Society was a front for Hamas.

Identifying Information

Al-Salah Society
AKAs:
Al-Salah Association
Al-Salah Islamic Foundation
Al-Salah
Al-Salah Islamic Society
Al-Salah Islamic Association
Al-Salah Islamic Committee
Al-Salah Organization
Islamic Salah Foundation
Islamic Salah Society
Islamic Salvation Society
Islamic Righteous Society
Islamic Al-Salah Society

Jamiat Al-Salah Society
Jamiat al-Salah al-Islamiya
Jami'at al-Salah al-Islami
Jami'a al-Salah
Jammeat El-Salah
Salah Islamic Association
Salah Welfare Organization
Salah Charitable Association

Addresses:
PO Box 6035, Beshara Street, Deir al-Balah, Gaza
Deir Al-Balah Camp, Gaza
Athalatheeniy Street, Gaza
Gaza City, Gaza
Bureij, Gaza
Al-Maghazi, Gaza
Rafah, Gaza

AHMAD HARB AL-KURD
AKAs:
Ahmed El-Kurd
Ahmed Al Kurd
Ahmed Hard Al-Kurd
Ahmad Al-Kird
Ahmad Al-Kard
DOB: circa 1949
ALT. DOB: circa 1951
POB: Deir Al-Balah, Gaza
Address: Deir Al-Balah, Gaza

August 8, 2007
2007-8-8-11-9-57-19862

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 $67,123 million as of the end of that week, compared to $67,062 million as of the end of the prior week.

I. Official reserve assets and other foreign currency assets (approximate market value, in US millions)

	August 3, 2007		
A. Official reserve assets (in US millions unless otherwise specified)	Euro	Yen	Total
(1) Foreign currency reserves (in convertible foreign currencies)			67,123
(a) Securities	13,288	10,721	24,009
of which: issuer headquartered in reporting country but located abroad			0
(b) total currency and deposits with:			
(i) other national central banks, BIS and IMF	13,312	5,293	18,605
ii) banks headquartered in the reporting country			0
of which: located abroad			0
(iii) banks headquartered outside the reporting country			0
of which: located in the reporting country			0
(2) IMF reserve position	4,635		
(3) SDRs	9,103		
(4) gold (including gold deposits and, if appropriate, gold swapped)	11,041		
--volume in millions of fine troy ounces	261.499		
(5) other reserve assets (specify)	0		
--financial derivatives			
--loans to nonbank nonresidents			
--other			
B. Other foreign currency assets (specify)			
--securities not included in official reserve assets			
--deposits not included in official reserve assets			
--loans not included in official reserve assets			
--financial derivatives not included in official reserve assets			
--gold not included in official reserve assets			
--other			

II. Predetermined short-term net drains on foreign currency assets (nominal value)

			Maturity breakdown (residual maturity)		
		Total	Up to 1 month	More than 1 and up to 3 months	More than 3 months and up to 1 year
1. Foreign currency loans, securities, and deposits					
--outflows (-)	Principal				
	Interest				
--inflows (+)	Principal				
	Interest				
2. Aggregate short and long positions in forwards and futures in foreign currencies vis-à-vis the domestic currency (including the forward leg of currency swaps)					
(a) Short positions (-)					
(b) Long positions (+)					
3. Other (specify)					
--outflows related to repos (-)					
--inflows related to reverse repos (+)					
--trade credit (-)					
--trade credit (+)					
--other accounts payable (-)					
--other accounts receivable (+)					

III. Contingent short-term net drains on foreign currency assets (nominal value)

		Maturity breakdown (residual maturity, where applicable)		
	Total	Up to 1 month	More than 1 and up to 3 months	More than 3 months and up to 1 year
1. Contingent liabilities in foreign currency				
(a) Collateral guarantees on debt falling due within 1 year				
(b) Other contingent liabilities				

2. Foreign currency securities issued with embedded options (puttable bonds)				
3. Undrawn, unconditional credit lines provided by:				
(a) other national monetary authorities, BIS, IMF, and other international organizations				
--other national monetary authorities (+)				
--BIS (+)				
--IMF (+)				
(b) with banks and other financial institutions headquartered in the reporting country (+)				
(c) with banks and other financial institutions headquartered outside the reporting country (+)				
Undrawn, unconditional credit lines provided to:				
(a) other national monetary authorities, BIS, IMF, and other international organizations				
--other national monetary authorities (-)				
--BIS (-)				
--IMF (-)				
(b) banks and other financial institutions headquartered in reporting country (-)				
(c) banks and other financial institutions headquartered outside the reporting country (-)				
4. Aggregate short and long positions of options in foreign currencies vis-à-vis the domestic currency				
(a) Short positions				
(i) Bought puts				
(ii) Written calls				
(b) Long positions				
(i) Bought calls				
(ii) Written puts				
PRO MEMORIA: In-the-money options [11]				
(1) At current exchange rate				
(a) Short position				
(b) Long position				
(2) + 5 % (depreciation of 5%)				
(a) Short position				
(b) Long position				
(3) - 5 % (appreciation of 5%)				
(a) Short position				
(b) Long position				
(4) +10 % (depreciation of 10%)				
(a) Short position				
(b) Long position				
(5) - 10 % (appreciation of 10%)				
(a) Short position				

(b) Long position				
(6) Other (specify)				
(a) Short position				
(b) Long position				

IV. Memo items

(1) To be reported with standard periodicity and timeliness:	
(a) short-term domestic currency debt indexed to the exchange rate	
(b) financial instruments denominated in foreign currency and settled by other means (e.g., in domestic currency)	
--nondeliverable forwards	
--short positions	
--long positions	
--other instruments	
(c) pledged assets	
--included in reserve assets	
--included in other foreign currency assets	
(d) securities lent and on repo	
--lent or repoed and included in Section I	
--lent or repoed but not included in Section I	
--borrowed or acquired and included in Section I	
--borrowed or acquired but not included in Section I	
(e) financial derivative assets (net, marked to market)	
--forwards	
--futures	
--swaps	
--options	
--other	
(f) derivatives (forward, futures, or options contracts) that have a residual maturity greater than one year, which are subject to margin calls.	
--aggregate short and long positions in forwards and futures in foreign currencies vis-à-vis the domestic currency (including the forward leg of currency swaps)	
(a) short positions (–)	
(b) long positions (+)	
--aggregate short and long positions of options in foreign currencies vis-à-vis the domestic currency	
(a) short positions	
(i) bought puts	
(ii) written calls	
(b) long positions	

(i) bought calls	
(ii) written puts	
(2) To be disclosed less frequently:	
(a) currency composition of reserves (by groups of currencies)	67,123
--currencies in SDR basket	67,123
--currencies not in SDR basket	
--by individual currencies (optional)	

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.

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.

August 13, 2007
HP-533

Department of the Treasury
2007-2008 Priority Guidance Plan
Joint Statement by:

Eric Solomon
Assistant Secretary (Tax Policy)
U.S. Department of the Treasury

Kevin M. Brown
Acting Commissioner
Internal Revenue Service

Donald L. Korb
Chief Counsel
Internal Revenue Service

Washington -- We are pleased to announce the release of the 2007-2008 Priority Guidance Plan.

In Notice 2007-41, 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 2007-2008 Priority Guidance Plan contains 303 projects to be completed over a twelve-month period, from July 2007 through June 2008. 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 2006 - 2007 Priority Guidance Plan to reflect the publication of substantial guidance implementing the Pension Protection Act of 2006 and the announcement of a settlement initiative related to the exercise of certain stock rights. We will continue to evaluate the priority of each guidance project in light of developments arising during the 2007-2008 plan year, including the enactment of tax legislation, if any.

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 2007-2008 Priority Guidance Plan can be obtained from the IRS website on the Internet at http://www.irs.gov/pub/irs-utl/2007-2008 . Copies can also be obtained by calling Treasury's Office of Public Affairs at (202) 622-2960.

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REPORTS

- 2007-08 Priority Guidance Plan

OFFICE OF TAX POLICY
AND
INTERNAL REVENUE SERVICE

2007-2008 PRIORITY GUIDANCE PLAN

August 13, 2007

CONSOLIDATED RETURNS

1. Regulations [1] under section 1502 regarding liquidations under section 332 into multiple members. Proposed regulations were published on February 22, 2004.

2. Regulations revising section 1.1502-13(g) regarding transactions involving obligations of consolidated group members.

3. Regulations regarding transfers of member stock. Proposed regulations were published on January 23, 2007.

4. Regulations revising section 1.1502-77 regarding agency for a consolidated group.

5. Regulations regarding the application of section 172(h) (corporate equity reduction interest losses) to a consolidated group.

CORPORATIONS AND THEIR SHAREHOLDERS

1. Guidance regarding the recovery of basis in redemptions of corporate stock governed by section 301. A notice was published in the Federal Register on April 19, 2006.

2. Regulations regarding basis tracing under section 358 and allocation of boot under section 356.

3. Regulations enabling elections for certain transactions under section 336(e).

4. Regulations regarding treatment of certain nuclear decommissioning funds for purposes of allocating purchase price in certain acquisitions. Temporary regulations were published on September 14, 2004.

5. Regulations revising section 1.355-3 regarding the active trade or business requirement. Proposed regulations were published on May 8, 2007.

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[1] As used in this document, unless otherwise indicated, the term "regulations" refers to proposed regulations, temporary regulations or final regulations.

6. Regulations regarding predecessors and successors under section 355(e). Proposed regulations were published on November 22, 2004.

7. Regulations regarding the applicability of section 358(h)(2)(B) to the assumption of certain liabilities. Temporary regulations were published on May 23, 2005.

8. Guidance under section 362(e) regarding the importation or duplication of losses. Notice 2005-70 was published on October 11, 2005. Proposed regulations were published on October 23, 2006 and January 23, 2007.

9. Regulations regarding continuity of interest. Temporary regulations were published on March 20, 2007.

10. Regulations regarding transactions involving the transfer or receipt of no net equity value. Proposed regulations were published on March 10, 2005.

11. Regulations revising section 1.368-2(k) regarding transfers of assets after putative reorganizations. Proposed regulations were published on August 18, 2004.

12. Revision of Rev. Proc. 81-70 providing guidelines for estimating stock basis in reorganizations under section 368(a)(1)(B). Comments regarding these guidelines were requested in Notice 2004-44.

13. Guidance regarding the scope of section 368(a)(1)(D). Temporary regulations were published on March 1, 2007.

14. Regulations under section 368(a)(1)(F). Proposed regulations were published on August 12, 2004.

15. Guidance under sections 382 and 384, including regulations regarding built-in items under section 382(h)(6). Built-in items under section 382(h)(6) were previously addressed in Notice 2003-65. Temporary regulations regarding the treatment of prepaid income were published on June 13, 2007.

16. Guidance regarding the transfer of treasury stock to a corporation controlled by the transferor. See Rev. Rul. 2006-2, revoking Rev. Rul. 74-503.

17. Revised regulations under section 1561 regarding the allocation of certain tax benefits among related corporations. Temporary regulations were published on December 21, 2006.

EMPLOYEE BENEFITS

A. Retirement Benefits

1. Guidance on special pay plans for governmental employees.

2. Notice providing transitional guidance on normal retirement age.
   - WILL BE PUBLISHED 8/27/2007 in IRB 2007-35 as NOTICE 2007-69

(released 8/10/2007)

3. Guidance regarding the treatment of incidental health insurance benefits provided under a profit-sharing or stock bonus plan.

4. Update of Employee Plans Compliance Resolution System (EPCRS).

5. Guidance on the transfer of assets from a section 401(a) plan to a Puerto Rico plan.

6. Proposed regulations under section 401(a)(9) on required minimum distribution rules for governmental plans, as directed by the Pension Protection Act of 2006.

7. Guidance on diversification requirements under section 401(a)(35), as added by the Pension Protection Act of 2006.

8. Update of model notice under section 402(f) relating to eligible rollover distributions

9. Announcement on the definition of insurance under section 402(l), as added by the Pension Protection Act of 2006.

10. Model plan provisions under section 403(b) for public school employees.

11. Announcement on the reporting of distributions of section 404(k) dividends.

12. Final regulations on converting an IRA annuity to a Roth IRA annuity. Temporary regulations were published on August 22, 2005. (408A)

13. Proposed regulations under section 411(a)(11) to provide a description of the consequences of failing to defer, as directed by the Pension Protection Act of 2006.

14. Proposed regulations on hybrid plans under sections 411(a)(13) and 411(b)(5), as added by the Pension Protection Act of 2006.

15. Guidance under section 414(d), as amended by the Pension Protection Act of 2006, for plans maintained by Indian Tribal governments.
    - WILL BE PUBLISHED 8/27/2007 in IRB 2007-35 as NOTICE 2007-67 (released 8/9/2007)

16. Guidance on automatic enrollment under sections 414(w), 401(k)(13) and 401(m)(12), as added by the Pension Protection Act of 2006.

17. Guidance on applicable interest and mortality assumptions under section 417(e), as amended by the Pension Protection Act of 2006.

18. Proposed regulations on the measurement of assets and liabilities under section 430, as added by the Pension Protection Act of 2006.

19. Proposed regulations on the determination of the minimum required contributions under

section 430, as added by the Pension Protection Act of 2006.

20. Final regulations on the funding of single employer plans under section 430, as added by the Pension Protection Act of 2006.

21. Guidance on the mortality tables for disabled individuals used under sections 430(h)(3)(D) and 431(c)(6)(D)(v), as added by the Pension Protection Act of 2006.

22. Guidance on multiemployer plans under section 432, as added by the Pension Protection Act of 2006.

23. Proposed regulations on funding-based benefit limits under section 436, as added by the Pension Protection Act of 2006.

24. Proposed regulations under section 4980F with respect to retroactive effective dates.

25. Guidance on Form 5500 reporting as a result of the Pension Protection Act of 2006.

26. Guidance on the 10-year amortization election for airlines under section 402(a)(2) of the Pension Protection Act of 2006.

B. Executive Compensation, Health Care and Other Benefits, and Employment Taxes

1. Guidance under section 162(l) regarding 2% S Corporation shareholders.

2. Guidance under section 162(m) on the definition of outside director.

3. Guidance on discrete issues on Health Savings Accounts (HSAs).

4. Guidance on qualified nonpersonal use vehicles.

5. Guidance under section 409A on funding restrictions applicable to nonqualified deferred compensation.

6. Proposed regulations under section 409A on the calculation of income inclusion and additional taxes.

7. Guidance regarding reporting and income tax withholding under section 409A.

8. Guidance on welfare benefit funds.

9. Guidance on deductions for contributions to a welfare benefit fund.

10. Guidance under section 419A on reserves for post-retirement medical and life insurance benefits.

11. Update of the regulations under section 423 regarding employee stock purchase plans.
12. Guidance under section 457(f).

- PUBLISHED 8/6/2007 in IRB 2007-32 as NOTICE 2007-62 (released 7/23/2007)

13. Final regulations under section 3121 regarding the definition of salary reduction agreement. Temporary regulations were published on November 16, 2004.

14. Revenue ruling on income tax withholding with respect to supplemental wages for employees who receive no regular wages.

15. Proposed regulation under section 4980B regarding calculation of the applicable premium for COBRA continuation coverage.

16. Final regulations under section 4980G on comparable HSA contributions. Proposed regulations were published on June 1, 2007.

17. Proposed regulations on Health Opportunity Patient Empowerment Act of 2006 changes to section 4980G.

18. Regulations for adjusting overpayment or underpayment of employment taxes.

EXCISE TAXES

1. Guidance under sections 4051 and 4071 on heavy trucks, trailers, tractors, and tires to update current regulations and to reflect recent statutory changes, including changes made by the American Jobs Creation Act of 2004.

2. Proposed regulations under sections 4081–4083 and 6427 on fuel tax provisions added or affected by the American Jobs Creation Act of 2004, the Energy Policy Act, and the Safe, Accountable, Flexible, Efficient Transportation Equity Act, and the Tax Relief and Health Care Act of 2006, including issues that are related to kerosene used in aircraft and the Leaking Underground Storage Tank Trust Fund. Many of these issues were discussed in Notices 2005-4 and 2005-80.

3. Final regulations under section 4082, as amended by the American Jobs Creation Act of 2004, on diesel fuel and kerosene that is dyed by mechanical injection. Temporary regulations were published on April 26, 2005.

4. Update of existing regulations and rulings regarding the tax on the retail sale of trucks, tractors, and trailers under sections 4051- 4053. Current guidance is in temporary regulations, regulations under section 4061 (which was terminated in 1983), and numerous revenue rulings.

5. Guidance under section 4481, as amended by the American Jobs Creation Act of 2004, related to electronic filing of highway use tax returns and the proration of tax when vehicles are sold.

6. Guidance on the eligibility of the credit or payment allowed for fuel used in certain buses

described in sections 6421(b) and 6427(b).

7. Guidance under section 6426(d)(2)(F), as added by the Safe, Accountable, Flexible, Efficient Transportation Equity Act, to define "liquid hydrocarbon derived from biomass" for purposes of the definition of alternative fuel and the credit and payment allowable for alternative fuel mixtures.

8. Proposed regulations under sections 40, 40A, 6426 and 6427 on fuel tax provisions added or affected by the American Jobs Creation Act of 2004, the Energy Policy Act, and the Safe, Accountable, Flexible, Efficient Transportation Equity Act, including issues that are related to alcohol fuels, biodiesel, renewable diesel, and alternative fuel. Many of these issues were discussed in Notices 2005-4 and 2005-62.

EXEMPT ORGANIZATIONS

1. Revenue procedure updating Rev. Proc. 90-27 on processing exemption applications.
   - Published 7/23/2007 in IRB 2007-30 as Rev. Proc. 2007-52 (released 7/9/2007)

2. Regulations under sections 501(c)(3) and 4958 on revocation standards. Proposed regulations were published on September 9, 2005.

3. Proposed regulations regarding the new requirements for supporting organizations, as added by the Pension Protection Act of 2006.

4. Regulations under section 529 regarding qualified tuition programs.

5. Final regulations on excise taxes on prohibited tax shelter transactions and related disclosure requirements.

6. Proposed regulations regarding the new excise taxes on donor advised funds, as added by the Pension Protection Act of 2006.

7. Regulations under section 6033, as amended by the Pension Protection Act of 2006, on notification requirement for entities currently not required to file.

8. Regulations to implement Form 990 revisions.

FINANCIAL INSTITUTIONS AND PRODUCTS

1. Guidance for RICs and REITs concerning the application of section 1(h) to capital gain dividends.

2. Final regulations under section 446 on notional principal contracts (NPC) relating to the inclusion in income or deduction of a contingent nonperiodic payment and guidance relating to the character of payments made pursuant to an NPC. Proposed regulations were published on February 26, 2004.
3. Guidance addressing the correction of minor errors by RICs and REITs.

4. Final regulations simplifying the reporting to shareholders of regulated investment companies with respect to the flow through of the foreign tax credit. Proposed regulations were published on September 18, 2006.

5. Final regulations under section 860G(b) regarding withholding obligations of partnerships allocating income from REMIC residual interests to foreign persons. Proposed regulations were published on August 1, 2006.

6. Proposed regulations under section 860G addressing modifications of commercial mortgages held by REMICs.

7. Final regulations under section 1221 regarding capital asset exclusion for accounts and notes receivable. Proposed regulations were published on August 7, 2006.

8. Guidance under section 1286(f) as added by the American Jobs Creation Act of 2004 regarding treatment of stripped interests in bond and preferred stock funds.

GENERAL TAX ISSUES

1. Notice concerning the section 30B phase out of the Honda Hybrid Vehicle Credit.

2. Guidance amplifying Notice 2006-54 regarding Fuel Cell Motor Vehicle Credit Certifications.

3. Guidance regarding the alternative simplified credit under section 41(c)(5), as added by the Tax Relief and Health Care Act of 2006.

4. Proposed regulations under section 41 regarding the exception from the definition of "qualified research" for internal use software under section 41(d)(4)(E).

5. Guidance under section 41 regarding whether the gross receipts component of the research credit computation for a controlled group under section 41(f) includes gross receipts from transactions between group members.

6. Final regulations under section 42 on applicable utility allowances.

7. Final regulations under section 42 on the requirements for a qualified contract.

8. Proposed regulations under section 45D on how an entity serving targeted populations meets the requirements to be a qualified active low-income community business.

9. Guidance under section 45D relating to the new markets tax credit.

10. Final regulations under section 45G relating to the railroad track maintenance credit. Temporary regulations were published on September 8, 2006.

11. Guidance concerning the credit for the production of low sulfur diesel fuel under section 45H regarding the certification requirement for complying with EPA regulations.

12. Temporary Regulations concerning the credit for production from advanced nuclear power facilities under section 45J.

13. Regulations under sections 46 and 167 relating to normalization.

14. Guidance under section 48 on the energy credit for qualified fuel cell and microturbine property.

15. Notice regarding the tax treatment and information reporting of market gain on repayments of Commodity Credit Corporation loans.

16. Revenue ruling under sections 61 and 451 on the inclusion in income of certain federal tax credits, such as credits related to alcohol and biodiesel fuel.

17. Revenue ruling addressing the consequences of certain transactions on the treatment of arrangements as leases for federal income tax purposes.

18. Guidance under section 108(f) regarding law school debt forgiveness programs.

19. Guidance addressing significant issues under section 152 concerning the definition of dependent.

20. Final regulations under section 152, as amended by the Working Families Tax Relief Act of 2004, regarding the release of a claim for exemption for a child of divorced or separated parents. Proposed regulations were published on May 2, 2007.

21. Regulations regarding the election by state legislators under section 162(h) relating to deemed expenses for travel away from home.

22. Regulations regarding the deductibility of expenses for lodging not incurred in traveling away from home. The expected issuance of these regulations was announced in Notice 2007-47.

23. Guidance under sections 162 and 165 on deducting and accounting for gaming losses and expenses.

24. Proposed regulations under section 170(f)(12), as added by the American Jobs Creation Act of 2004, and related provisions, regarding contributions of qualified vehicles. Interim guidance was issued as Notice 2005-44.

25. Regulations under section 170 regarding substantiation and reporting requirements for cash and noncash charitable contributions to reflect amendments made by the American Jobs Creation Act of 2004 and the Pension Protection Act of 2006. Interim guidance was issued as Notice 2006-96.

26. Guidance under section 174 concerning inventory property.

27. Temporary regulations under section 179B regarding the deduction for capital cost incurred by a refinery in complying with EPA regulations.

28. Guidance under section 179C on the election to expense certain refineries.

29. Guidance under section 179D, amplifying Notice 2006-52, on the deduction for energy efficient commercial buildings.

30. Final regulations under section 199, as amended by the Tax Increase Prevention and Reconciliation Act of 2005, on the deduction for income attributable to domestic production activities.

31. Final regulations under section 199 on the definition of a qualified film.

32. Revenue ruling under section 213 regarding the deductibility of costs incurred for diagnostic procedures as medical expenses.

33. Guidance regarding the section 274(n) limitations in employee leasing arrangements.

34. Regulations under section 468A, as amended by the Energy Policy Act of 2005, regarding special rules for nuclear decommissioning costs.

35. Guidance under section 469 involving grouping and regrouping of activities.

36. Regulations under section 1221 regarding the election, as added by the Tax Increase Prevention and Reconciliation Act of 2005, to treat musical compositions sold or exchanged before January 1, 2011, as capital assets.

37. Regulations under section 1301(a), as amended by the American Jobs Creation Act of 2004, regarding income averaging for fishermen.

38. Final regulations under section 7701 regarding disregarded entities and employment and excise taxes. Proposed regulations were published on October 18, 2005.

39. Regulations providing criteria for treating an entity as an integral part of a state, local, or tribal government.

GIFTS, ESTATES AND TRUSTS

1. Final regulations under section 67 regarding miscellaneous itemized deductions of a trust or estate. Proposed regulations were published on July 27, 2007.

2. Guidance under section 642(c) concerning the ordering rules for charitable payments made by a charitable lead trust.

3. Revenue ruling on the division of charitable remainder trusts under section 664.
4. Proposed regulations under section 664(c) to reflect the 2006 Tax Relief Act amendment concerning the effect of UBIT on charitable remainder trusts.

5. Proposed regulations under section 2032(a) regarding the imposition of restrictions on estate assets during the 6 month alternate valuation period.

6. Guidance regarding the consequences under various estate, gift and generation-skipping transfer tax provisions of using a family-owned trust company as the trustee of a trust.

7. Guidance under section 2036 regarding the tax consequences of a retained power to substitute assets in a trust.

8. Final regulations under sections 2036 and 2039 regarding the portion of a split-interest trust that is includible in a grantor's gross estate in certain circumstances in which the grantor retains an annuity or other payment for life.

9. Final regulations providing guidance under section 2053 regarding the extent to which post-death events may be considered in determining the value of the taxable estate.

10. Revenue Procedure under section 2522 containing sample inter vivos Charitable Lead Unitrusts.

11. Guidance under section 2642(g) regarding extensions of time to make allocations of the generation-skipping transfer tax exemption.

12. Guidance under section 2703 regarding the gift and estate tax consequences of the transfer of assets to investment accounts that are restricted.

13. Guidance under section 2704 regarding restrictions on the liquidation of an interest in a corporation or partnership.

INSURANCE COMPANIES AND PRODUCTS

1. Final regulations on the exchange of property for an annuity contract. Proposed regulations were published on October 18, 2006.

2. Guidance concerning section 72(e) and partial exchanges of annuity contracts. Interim rules were provided in Notice 2003-51.

3. Guidance on the qualification of certain arrangements as insurance.

4. Final regulations regarding taxable asset acquisitions and dispositions of insurance companies. Temporary and proposed regulations were published on April 10, 2006.

5. Revenue ruling concerning the meaning of the term "statutory reserves" under section 807 where the company is subject to different statutory reserve requirements in different states.

6. Final regulations to expand the list of holders whose beneficial interests in an investment company, partnership, or trust do not prevent a segregated asset account

from looking through to the assets of the investment company, partnership, or trust to satisfy the requirements of section 817(h). Proposed regulations were published on July 31, 2007.

7. Guidance concerning corporate-owned life insurance under section 863 of the Pension Protection Act of 2006.

8. Guidance concerning remediation procedures for life insurance and annuity contracts based on comments received pursuant to Notice 2007-15.

INTERNATIONAL ISSUES

A. Subpart F/Deferral

1. Regulations and other guidance under subpart F related to the American Jobs Creation Act of 2004 and the Tax Increase Prevention and Reconciliation Act of 2005. See Notice 2006-48 regarding active aircraft or vessel leasing rents under section 954(c)(2)(A), which was published on May 22, 2006, and Notice 2007-9 regarding section 954(c)(6), which was published on January 29, 2007.

2. Final regulations under section 959 on previously taxed earnings and profits. Proposed regulations were published on August 29, 2006.

3. Other guidance under subpart F, including guidance on contract manufacturing and substantial assistance. See Notice 2007-13 regarding substantial assistance under subpart F, which was published on January 29, 2007.

4. Final regulations on the gain recognition election and PFIC/CFC overlap rule and other guidance under sections 1296, 1297 and 1298. Final, temporary, and proposed regulations on gain recognition election and PFIC/CFC overlap were published on December 8, 2005.

B. Inbound Transactions

1. Guidance on financing activities, including lending activities under section 864.

2. Guidance related to the American Jobs Creation Act of 2004 and other issues under sections 897, 1445, and 1446. Final, temporary, and proposed regulations under section 1446 were published on May 18, 2005. See Notice 2006-46 on the tax treatment of certain restructuring transactions under section 897, which was published on June 12, 2006.

3. Regulations on withholding and reporting obligations under section 1441 regarding tender offers.

4. Guidance on documentation, securities lending, and other withholding issues under section 1441.

C. Outbound Transactions

1. Guidance on the use of parent stock to avoid dividend treatment. See Notice 2006-85 regarding use of parent stock to avoid dividend treatment, which was published on

October 10, 2006, and Notice 2007-48, which was published on June 18, 2007.

2. Final regulations under section 1.367(a)-8.

3. Regulations or other guidance under section 7701. See Notice 2007-10, adding a Bulgarian entity to the list of entities always treated as corporations under section 7701, which was published on January 22, 2007.

4. Regulations under section 7874, as added by the American Jobs Creation Act of 2004, regarding the treatment of expatriated entities and their foreign parents. Temporary regulations regarding the determination of ownership under section 7874 were published on December 28, 2005, and temporary regulations regarding the substantial business activities test were published on June 6, 2006.

5. Other regulations on international restructurings. Proposed regulations under sections 367 and 1248 regarding the attribution of earnings and profits to stock following certain nonrecognition transactions were published on June 2, 2006. Final regulations under section 367(b) were published on August 8, 2006. Temporary regulations under section 367(d) were published on May 16, 1986.

D. Foreign Tax Credits

1. Final regulations under section 901 on legal liability. Proposed regulations relating to the determination of who is considered to pay a foreign tax for purposes of sections 901 and 903 were published on August 4, 2006.

2. Final regulations on the determination of the amount of taxes paid for purposes of section 901 for taxpayers who claim direct and indirect foreign tax credits. Proposed regulations were published on March 30, 2007.

3. Guidance under the American Jobs Creation Act of 2004 on recharacterization of overall domestic losses under section 904(g), and related guidance on overall foreign loss recapture provisions under section 904(f).

4. Regulations or other guidance on other foreign tax credit provisions of the American Jobs Creation Act of 2004, including the reduction in the number of separate categories under section 904(d), the credit disallowance rule under section 901(l), and related issues under section 901(k). A notice soliciting comments under section 901(l) was published on December 19, 2005.

5. Guidance on foreign tax redeterminations under section 905(c).
6. Final regulations related to look-through treatment for 10/50 company dividends and other foreign tax credit guidance. Temporary regulations on look-through treatment for 10/50 company dividends were published on April 25, 2006.

E. Transfer Pricing

1. Regulations and other guidance on the treatment of cross border services. Proposed regulations under section 482 were published on September 10, 2003, and temporary and final regulations

were published on August 4, 2004. See Rev. Proc. 2007-13, which identifies services eligible to be evaluated at cost, and Notice 2007-5, which provides transition rules regarding the temporary regulations, which were both published on January 16, 2007.

2. Regulations and other guidance on global dealing. Proposed regulations under section 482 were published on March 6, 1998.

3. Regulations on cost sharing and other guidance under section 482. Proposed cost sharing regulations were issued on August 22, 2005.

4. Annual Report on the Advance Pricing Agreement Program.

F. Sourcing and Expense Allocation

1. Regulations or other guidance under the American Jobs Creation Act of 2004 on interest expense apportionment, and other guidance on expense allocation, including issues relating to partnership structures. Notice 2005-53 regarding section 1.882-5 was published on August 8, 2005. Temporary regulations under section 1.882-5 were published on August 17, 2006.

2. Regulations or other guidance on mixed source of income, including rents and royalties.

G. Treaties

1. Guidance under treaties, including on the zero percent reduced withholding rate on certain dividends.

2. Announcements of Mutual Agreements under income tax conventions (MAPs).

H. Other

1. Regulations or other guidance related to shipping and aircraft transportation. Temporary regulations under section 1.883-3 were published on June 25, 2007.

2. Guidance on cross-border treatment of insurance contracts.

3. Regulations or other guidance on the exemption of certain investment income of foreign governments under section 892. Temporary regulations under section 892 were published on June 24, 1988. Regulations finalizing section 1.892-5 were published on July 31, 2002.

4. Guidance under section 911, including guidance under the Tax Increase Prevention and Reconciliation Act of 2005.

5. Regulations or other guidance on the source and effectively connected income rules, and other guidance on possessions. Temporary regulations, including under section 937, were published on April 11, 2005. Final regulations under section 937 providing residency rules were published on January 31, 2006.

6. Regulations and other guidance concerning the treatment of currency gain or loss. Proposed regulations under section 987 were published on September 7, 2006.

7. Guidance on cross border information reporting and filing issues, including regulations relating to the reporting of bank deposit interest. Proposed regulations under section 6049 were published on January 17, 2001.

PARTNERSHIPS

1. Proposed regulations under section 108(e)(8), as amended by the American Jobs Creation Act of 2004, regarding debt satisfied by a partnership interest.

2. Guidance under section 465, 704(b) and 752 concerning the interaction of the at-risk provisions, deficit and 752 concerning the interaction of the at-risk provisions, deficit restoration obligations and the partnership liability rules.

3. Regulations under sections 704 and 737 regarding partnership mergers. Interim guidance was issued as Notice 2005-15.

4. Proposed regulations under sections 704, 743, and 755, as amended by the American Jobs Creation Act of 2004, regarding the disallowance of certain partnership loss transfers and no reduction of basis in stock held by a partnership in a corporate partner. Interim guidance was issued as Notice 2005-32.

5. Guidance under section 704 involving remedials and related parties.

6. Final regulations under section 704(b)(2) regarding whether partnership allocations have substantial economic effect. Proposed regulations were published on November 18, 2005.

7. Revenue procedure under sections 704(b) and 45 that provides the necessary requirements for partnerships to meet a safe harbor in allocating wind energy production tax credits.

8. Modification of Rev. Proc. 2003-84 regarding monthly closing elections for partnership investments in tax-exempt bonds to impose certain additional conditions on the equity investment structure of eligible partnerships.
9. Proposed regulations under section 706(d) regarding the determination of distributive share when a partner's interest changes.

10. Final regulations under section 707 regarding disguised sales. Proposed regulations were published on November 26, 2004.

11. Final regulations under sections 721 and 83 regarding partnership equity issued in connection with the performance of services. Proposed regulations were published on May 24, 2005.

12. Final regulations under 721 regarding the tax treatment of noncompensatory options and convertible instruments issued by a partnership. Proposed regulations were published on January 22, 2003.

13. Proposed regulations under section 751(b) regarding unrealized receivables and inventory items of a partnership.

14. Final regulations regarding the application of section 1045 to certain partnership transactions. Proposed regulations were published on July 15, 2004.

SUBCHAPTER S

1. Revenue ruling on S corporation losses/reduction in tax attributes under section 108(b) for discharge of indebtedness income that is excluded from gross income.

2. Proposed regulations under section 1361 to reflect provisions of the American Jobs Creation Act of 2004 and Gulf Opportunity Zone Act of 2005, including the family shareholder provision, and to update obsolete provisions in the current regulations.

3. Guidance under sections 1361 and 1362 regarding employer identification numbers of parents and subsidiaries in F reorganizations involving S corporations and qualified subchapter S subsidiaries.

4. Guidance under section 1362 involving late S corporation elections.

5. Final regulations under section 1363 providing guidance for S corporation banks. Proposed regulations were issued on August 24, 2006.

6. Guidance under sections 1366 and 1367(a)(2) regarding the amount of deduction, and adjustments to basis of S corporation stock, for charitable contributions of property by S corporations made after the Pension Protection Act of 2006 amendments.

7. Final regulations under section 1367 regarding adjustments in basis of indebtedness. Proposed regulations were published on April 12, 2007.

8. Guidance under section 1367 regarding S corporations and back-to-back loans.

9. Guidance under section 1368(e) on whether premiums paid by S corporations for life insurance decrease the corporation's AAA.

TAX ACCOUNTING

1. Clarification of Rev. Rul. 2005-28 regarding the treatment of Medicaid rebates incurred by a pharmaceutical manufacturer in determining gross receipts.

2. Regulations under sections 162 and 263 regarding the deduction and capitalization of expenditures for tangible assets.

3. Guidance on the treatment of wrap fees.

4. Guidance under section 174 regarding changes in method of accounting from an impermissible method.

5. Regulations under sections 195, 248, and 709, as amended by the American Jobs Creation Act of 2004, regarding the elections to amortize start-up and organizational expenditures.

6. Proposed regulations under section 263(a) regarding the treatment of capitalized transaction costs.

7. Guidance regarding the supporting documentation required under section 1.263(a)-5(f) to allocate success-based fees between activities that facilitate a transaction and activities that do not facilitate a transaction.

8. Guidance under section 263A regarding the treatment of post-production costs, such as sales-based royalties.

9. Guidance under section 263A regarding whether "negative" additional section 263A costs are taken into account under section 1.263A-1(d)(4).

10. Guidance regarding whether an automobile dealership is a producer for purposes of section 263A when it installs parts on customer-owned and dealership-owned vehicles.

11. Regulations under section 381(c)(4) and (5) regarding changes in method of accounting.

12. Revenue procedures updating Rev. Proc. 2002-39 and Rev. Proc. 2006-45 to modify and clarify the rules for changing an accounting period under section 442.

13. Guidance under section 446 regarding whether a change between (1) separately reporting an item as income and deducting a related expense (either in the same or a different tax year) and (2) either (a) excluding the item from income and not deducting the expense, or (b) netting the item of income with the related expense, is a change in method of accounting.

14. Update of Rev. Proc. 2002-9 regarding automatic changes in methods of accounting.
15. Guidance regarding the nonaccrual experience method under section 448.

16. Guidance under section 453 addressing the exchange of property for an annuity.

17. Guidance regarding the application of section 453A to contingent payment installment sales.

18. Regulations under section 460 providing rules for home construction contracts.

19. Guidance under section 460 addressing the application of the lookback interest rules to

certain pass-thru entities with tax-exempt owners.

20. Guidance applying the all events test of section 461 to services and other liabilities related to such services.

21. Guidance under section 468B regarding the tax treatment of a single-claimant qualified settlement fund.

22. Regulations under section 468B regarding escrow accounts and other funds used in like-kind exchanges. Proposed regulations were published on February 7, 2006.

23. Guidance regarding the permissibility of a moving average cost method for valuing inventory.

24. Guidance under section 1.472-8 regarding the inventory price index computation (IPIC) method.

25. Guidance under section 1.472-8 regarding the treatment of crossover vehicles for purposes of dollar-value LIFO pooling.

26. Guidance regarding the application of the Gulf Opportunity Zone bonus depreciation recapture rule in section 1400N(d)(5) to like-kind exchanges.

TAX ADMINISTRATION

1. Revenue procedure under section 3402 regarding the withholding rules applicable to poker tournaments.

2. Notice under section 3402(t) soliciting comments regarding guidance to Government entities required to withhold on certain payments made by the entities.

3. Final regulations regarding mandatory Corporate E-File. Temporary regulations were published on January 12, 2005.

4. Final regulations under section 6011 with respect to taxpayer disclosure of reportable transactions. Proposed regulations were published on November 2, 2006.

5. Guidance under section 6011 regarding reportable transactions.
6. Guidance concerning patented transactions.

7. Final regulations under section 6020(b) regarding substitutes for return. Temporary regulations were published on July 18, 2005.

8. Guidance regarding information reporting under section 6041 for commissions paid to insurance agents.

9. Final regulations under section 6050L, as amended, regarding the information reporting requirements relating to certain donated property. Proposed regulations were published

on May 23, 2005.

10. Regulations regarding information reporting for lump sum timber sales.

11. Guidance under section 6050P regarding the information reporting requirements relating to the purchase of debt that has been written off as uncollectible. Final regulations were published on October 25, 2004.

12. Notice regarding the use of alternative signature methods by electronic return originators.

13. Regulations under section 6081 simplifying the extension process. Temporary regulations were published on November 7, 2005.

14. Final and temporary regulations under section 6103 regarding disclosures to the Department of Commerce, Bureau of the Census. Temporary regulations were published on March 11, 2005.

15. Regulations under section 6103 regarding disclosures to whistleblowers under section 7623, as amended by the Tax Reform and Health Care Act of 2006.

16. Final regulations under section 6111 with respect to material advisor disclosure of reportable transactions. Proposed regulations were published on November 2, 2006.

17. Final regulations under section 6112 with respect to list maintenance and reportable transactions. Proposed regulations were published on November 2, 2006.

18. Guidance under section 6112 with respect to list maintenance.

19. Regulations under section 6159 regarding installment agreements.

20. Guidance regarding the furnishing of security in connection with an election to pay the estate tax in installments under section 6166.

21. Revenue procedure under section 6213 regarding internet and oral change of address requests.

22. Regulations under section 6231 regarding the special enforcement exception to the application of the TEFRA partnership procedures.
23. Proposed regulations under section 6302 regarding payments under the Electronic Federal Tax Payment System.

24. Regulations under section 6302 regarding the failure-to-deposit penalty under section 6656.

25. Regulations regarding the filing of Form 941 under the Annual Employment Tax Return Program. Proposed regulations were published on January 3, 2006.

26. Regulations under section 6323 regarding electronic lien filing authority.

27. Final regulations implementing the substitution of value procedures under section 6325. Proposed regulations were published on January 11, 2007.

28. Guidance regarding the limitations on setoff.

29. Revenue ruling regarding setoff with respect to a taxpayer in bankruptcy.

30. Revision of Notice 2002-44 regarding the filing of certain claims for credit or refund.

31. Final regulations under section 6404(g) regarding the application of the interest suspension period. Proposed and temporary regulations were published on June 21, 2007.

32. Regulations under section 6501(c)(10) regarding the extension of the statute of limitations for assessment relating to failures to report required information concerning listed transactions. Interim guidance was issued as Rev. Proc. 2005-26.

33. Regulations under section 6503 regarding the suspension of the period of limitations for noncompliance with a designated summons. Proposed regulations were published on July 31, 2003.

34. Regulations under section 6611 regarding interest on overpayments by tax exempt organizations.

35. Regulations under sections 6662A, 6662 and 6664 regarding accuracy-related penalties relating to understatements. Interim guidance was issued as Notice 2005-12.

36. Update of Rev. Proc. 94-69 regarding qualified amended returns filed by CIC taxpayers. Final regulations under section 6664 were published on January 9, 2007.

37. Guidance under section 6676 regarding the penalty for erroneous claims for refund.

38. Guidance under section 6694, as amended, regarding the penalty for understatements of taxpayer's liability by tax return preparers.

39. Guidance implementing amendments to the return preparer penalties, including guidance regarding the expansion of the scope of the penalties and clarifying application of those penalties.

40. Guidance under section 6695A, as added by the Pension Protection Act of 2006, regarding the penalty applicable to appraisers.

41. Notice identifying additional frivolous positions for purposes of the section 6702 penalty as amended by the Tax Reform and Health Care Act of 2006. A previous list of frivolous positions was issued as Notice 2007-30.

42. Regulations under section 6707 regarding the penalty for failure to furnish information required by section 6111.

43. Regulations under section 6707A regarding the penalty for failure to disclose reportable transactions. Prior guidance was issued as Notice 2005-11, Rev. Proc. 2005-51, Rev. Proc. 2007-21 and Rev. Proc. 2007-25.

44. Revenue procedure regarding the procedures to request Appeals consideration of the section 6707A penalty.

45. Regulations under section 6708 regarding the penalty for failure to make a list of advisees available as required by section 6112. Interim guidance was issued as Notice 2004-80.

46. Guidance under section 7122 as amended by the Tax Increase Prevention and Reconciliation Act of 2005 regarding the partial payment requirement for offers in compromise.

47. Guidance regarding Appeals mediation procedures.

48. Guidance regarding fast track procedures for TEGE taxpayers.

49. Guidance under section 7216 regarding the disclosure and use of tax return information by tax return preparers. Proposed regulations were published on December 7, 2005. Notice 2005-93 providing additional proposed guidance was published on December 19, 2005.

50. Final regulations under section 7425(c) regarding where to send notices of nonjudicial sale and wrongful levy claims. Proposed regulations were published on July 20, 2007.

51. Guidance under section 7430 regarding attorney fees to reflect miscellaneous changes made by the Tax Reform Act of 1997 and the Internal Revenue Service Restructuring and Reform Act of 1998.

52. Proposed regulations under the section 7477 regarding declaratory judgment procedures relating to gift tax valuation issues.

53. Final regulations under section 7502 regarding the timely mailing/delivery of documents.

Proposed regulations were published on September 21, 2004.

54. Revenue ruling under section 7508 regarding the effect of disaster and combat zone relief on priority and dischargeability of tax obligations in bankruptcy.

55. Amendments to the section 7508A regulations regarding the postponement of certain deadlines by reason of a Presidentially declared disaster or terroristic or military actions.

56. Amplification of Notice 2006-56 regarding certain individuals affected by Hurricane Katrina.

57. Final regulations regarding the procedures relating to third party and John Doe summonses.

58. Proposed regulations under section 7811 regarding taxpayer assistance orders.

59. Revisions to Circular 230 regarding practice before the IRS. Proposed regulations regarding various general practice (nonshelter) matters were published on February 8, 2006. Final regulations regarding matters relating to tax shelters, including standards for covered opinions and other written advice, were published on December 20, 2004.

60. Regulations regarding user fees for enrolled actuaries.

61. Guidance regarding the procedures for the imposition of a monetary penalty under Circular 230. Prior guidance was issued as Notice 2007-39.

62. Update of guidance regarding the Appeals function.

63. Revision of Rev. Proc. 2000-43 regarding ex parte communications with Appeals.

TAX EXEMPT BONDS

1. Temporary regulations on clean renewable energy bonds under section 54. Interim guidance was published as Notices 2005-98, 2006-7 and 2007-26.

2. Update Notice 2001-60, which provides guidance on a voluntary resolution program for tax-exempt bonds under section 103 and related sections.

3. Final regulations under section 141, including allocation and accounting principles. Proposed regulations regarding allocation and accounting principles were published on September 26, 2006.

4. Final regulations under section 142 regarding solid waste disposal facilities. Proposed regulations were published on May 10, 2004.

5. Proposed regulations on the public approval requirements for private activity bonds under section 147(f).

6. Update Rev. Proc. 92-63, which sets forth the process for recovery of rebate overpayments under section 148.

7. Proposed regulations on arbitrage investment restrictions under section 148.

APPENDIX - Regularly Scheduled Publications

JULY 2007

1. Revenue ruling setting forth tables of the adjusted applicable federal rates for the current month for purposes of sections 42, 382, 1274, 1288 and 7520.

2. Notice setting forth the weighted average interest rate and the resulting permissible range of interest rates used to calculate current liability and to determine the required contribution for plan years beginning in July 2007.

3. Revenue ruling providing the monthly bond factor amounts to be used by taxpayers who dispose of qualified low-income buildings or interests therein during the period July through September 2007.

AUGUST 2007

1. Revenue ruling setting forth tables of the adjusted applicable federal rates for the current month for purposes of sections 42, 382, 1274, 1288 and 7520.

2. Notice providing the inflation adjustment factor to be used in determining the enhanced of recovery credit under section 43 for tax years beginning in the calendar year.

3. Notice providing the applicable percentage to be used in determining percentage depletion for marginal properties under section 613A for the calendar year.

4. Revenue ruling setting forth the terminal charge and the standard industry fare level (SIFL) cents-per-mile rates for the second half of 2007 for use in valuing personal flights on employer-provided aircraft.

5. Notice setting forth the weighted average interest rate and the resulting permissible range of interest rates used to calculate current liability and to determine the required contribution for plan years beginning in August 2007.

SEPTEMBER 2007

1. Revenue ruling setting forth tables of the adjusted applicable federal rates for the current month for purposes of sections 42, 382, 1274, 1288 and 7520.

2. Revenue procedure providing the amounts of unused housing credit carryover allocated to qualified states under section 42(h)(3)(D) for the calendar year.

3. Revenue ruling under section 6621 regarding the applicable interest rates for overpayments and underpayments of tax for the period October through December 2007.

4. Notice setting forth the weighted average interest rate and the resulting permissible range of interest rates used to calculate current liability and to determine the required contribution for plan years beginning in September 2007.

5. Revenue procedure under section 62 regarding the deduction and deemed substantiation of federal standard mileage amounts.

6. Revenue procedure under section 62 regarding the deduction and deemed substantiation of federal travel per diem amounts.

7. Update of Notice 2004-83 to add approved applicants for designated private delivery service status under section 7502(f). Will be published only if any new applicants are approved.

8. Notice identifying the counties that experienced exceptional, extreme, or severe drought during the preceding 12-month period ending August 31, 2007, for purposes of determining whether the replacement period within which to replace livestock sold on account of drought is extended under section 1033(e)(2)(B) and Notice 2006-82.

OCTOBER 2007

1. Revenue ruling setting forth tables of the adjusted applicable federal rates for the current month for purposes of sections 42, 382, 1274, 1288 and 7520.

2. Notice setting forth the weighted average interest rate and the resulting permissible range of interest rates used to calculate current liability and to determine the required contribution for plan years beginning in October 2007.

3. Revenue procedure under section 1 and other sections of the Code regarding the inflation adjusted items for 2008.

4. Revenue procedure providing the loss payment patterns and discount factors for the 2007 accident year to be used for computing unpaid losses under section 846.

5. Revenue procedure providing the salvage discount factors for the 2007 accident year to be used for computing discounted estimated salvage recoverable under section 832.

6. Update of Rev. Proc. 2005-27 listing the tax deadlines that may be extended by the Commissioner under section 7508A in the event of a Presidentially-declared disaster or terrorist attack.

7. Revenue ruling providing the monthly bond factor amounts to be used by taxpayers who dispose of qualified low-income buildings or interests therein during the period October through December 2007.

NOVEMBER 2007

1. Revenue ruling setting forth tables of the adjusted applicable federal rates for the current month for purposes of sections 42, 382, 1274, 1288 and 7520.

2. Revenue ruling providing the "base period T-Bill rate" as required by section 995(f)(4).

3. Revenue ruling setting forth covered compensation tables for the 2008 calendar year for determining contributions to defined benefit plans and permitted disparity.

4. Notice setting forth the weighted average interest rate and the resulting permissible range of interest rates used to calculate current liability and to determine the required contribution for plan years beginning in November 2007.

5. Update of Rev. Proc. 2006-48 regarding adequate disclosure for purposes of the section 6662 substantial understatement penalty and the section 6694 preparer penalty.

6. News release setting forth cost-of living adjustments effective January 1, 2008, applicable to the dollar limits on benefits under qualified defined benefit pension plans and other provisions affecting certain plans of deferred compensation.

DECEMBER 2007

1. Revenue ruling setting forth tables of the adjusted applicable federal rates for the current month for purposes of sections 42, 382, 1274, 1288 and 7520.

2. Revenue procedure modifying Rev. Proc. 2006-53 to reflect the increased section 179 limitations in the Small Business and Work Opportunity Tax Act of 2007.

3. Revenue ruling under section 6621 regarding the applicable interest rates for overpayments and underpayments of tax for the period January through March 2008.

4. Notice setting forth the weighted average interest rate and the resulting permissible range of interest rates used to calculate current liability and to determine the required contribution for plan years beginning in December 2007.

5. Revenue procedure setting forth, pursuant to section 1397E, the maximum face amount of Qualified Zone Academy Bonds that may be issued for each state during 2008.

6. Federal Register notice on Railroad Retirement Tier 2 tax rate.

JANUARY 2008

1. Revenue procedure updating the procedures for issuing private letter rulings, determination letters, and information letters on specific issues under the jurisdiction of the Chief Counsel.

2. Revenue procedure updating the procedures for furnishing technical advice, including technical expedited advice, to certain IRS offices, in the areas under the jurisdiction of the Chief Counsel.

3. Revenue procedure updating the previously published list of "no-rule" issues under the jurisdiction of certain Associates Chief Counsel other than the Associate Chief Counsel (International) on which advance letter rulings or determination letters will not be issued.

4. Revenue procedure updating the previously published list of "no-rule" issues under the jurisdiction of the Associate Chief Counsel (International) on which advance letter ruling or determination letters will not be issued.

5. Revenue procedure updating procedures for furnishing letter rulings, general information letters, etc. in employee plans and exempt organization matters relating to sections of the Code under the jurisdiction of the Office of the Commissioner, Tax Exempt and Government Entities Division.

6. Revenue procedure updating procedures for furnishing technical advice in employee plans and exempt organization matters under the jurisdiction of the Commissioner, Tax Exempt and Government Entities Division.

7. Revenue ruling setting forth tables of the adjusted applicable federal rates for the current month for purposes of sections 42, 382, 1274, 1288 and 7520.

8. Revenue ruling setting forth the prevailing state assumed interest rates provided for the determination of reserves under section 807 for contracts issued in 2007 and 2008.

9. Revenue ruling providing the dollar amounts, increased by the 2008 inflation adjustment, for section 1274A.

10. Revenue procedure providing procedures for limitations on depreciation deductions for owners of passenger automobiles first placed in service during the calendar year and amounts to be included in income by lessees of passenger automobiles first leased during the calendar year.

11. Revenue procedure updating procedures for issuing determination letters on the qualified status of employee plans under sections 401(a), 403(a), 409, and 4975.

12. Revenue procedure updating the user fee program as it pertains to requests for letter rulings, determination letters, etc. in employee plans and exempt organizations matters under the jurisdiction of the Office of the Commissioner, Tax Exempt and Government Entities Division.

13. Notice setting forth the weighted average interest rate and the resulting permissible range of interest rates used to calculate current liability and to determine the required contribution for plan years beginning in January 2008.

14. Revenue procedure under section 143 regarding average area purchase price.

15. Revenue procedure providing the maximum allowable value for use of the fleet-average value and vehicle-cents-per-mile rules to value employer-provided automobiles first made available to employees for personal use in the calendar year.

16. Revenue ruling providing the monthly bond factor amounts to be used by taxpayers who dispose of qualified low-income buildings or interests therein during the period January through March 2008.

FEBRUARY 2008

1. Revenue ruling setting forth tables of the adjusted applicable federal rates for the current month for purposes of sections 42, 382, 1274, 1288 and 7520.

2. Notice setting forth the weighted average interest rate and the resulting permissible range of interest rates used to calculate current liability and to determine the required contribution for plan years beginning in February 2008.

MARCH 2008

1. Revenue ruling setting forth tables of the adjusted applicable federal rates for the current month for purposes of sections 42, 382, 1274, 1288 and 7520.

2. Notice providing the 2008 calendar year resident population estimates used in determining the state housing credit ceiling under section 42(h) and the private activity bond volume cap under section 146.

3. Revenue ruling under section 6621 regarding the applicable interest rates for overpayments and underpayments of tax for the period April through June 2008.

4. Revenue ruling setting forth the terminal charge and the standard industry fare level (SIFL) cents-per-mile rates for the first half of 2008 for use in valuing personal flights on employer-provided aircraft.

5. Notice setting forth the weighted average interest rate and the resulting permissible range of interest rates used to calculate current liability and to determine the required contribution for plan years beginning in March 2008.

APRIL 2008

1. Revenue ruling setting forth tables of the adjusted applicable federal rates for the current month for purposes of sections 42, 382, 1274, 1288 and 7520.

2. Notice providing the inflation adjustment factor, nonconventional fuel source credit, and reference price for the calendar year that determines the availability of the credit for producing fuel from a nonconventional source under section 45K.

3. Revenue procedure providing a current list of countries and the dates those countries are subject to the section 911(d)(4) waiver and guidance to individuals who fail to meet the eligibility requirements of section 911(d)(1) because of adverse conditions in a foreign country.

4. Notice setting forth the weighted average interest rate and the resulting permissible range of interest rates used to calculate current liability and to determine the required contribution for plan years beginning in April 2008.

5. Revenue ruling providing the monthly bond factor amounts to be used by taxpayers who dispose of qualified low-income buildings or interests therein during the period April through June 2008.

6. Notice providing the calendar year inflation adjustment factor and reference prices for the renewable electricity production credit under section 45.

MAY 2008

1. Revenue ruling setting forth tables of the adjusted applicable federal rates for the current month for purposes of sections 42, 382, 1274, 1288 and 7520.

2. Notice setting forth the weighted average interest rate and the resulting permissible range of interest rates used to calculate current liability and to determine the required contribution for plan years beginning in May 2008.

3. Revenue procedure providing guidance for use of the national and area median gross income figures by issuers of qualified mortgage bonds and mortgage credit certificates in determining the housing cost/income ratio under section 143.

4. Revenue procedure under section 223 regarding the inflation adjusted items for 2009.

JUNE 2008

1. Revenue ruling setting forth tables of the adjusted applicable federal rates for the current month for purposes of sections 42, 382, 1274, 1288 and 7520.

2. Revenue ruling under section 6621 regarding the applicable interest rates for overpayments and underpayments of tax for the period July through September 2008.

3. Notice setting forth the weighted average interest rate and the resulting permissible range of interest rates used to calculate current liability and to determine the required contribution for plan years beginning in June 2008.

4. Revenue procedure providing the domestic asset/liability percentages and the domestic investment yield percentages for taxable years beginning after December 31, 2007, for foreign companies conducting insurance business in the U.S.

5. Revenue ruling providing the average annual effective interest rates charged by each Farm Credit Bank District.

FROM THE OFFICE OF PUBLIC AFFAIRS

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August 15, 2007
HP-534

Treasury International Capital (TIC) 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, which will report on data for July, is scheduled for September 18, 2007.

Net foreign purchases of long-term securities were $120.9 billion.

- Net foreign purchases of long-term U.S. securities were $148.6 billion. Of this, net purchases by foreign official institutions were $53.8 billion, and net purchases by private foreign investors were $94.8 billion.

- U.S. residents purchased a net $27.8 billion of long-term foreign securities.

Net foreign acquisition of long-term securities, taking into account adjustments, is estimated to have been $107.0 billion.

Foreign holdings of dollar-denominated short-term U.S. securities, including Treasury bills, and other custody liabilities decreased $27.6 billion. Foreign holdings of Treasury bills decreased $17.9 billion.

Banks' own net dollar-denominated liabilities to foreign residents decreased $20.5 billion.

Monthly net TIC flows were $58.8 billion. Of this, net foreign private flows were $0.7 billion, and net foreign official flows were $58.2 billion.

TIC Monthly Reports on Cross-Border Financial Flows

(Billions of dollars, not seasonally adjusted)

				12 Months Through					
		2005	2006	Jun-06	Jun-07	Mar-07	Apr-07	May-07	Jun-07
	Foreigners' Acquisitions of Long-term Securities								
1	Gross Purchases of Domestic U.S. Securities	17157.5	21066.7	18928.2	24299.3	2711.1	2023.8	2414.1	2611.2
2	Gross Sales of Domestic U.S. Securities	16145.9	19931.7	17801.0	23014.3	2612.2	1926.3	2250.5	2462.6
3	**Domestic Securities Purchased, net** (line 1 less line 2) /1	**1011.5**	**1135.0**	**1127.2**	**1285.0**	**98.9**	**97.5**	**163.7**	**148.6**
4	**Private, net /2**	**891.1**	**938.4**	**1005.0**	**1022.1**	**78.1**	**72.2**	**152.2**	**94.8**
5	Treasury Bonds & Notes, net	269.4	125.9	211.1	170.2	28.6	-9.0	26.2	21.8
6	Gov't Agency Bonds, net	187.6	196.0	224.5	159.4	-1.0	22.4	14.7	23.7
7	Corporate Bonds, net	353.1	471.8	430.8	488.5	41.4	30.6	68.6	22.2
8	Equities, net	81.0	144.6	138.5	204.0	9.1	28.1	42.7	27.2
9	**Official, net /3**	**120.4**	**196.6**	**122.2**	**262.9**	**20.8**	**25.3**	**11.5**	**53.8**
10	Treasury Bonds & Notes, net	68.7	69.6	34.7	94.9	1.4	9.4	-4.6	32.5
11	Gov't Agency Bonds, net	31.6	92.6	52.0	134.2	16.1	13.7	12.8	16.0
12	Corporate Bonds, net	19.1	28.6	26.3	35.2	2.9	2.9	4.0	3.7
13	Equities, net	1.0	5.8	9.2	-1.4	0.4	-0.7	-0.7	1.7
14	Gross Purchases of Foreign Securities from U.S. Residents	3700.0	5515.9	4741.7	6707.7	706.4	631.9	742.3	730.5
15	Gross Sales of Foreign Securities to U.S. Residents	3872.4	5766.8	4929.8	7016.4	748.7	649.2	780.0	758.2
16	**Foreign Securities Purchased, net** (line 14 less line 15) /4	**-172.4**	**-250.9**	**-188.1**	**-308.6**	**-42.3**	**-17.3**	**-37.6**	**-27.8**
17	Foreign Bonds Purchased, net	-45.1	-144.5	-63.7	-180.6	-34.9	-9.7	-21.2	-14.2
18	Foreign Equities Purchased, net	-127.3	-106.5	-124.4	-128.0	-7.4	-7.7	-16.5	-13.5
19	**Net Long-Term Securities Transactions** (line 3 plus line 16):	**839.1**	**884.1**	**939.1**	**976.4**	**56.6**	**80.1**	**126.0**	**120.9**
20	**Other Acquisitions of Long-term Securities, net /5**	**-140.0**	**-155.3**	**-150.7**	**-162.2**	**-13.8**	**-7.6**	**-13.5**	**-13.9**
21	**Net Foreign Acquisition of Long-Term Securities** (lines 19 and 20):	**699.1**	**728.8**	**788.4**	**814.2**	**42.8**	**72.5**	**112.5**	**107.0**
22	**Increase in Foreign Holdings of Dollar-denominated Short-term U.S. Securities and Other Custody Liabilities: /6**	**-47.6**	**135.2**	**71.4**	**48.3**	**18.9**	**-25.9**	**1.2**	**-27.6**

23	**U.S. Treasury Bills**	**-58.9**	**-9.0**	**-28.1**	**-24.1**	**20.4**	**-28.6**	**-4.5**	**-17.9**
24	Private, net	-15.6	16.0	-8.1	0.0	7.3	-11.7	0.9	-6.2
25	Official, net	-43.3	-25.0	-20.1	-24.1	13.1	-17.0	-5.5	-11.8
26	**Other Negotiable Instruments and Selected Other Liabilities: /7**	**11.4**	**144.2**	**99.6**	**72.5**	**-1.5**	**2.7**	**5.7**	**-9.7**
27	Private, net	10.6	164.0	101.4	90.7	-4.3	7.2	5.3	-14.3
28	Official, net	0.8	-19.8	-1.8	-18.3	2.7	-4.4	0.4	4.6
29	**Change in Banks' Own Net Dollar-Denominated Liabilities**	**16.4**	**185.1**	**247.2**	**20.9**	**-29.1**	**50.8**	**-6.4**	**-20.5**
30	**Monthly Net TIC Flows** (lines 21,22,29) /8	**667.9**	**1049.1**	**1107.0**	**883.4**	**32.7**	**97.4**	**107.3**	**58.8**
	of which								
31	Private, net	580.6	907.1	1002.3	642.0	4.1	83.9	109.0	0.7
32	Official, net	87.3	142.0	104.7	241.5	28.5	13.5	-1.7	58.2

/1 Net foreign purchases of U.S. securities (+)

/2 Includes international and regional organizations

/3 The reported division of net purchases of long-term securities between net purchases by foreign official institutions and net purchases of other foreign investors is subject to a "transaction bias" described in Frequently Asked Questions 7 and 10.a.4 on the TIC web site.

/4 Net transactions in foreign securities by U.S. residents. Foreign purchases of foreign securities = U.S. sales of foreign securities to foreigners. Thus negative entries indicate net U.S. purchases of foreign securities, or an outflow of capital from the United States; positive entries indicate net U.S. sales of foreign securities.

/5 Minus estimated unrecorded principal repayments to foreigners on domestic corporate and agency asset-backed securities +
estimated foreign acquisitions of U.S. equity through stock swaps -
estimated U.S. acquisitions of foreign equity through stock swaps +
increase in nonmarketable Treasury Bonds and Notes Issued to Official Institutions and Other Residents of Foreign Countries.

/6 These are primarily data on monthly changes in banks' and broker/dealers' custody liabilities. Data on custody claims are collected quarterly and published in the Treasury Bulletin and the TIC web site.

/7 "Selected Other Liabilities" are primarily the foreign liabilities of U.S. customers that are managed by U.S. banks or broker/dealers.

/8 TIC data cover most components of international financial flows, but do not include data on direct investment flows, which are collected and published by the Department of Commerce's Bureau of Economic Analysis. In addition to the monthly data summarized here, the TIC collects quarterly data on some banking and nonbanking assets and liabilities. Frequently Asked Question 1 on the TIC web site describes the scope of TIC data collection.

REPORTS

- (PDF) TIC Monthly Reports on Cross-Border Financial Flows (Billions of dollars, not seasonally adjusted)

PRESS ROOM

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August 15, 2007
hp-535

Treasury Targets Financial Network of Ramierz Abadia

The U.S. Department of the Treasury's Office of Foreign Assets Control (OFAC) today added to its list of Specially Designated Narcotics Traffickers 23 Colombian individuals and 23 Colombian companies tied to Juan Carlos Ramirez Abadia (a.k.a. Chupeta), a leader of Colombia's North Valle drug cartel.

"At the peak of his career, Juan Carlos Ramirez Abadia was one of the wealthiest and most elusive drug traffickers in Colombia," said OFAC Director Adam J. Szubin. "Today he is under arrest and his assets are under attack. OFAC will continue its assault on Chupeta's ill-gotten gains until his empire collapses."

Juan Carlos Ramirez Abadia was named as a Specially Designated Narcotics Trafficker (SDNT) by OFAC in August 2000 and was arrested in Brazil on August 7, 2007. He was indicted on federal drug trafficking charges in Colorado in 1994 and the Eastern District of New York in 1995. 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. OFAC has worked closely with the Drug Enforcement Administration (DEA) on this investigation.

Among the 23 individuals designated today, Hernan Felipe Ramirez Garcia, Jhon Jairo Ramirez Lenis, Sergio Alberto Ramirez Rivera, and German Rosero Angulo help form the leadership of the criminal organization headed by Ramirez Abadia. Other individuals named as SDNTs today include Alvaro Barrera Marin and his son Alvaro Enrique Barrera Rios, who act as key front persons by holding companies and real estate on behalf of Juan Carlos Ramirez Abadia.

Companies designated today include: *APVA S.A.*, a real estate company located in Cali, Colombia; *Campo a la Diversion E.U.* (a.k.a. *Parque Yaku*), an amusement park located in Yumbo, Valle, Colombia; *Criadero Santa Gertrudis S.A.*, a horse breeding farm in Jamundi, Valle, Colombia; and *Ensambladora Colombiana Automotriz S.A.*, an automotive assembly company located in Barranquilla, Colombia.

SDNTs are subject to the economic sanctions imposed against Colombian drug cartels in Executive Order 12978. Today's designation action freezes any assets the designees may have subject to U.S. jurisdiction, and prohibits all financial and commercial transactions by any U.S. person with the designated companies and individuals.

The assets of a total of 1,521 business and individuals in Aruba, Barbados, Colombia, Costa Rica, Ecuador, Guatemala, Honduras, Jamaica, Mexico, Panama, Peru, Spain, Vanuatu, Venezuela, the Bahamas, the British Virgin Islands, the Cayman Islands, and the United States have been blocked pursuant to E.O. 12978. The 597 businesses that have been named as SDNTs include agricultural, aviation, consulting, construction, distribution, financial, hotel, investment, manufacturing, maritime, mining, offshore, pharmaceutical, real estate, retail, service, sporting, telecommunication, and textile companies. The SDNT list includes 22 kingpins from the Cali, Medellin, North Valle, and North Coast drug trafficking organizations in Colombia.

A detailed look at the program against Colombian drug organizations is provided in OFAC's March 2007 *Impact Report on Economic Sanctions Against Colombian Drug Cartels.*
http://www.treasury.gov/offices/enforcement/ofac/reports/narco_impact_report_05042007.pdf

REPORTS

- Chart of the Individuals and Entities Included in Today's Designation

North Valle Cartel Financial Network

August 2007

U.S. Department of the Treasury
Office of Foreign Assets Control

Specially Designated Narcotics Traffickers

SDNT Principal since 2000

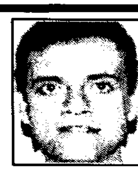
Juan Carlos RAMIREZ ABADIA
CC 16684736 (Colombia)
DOB 16 February 1963
(a.k.a. "Chupeta")

Over $70 Million Seized from "Chupeta" in 2007

Arrested in Brazil August 7, 2007

Key Associates of "Chupeta"

German
ROSERO ANGULO
CC 16708846 (Colombia)



Sergio Alberto
RAMIREZ RIVERA
CC 16694220 (Colombia)

Hernan Felipe
RAMIREZ GARCIA
CC 16772586 (Colombia)

Jhon Jairo
RAMIREZ LENIS
CC 79395056 (Colombia)

Alvaro Enrique
BARRERA RIOS
CC 16758185 (Colombia)

Alvaro
BARRERA MARIN
CC 6451857 (Colombia)

Key Companies of "Chupeta"

Cali, Colombia

- ALFONSO BARRERA RIOS Y CIA. S. EN C.S.
- ALVARO ENRIQUE BARRERA RIOS Y CIA. S. EN C.S.
- APVA S.A.
- ARQUITECTOS UNIDOS LTDA.
- ASESORIAS OCUPACIONALES LTDA.
- BARRERA RIOS NEGOCIOS INMOBILIARIOS E.U.
- CECEP S.A.
- CECEP EDITORES S.A.
- COMERCIALIZADORA DE BIENES Y SERVICIOS ADMINISTRATIVOS Y FINANCIEROS S.A.
- CONSULTORIAS FINANCIERAS S.A.
- ESVA S.C.S. (a.k.a. FLEXX GYM)
- M S CONSTRUCTORES LTDA.
- QUINONES MELO Y CIA. LTDA.
- RFA CONSULTORES Y AUDITORES LTDA.
- SPITIA VALENCIA LTDA.
- WORLD LINE SYSTEM S.A.
- UNIDAD CARDIOVASCULAR LTDA.

Other Colombian Locations

- BENOIT VELEZ AGROPECUARIA LA VEREDA Y CIA. S.C.S. Pereira, Colombia
- CAMPO A LA DIVERSION E.U. a.k.a. PARQUE YAKU Yumbo, Valle, Colombia
- CIDCA Bogota, Colombia
- CRIADERO SANTA GERTRUDIS S.A. Jamundi, Valle, Colombia
- E.C.A. S.A. Barranquilla, Colombia
- NEGOCIOS Y CAPITALES S.A. Pereira, Colombia

August 17, 2007
2007-8-17-13-54-10-22970

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 $67,032 million as of the end of that week, compared to $67,139 million as of the end of the prior week.

I. Official reserve assets and other foreign currency assets (approximate market value, in US millions)

	August 10, 2007		
A. Official reserve assets (in US millions unless otherwise specified)	Euro	Yen	Total
(1) Foreign currency reserves (in convertible foreign currencies)			67,032
(a) Securities	13,213	10,765	23,978
of which: issuer headquartered in reporting country but located abroad			0
(b) total currency and deposits with:			
(i) other national central banks, BIS and IMF	13,227	5,313	18,540
ii) banks headquartered in the reporting country			0
of which: located abroad			0
(iii) banks headquartered outside the reporting country			0
of which: located in the reporting country			0
(2) IMF reserve position	4,366		
(3) SDRs	9,107		
(4) gold (including gold deposits and, if appropriate, gold swapped)	11,041		
--volume in millions of fine troy ounces	261.499		
(5) other reserve assets (specify)	0		
--financial derivatives			

--loans to nonbank nonresidents	
--other	
B. Other foreign currency assets (specify)	
--securities not included in official reserve assets	
--deposits not included in official reserve assets	
--loans not included in official reserve assets	
--financial derivatives not included in official reserve assets	
--gold not included in official reserve assets	
--other	

II. Predetermined short-term net drains on foreign currency assets (nominal value)

			Maturity breakdown (residual maturity)		
		Total	Up to 1 month	More than 1 and up to 3 months	More than 3 months and up to 1 year
1. Foreign currency loans, securities, and deposits					
--outflows (-)	Principal				
	Interest				
--inflows (+)	Principal				
	Interest				
2. Aggregate short and long positions in forwards and futures in foreign currencies vis-à-vis the domestic currency (including the forward leg of currency swaps)					
(a) Short positions (-)					
(b) Long positions (+)					
3. Other (specify)					
--outflows related to repos (-)					
--inflows related to reverse repos (+)					
--trade credit (-)					
--trade credit (+)					
--other accounts payable (-)					

--other accounts receivable (+)				

III. Contingent short-term net drains on foreign currency assets (nominal value)

		Maturity breakdown (residual maturity, where applicable)		
	Total	Up to 1 month	More than 1 and up to 3 months	More than 3 months and up to 1 year
1. Contingent liabilities in foreign currency				
(a) Collateral guarantees on debt falling due within 1 year				
(b) Other contingent liabilities				
2. Foreign currency securities issued with embedded options (puttable bonds)				
3. Undrawn, unconditional credit lines provided by:				
(a) other national monetary authorities, BIS, IMF, and other international organizations				
--other national monetary authorities (+)				
--BIS (+)				
--IMF (+)				
(b) with banks and other financial institutions headquartered in the reporting country (+)				
(c) with banks and other financial institutions headquartered outside the reporting country (+)				
Undrawn, unconditional credit lines provided to:				
(a) other national monetary authorities, BIS, IMF, and other international organizations				
--other national monetary authorities (-)				
--BIS (-)				
--IMF (-)				
(b) banks and other financial institutions headquartered in reporting country (-)				

(c) banks and other financial institutions headquartered outside the reporting country (-)				
4. Aggregate short and long positions of options in foreign currencies vis-à-vis the domestic currency				
(a) Short positions				
(i) Bought puts				
(ii) Written calls				
(b) Long positions				
(i) Bought calls				
(ii) Written puts				
PRO MEMORIA: In-the-money options [11]				
(1) At current exchange rate				
(a) Short position				
(b) Long position				
(2) + 5 % (depreciation of 5%)				
(a) Short position				
(b) Long position				
(3) - 5 % (appreciation of 5%)				
(a) Short position				
(b) Long position				
(4) +10 % (depreciation of 10%)				
(a) Short position				
(b) Long position				
(5) - 10 % (appreciation of 10%)				
(a) Short position				
(b) Long position				
(6) Other (specify)				
(a) Short position				
(b) Long position				

IV. Memo items

(1) To be reported with standard periodicity and timeliness:	
(a) short-term domestic currency debt indexed to the exchange rate	
(b) financial instruments denominated in foreign currency and settled by other means (e.g., in domestic currency)	
--nondeliverable forwards	
--short positions	
--long positions	
--other instruments	
(c) pledged assets	
--included in reserve assets	
--included in other foreign currency assets	
(d) securities lent and on repo	
--lent or repoed and included in Section I	
--lent or repoed but not included in Section I	
--borrowed or acquired and included in Section I	
--borrowed or acquired but not included in Section I	
(e) financial derivative assets (net, marked to market)	
--forwards	
--futures	
--swaps	
--options	
--other	
(f) derivatives (forward, futures, or options contracts) that have a residual maturity greater than one year, which are subject to margin calls.	
--aggregate short and long positions in forwards and futures in foreign currencies vis-à-vis the domestic currency (including the forward leg of currency swaps)	
(a) short positions (–)	
(b) long positions (+)	
--aggregate short and long positions of options in foreign currencies vis-à-vis the domestic currency	
(a) short positions	
(i) bought puts	
(ii) written calls	
(b) long positions	
(i) bought calls	
(ii) written puts	

(2) To be disclosed less frequently:	
(a) currency composition of reserves (by groups of currencies)	67,032
--currencies in SDR basket	67,032
--currencies not in SDR basket	
--by individual currencies (optional)	

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.

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.

August 20, 2007
2007-8-20-15-21-57-23681

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 $67,271 million as of the end of that week, compared to $67,032 million as of the end of the prior week.

I. Official reserve assets and other foreign currency assets (approximate market value, in US millions)

	August 17, 2007		
A. Official reserve assets (in US millions unless otherwise specified)	Euro	Yen	Total
(1) Foreign currency reserves (in convertible foreign currencies)			67,271
(a) Securities	13,076	11,176	24,252
of which: issuer headquartered in reporting country but located abroad			0
(b) total currency and deposits with:			
(i) other national central banks, BIS and IMF	13,049	5,511	18,560
ii) banks headquartered in the reporting country			0
of which: located abroad			0
(iii) banks headquartered outside the reporting country			0
of which: located in the reporting country			0
(2) IMF reserve position	4,349		
(3) SDRs	9,070		
(4) gold (including gold deposits and, if appropriate, gold swapped)	11,041		
--volume in millions of fine troy ounces	261.499		
(5) other reserve assets (specify)	0		
--financial derivatives			
--loans to nonbank nonresidents			
--other			
B. Other foreign currency assets (specify)			

--securities not included in official reserve assets	
--deposits not included in official reserve assets	
--loans not included in official reserve assets	
--financial derivatives not included in official reserve assets	
--gold not included in official reserve assets	
--other	

II. Predetermined short-term net drains on foreign currency assets (nominal value)

			Maturity breakdown (residual maturity)		
		Total	Up to 1 month	More than 1 and up to 3 months	More than 3 months and up to 1 year
1. Foreign currency loans, securities, and deposits					
--outflows (-)	Principal				
	Interest				
--inflows (+)	Principal				
	Interest				
2. Aggregate short and long positions in forwards and futures in foreign currencies vis-à-vis the domestic currency (including the forward leg of currency swaps)					
(a) Short positions (-)					
(b) Long positions (+)					
3. Other (specify)					
--outflows related to repos (-)					
--inflows related to reverse repos (+)					
--trade credit (-)					
--trade credit (+)					
--other accounts payable (-)					
--other accounts receivable (+)					

III. Contingent short-term net drains on foreign currency assets (nominal value)

		Maturity breakdown (residual maturity, where applicable)		
	Total	Up to 1 month	More than 1 and up to 3 months	More than 3 months and up to 1 year
1. Contingent liabilities in foreign currency				
(a) Collateral guarantees on debt falling due within 1 year				
(b) Other contingent liabilities				
2. Foreign currency securities issued with embedded options (puttable bonds)				
3. Undrawn, unconditional credit lines provided by:				
(a) other national monetary authorities, BIS, IMF, and other international organizations				
--other national monetary authorities (+)				
--BIS (+)				
--IMF (+)				
(b) with banks and other financial institutions headquartered in the reporting country (+)				
(c) with banks and other financial institutions headquartered outside the reporting country (+)				
Undrawn, unconditional credit lines provided to:				
(a) other national monetary authorities, BIS, IMF, and other international organizations				
--other national monetary authorities (-)				
--BIS (-)				
--IMF (-)				
(b) banks and other financial institutions headquartered in reporting country (-)				
(c) banks and other financial institutions headquartered outside the reporting country (-)				
4. Aggregate short and long positions of options in foreign currencies vis-à-vis the domestic currency				
(a) Short positions				
(i) Bought puts				
(ii) Written calls				
(b) Long positions				
(i) Bought calls				
(ii) Written puts				

PRO MEMORIA: In-the-money options [11]				
(1) At current exchange rate				
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(a) Short position				
(b) Long position				
(4) +10 % (depreciation of 10%)				
(a) Short position				
(b) Long position				
(5) - 10 % (appreciation of 10%)				
(a) Short position				
(b) Long position				
(6) Other (specify)				
(a) Short position				
(b) Long position				

IV. Memo items

(1) To be reported with standard periodicity and timeliness:	
(a) short-term domestic currency debt indexed to the exchange rate	
(b) financial instruments denominated in foreign currency and settled by other means (e.g., in domestic currency)	
--nondeliverable forwards	
--short positions	
--long positions	
--other instruments	
(c) pledged assets	
--included in reserve assets	
--included in other foreign currency assets	
(d) securities lent and on repo	

--lent or repoed and included in Section I	
--lent or repoed but not included in Section I	
--borrowed or acquired and included in Section I	
--borrowed or acquired but not included in Section I	
(e) financial derivative assets (net, marked to market)	
--forwards	
--futures	
--swaps	
--options	
--other	
(f) derivatives (forward, futures, or options contracts) that have a residual maturity greater than one year, which are subject to margin calls.	
--aggregate short and long positions in forwards and futures in foreign currencies vis-à-vis the domestic currency (including the forward leg of currency swaps)	
(a) short positions (–)	
(b) long positions (+)	
--aggregate short and long positions of options in foreign currencies vis-à-vis the domestic currency	
(a) short positions	
(i) bought puts	
(ii) written calls	
(b) long positions	
(i) bought calls	
(ii) written puts	
(2) To be disclosed less frequently:	
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--currencies in SDR basket	67,271
--currencies not in SDR basket	
--by individual currencies (optional)	

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.

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

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May 3, 2007
HP-536

2007 National Money Laundering Strategy Released

The U.S. Departments of Treasury, Justice, and Homeland Security today joined together in issuing the 2007 National Money Laundering Strategy, a report detailing continued efforts to dismantle money laundering and terrorist financing networks and bring these criminals to justice.

"The 2007 National Money Laundering Strategy is a direct result of close cooperation by the Departments of Justice, Treasury and Homeland Security, along with our foreign counterparts, and signifies our collective commitment to fight money laundering," said Assistant Attorney General Alice S. Fisher of the Justice Department's Criminal Division. "Implementation of this strategy will greatly assist in efforts to seize and forfeit millions in illegal proceeds that flow through the international financial system."

The 2007 Strategy addresses the priority threats and vulnerabilities identified by the Money Laundering Threat Assessment released in 2006, the product of an extremely valuable investigation into the current and emerging trends and techniques used by criminals to raise, move, and launder proceeds. The Assessment – the first government-wide analysis of its kind – brought together the expertise of regulatory, law enforcement, and investigative officials from across the government, culminating in a comprehensive analysis of specific money laundering methods, patterns of abuse, geographical concentrations, and the associated legal and regulatory regimes.

"The 2007 National Money Laundering Strategy builds upon the groundbreaking work of the Money Laundering Threat Assessment," said Pat O'Brien, Treasury's Assistant Secretary for Terrorist Financing. "Focusing on well-established money laundering methods and emerging trends identified in the Assessment, we have created a robust strategy for combating money laundering, deterring criminals, and addressing areas vulnerable to exploitation."

The 2007 Strategy builds on initiatives and programs pioneered in preceding National Money Laundering Strategies. The constant searching by criminals for new ways to launder and hide dirty money is evidence of our successful regulatory and law enforcement efforts to safeguard the banking system. With an aim at continuing these robust efforts, the 2007 Strategy places an emphasis on bolstering the efficiency of the anti-money laundering processes currently in place.

"In every type of case, from human smuggling and drug trafficking to intellectual property rights violations and illegal alien employment schemes, the need to hide and move ill-gotten gains is a constant. ICE's anti-money laundering initiatives are at the forefront of attacking existing and emerging money laundering threats" said Julie L. Myers, Assistant Secretary for Immigration and Customs Enforcement at the Department of Homeland Security. "ICE's trade transparency unit, bulk cash smuggling initiative and programs targeting illegal money service businesses and stored value card schemes are making it less profitable to commit these crimes."

Additionally, the 2007 Strategy focuses on leveling the playing field internationally, helping to ensure U.S. financial institutions are not disadvantaged through the implementation of controls and standards to combat money laundering and terrorist financing. Indeed, money laundering is a global threat the United States is working to address through international bodies, including the Financial Action Task Force (FATF), and through direct private sector outreach in regions around the world.

REPORTS

- 2007 National Money Laundering Strategy

PRESS ROOM

November 15, 2004
HP-538

Performance & Accountability Report FY 2004

On behalf of the U.S. Department of the Treasury, I am pleased to present our Fiscal Year (FY) 2004 Performance and Accountability Report. This report provides clear information on Treasury's operations,accomplishments and challenges over the past year. Treasury aids national prosperity by developing policies that stimulate economic growth and job creation as well as maintaining public trust and confidence in our economic and financial systems.

In FY 2004, Treasury focused on its core missions of economy and finance. In FY 2004, Treasury worked to implement the Jobs and Growth Tax Relief Reconciliation Act of 2003 as well as other tax relief efforts. Treasury moved forward with improvements in our core functions in the areas of domestic and international economies, banking oversight, tax law compliance, cash and debt management, and the production of coins and currency. We also continue to work on streamlining our nation's regulatory framework to ensure the integrity of the financial sector and promote the growth of financial services worldwide.

Treasury is making the nation safer by detecting, disrupting and dismantling the financial sources of terrorism. During this year we created the Office of Terrorism and Financial Intelligence (TFI), a new office that centralizes policy-making and coordinates Treasury's efforts to eradicate terrorist funding and protect the integrity of financial systems. This office also fights financial crime, enforces economic sanctions against rogue nations, and assists in the ongoing search for Iraqi assets.

Regarding the management and reporting of finances, Treasury has again received an unqualified opinion on our financial statements. This accomplishment demonstrates the accuracy and reliability of the information presented. Treasury also met most of its performance targets for the year, and I have determined that the enclosed performance data are reliable and complete. During FY 2004, we continued our emphasis on ensuring that Treasury has strong internal controls in place to minimize the risk of waste, fraud, and erroneous payments. We also intensified our efforts to identify and reduce improper payments across Treasury and continued our progress toward addressing material management control weaknesses.

As we look ahead, Treasury will continue its work to generate economic growth, increase the number of jobs for our citizens, and keep our financial systems strong and secure. Treasury will develop and implement strategies to find and eliminate sources of funding for terrorists and to detect and pursue financial criminals. Finally, for our customers, America's taxpayers, Treasury will continue to work very hard to provide excellent service, efficiency and value.

Sincerely,
John W. Snow
Secretary of the Treasury

REPORTS

- Performance & Accountability Report FY 2004

PRESS ROOM

November 15, 2005
HP-539

Fiscal Year 2005 Performance & Accountability Report

Mission: 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.

History: On September 2, 1789, the First Congress of the United States created a permanent institution for the management of government finances. The Congress assembled a Department of the Treasury and named the following officers: a Secretary of the Treasury, a Comptroller, an Auditor, a Treasurer, a Register, and an Assistant to the Secretary.

Alexander Hamilton took the oath of office as the first Secretary of the Treasury on September 11, 1789. Hamilton foresaw the development of industry and trade in the United States, and suggested that government revenues be based upon customs duties. His vision also inspired investment in the Bank of the United States, which acted as the government's fiscal agent. Throughout history, the Department of the Treasury has been a dynamic institution of the government's service to the people, expanding to accommodate a growing and ever-changing nation.

Leadership Changes: Treasury experienced leadership changes in Fiscal Year (FY) 2005 with the departure of Deputy Secretary Samuel Bodman (now Secretary of Energy), and a handful of other top officials. During the third quarter of 2005, the Administration nominated and the Senate confirmed a new Treasury deputy secretary, two under secretaries, and five assistant secretaries including a newly created position, the assistant secretary for the Office of Intelligence and Analysis, as well as new leadership at the Office of Thrift Supervision, the Office of the Comptroller of the Currency, and the Alcohol and Tobacco Tax and Trade Bureau.

REPORTS

- Fiscal Year 2005 Performance & Accountability Report

PRESS ROOM

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November 15, 2006
HP-540

Performance and Accountability Report

On behalf of the Department of the Treasury, I am submitting the Department's Performance and Accountability Report for Fiscal Year (FY) 2006. This report presents information on the Department's financial, management and programmatic results for the previous year and provides a transparent picture of the Department's successes and shortcomings

REPORTS

- Performance and Accountability Report

PRESS ROOM

August 2, 2007
HP-541

14th APEC Finance Ministers' Meeting 2007
Joint Ministerial Statement

I. Introduction

We, the finance ministers of the APEC economies, convened our 14th annual meeting in Coolum, Queensland, Australia on 2-3 August 2007 under the chairmanship of the Honourable Mr Peter Costello, MP, Treasurer of Australia. The meeting was also attended by the First Deputy Managing Director of the International Monetary Fund, the President of the World Bank, the President of the Asian Development Bank and the Chair of the APEC Business Advisory Council (ABAC).

Under Australia's APEC 2007 theme of *strengthening our community, building a sustainable future*, we discussed the key economic and financial issues that are shaping our region's future prosperity.

In discussing the regional economic outlook, we considered two key medium-term challenges. The first is to ensure that sufficient well-targeted investment occurs to underpin sustainable economic growth. We highlighted the need for appropriate macroeconomic policies and continued structural reform in our economies to further enhance investment in the region, sustain domestic growth and help resolve global imbalances and reap the benefits of globalisation. The second challenge is to ensure that energy markets operate efficiently and transparently to deliver long-term energy security and meet the dual key objectives of sustaining economic growth while addressing climate change. We recognise that these are fundamentally economic issues that are best addressed through market-based solutions.

Consistent with the policy priorities outlined in the Hanoi Medium-Term Agenda, we considered two policy themes in our meeting - the importance of managing fiscal risks, including contingent liabilities and longer term fiscal pressures, and the need to deepen private capital markets to create new economic opportunities. Identifying and managing off-balance sheet risks in a transparent manner contributes to fiscal sustainability. We noted the important role private capital markets play in providing diverse sources of funding and channelling savings to fuel economic growth, including for infrastructure.

We discussed the evolving regional economic architecture and stressed the importance of APEC in drawing Asia-Pacific economies together. Recognising the need to take strong and early actions to address the challenge of climate change while maintaining economic growth, we considered the global architecture for addressing climate change and shared the view that it is important to establish an effective framework beyond the Kyoto Protocol under the UN climate process.

Our ongoing objective is to realise the APEC region's economic potential by drawing together the interests of member economies and exploring opportunities for cooperation and capacity building.

These issues are integral to continuing the strong economic performance of the APEC region and we support further discussion of them by APEC Economic Leaders.

II. Global and Regional Economic Developments

We noted the continued strong contribution the APEC region is making to global economic growth. Despite the persistent threat of high oil prices, the APEC region grew by a robust 4 per cent in 2006 and inflation across the region has generally been moderate. This strong economic performance has raised living standards and reduced poverty throughout the region, and we remain committed to sound economic policies that will help to sustain this performance.

Growth and development in our region are based on an open and rules-based global trading system. We regard a rise in protectionist trade and investment sentiment around the globe as a serious threat to growth and living standards in our region. We will work with our own trade authorities towards a successful outcome in the Doha Development Round that is comprehensive and well-balanced, resulting in new trade and investment flows. We agree to work towards this goal in financial services negotiations.

The orderly reduction of global imbalances remains a priority. In the APEC region, this requires efforts to increase national savings in the United States, strengthen consumption in China, continue structural reform efforts including fiscal consolidation in Japan, and encourage domestic investment in much of emerging Asia. Flexibility of exchange rates and prices will facilitate these necessary adjustments and reduce the costs. Such changes are in the interests of each individual economy, are desirable from a multilateral perspective and would help dampen protectionist sentiment.

As the process of integration intensifies, new ways of conducting business and new barriers to trade and investment are emerging. We noted the increased focus on behind-the-border impediments to trade and investment and the need for ongoing domestic structural reform to tackle them. We are firmly committed to reforms that support the efficient operation and integration of domestic markets. We expressed our strong support for the work of the APEC Economic Committee in advancing the APEC Leaders' Agenda to Implement Structural Reform.

Strengthening investment in the region

We noted the important role that domestic and foreign investment has in driving economic growth and development and enhancing regional economic integration.

While the investment outlook for the region looks promising, we considered why investment levels in some APEC economies remain relatively low despite favourable financing conditions. It was noted that most APEC economies had improved their monetary and fiscal policy frameworks and strengthened their financial systems, particularly through balance-sheet restructuring and improved lending practices.

Investment outcomes are affected by institutional and regulatory factors, including barriers to market entry, the operation of financial markets, and the degree of policy certainty. Sound monetary and fiscal policies, well-established legal and regulatory frameworks, and high-quality public- and private-sector governance all contribute to reducing risk and encouraging investment. Deep and liquid financial markets also offer an expanded source of funding for investment and assist with risk management and diversification.

We noted that the quality of investment, both public and private, is important and that investment should be attracted to areas where the greatest social and economic returns can be achieved. In this context, we identified infrastructure and the services sector as priority areas for future investment within the region. Stronger and more efficient investment, both domestic and foreign, is expected to strengthen domestic growth and stability and help resolve global imbalances.

Energy security and climate change

We recognise the ongoing economic risks around high and volatile energy prices and the need to maintain vigilance in macroeconomic policy to sustain growth and manage inflation. We noted that medium-term macroeconomic frameworks are proving very useful in managing the challenges of energy shocks and that greater flexibility in price mechanisms, including exchange rates, can enable economies to better manage the macroeconomic impact of changes in energy markets. We discussed a range of policy instruments that could be adopted to protect the poor from the effects of higher and more volatile energy prices while ensuring that price signals work and other government spending that matters for economic and social progress is not crowded out.

Looking to the medium-term, rising energy demand and import dependence in the Asia Pacific can be met by expanded trade and investment to boost supply and greater efficiency in use. For markets to be able to provide energy security, they need to be strong, open and transparent, with depth in spot and derivatives markets, long-term contracting, and investment. Markets need to be underpinned by effective regulatory regimes, transparency and governance, and efficient firms in both the private and state-owned sectors.

The region needs strong financial markets both to fund the investment required to expand supply and to provide the range of financial instruments - including derivatives - that are necessary for firms and governments to manage the risks around high and volatile energy prices.

Climate change is one of the major international challenges with implications for both the environment and global economy. New clean technology initiatives and greater efficiency and diversity in energy supply provide greater energy security and underpin a sustainable response to the challenges of climate change. Energy efficiency, based on advances in education, science and technology, is one of the most cost-effective means for achieving these objectives. As finance ministers, we play a key role in developing and linking market-based economic policy responses to these challenges.

It is important that new domestic policies are comprehensively assessed to ensure they meet the desired objectives of ongoing economic growth, energy efficiency, and clean development consistently over time and do not give rise to unanticipated adverse consequences. Practical cooperation between Asia Pacific economies is necessary to meet these objectives, especially in the development and transfer of cleaner and more efficient technology and the strengthening of domestic carbon accounting and reporting frameworks.

To respond effectively to the challenge of ensuring economic growth, addressing energy security and minimising the environmental impact of increased energy use, it is important to understand the economic and market impact of policy and business responses to deal with climate change. We welcome further work on this by APEC economies. In particular, we see value in bringing together and sharing APEC economies' experience with the suite of policy instruments for promoting energy efficiency and greenhouse gas reduction, including market-based mechanisms (such as emissions trading and taxes), incentives for new technologies and alternative energy sources, and regulation.

III. 14th APEC Finance Ministers' Process Policy Themes

1. Making private capital markets work better

Deep and integrated private capital markets can assist governments in achieving their economic and social objectives by providing secure and diverse funding sources for development. We noted the importance of private domestic capital markets in funding infrastructure and investment and helping manage key risks, including with respect to volatile energy prices and an ageing population.

We reaffirmed commitments to strengthen the legal, regulatory and commercial infrastructure needed to support financial deepening. We agreed that broadening and diversifying the investor base is critical for strengthening capital markets. Greater participation of specialist institutions such as pension funds, insurance companies, fund managers and securitisation originators is needed to provide depth and innovation in markets. We noted the potential complementary roles that savings policy, structural and regulatory policies and taxation policy can have in fostering capital market deepening, and the positive spill-over effects that investment in education and information technology can have on private capital markets. Macroeconomic stability is essential for financial markets to grow.

Similarly, we recognised the importance of developing and allowing greater access to a wider range of financial products such as corporate bonds, equities and derivatives for domestic and foreign participants. It is also essential to have effective trading, settlement and custodial arrangements, maintain credible corporate governance, ensure reliable disclosure and ratings, and strengthen regulatory supervision.

In considering priorities and sequencing of reform within our own economies, we agreed that it is important to approach reform holistically and strategically - ensuring that reforms are mutually reinforcing and consistent with economies' development priorities - and also pragmatically.

Implementing to the extent possible, we embrace international best practice and standards to support the achievement of important objectives such as investor protection; fair, transparent and efficient markets; and management of systemic risks. Continued progress in strengthening financial institutions and regulatory frameworks is central to secure the benefits of increasing regional and international market integration. We recognise that there are many domestic, regional and global mechanisms available to help economies progress financial market reform, including domestic reviews and the IMF/World Bank Financial Sector Assessment Program (FSAP) and associated reports on standards and codes. We encourage participation in FSAPs, taking into account the level and pace of development and the specific conditions of each member economy, to help economies prioritise financial sector reforms and evaluate risks to the financial system.

Recognising the contribution of capital flows, we emphasised the importance of open investment regimes to develop and strengthen domestic financial institutions and markets, improve productivity and boost growth.

We endeavour to support each other in strengthening and deepening the region's capital markets. Many of the initiatives underway in the finance ministers' process target capacity building and the sharing of experience with regard to the financial sector. We agreed to develop a web-based information system - the APEC Catalogue of Policy Experience and Choice - for finance ministries, central banks and regulatory agencies in the APEC region to collect and share knowledge on financial reform based on the practical experience of member economies and international agencies. We welcomed ABAC's report and recognise its contribution to strengthening financial systems in the region.

2. Transparency and sustainability of the public balance sheet

We agree that fiscal sustainability is essential for economic development and stability. Fiscal risks that are not well managed can result in obligations that damage the budget position, increase government indebtedness, and amplify the effect of negative economic and financial shocks.

We discussed our experience in managing a range of off-balance sheet risks, including public-private partnerships, state-owned enterprises, layers of government, pensions and health care, and guarantees. In the areas of infrastructure investment, we noted that public-private partnership projects, when supported by sound management and appropriate risk sharing, tend to have lower ongoing operating costs and significant public benefit. We also noted that guarantees work more effectively when their likely costs are identified, quantified where possible, and assessed against competing calls on government resources. We recognised that risks related to state-owned enterprises and layers of government are lower when they are adequately resourced to meet their responsibilities and where central agencies are well informed about their financial positions and effective accountability arrangements are in place.

We discussed these issues within the framework of addressing risks at their source, sharing risks with the private sector where appropriate, and ensuring that residual risks are effectively monitored and managed. We acknowledge the extensive assistance available to economies seeking to improve fiscal transparency in these areas.

We welcomed the steps being taken by APEC economies to improve fiscal risk management, agreeing that small changes made now can generate large improvements in the long-term fiscal position. We identified a need for further guidance to support continued fiscal sustainability and highlighted the importance of a set of principles to guide further progress, recognising that our economies are at various stages of economic development and that the form of implementation is a matter for each economy. The APEC fiscal sustainability principles include:

- fostering well-functioning markets to reduce fiscal pressures on governments;
- establishing a clear framework of accountability and responsibility for addressing fiscal risks;
- collecting and reporting information about on and off-balance sheet risks across the whole of government;
- assessing the potential consequences of current and emerging fiscal risks or long-term pressures to determine the best ways to manage these risks;
- including risk in government measures of fiscal performance to help governments understand the true nature of their fiscal position;
- improving transparency and accountability to the public through appropriate means; and
- creating fiscal space or provisioning - even notionally - for expected future payments, especially for liabilities with a high probability of realisation in the near to medium-term.

In this context, the IMF and World Bank may provide further practical insights into best practices in managing fiscal risks.

We welcomed the revisions to the IMF Fiscal Transparency Manual and Code of Good Practices and acknowledged the benefits of undertaking a fiscal transparency Report on the Observance of Standards and Codes (ROSC). We encouraged economies to take advantage of this initiative and for those that have already undertaken this ROSC, to assess their current practices against the revised code. We welcomed the work by the Pacific Economic Cooperation Council on public-private partnerships.

IV. Other Matters and the Venue FOR the Next Meeting

We supported further work on quota and voice reform in the IMF and underscored the need for early agreement on comprehensive second-stage reform to enhance the Fund's legitimacy and representativeness. APEC economies believe comprehensive reform of IMF quotas and voice should recognise the strong growth of many emerging markets with significant increases in voting share, while protecting the voice of low-income members. We call for support to conclude negotiations as soon as the 2007 IMF annual meeting.

We support continuing efforts of the IMF and World Bank to respond to global challenges and early progress on reform of World Bank governance. We also welcomed commencement of the ADB's review of its Long-Term Strategic Framework as an important opportunity to reinforce the ADB's strategic and operational priorities consistent with the current and future needs of its developing members and its poverty reduction mandate.

We are committed to fighting money laundering, terrorist financing, and other illicit financing involving similar risks to the stability and integrity of financial markets, and will continue to work to comply with international standards. To this end, we tasked our officials to continue to collaborate closely with the APEC Anti-Corruption Taskforce, APEC Counter-Terrorism Taskforce and other jurisdictions. We call on the IMF and the World Bank to cooperate more closely with the Financial Action Task Force (FATF). We see merit in further efforts by the FATF in examining the risks involved in financing the proliferation of weapons of mass destruction.

We thanked Australia for hosting the APEC Finance Ministers' Process this year. We will meet again for our 15th meeting in Trujillo, Peru in October 2008.

PRESS ROOM

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August 28, 2007
hp-542

Treasury, IRS Issue Proposed Regulations
Outlining New Rules Restricting Benefits in Underfunded Pension Plans

Washington, D.C.--The Treasury Department and IRS issued today proposed regulations to provide guidance on new rules enacted as part of the Pension Protection Act of 2006 (PPA) that restrict benefits in pension plans that are underfunded.

The restrictions on benefits will apply next year to underfunded pension plans under section 436 of the Internal Revenue Code. The proposed regulations reflect the new law and include a number of transition rules. The proposed regulations also include guidance under section 430(f) of the Internal Revenue Code regarding the treatment of an employer's contributions in excess of the minimum required contribution for a plan year that results in a credit or funding balance. PPA generally requires such a balance to be excluded in determining a plan's funded percentage for purposes of applying the limitations of section 436.

The proposed regulations will apply to plan years beginning after December 31, 2007, and can be relied on for qualification purposes pending the final regulations.

A copy of the proposed regulations is attached.

-30-

REPORTS

- REG 113891-07

August 29, 2007
2007-8-29-15-39-46-26849

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 $67,292 million as of the end of that week, compared to $67,271 million as of the end of the prior week.

I. Official reserve assets and other foreign currency assets (approximate market value, in US millions)

	August 24, 2007		
A. Official reserve assets (in US millions unless otherwise specified)	Euro	Yen	Total
(1) Foreign currency reserves (in convertible foreign currencies)			67,292
(a) Securities	13,226	10,954	24,180
of which: issuer headquartered in reporting country but located abroad			0
(b) total currency and deposits with:			
(i) other national central banks, BIS and IMF	13,208	5,399	18,607
ii) banks headquartered in the reporting country			0
of which: located abroad			0
(iii) banks headquartered outside the reporting country			0
of which: located in the reporting country			0
(2) IMF reserve position	4,363		
(3) SDRs	9,100		
(4) gold (including gold deposits and, if appropriate, gold swapped)	11,041		
--volume in millions of fine troy ounces	261.499		
(5) other reserve assets (specify)	0		
--financial derivatives			

--loans to nonbank nonresidents			
--other			
B. Other foreign currency assets (specify)			
--securities not included in official reserve assets			
--deposits not included in official reserve assets			
--loans not included in official reserve assets			
--financial derivatives not included in official reserve assets			
--gold not included in official reserve assets			
--other			

II. Predetermined short-term net drains on foreign currency assets (nominal value)

			Maturity breakdown (residual maturity)		
		Total	Up to 1 month	More than 1 and up to 3 months	More than 3 months and up to 1 year
1. Foreign currency loans, securities, and deposits					
--outflows (-)	Principal				
	Interest				
--inflows (+)	Principal				
	Interest				
2. Aggregate short and long positions in forwards and futures in foreign currencies vis-à-vis the domestic currency (including the forward leg of currency swaps)					
(a) Short positions (-)					
(b) Long positions (+)					
3. Other (specify)					
--outflows related to repos (-)					
--inflows related to reverse repos (+)					
--trade credit (-)					
--trade credit (+)					
--other accounts payable (-)					

--other accounts receivable (+)				

III. Contingent short-term net drains on foreign currency assets (nominal value)

		Maturity breakdown (residual maturity, where applicable)		
	Total	Up to 1 month	More than 1 and up to 3 months	More than 3 months and up to 1 year
1. Contingent liabilities in foreign currency				
(a) Collateral guarantees on debt falling due within 1 year				
(b) Other contingent liabilities				
2. Foreign currency securities issued with embedded options (puttable bonds)				
3. Undrawn, unconditional credit lines provided by:				
(a) other national monetary authorities, BIS, IMF, and other international organizations				
--other national monetary authorities (+)				
--BIS (+)				
--IMF (+)				
(b) with banks and other financial institutions headquartered in the reporting country (+)				
(c) with banks and other financial institutions headquartered outside the reporting country (+)				
Undrawn, unconditional credit lines provided to:				
(a) other national monetary authorities, BIS, IMF, and other international organizations				
--other national monetary authorities (-)				
--BIS (-)				
--IMF (-)				
(b) banks and other financial institutions headquartered in reporting country (-)				

(c) banks and other financial institutions headquartered outside the reporting country (-)				
4. Aggregate short and long positions of options in foreign currencies vis-à-vis the domestic currency				
(a) Short positions				
(i) Bought puts				
(ii) Written calls				
(b) Long positions				
(i) Bought calls				
(ii) Written puts				
PRO MEMORIA: In-the-money options [11]				
(1) At current exchange rate				
(a) Short position				
(b) Long position				
(2) + 5 % (depreciation of 5%)				
(a) Short position				
(b) Long position				
(3) - 5 % (appreciation of 5%)				
(a) Short position				
(b) Long position				
(4) +10 % (depreciation of 10%)				
(a) Short position				
(b) Long position				
(5) - 10 % (appreciation of 10%)				
(a) Short position				
(b) Long position				
(6) Other (specify)				
(a) Short position				
(b) Long position				

IV. Memo items

(1) To be reported with standard periodicity and timeliness:	
(a) short-term domestic currency debt indexed to the exchange rate	
(b) financial instruments denominated in foreign currency and settled by other means (e.g., in domestic currency)	
--nondeliverable forwards	
--short positions	
--long positions	
--other instruments	
(c) pledged assets	
--included in reserve assets	
--included in other foreign currency assets	
(d) securities lent and on repo	
--lent or repoed and included in Section I	
--lent or repoed but not included in Section I	
--borrowed or acquired and included in Section I	
--borrowed or acquired but not included in Section I	
(e) financial derivative assets (net, marked to market)	
--forwards	
--futures	
--swaps	
--options	
--other	
(f) derivatives (forward, futures, or options contracts) that have a residual maturity greater than one year, which are subject to margin calls.	
--aggregate short and long positions in forwards and futures in foreign currencies vis-à-vis the domestic currency (including the forward leg of currency swaps)	
(a) short positions (–)	
(b) long positions (+)	
--aggregate short and long positions of options in foreign currencies vis-à-vis the domestic currency	
(a) short positions	
(i) bought puts	
(ii) written calls	
(b) long positions	
(i) bought calls	
(ii) written puts	

(2) To be disclosed less frequently:	
(a) currency composition of reserves (by groups of currencies)	67,292
--currencies in SDR basket	67,292
--currencies not in SDR basket	
--by individual currencies (optional)	

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.

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

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August 30, 2007
HP-543

Treasury Targets Colombian Drug Traffickers

The U.S. Department of the Treasury's Office of Foreign Assets Control (OFAC) today designated four significant Colombian drug traffickers, Miguel Angel Mejia Munera, Victor Manuel Mejia Munera, Ramiro Vanoy Murillo and Francisco Javier Zuluaga Lindo as Specially Designated Narcotics Traffickers (SDNTs) pursuant to Executive Order 12978. OFAC also designated today several front companies and related individuals.

"The Mejia Munera brothers are violent fugitives from justice," said OFAC Director Adam J. Szubin. "Today's action furthers OFAC's effort to destabilize and undermine the operations of these Colombian traffickers."

In 2004, the District Court for the District of Columbia indicted twin brothers Miguel Angel Mejia Munera and Victor Manuel Mejia Munera ("Los Mellizos") on narcotics trafficking charges. The Mejia Munera brothers have been involved in narcotics trafficking since the early 1990s when they guarded ships transporting cocaine loads from the western coast of Colombia to Mexico. Over time, Los Mellizos rose through the ranks to lead their own narcotics trafficking organization. Recent reports indicate that Los Mellizos may be funding their own illegal armed groups to facilitate their narcotics trafficking activities. Both are fugitives from justice and the United States is offering up to $5 million for information leading to the arrest of Miguel Angel Mejia Munera.

In 1999, the Southern District of Florida indicted Ramiro Vanoy ("Cuco Vanoy") and Zuluaga Lindo ("Gordo Lindo") on narcotics trafficking charges. Ramiro Vanoy Murillo and Francisco Javier Zuluaga Lindo are currently in a Colombian prison awaiting extradition to the United States.

OFAC also designated several front companies and individuals including a Mejia Munera holding company, Compania Comercializadora de Bienes Raices Ltda. in Cali and a sporting company, Sociedad Superdeportes Ltda. in Bogotá owned by Zuluaga Lindo. Two key Zuluaga Lindo front individuals, Daniel Alberto Mora Ricardo and Mary Luz Nova Carvajal were also named by OFAC along with their company, ABS Health Club S.A.

This designation is part of the ongoing interagency effort by the Departments of the Treasury, Justice, State and Homeland Security and others to implement Executive Order 12978 of October 21, 1995, which applies economic sanctions against Colombia's drug cartels. Today's designation action freezes any assets the designees may have subject to U.S. jurisdiction, and prohibits all financial and commercial transactions by any U.S. person with the designated companies and individuals.

The assets of a total of 1,530 businesses and individuals in Aruba, Barbados, Belize, Colombia, Costa Rica, Ecuador, Guatemala, Honduras, Jamaica, Mexico, Panama, Peru, Spain, Vanuatu, Venezuela, the Bahamas, the British Virgin Islands, the Cayman Islands, and the United States have been blocked pursuant to E.O. 12978. The 600 businesses that have been named as SDNTs include agricultural, aviation, consulting, construction, distribution, financial, hotel, investment, manufacturing, maritime, mining, offshore, pharmaceutical, real estate, retail, service, sporting, telecommunication, and textile companies. The SDNT list includes 26 drug kingpins from the Cali, Medellin, North Valle, and North Coast narcotics trafficking organizations in Colombia, including those named today.

Please find attached a chart of the individuals and entities designated today.

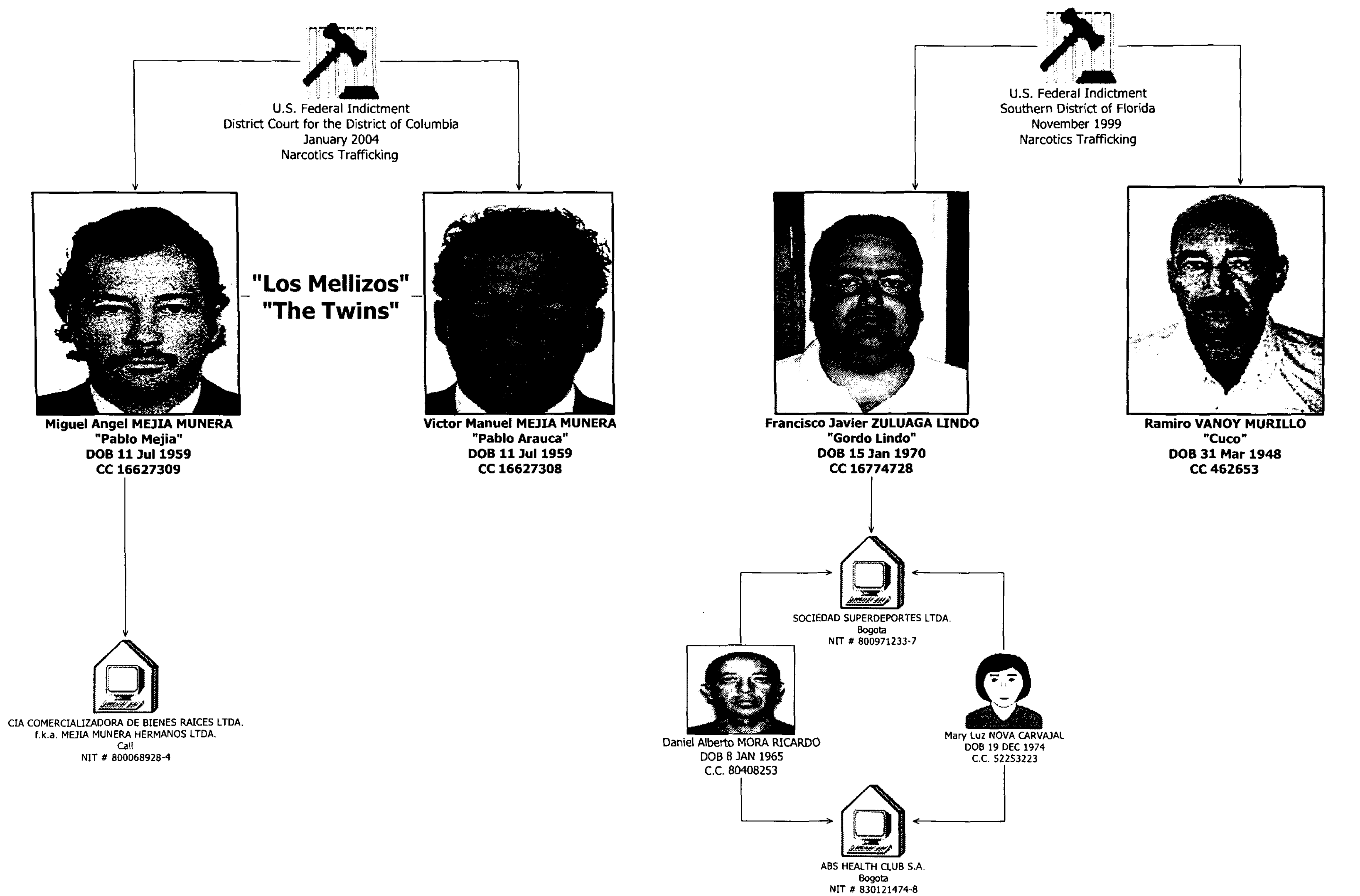
-30-

REPORTS

- Chart

NEW PRINCIPAL NARCOTICS TRAFFICKERS
August 2007

U.S. Department of the Treasury
Office of Foreign Assets Control
Specially Designated Narcotics Traffickers



PRESS ROOM

August 30, 2007
HP-544

Treasury Updates Department Homepage

Washington, DC-- Treasury launched an updated website this week designed to improve access to information on key issues before the Department.

New Homepage Look & Features

Treasury's homepage (www.treasury.gov) has a new look and feel including additional options for web-users to access press releases, speeches and reports on key issues before the Department. The day's top news and most recent releases will continue to be featured in the center column of the page. Information tabs on Treasury's core issues – financial markets, taxes, economy, fighting illicit finance, international affairs and coins and currency – are listed along the top of the page. Links listed in the left navigation bar were consolidated and reorganized to provide easy access to the most popular pages on the site. And key priorities for Secretary Paulson are featured in the right hand navigation bar. In the lower right-hand corner of the page is a new feature called the Secretary's Corner where all of Secretary Paulson's speeches, statements, testimony and travel updates have been consolidated.

New Email and RSS Capabilities

Treasury also recently updated its email subscription service and added RSS capability. Web users can now sign up to receive email or RSS updates on specific topics they're interested in. Options include:

- Press Releases by Topic
- Press Releases by Type (reports, speeches, testimony, etc.)
- Treasury Official Staff Updates
- Accounting and Budget Information
- Auctions
- Economic Statistics
- Interest Rate Statistics
- Health Savings Account Information
- Treasury International Capital ("TIC") Data

Please send any comments or concerns on the updated website using the redesign comment form. Feedback is appreciated.

PRESS ROOM

September 4, 2007
HP-545

Treasury Department Names Jeb Mason as Deputy Assistant Secretary for Business Affairs and Public Liaison

The Treasury Department announced that Jeb Mason has been appointed as Deputy Assistant Secretary for Business Affairs and Public Liaison.

In this position, Mason will manage the Treasury Department's outreach to the business, advocacy, and financial community. He will advise Secretary Henry M. Paulson, Jr. and the Department's leadership on economic and international issues. He will solicit information, analysis, and opinions from public and private organizations representing business and consumer interests, and will communicate Treasury's views to these organizations.

Immediately prior to this appointment, Mason served as Policy Advisor to Secretary Paulson. In this role he provided counsel to the Secretary and the Department's leadership on key policy matters. Mason also will continue to advise the Secretary on policy matters in his new position.

Prior to joining Treasury, Mason served as Associate Director for Strategic Initiatives at the White House. He previously held several positions with the Department of Defense, including Executive Secretary for the Coalition Provisional Authority.

Mason earned degrees in economics and public policy from Southern Methodist University.

PRESS ROOM

September 4, 2007
2007-9-4-14-27-10-28537

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 $67,376 million as of the end of that week, compared to $67,292 million as of the end of the prior week.

I. Official reserve assets and other foreign currency assets (approximate market value, in US millions)

	August 31, 2007		
A. Official reserve assets (in US millions unless otherwise specified)	Euro	Yen	Total
(1) Foreign currency reserves (in convertible foreign currencies)			67,376
(a) Securities	13,232	10,984	24,216
of which: issuer headquartered in reporting country but located abroad			0
(b) total currency and deposits with:			
(i) other national central banks, BIS and IMF	13,214	5,413	18,627
ii) banks headquartered in the reporting country			0
of which: located abroad			0
(iii) banks headquartered outside the reporting country			0
of which: located in the reporting country			0
(2) IMF reserve position	4,373		
(3) SDRs	9,120		
(4) gold (including gold deposits and, if appropriate, gold swapped)	11,041		
--volume in millions of fine troy ounces	261.499		
(5) other reserve assets (specify)	0		
--financial derivatives			
--loans to nonbank nonresidents			
--other			
B. Other foreign currency assets (specify)			
--securities not included in official reserve assets			
--deposits not included in official reserve assets			
--loans not included in official reserve assets			
--financial derivatives not included in official reserve assets			
--gold not included in official reserve assets			
--other			

II. Predetermined short-term net drains on foreign currency assets (nominal value)

			Maturity breakdown (residual maturity)		
		Total	Up to 1 month	More than 1 and up to 3 months	More than 3 months and up to 1 year
1. Foreign currency loans, securities, and deposits					
--outflows (-)	Principal				
	Interest				
--inflows (+)	Principal				
	Interest				
2. Aggregate short and long positions in forwards and futures in foreign currencies vis-à-vis the domestic currency (including the forward leg of currency swaps)					
(a) Short positions (-)					
(b) Long positions (+)					
3. Other (specify)					
--outflows related to repos (-)					
--inflows related to reverse repos (+)					
--trade credit (-)					
--trade credit (+)					
--other accounts payable (-)					
--other accounts receivable (+)					

III. Contingent short-term net drains on foreign currency assets (nominal value)

		Maturity breakdown (residual maturity, where applicable)		
	Total	Up to 1 month	More than 1 and up to 3 months	More than 3 months and up to 1 year
1. Contingent liabilities in foreign currency				
(a) Collateral guarantees on debt falling due within 1 year				
(b) Other contingent liabilities				
2. Foreign currency securities issued with embedded options (puttable bonds)				
3. Undrawn, unconditional credit lines provided by:				
(a) other national monetary authorities, BIS, IMF, and other international organizations				
--other national monetary authorities (+)				
--BIS (+)				
--IMF (+)				
(b) with banks and other financial institutions headquartered in the reporting country (+)				

(c) with banks and other financial institutions headquartered outside the reporting country (+)				
Undrawn, unconditional credit lines provided to:				
(a) other national monetary authorities, BIS, IMF, and other international organizations				
--other national monetary authorities (-)				
--BIS (-)				
--IMF (-)				
(b) banks and other financial institutions headquartered in reporting country (-)				
(c) banks and other financial institutions headquartered outside the reporting country (-)				
4. Aggregate short and long positions of options in foreign currencies vis-à-vis the domestic currency				
(a) Short positions				
(i) Bought puts				
(ii) Written calls				
(b) Long positions				
(i) Bought calls				
(ii) Written puts				
PRO MEMORIA: In-the-money options [11]				
(1) At current exchange rate				
(a) Short position				
(b) Long position				
(2) + 5 % (depreciation of 5%)				
(a) Short position				
(b) Long position				
(3) - 5 % (appreciation of 5%)				
(a) Short position				
(b) Long position				
(4) +10 % (depreciation of 10%)				
(a) Short position				
(b) Long position				
(5) - 10 % (appreciation of 10%)				
(a) Short position				
(b) Long position				
(6) Other (specify)				
(a) Short position				
(b) Long position				

IV. Memo items

(1) To be reported with standard periodicity and timeliness:	
(a) short-term domestic currency debt indexed to the exchange rate	
(b) financial instruments denominated in foreign currency and settled by other means (e.g., in domestic	

currency)	
--nondeliverable forwards	
--short positions	
--long positions	
--other instruments	
(c) pledged assets	
--included in reserve assets	
--included in other foreign currency assets	
(d) securities lent and on repo	
--lent or repoed and included in Section I	
--lent or repoed but not included in Section I	
--borrowed or acquired and included in Section I	
--borrowed or acquired but not included in Section I	
(e) financial derivative assets (net, marked to market)	
--forwards	
--futures	
--swaps	
--options	
--other	
(f) derivatives (forward, futures, or options contracts) that have a residual maturity greater than one year, which are subject to margin calls.	
--aggregate short and long positions in forwards and futures in foreign currencies vis-à-vis the domestic currency (including the forward leg of currency swaps)	
(a) short positions (–)	
(b) long positions (+)	
--aggregate short and long positions of options in foreign currencies vis-à-vis the domestic currency	
(a) short positions	
(i) bought puts	
(ii) written calls	
(b) long positions	
(i) bought calls	
(ii) written puts	
(2) To be disclosed less frequently:	
(a) currency composition of reserves (by groups of currencies)	67,376
--currencies in SDR basket	67,376
--currencies not in SDR basket	
--by individual currencies (optional)	

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.

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 4, 2007
2007-9-4-14-27-39-28545

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 $67,376 million as of the end of that week, compared to $67,292 million as of the end of the prior week.

I. Official reserve assets and other foreign currency assets (approximate market value, in US millions)

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of which: located in the reporting country			0
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(3) SDRs	9,120		
(4) gold (including gold deposits and, if appropriate, gold swapped)	11,041		
--volume in millions of fine troy ounces	261.499		
(5) other reserve assets (specify)	0		
--financial derivatives			
--loans to nonbank nonresidents			
--other			
B. Other foreign currency assets (specify)			
--securities not included in official reserve assets			
--deposits not included in official reserve assets			
--loans not included in official reserve assets			
--financial derivatives not included in official reserve assets			
--gold not included in official reserve assets			
--other			

II. Predetermined short-term net drains on foreign currency assets (nominal value)

			Maturity breakdown (residual maturity)		
		Total	Up to 1 month	More than 1 and up to 3 months	More than 3 months and up to 1 year
1. Foreign currency loans, securities, and deposits					
--outflows (-)	Principal				
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--inflows (+)	Principal				
	Interest				
2. Aggregate short and long positions in forwards and futures in foreign currencies vis-à-vis the domestic currency (including the forward leg of currency swaps)					
(a) Short positions (-)					
(b) Long positions (+)					
3. Other (specify)					
--outflows related to repos (-)					
--inflows related to reverse repos (+)					
--trade credit (-)					
--trade credit (+)					
--other accounts payable (-)					
--other accounts receivable (+)					

III. Contingent short-term net drains on foreign currency assets (nominal value)

		Maturity breakdown (residual maturity, where applicable)		
	Total	Up to 1 month	More than 1 and up to 3 months	More than 3 months and up to 1 year
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(b) Other contingent liabilities				
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(a) other national monetary authorities, BIS, IMF, and other international organizations				
--other national monetary authorities (+)				
--BIS (+)				
--IMF (+)				
(b) with banks and other financial institutions headquartered in the reporting country (+)				

(c) with banks and other financial institutions headquartered outside the reporting country (+)				
Undrawn, unconditional credit lines provided to:				
(a) other national monetary authorities, BIS, IMF, and other international organizations				
--other national monetary authorities (-)				
--BIS (-)				
--IMF (-)				
(b) banks and other financial institutions headquartered in reporting country (-)				
(c) banks and other financial institutions headquartered outside the reporting country (-)				
4. Aggregate short and long positions of options in foreign currencies vis-à-vis the domestic currency				
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PRO MEMORIA: In-the-money options [11]				
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(b) Long position				
(5) - 10 % (appreciation of 10%)				
(a) Short position				
(b) Long position				
(6) Other (specify)				
(a) Short position				
(b) Long position				

IV. Memo items

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Notes:

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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 5, 2007
HP-546

Testimony of Robert K. Steel
Under Secretary for Domestic Finance
U.S. Department of the Treasury
Before the House Committee on Financial Services

Washington- Chairman Frank, Ranking Member Bachus, Members of the Committee, good morning. I very much appreciate the opportunity to appear before you today to present the Treasury Department's perspective on the recent events in the credit and mortgage markets and their impact upon consumers and the economy. The Treasury Department and Secretary Paulson know that these events are of considerable interest to the American people, this Committee, and other Members of Congress.

To give context to the current market situation, I would like to begin my remarks today with a description of both domestic and global economic conditions. In the United States, the unemployment rate is at 4.6%, close to its lowest reading in 6 years. Real GDP growth was 4.0 percent in the second quarter, supported by strong gains in business investment and exports. Core inflation is under control. Since August 2003, 8.3 million jobs have been created, more jobs than all the major industrialized countries combined; over the past 12 months, nearly 2 million jobs have been created. Real wages have increased 1.7% over the past 12 months. In the corporate sector, earnings continue to outperform expectations and default rates on corporate credits of all kinds are at historically low levels. On the government side, the U.S. fiscal deficit is declining and well below long-term averages as a share of the economy, reflecting strong revenue growth and the continued strength of the U.S. economy.

The global economy continues to grow at around 5% annually, with many emerging market economies growing even more rapidly than the global average. The advanced economies also continue to perform well, with unemployment down sharply in Europe, helping to make growth of the last several years the strongest since the early 1970s.

The Treasury Department, as the steward of economic and financial systems in the United States, is committed to ensuring these strong U.S. and global economic fundamentals. At the same time, the Treasury Department's mission includes the promotion of economic stability. It is important to appreciate that the core fundamental economic environment is strong globally, and it is against this backdrop that I turn to the current credit and market challenges.

General Trends in the Mortgage Industry

As just discussed, over the past several years the United States has enjoyed favorable economic conditions: low unemployment, low inflation, and low interest rates. These positive conditions served to fuel a demand for credit and investment and the marketplace responded with a vast supply of both to satisfy consumers and sophisticated market participants. At the consumer level, this demand was very noticeable in the mortgage industry, and in recent years particularly, the subprime arena. For the first time, in the early 1990s, consumers with lower incomes and challenged credit history--typical subprime borrowers--were able to gain access to mortgage credit at interest rates a few percentage points higher than prime borrower rates. Homeownership became more widely available in the United States, growing from 64% in 1994 to 69% today, some of that due to subprime mortgage origination volume, which increased from less than 5%, or $35 billion, of total mortgage origination volume in 1994 to nearly 20%, or $625 billion, in 2005.

Mortgage securitization has fundamentally changed the mortgage industry and has played a significant role in the growth of the mortgage market. Typically in a private label mortgage securitization, the mortgage originator transfers loans to a securitization sponsor, who pools together mortgages into mortgage-backed securities, and sells pieces, or tranches, of these securities to investors. Thus, the mortgage originator, instead of holding the mortgage loan on its balance sheet, distributes the loan and its attendant risks to a securitization sponsor in return for capital. The credit rating agencies work closely with the sponsor to rate the credit risk of each tranche.

These innovative securities offered sophisticated investors a diversification tool and the ability to better target their risk/return profile. The demand for mortgage-backed securities has been global in nature and has helped to provide mortgage originators with a steady stream of capital. Over 55% of total mortgage origination volume and over 70% of subprime mortgage origination volume were securitized in 2006. Further fueling this growth has been the development of another structured product, the collateralized debt obligation, which purchases asset-backed securities, such as mortgage-backed securities. Mortgage-backed CDOs, nearly 40% of the entire $500 billion CDO market in 2006, have been one of the major purchasers of mortgage-backed securities, in particular the lower rated tranches.

Recent Mortgage Market and Credit Market Events

Through most of the 1990s, annual mortgage origination stood at approximately $1 trillion. With the historically low interest rate environment of 2001-2003, mortgage origination climbed to nearly $4 trillion in 2003. Infrastructure build-up and the entry of many new participants into the mortgage industry matched this increase. With the rise in interest rates in 2004, mortgage origination fell to just under $3 trillion. With this decline, there was significant overcapacity in the mortgage industry. Competition among mortgage originators and brokers intensified. At the same time, investor demand for securitized products remained unabated. To satisfy this demand and their excess capacity, some mortgage originators relaxed their underwriting standards, lending to individuals with a lower standard of documentation and selling mortgage products, which for some borrowers would become unaffordable.

In the past few years, some of the most popular subprime products were adjustable rate mortgages, like the 2/28: a hybrid mortgage with a fixed rate of interest, often free of amortization payments, for the first two years, resetting at an adjustable rate for the remaining 28 years. The fixed rate of interest in the first two-year period was typically lower than the initial adjustable rate in the reset period. In the initial period of these resets, rising housing prices enabled these borrowers to refinance their original mortgages on terms more attractive and affordable. Eventually, due to both an upwards adjustment in rates and commencement of principal amortization as these mortgages began to reset in 2005, 2006, and 2007, many borrowers were faced with payment shock. These resets, combined with a decline in housing price appreciation, led to rising delinquencies and defaults among subprime borrowers, first widely evidenced in autumn 2006. In 2007 this trend has continued and spread to other participants in the mortgage industry: several mortgage originators and brokers have exited the industry.

In turn, the mortgage-backed securities investor has felt the repercussions of the weaknesses in the mortgage assets underlying some of these securitized products: in autumn 2006 with rising defaults on the underlying assets, mortgage-backed securities spreads began to widen. Over the past several months, a small number of U.S. and foreign financial institutions and hedge funds that invested in mortgage-backed CDOs and other mortgage-backed securities have reported large losses. Some have suspended or limited redemptions, while others have closed or received capital infusions. At the same time, credit rating agencies announced their intent to downgrade some of these securitized products and revise their ratings methodologies.

The uncertainty regarding both the future prospects of these mortgage-backed securities and the methodologies the credit rating agencies used to rate these securities compelled investors to reassess the risk of these securities and subsequently reassess price. Given the uncertainty of the underlying credit and cash flows, few buyers were willing to risk their capital. Valuation became extremely difficult as a no-bid environment seized certain segments of the market. This reappraisal has spread across the credit market spectrum, first affecting residential-mortgage backed securities and then spreading to other asset classes and, particularly, securitized products. Spreads have widened and a lack of liquidity has affected these other asset classes. The financing of buy-out transactions has also been challenged as higher risk premia resurfaced after a long period of favorable conditions. Volatility has increased: from Treasury bills to the stock markets.

This reappraisal of risk is normal and typically follows periods of widely available credit when markets have undervalued risk. As in other times of reappraisal, investors, adverse to risk and protective of their capital, have fled to quality assets, demanding and driving up the prices--and in turn driving down significantly the rates--of Treasury bills. For example, during the past three weeks, the demand for Treasury securities by global investors was so enormous that rates on the safest, most liquid asset in the world dropped over 250 basis points--a decline of such magnitude not seen in the past.

In early August, this uncertainty began to spread to the asset-backed commercial paper market, typically a very liquid market. The uncertainty surrounding the health of the assets underlying commercial paper (especially asset-backed commercial paper, which represents approximately 55% of the commercial paper market) compelled investors to shorten the terms to maturity that they were willing to purchase and, in some cases, even to decline to buy such paper altogether. Subsequently, banks became increasingly concerned about their own liquidity in view of the possibility that they might have to provide backup for commercial paper and take other assets onto their balance sheets. In response to such developments, the Federal Reserve took several measures to increase liquidity and promote the orderly functioning of financial markets. The Federal Reserve provided additional reserves through open market operations in order to promote trading in the Federal Funds market at rates close to the target rate. The Federal Reserve also lowered the discount rate and changed Reserve Banks' usual practices to allow the provision of term funding at the discount window. Such actions have helped stabilize the markets.

The ultimate impact of these events on the economy has yet to play out. At the time of its discount rate cut, the Federal Reserve noted that "[f]inancial market conditions have deteriorated, and tighter credit conditions and increased uncertainty have the potential to restrain economic growth going forward. In these circumstances, although recent data suggest that the economy has continued to expand at a moderate pace...the downside risks to growth have increased appreciably."

The Treasury Department respects the independent actions and leadership of the Federal Reserve. Like the Federal Reserve, the Treasury Department shares the perspective that recent market developments pose downside risks to economic growth. However, the economy was in strong condition going into the recent period of volatility, and while certain sectors like housing are undergoing a transition, overall economic fundamentals remain solid. And while recent difficulties in the subprime mortgage market are having and will continue to have a profound effect for many families, the underlying strength of the economy should allow for continued growth. Just last Friday, the President announced plans to help those homeowners facing mortgage delinquencies and foreclosures and I will return to these initiatives later.

Impact of Recent Market Developments on the Mortgage and Credit Markets

The financial services industry has enjoyed a period of extraordinary growth over the last several decades. Key drivers to this growth have been successful engagement with the trends of innovation, institutionalization, and internationalization.

The complexity and innovation of financial products have brought great benefits to the mortgage and credit markets. In the mortgage industry, securitization allows mortgage originators to undertake better risk management as they do not have to hold loans on their balance sheets and instead have another source of capital funding. Investors purchasing a securitized product have reduced transaction costs and can purchase an array of products at targeted risk levels. Homebuyers have expanded product offerings and more lenders competing for their business.

The recent market events have revealed potential complexities in the securitization model. In some cases, risk evaluation of securitized products can be difficult. In mortgage-backed securities and mortgage-backed collateralized debt obligations, the performance of the underlying assets, particularly many of the innovative subprime mortgage products, may not have been properly understood, or investors may have failed to perform adequate due diligence prior to their investment decision. At the same time, mortgage originators may have possessed less incentive to perform appropriate levels of due diligence because of their distributing their loans and the attendant risks through securitization.

Over the past few decades the capital markets have experienced growing institutionalization. These institutions, such as pension funds, mutual funds, and hedge funds, have provided the markets with liquidity, pricing efficiency, and risk dispersion. These institutions have also spurred on financial product innovation and complexity and possess the incentives, resources, and information to make prudent decisions. At the same time, these institutions can be highly leveraged and employ highly correlated strategies, potentially leading to more widespread market disruptions.

Finally, the capital markets are becoming increasingly internationalized. Market participants, sources of capital, product offerings, and trading strategies ignore national borders. This has contributed to the significant global economic growth over the past decade, especially in the emerging market economies. At the same time, an event in one country's market may impact the rest of the world.

Treasury, Administration, and Federal Banking Regulator Actions

The Treasury Department closely monitors the global capital markets on a daily basis. This is especially true given the events unfolding in the credit and mortgage markets. Secretary Paulson has been communicating regularly with federal banking regulators and the members of the President's Working Group on Financial Markets, which includes Federal Reserve Chairman Bernanke, Securities and Exchange Commission Chairman Cox, and Commodity Futures Trading Commission Acting Chairman Lukken. This complements information gathering from market participants, finance ministers, and other participants in the global marketplace. Enhanced communication is vitally important for understanding where disruptions are occurring, and evaluating what actions can be considered.

Under Secretary Paulson's leadership, the President's Working Group on Financial Markets will examine some of the broader market issues underlying the recent market events, including the impact of securitization and the role of rating agencies in the credit and mortgage markets. The Treasury Department will also be releasing early next year a blueprint of structural reforms to make financial services industry regulation more effective, taking into account consumer and investor protection and the need to maintain U.S. capital markets competitiveness.

Most important and in addition to efforts to fully understand the current situation in the financial markets, the Treasury Department, the Department of Housing and Urban Development, and others in the Administration have carefully focused on evaluating the challenges faced by individuals in the subprime market. Last week, the President announced a series of market-based initiatives to help more homeowners keep their homes. The Administration, led by the Treasury Department and HUD, has undertaken several actions to provide assistance to homeowners, including the Administration's continued pursuit of legislation modernizing the Federal Housing Administration. Coordinating with HUD, the Treasury Department also will reach out to a wide variety of entities, such as NeighborWorks America, mortgage originators and servicers, and government-sponsored entities, like Fannie Mae and Freddie Mac, to identify struggling homeowners and expand their mortgage financing options. The President has also asked Congress to temporarily change a provision of the federal tax code that currently considers cancelled mortgage debt on a primary residence as taxable income. The Treasury Department looks forward to working with Congress in the days ahead.

In addition, the federal government has taken several actions to increase transparency and enhance lending standards in the mortgage industry. For example, in 2006, the banking regulators issued supervisory guidance addressing nontraditional mortgages and in June 2007 finalized subprime lending guidance. Separately, the Federal Reserve has undertaken a comprehensive review of the disclosure system for mortgage loans under the Truth in Lending Act and is currently addressing unfair and deceptive mortgage practices using its authority under the Home Ownership and Equity Protection Act. Later this fall, HUD will propose reforms to the Real Estate Settlement Procedures Act to promote comparative shopping for the best loan terms, provide more transparent and comprehensible disclosures, including fee disclosure, and limit settlement cost increases.

Conclusion

The recent volatility in the credit and mortgage markets reflects a reassessment of risk across a broad spectrum of securities. These events have occurred during a time of solid domestic and global growth, helping to mute some of the impact of this turbulence. I do want to caution policymakers that this process is far from over. It will take more time to play out and certain segments of the capital markets are stressed. Risk is being repriced. This repricing will lead to a reevaluation of assets. This reevaluation will inevitably impact the balance sheets of financial market participants. As investors review fundamental characteristics and confidence returns, liquidity will improve. Yet, policymakers must remain vigilant as further stress could create further challenges and continued volatility.

It is critical that policymakers understand these issues and their underlying causes and continue to enhance the capital markets regulatory structure to adapt to market developments. I appreciate having the opportunity to present the Treasury Department's perspectives on these important issues.

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PRESS ROOM

September 5, 2007
HP-547

Treasury Assistant Secretary Swagel to Hold Monthly Economic Briefing

U.S. Treasury Assistant Secretary for Economic Policy Phillip Swagel 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
U. S. Treasury Assistant Secretary Phillip Swagel

What
Economic Media Briefing

When
Friday, September 7, 2007, 11:30 a.m. (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: full name, Social Security number and date of birth.

PRESS ROOM

September 6, 2007
HP-548

Testimony of Treasury Assistant Secretary for Economic Policy Phillip Swagel Before the House Committee on Financial Services Subcommittees on Capital Markets, Insurance, and Government Sponsored Enterprises; and Housing and Community Opportunity

Washington, DC -- Good afternoon Chairman Kanjorski, Chairwoman Waters, Ranking Member Pryce, Ranking Member Biggert, and Members of the Subcommittees. The effects of Hurricanes Katrina, Rita, and Wilma are reminders of the destructive forces of nature. Insurance coverage against natural catastrophes cannot undo the toll of these events, but insurance can provide families and businesses with the ability to recover from their financial losses. Government actions that interfere with well-functioning private insurance markets can have unintended consequences that make it more difficult and costly for families and businesses to obtain coverage. Such actions can further detract from the long-term financial soundness of our government.

The Administration seeks to ensure that there is a stable and well-developed private market for natural hazard insurance and reinsurance. The Administration strongly opposes H.R. 3355 because its provisions are at odds with this goal.

The Private Insurance Market Provides Coverage for Natural Hazards

Private insurance markets for natural hazard insurance are active and effective. The experiences with catastrophes in 2004 and 2005 led insurers to increase their estimates of probable losses from future hurricanes. As a result, insurers obtained state regulatory approval and increased their premiums to cover future losses and enhance solvency. Certain coastal areas have experienced increases in rates. This can be difficult for homeowners, but this is fundamentally a reflection of the cost of risk, not a defect of the market. While certain coastal areas have seen reduced availability of private insurance as well, these shortages generally can be traced to state regulatory actions.

H.R. 3355: The Homeowners' Defense Act of 2007

H.R. 3355, the Homeowners' Defense Act of 2007, is intended to provide support and assistance to state-sponsored insurance and reinsurance programs. State-sponsored programs generally can be divided into two categories: (1) programs such as assigned risk pools or residual market facilities that provide coverage directly to homeowners who cannot obtain private coverage, and (2) state-run reinsurance programs that provide coverage for private insurers and state-run residual funds. Florida, for example, has both types of programs: the state-sponsored Citizens Property Insurance Corporation sells wind-loss property insurance and homeowners' insurance to homeowners, and the Hurricane Catastrophe Fund, backed by the state's ability to cover future losses through taxation, provides reinsurance to private insurers at below-market rates. Florida is currently the only state with a reinsurance program.

H.R. 3355 provides two distinct mechanisms to help state-sponsored programs. The first is the creation of a federally chartered organization, the National Catastrophe Risk Consortium. The bill empowers the Consortium to issue risk-linked securities in the capital markets and enter into reinsurance contracts. The Consortium would facilitate the transfer of catastrophe risks insured by state-sponsored programs to private reinsurance markets and capital markets. The second proposed mechanism is the establishment of the National Homeowners' Insurance Stabilization Program at the Treasury Department. Through the Stabilization Program, the Treasury Department would provide medium- and long-term loans to state insurance programs at below-market rates.

The Consortium and the Stabilization Program Provide Subsidies

The functions of the Consortium could be accomplished without new legislation. State-sponsored programs are free to pool risks today and they have access to competitive, world-wide reinsurance and capital markets designed to pool risks globally. This can be done today with traditional reinsurance arrangements or through natural catastrophe bonds.

I understand that in designing the Consortium, the intent of the bill's sponsors may not have been to create a new subsidy; nevertheless, as written, the Consortium would provide one. The Consortium's federal charter would benefit state-sponsored programs in that the reinsurance contracts and financial instruments entered into or facilitated by the Consortium would be seen as carrying an implicit federal government guarantee. This implicit guarantee would distort prices for these instruments and result in subsidized coverage for the participating states. This would impose a hidden cost to all taxpayers.

The Stabilization Program would provide subsidies in a more straightforward manner. The Stabilization Program's title requires Treasury to extend 5- to 10-year "liquidity loans" and longer-term, post-disaster "catastrophe loans" at below-market rates to state-sponsored programs.

The ability to borrow at below-market rates would lower the cost of running a state-sponsored program and reduce the need for states to purchase private reinsurance and charge adequate rates in order to maintain capital reserves. This would lead the state-sponsored programs to further subsidize rates.

Subsidizing Insurance Would Displace Private Markets, Promote Riskier Behavior, Be Costly, and Be Unfair to Taxpayers

The subsidies provided by the Consortium and the Stabilization Program would encourage the creation of new state-sponsored programs and the expansion of existing state-sponsored programs to offer subsidized insurance and reinsurance. These subsidies would result in the displacement of private coverage, lead to costly inefficiencies, and retard innovation in the private sector. Lower insurance premiums would reduce economic incentives to mitigate risks and encourage individuals to take on inappropriate risks. This would also make taxpayers nationwide subsidize insurance rates in high-risk areas.

Rather than relying on the federal government, state programs should purchase private market reinsurance to cover their capital needs. Purchasing reinsurance from private markets would allow the states to take full advantage of the world-wide diversification of private markets and send the appropriate economic signals to mitigate risk and to discourage individuals from taking on inappropriate risk.

State-sponsored programs that lower insurance prices below the actuarially fair value encourage people to locate in high-risk areas. The experience of the National Flood Insurance Program (NFIP) illustrates this concern. The NFIP provides insurance to some older properties at below-market rates, including some properties that have been damaged numerous times by floods. This encourages families to continue to live in vulnerable areas without sufficient mitigation. Subsidies for natural catastrophe insurance will encourage over-development in hurricane- and earthquake-prone areas, putting more people in harm's way.

The bill could result in large liabilities for the federal government, which might be expected to step in to support the operations of the contracts entered into or facilitated by the Consortium. In addition, there is a risk that the Stabilization

Program would not receive full repayment of the loans with interest. The Stabilization Program reduces incentives for state reinsurance programs to be sufficiently capitalized--state programs will hold less capital because they have the federal line of credit. The burden of repaying those federal loans will fall on the state's citizens. This tax burden may lead the state to seek deferrals or reductions in its federal loans. With federal financing, it is more than likely that there will be significant pressures to forgive outstanding debt in the case of a huge catastrophe. The NFIP again illustrates this likelihood. In these cases, taxpayers nationwide would subsidize insurance rates in high-risk areas, which would be both costly and unfair.

Conclusion

Allowing private insurance and capital markets to fulfill their roles is the best way to maintain the economic sustainability of communities at greatest risk of natural catastrophes. Federal government interference in a functioning natural hazard insurance market would crowd out an active and effective private market, increase the incentive for people to locate in high-risk areas, result in potentially large federal liabilities, and be unfair to taxpayers. For these reasons, the Administration opposes H.R. 3355.

PRESS ROOM

September 7, 2007
HP-549

Treasury Economic Update

"Hiring in August came in below where anyone would want it to be, but a broad view of the economy reveals many sources of strength. The unemployment rate remains low, wages are rising, core inflation is contained, business investment has picked up, and strong global growth is boosting U.S. exports. Recent developments in housing and financial markets will affect economic growth, but the U.S. economy is fundamentally healthy."

Assistant Secretary Phillip Swagel, September 7, 2007

Job Creation Has Slowed:

Job Growth: Employment edged down by 4,000 in August partly due to a large drop in government jobs. Private-sector job growth continued for a 48th straight month, with 24,000 new jobs added in August. The United States has added 1.6 million jobs in the past 12 months and over 8.2 million since August 2003. Employment increased in 48 states and the District of Columbia over the year ending in July. *(Last updated: September 7, 2007)*

Low Unemployment: The unemployment rate of 4.6 percent is close to the lowest reading in 6 years. Unemployment rates have decreased or held steady in 23 states and the District of Columbia over the year ending in July. *(Last updated: September 7, 2007)*

There are Still Many Signs of Economic Strength:

Economic Growth: Real GDP growth was 4.0 percent in the second quarter of 2007, supported by strong gains in business investment and exports. *(Last updated: August 30, 2007)*

Household Spending: Consumer spending has been affected by increased energy and food prices and weakness in the housing sector, but incomes are growing and should continue to support household consumption. *(Last updated: August 30, 2007)*

Business Investment: Business spending on commercial structures and equipment strengthened in the second quarter. Strong corporate profits and healthy balance sheets bode well for continued investment growth. *(Last updated: August 30, 2007)*

Exports: Strong global growth is boosting U.S. exports, which grew by 7.1 percent over the past 4 quarters. *(Last updated: August 30, 2007)*

Inflation: Core inflation remains contained. The consumer price index excluding food and energy rose 2.2 percent over the 12 months ending in July.

Tax Revenues: Tax receipts rose 11.8 percent in fiscal year 2006 (FY06) on top of FY05's 14.6 percent increase. As a share of GDP, FY07 receipts are projected to be above their 40-year average. *(Last updated: July 13, 2007)*

Americans Are Keeping More of Their Hard-Earned Money:

Real Wages Increased 1.7 percent Over the Past 12 Months (ending in July). This translates into an additional $553 above inflation for the average full-time production worker over the last year.

Pro-Growth Policies will Enhance Long-Term U.S. Economic Strength:

We are on track to balance the budget by 2012. The Mid-Session Review of the FY 2008 Budget shows that we are on track to achieve a small surplus in 2012. This year, the deficit is projected to be down to 1.5 percent of GDP. Much of the improvement in the deficit reflects strong revenue growth, which in turn reflects the continued strength of the U.S. economy. Looking ahead, higher spending on entitlement programs dominates the future fiscal situation; we must squarely face up to the challenge of reforming these programs.

www.treas.gov/economic-plan

PRESS ROOM

September 10, 2007
HP-550

Treasury Secretary Paulson to Visit Paris and London Next Week

Treasury Secretary Henry M. Paulson, Jr. will travel to Europe next week to meet with officials in Paris and London. Secretary Paulson will meet with French President Nicolas Sarkozy, and senior French officials, including Finance Minister Christine Lagarde, on Monday, September 17. He will then travel to London to meet with Prime Minister Gordon Brown and Chancellor of the Exchequer Alistair Darling that afternoon.

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PRESS ROOM

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September 10, 2007
HP-551

Treasury, IRS Extend Documentation Deadline for 409A Compliance

Washington, DC -- The Treasury Department and the Internal Revenue Service (IRS) announced today that taxpayers will have until December 31, 2008 to bring documents into compliance with the final nonqualified deferred compensation regulations under section 409A of the Internal Revenue Code.

In April, Treasury and IRS issued final 409A regulations, which provided guidance regarding the requirements for deferral elections and payment timing under section 409A. Affected plans and arrangements were required to comply with the final regulations by December 31, 2007. IRS Notice 2007-78 extends the document compliance deadline for one year and provides additional limited transition relief, but does not extend the January 1, 2008 effective date of the final regulations.

Notice 2007-78 also announces that Treasury and the IRS anticipate issuing guidance containing a limited voluntary compliance program that will permit corrections of certain unintentional operational violations of section 409A.

The final regulations were in response to legislation enacted by Congress in 2004 to address concerns involving reported abuses of nonqualified deferred compensation plans.

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REPORTS

- Notice 2007-78

Part III – Administrative, Procedural, and Miscellaneous

2008 Transition Relief and Additional Guidance on the Application of § 409A to Nonqualified Deferred Compensation Plans

Notice 2007-78

I. PURPOSE

This notice provides transition relief and additional guidance on the application of § 409A of the Internal Revenue Code to nonqualified deferred compensation plans. This transition relief and additional guidance includes:

- Extension to December 31, 2008, of the deadline to adopt documents that comply with § 409A, subject to limited requirements regarding the timely written designation of a time and form of payment.
- Guidance and additional relief addressing certain issues raised by the application to employment agreements and cashout features of § 409A and the final regulations.
- Announcement that the Treasury Department and the IRS anticipate issuing guidance containing a limited voluntary compliance program that will permit taxpayers to correct certain unintentional operational violations of § 409A and thereby limit the amount of additional taxes due under § 409A.
- Announcement that the relief from the application of § 409A(b) (which prohibits the use of certain types of arrangements to pay for nonqualified deferred

compensation) provided in Notice 2006-33 with respect to certain "grace period assets", which expires December 31, 2007, is not being extended, so that after December 31, 2007, taxpayers must comply with a reasonable, good faith interpretation of § 409A(b) with respect to all assets in arrangements subject to § 409A(b).

II. BACKGROUND

Section 409A provides certain requirements applicable to nonqualified deferred compensation plans. If a plan does not meet those requirements, participants in the plan are required to immediately include amounts deferred under the plan in income and pay additional taxes on such income.

The Treasury Department and the IRS issued final regulations under § 409A in April 2007 (72 Fed. Reg. 19234 (April 17, 2007)). The final regulations apply to taxable years beginning on or after January 1, 2008. In general, the final regulations require that the material terms of a nonqualified deferred compensation plan be in writing. See § 1.409A-1(c). Commentators stated that taxpayers anticipate difficulties in formally amending existing plans to comply with the final regulations by the January 1, 2008 deadline. In addition, a number of commentators have raised questions regarding the application of the final regulations to certain types of plans. This notice is issued in response to these comments and questions.

III. 2008 TRANSITION RELIEF

A. In General

Section 409A generally applies to amounts deferred under a nonqualified deferred compensation plan to the extent the amounts deferred under the plan were not earned and vested before January 1, 2005. The final regulations are applicable for taxable years beginning on or after January 1, 2008, and a nonqualified deferred compensation plan must meet the requirements set forth in the final regulations as of the first day of the taxable year. This section provides certain limited transition relief, until December 31, 2008, with respect to the plan document requirements. The transition relief in this notice is not an extension of any of the transition relief provided in Notice 2005-1, 2005-1 CB 274, the preamble to the proposed regulations under § 409A, 70 Fed. Reg. 57930 (Oct. 4, 2005), or Notice 2006-79, 2006-43 IRB 763. Accordingly, except where otherwise provided in the section of the preamble to the final regulations entitled "Effect on Other Documents," taxpayers may not rely upon Notice 2005-1, the proposed regulations, or a reasonable, good faith interpretation of the statute for taxable years beginning on or after January 1, 2008. In addition, after December 31, 2007, taxpayers may not change the time and form of payment except as permitted under the final regulations and this notice, and no change in the time and form of payment after December 31, 2007, may result in an amount that was deferred as of December 31, 2007, qualifying for an exclusion from the definition of deferred compensation under the final regulations. See § 1.409A-1(a)(1).

B. Retroactive Amendment Period

The written provisions of a plan may fail to meet the requirements of § 409A, the final regulations, and any other applicable guidance, because the plan includes a provision that causes the plan to fail to satisfy the requirements of § 409A, or because the plan fails to include a written provision that is required to satisfy the requirements of § 409A. (For purpose of this notice, § 409A, the final regulations, and any other guidance applicable to a plan or a deferred amount is referred to collectively as "the § 409A guidance".) However, under the transition relief provided in this notice, except as otherwise provided in section III.C of this notice addressing the designation of the time and form of payment of deferred amounts, a nonqualified deferred compensation plan will not violate the requirements of § 409A on or before December 31, 2008 merely because the written provisions of the plan fail to meet the requirements of the § 409A guidance, provided that the plan is operated in accordance with the requirements of the § 409A guidance and is amended on or before December 31, 2008 to comply with the § 409A guidance retroactively to January 1, 2008.

A plan is treated as having been amended to comply with the § 409A guidance retroactively to January 1, 2008, only if the written plan, as amended, contains all of the written provisions required by the final regulations and accurately reflects the operation of the plan on and after January 1, 2008, through the date of the amendment, including the terms and conditions under which any initial deferral elections or subsequent deferral elections were permitted, and how the operation of such plan met the requirements of the § 409A guidance on and after January 1, 2008, through the date of the amendment. For additional guidance related to the adoption of new plans, or the adoption of an amendment to an existing plan increasing amounts deferred under the plan, see § 1.409A-1(c)(3)(i) and (vi).

C. Transition Relief - Designation of a Compliant Time and Form of Payment

This section provides guidelines under which, for periods on or before December 31, 2008, a nonqualified deferred compensation plan will be treated as meeting the requirement to timely designate a time and form of payment of an amount deferred under the plan. Nothing in this section alters the requirement that the plan be operated in accordance with the requirements of the § 409A guidance (including this notice) on and after January 1, 2008, and be amended on or before December 31, 2008, to comply with § 409A and the applicable guidance retroactively to January 1, 2008. For example, nothing in this notice alters the taxpayer's burden to demonstrate that any initial deferral election or subsequent deferral election was made in a manner that complied in operation with the § 409A guidance. In addition, nothing in this section alters the restrictions on changes in the time and form of payment on or before December 31, 2007 under the transition rules set forth in Notice 2005-1, the preamble to the proposed regulations, Notice 2006-79, and the preamble to the final regulations.

1. How to Designate the Time and Form of Payment

Unless a later date is permitted under the final regulations, if there have been deferrals of compensation under a plan as of January 1, 2008, but the deferred compensation has not been paid, the plan will not comply with § 409A after December 31, 2007, unless the plan designates in writing before January 1, 2008, a compliant time and form of payment of such deferred compensation. Amounts deferred after December 31, 2007, and before January 1, 2009, will not comply with § 409A unless the plan designates in writing a compliant time and form of payment of such amounts on or before the applicable deadline under the final regulations (See § 1.409A-2(a) for the rules governing initial deferral elections). For purposes of this section, a plan will designate a compliant time and form of payment of an amount if the written plan terms, disregarding any written plan provisions that do not comply with the § 409A guidance (including this section), provide a compliant time and form of payment as described in section III.C.2 of this notice. For example, if a plan provides for a payment upon a separation from service, but permits the service provider to elect an immediate lump sum payment subject to a forfeiture of a specified portion of the deferred amount (a haircut provision), the haircut provision may be disregarded and the plan will be treated as providing for a payment upon a separation from service, provided the haircut provision is not utilized, and that the haircut provision is removed and the time and form of payment is otherwise fully compliant with the regulations by December 31, 2008. Also, for purposes of this section, a separate written document may be adopted that provides a time and form of payment for amounts deferred under arrangements that are specifically identified (for example, amounts deferred under the Company X Salary Deferral Plan), or that provides a time and form of payment for amounts deferred under arrangements that are not specifically identified (for example, amounts deferred under any arrangement with the service recipient providing the service provider deferred compensation subject to § 409A), or a combination (for example specifying a time and form of payment for amounts deferred under the Company X Salary Deferral Plan, and another time and form of payment for amounts deferred under all other arrangements with the service recipient providing the service provider deferred compensation subject to § 409A), provided that the deferred amounts to which each designated time and form of payment applies are objectively determinable.

2. How to Designate a Compliant Time and Form of Payment

For purposes of this section III.C, a plan will only provide for a compliant time and form of payment for a deferred amount if the plan provides for an objectively determinable form of payment payable upon:

(1) A separation from service;

(2) A change in control event;

(3) An unforeseeable emergency;

(4) A specified date or fixed schedule of payments;

(5) Death; or

(6) Disability.

For example, a plan may provide that an amount deferred under the plan will be paid in the form of a life annuity commencing on the later of the service provider's separation from service or attaining age 65. However, a plan may not provide that an amount deferred under the plan will be paid during the three years following the service provider's separation from service (with the exact timing of the payment during the three-year period determined at the discretion of the service recipient), because that plan term would not provide a compliant time and form of payment. Similarly, a stock option that is subject to § 409A could not provide the service provider the discretion to exercise the stock option over more than one taxable year, because that plan term would not provide a compliant time of payment. See § 1.409A-3(c) for rules on when a plan may designate alternative specified dates or payment schedules with respect to particular payment events.

If the objectively determinable form of payment is a series of installment payments, as defined in § 1.409A-2(b)(2)(iii), the series of installment payments is treated as a single payment unless the plan designates in writing on or before the deadline by which the time and form of payment must be set forth in writing under section III.C.1 of this notice (the section III.C.1 deadline), that the series of installment payments is to be treated as a right to a series of separate payments. On and after the section III.C.1 deadline, the treatment of a series of installment payments as a single payment or as a series of separate payments may not be modified except as permitted under the final regulations.

The plan may specify any combination of payment events that is permissible under the final regulations, including that a deferred amount is to be paid upon the earliest of these events or the latest of these events. However, if a payment event is not specified in writing as a potential payment event on or before the section III.C.1 deadline, the addition of that payment event as a potential payment event is subject to the anti-acceleration provisions under § 1.409A-3(j) and the subsequent deferral election provisions under § 1.409A-2(b). For example, a plan providing for the payment of an amount upon the earliest of a service provider's death, disability, or separation from service would provide for a compliant time and form of payment. However, the modification of the provision after the section III.C.1 deadline to provide for the payment of the amount upon the earliest of a service provider's death, disability, or separation from service, or a change in control event, would be an impermissible acceleration of the payment. Similarly, if a payment event is specified in writing on the section III.C.1 deadline as a potential payment event, the removal of the payment event after the applicable deadline as a potential payment event is subject to the anti-acceleration provisions under § 1.409A-3(j) and the subsequent deferral election provisions under § 1.409A-2(b).

3. Retroactive Adoption of Permissible Payment Event Definitions

For purposes of this section, *separation from service* means any event that may qualify as a separation from service under § 1.409A-1(h), *change in control event* means any event that may qualify as a change in control event under § 1.409A-3(i)(5), *unforeseeable emergency* means any event that may qualify as an unforeseeable emergency under § 1.409A-3(i)(3), and *disability* means any event that may qualify as a disability under § 1.409A-3(i)(4). For example, a plan providing only that a payment will be made upon a separation from service (or similar term such as termination of employment) may be treated as providing for a payment upon a separation from service as defined in § 1.409A-1(h). However, the plan must be operated in accordance with the final regulations, so that a payment due upon the service provider's separation from service could only be made upon an event that met the requirements of the definition of separation from service set forth in §1.409A-1(h), and the plan must be amended by December 31, 2008 to accurately reflect the application of the provisions during 2008 and to fully comply with the requirements of the final regulations. Similarly, a plan providing that a payment will be made upon the service provider's disability may be treated as providing for a payment upon a disability as defined in § 1.409A-3(i)(4). However, the plan must be operated in accordance with the final regulations, so that a payment due upon the service provider's disability could only be made upon a disability that met the requirements of the definition of disability set forth in § 1.409A-3(i)(4), and the plan must be amended by December 31, 2008 to accurately reflect the application of the provision during 2008 and to fully comply with the requirements of the final regulations.

For a deferred amount, a plan will not be treated as failing to meet the requirements of § 409A and the final regulations merely because the plan fails to specify in writing the definition of a payment event that is a separation from service, a change in control event, disability, or unforeseeable emergency, applied under the plan on or before December 31, 2008, provided that the definition applied is permissible under the final regulations and the plan is amended on or before December 31, 2008, to accurately reflect the application of the provision during 2008 and to fully comply with the requirements of the final regulations. For example, § 1.409A-1(h)(1)(ii) provides that whether a termination of employment that is a separation from service has occurred is determined based on whether the facts and circumstances indicate that the employer and employee reasonably anticipated that no further services would be performed after a certain date or that the level of bona fide services the employee would perform after such date (whether as an employee or as an independent contractor) would permanently decrease to no more than 20 percent of the average level of bona fide services performed (whether as an employee or an independent contractor) over the immediately preceding 36-month period (or the full period of services to the employer if the employee has been providing services to the employer for less than 36 months). Section 1.409A-1(h)(1)(ii) further provides that a plan may treat another level of reasonably anticipated permanent reduction in the level of bona fide services as a separation from service, provided that the level of reduction required must be designated in writing as a specific percentage, and the reasonably anticipated reduced level of bona fide services must be greater than 20% but less than 50% of the average level of bona fide services provided in the immediately preceding 36 months. A plan is not required to set forth in writing as of January 1, 2008 whether this alternative definition has been adopted, and may provide that a payment is to be made upon a separation from service of an employee without designating whether the required reduction in the level of services is 20%, 50%, or some other reduction in the level of services available under the final regulations. However, not later than December 31, 2008, the written terms of the plan, including the designation of the payment date, must be both fully compliant with the final regulations and consistent with the application of such designated payment event on and after January 1, 2008.

If a payment event that is a separation from service, a change in control event, an unforeseeable emergency, or a disability, has been timely designated, a later adoption of an alternative definition of the designated payment event, as applicable (or if an alternative definition has been adopted, an adoption of the default definition or another alternative definition), on or before December 31, 2008, will not be treated as a change in the time or form of payment, regardless of whether the adoption of the alternative definition would result in a payment being made at an earlier or later date than under the default definition or the previously designated definition (for example, an alternative definition is adopted during 2007, and a new alternative definition is adopted during 2008). Solely for purposes of effecting the relief provided in this section III.C.3, the availability of a payment to a service provider had the service recipient not been permitted to adopt an alternative definition will not be treated as causing the amount to be includible in income under § 451 or the doctrine of constructive receipt. However, once an event has occurred in 2008 and been treated as a payment event (or as not qualifying as a payment event), the service recipient and service provider may not retroactively alter the definition of the payment event applicable to such deferred amount.

For example, assume that as of December 31, 2007, a plan provided for a deferred amount to be paid as a lump sum payment on or before the 30th day following an employee's separation of service whose level of services for the past 3 years has been 40 hours per week. Assume further that on April 1, 2008, the participating employee (who is not a specified employee) permanently reduces his level of services from 40 hours per week to 10 hours per week. If the amount is paid on or before December 31, 2008, the payment would be consistent with the adoption of a definition of separation from service that is consistent with the requirements of the final regulations for a separation from service, which in this case would be a permanent reduction in the level of services to a level at or below 25% of the level of services previously provided. As of December 31, 2008, the plan would be required to be amended retroactively with respect to that deferred amount to reflect a definition of separation from service consistent with that treatment. In contrast, if the amount is not paid on or before December 31, 2008, the failure to make a payment would be consistent with a definition of separation from service that did not include a reduction in the level of services to a level at or above 25% of the level of services previously provided. As of December 31, 2008, the plan either would be required to apply the default definition of separation from service in the final regulations or would be required to be amended retroactively to reflect a definition of separation from service consistent with that treatment , and any change in the definition of separation from service with respect to such deferred amount after the participating employee's permanent reduction in the level of services on April 1, 2008, would be subject to the anti-acceleration provisions of § 1.409A-3(j) and the subsequent deferral election provisions of § 1.409A-2(b).

4. How to Designate a Specified Payment Date or a Fixed Schedule of Payments

For purposes of section III.C.1, the designation of a specified payment date or a fixed schedule of payments, including the use of a specified payment date or a fixed schedule of payments after a permissible payment event or the lapse of a substantial risk of forfeiture, must meet the requirements of § 1.409A-3(i)(1). Accordingly, the plan must meet the requirements of § 1.409A-3(i)(1) by December 31, 2007, for any amount that will be paid in accordance with:

(1) § 1.409A-3(i)(1)(i) (specified time or fixed schedule in general);

(2) § 1.409A-3(i)(1)(ii) (payment schedules with formula and fixed limitations);

(3) § 1.409A-3(i)(1)(iii) (payment schedules determined by timing of payments received by the service recipient);

(4) § 1.409A-3(i)(1)(iv) (reimbursement or in-kind benefit plans); and

(5) § 1.409A-3(i)(1)(v) (tax gross-up payments)

However, a payment schedule that would otherwise qualify as a fixed schedule of payments under § 1.409A-3(i)(1)(v) (tax gross-up payments), except that the arrangement does not require that the payment be made by the end of the service provider's taxable year next following the service provider's taxable year in which the service provider remits the related taxes, will be treated as designating a fixed schedule of payments if the plan is amended on or before December 31, 2008 to provide for such a requirement, and the plan is operated in compliance with such requirement for periods after December 31, 2007 through the date of the amendment.

In addition, for a specified payment date or a fixed schedule of payments, the addition or deletion of a designated payment provision that meets the requirements of

§ 1.409A-3(b) or § 1.409A-3(i)(1)(i), as applicable, and does not affect the taxable year in which the payment will be made, is not treated as a change in the time and form of payment if the addition or deletion is made on or before December 31, 2008. For example, if a plan provides for an immediate lump sum payment upon death, the addition of a plan provision on or before December 31, 2008, providing that the payment will be made on or before the end of the service provider's taxable year in which the event occurs will not be treated as a change in the time and form of payment. The addition, deletion or modification of a provision that provides that a payment (including a payment that is part of a schedule) is to be made during a designated period objectively determinable and nondiscretionary at the time the payment event occurs if the designated period is not more than 90 days and the service provider does not have a right to designate the taxable year of the payment (other than an election that complies with the subsequent deferral election rules of § 1.409A-2(b)), also will not be treated as a change in the time and form of payment. For example, if a plan provides that a payment will be made in a lump sum payment upon separation from service, a modification of the plan on or before December 31, 2008, to provide that the payment will be made on or before the 90^{th} day following the separation from service, determined at the sole discretion of the service recipient, is not treated as a change in the time and form of payment. However, plan provisions designating the time and form of payment must be fully compliant with the final regulations as of December 31, 2008.

5. Retroactive Amendments and the Six-Month Delay on Payments to Specified Employees

Section 1.409A-3(i)(2) provides that in the case of any service provider who is a specified employee (as defined in § 1.409A-1(i)) as of the date of a separation from service, the requirements of § 1.409A-1(a)(1) permitting a payment upon a separation from service are satisfied only if payments may not be made before the date that is six months after the date of separation from service (or, if earlier than the end of the six-month period, the date of death of the specified employee). Section 1.409A-1(c)(3)(v) generally requires that the delay requirement be a written provision of any plan providing for a payment upon separation from service to a specified employee. Provided that such payments are delayed in accordance with § 1.409A-1(a)(1), a plan will not be treated as failing to meet the requirements of § 1.409A-1(c)(3)(v) provided that the plan is amended on or before December 31, 2008, retroactively to January 1, 2008, to contain the requirement, and the written plan provision accurately reflects the operation of the plan through the date of the amendment. Taxpayers must demonstrate that the required delay was applied to affected payments. Accordingly, if the service recipient has used any provisions other than the default provisions of § 1.409A-1(i) to identify specified employees, taxpayers must demonstrate the method by which the service recipient identified any specified employees, and that such method of identifying specified employees was applied consistently to all plans and all service providers.

IV. APPLICATION OF FINAL REGULATIONS AND ADDITIONAL RELIEF

A. Employment Agreements - Good Reason Provisions

Whether a separation from service is involuntary generally is important for the application of the exception from the definition of deferred compensation contained in § 1.409A-1(b)(4) (the short-term deferral rule). Under the short-term deferral rule, an arrangement that provides for a payment within certain limited periods following the lapse of a substantial risk of forfeiture may not constitute deferred compensation. Section 1.409A-1(d) provides that if a service provider's entitlement to an amount is conditioned on the occurrence of the service provider's involuntary separation from service without cause, the right is subject to a substantial risk of forfeiture if the possibility of forfeiture is substantial.

Whether a separation from service is involuntary is also important for the application of the exclusion for certain separation pay arrangements under § 1.409A-1(b)(9). That provision excludes from deferred compensation a right to certain amounts that are payable within a limited period of time following an involuntary separation from service, and is available only if the amounts are payable upon an involuntary separation from service (often referred to as the "two-year, two-time rule").

Section 1.409A-1(n) provides a definition of an involuntary separation from service. Section 1.409A-1(n)(2)(i) provides that as a general rule a service provider's voluntary separation from service will be treated as an involuntary separation from service if the separation from service occurs under certain limited bona fide conditions, where the avoidance of the requirements of § 409A is not a purpose of the inclusion of these conditions in the plan or of the actions by the service recipient in connection with the satisfaction of these conditions, and a voluntary separation from service under such conditions effectively constitutes an involuntary separation from service. Section 1.409A-1(n)(2)(ii) contains a safe harbor setting forth a set of conditions often referred to as the "safe harbor good reason conditions". The safe harbor states that if a plan provides that a voluntary separation from service will be treated as an involuntary separation from service if the separation from service occurs under certain express conditions, a separation from service satisfying the conditions set forth in the plan will be treated as an involuntary separation from service if the necessary conditions (or set of conditions) satisfy the requirements of the regulations.

Commentators have stated that to ensure qualification for one or both of the short-term deferral rule or the two-year, two-time rule, taxpayers have considered modifying employment arrangements that currently provide for a payment upon a voluntary separation from service under certain conditions (often referred to as "good reason conditions"), including modifying the good reason conditions under which an employee could voluntarily terminate employment and receive payments. Some taxpayers want to replace the existing good reason conditions in their agreements with a set of safe harbor good reason conditions qualifying under § 1.409A-1(n)(2)(ii). Other taxpayers want to add only some of the safe harbor good reason conditions (for example, adding a requirement that the employee provide notice to the employer that the good reason condition has been satisfied). Other taxpayers have proposed removing a condition from an existing agreement, because the condition is not a condition found in the good reason safe harbor.

The modification of these arrangements raises issues regarding whether a substantial risk of forfeiture condition has been added or modified in a manner that would not be respected under Notice 2005-1, Q&A-10, proposed § 1.409A-1(d) or final § 1.409A-1(d). Notice 2005-1, Q&A-10 provides that any addition of a substantial risk of forfeiture after the beginning of the service period to which the compensation relates, or any extension of a period during which compensation is subject to a substantial risk of forfeiture, in either case whether elected by the service provider, service recipient or other person (or by agreement of two or more of such persons), is disregarded for purposes of determining whether such compensation is subject to a substantial risk of forfeiture. See also proposed and final § 1.409A-1(d).

The Treasury Department and the IRS understand that taxpayers may desire to conform existing good reason conditions to the requirements of the definition of an involuntary separation from service under the regulations. Accordingly, to the extent that a right to a payment subject to an existing good reason condition is subject to a substantial risk of forfeiture, the modification of the good reason condition on or before December 31, 2007 to conform to some or all of the conditions set forth in § 1.409A-1(n)(2) will not be treated as an extension of the substantial risk of forfeiture. However, if the right to a payment subject to existing good reason conditions is not subject to a substantial risk of forfeiture, the modification of such condition to include one or more of the conditions set forth in § 1.409A-1(n)(2)(ii), or to remove one or more of the existing good reason conditions, will not cause the amount to be treated as subject to a substantial risk of forfeiture.

As provided by Notice 2006-79, for amounts subject to § 409A, a plan may provide, or be amended to provide, for new payment elections on or before December 31, 2007, with respect to both the time and form of payment of such amounts and the election or amendment will not be treated as a change in the time or form of payment under § 409A(a)(4) or an acceleration of a payment under § 409A(a)(3), provided that the plan is so amended and elections are made on or before December 31, 2007. With respect to an election or amendment to change a time and form of payment made on or after January 1, 2007, and on or before December 31, 2007, the election or amendment may apply only to amounts that would not otherwise be payable in 2007 and may not cause an amount to be paid in 2007 that would not otherwise be payable in 2007. An election of a new time and form of payment under these transition rules may cause an amount to be excluded from coverage under § 409A. In the case of a right to a payment of deferred compensation, the modification of the time and form of the payment such that the payment will only be made upon an involuntary separation from service may result in the exclusion of such right, or a portion of such right, from the definition of deferred compensation under § 1.409A-1(b)(9) (the two-year, two-time rule), to the extent the amended arrangement otherwise met the requirements for the exclusion. In modifying the arrangement, however, taxpayers should ensure that the amendment does not affect amounts that otherwise would be payable in 2007 (for example, because a separation from service occurred during 2007).

B. Employment Agreements – Application of Substitution Rule

Commentators have asked about the conditions under which rights to deferred compensation under an extension of an employment agreement, or a negotiation of a new employment agreement, will constitute a new legally binding right to compensation rather than a substitution for rights to deferred compensation contained under a previous agreement. Until further guidance, if a right to deferred compensation payable only upon an involuntary separation from service (as defined under § 1.409A-1(n)) at all times under an employment agreement would automatically be forfeited at the end of the term of the employment agreement, then the grant of a right to deferred compensation in an extended, renewed or renegotiated employment agreement will not be treated as a substitute for the right that was forfeited at the termination of the prior employment agreement. For example, if an employment agreement at all times provides that an employee has a right to deferred compensation if the employee is involuntarily separated from service without cause during the three-year term of the employment agreement, but that deferred compensation will become payable at the end of the original three-year term of the employment agreement if the employee is available to perform services and the employer does not extend, renew, or replace the employment agreement, and at the end of the three-year term of the employment agreement the employee has not been involuntarily separated, the right to deferred compensation in a renewed, extended or renegotiated employment agreement may be viewed as a substitute for the right to deferred compensation in the original agreement. However, if the employment agreement had not provided that any deferred compensation would become payable at the end of the original three-year term of the employment agreement if the employee had been available to perform services and the employer had not extended, renewed or replaced the employment agreement, and the employee had not been involuntarily separated during the three-year term of the employment agreement, then a right to deferred compensation under an employment agreement covering services after the end of the original three-year term would not be treated as a substitute for the right to the deferred compensation upon an involuntary separation from service during the original three-year term.

C. Predetermined Cashouts

Section 1.409A-2(b)(2)(iii) provides a limited ability to provide for the cashout of all remaining installments under an installment payment provision when the present value of the remaining payments falls below the predetermined threshold. Section 1.409A-2(b)(2)(ii) provides a similar rule with respect to annuity payments.

Commentators asked whether a plan may provide for a lump sum payment at the payment date only if the present value of the payments at that date is below a predetermined amount, but continue to make any properly elected installment payments or annuity payments if the present value of the payments at the original payment date is above the predetermined amount, even if the present value of the remaining payments falls below the predetermined amount at a future date. In other words, the cashout threshold would apply only at the time of the original payment date, and not at any future date.

Section 1.409A-2(b)(2)(ii) and (iii) does not provide for this type of payment. However, commentators have asked whether such a provision would be treated as an objective, nondiscretionary payment formula for purposes of § 1.409A-3(b). Section 1.409A-3(b) provides that a plan may provide that a payment upon a qualifying payment event is to be made in accordance with a schedule that is objectively determinable and nondiscretionary based on the date the event occurs and that would qualify as a fixed schedule under § 1.409A-2(i)(1) if the payment event were instead a fixed date, provided that the schedule must be fixed at the time the permissible payment event is designated.

The use of this type of a cashout provision may, in certain circumstances, be subject to manipulation, so that this type of provision is not an objectively determinable and nondiscretionary schedule of payments. However, until further guidance, a taxpayer may treat such a provision as part of an objectively determinable and nondiscretionary payment schedule if the payment schedule would otherwise meet the requirements of the regulations, including that the cashout threshhold be fixed at the time the permissible payment event is designated, and if the taxpayer can demonstrate that the provision operated in an objective, nondiscretionary manner and did not operate so as to provide either the service provider or the service recipient with rights having substantially the effect of a right to a late election as to the time and form of payment. Any subsequent change in a cashout threshold applicable to a deferred amount is subject to the rules governing subsequent deferral elections and the acceleration of payments.

If such a provision is used in conjunction with an installment payment or annuity, the payment schedule generally would not meet the definition of an installment payment or annuity under § 1.409A-2(b)(2)(ii) and (iii), because the payment schedule would not necessarily provide for substantially equal payments over the service provider's lifetime or other predetermined period of time, but instead a lump sum payment if the threshold were not met and periodic payments if the threshold were met. However, until further guidance, the classification of the resulting schedule of payments if the cashout threshold is exceeded at the applicable payment date, whether or not such schedule of payments is intended to be an installment payment or life annuity, is determined as if the lump sum payment cashout threshold were not available. Accordingly, the resulting schedule of payments if the threshold is met must otherwise meet the requirements of § 1.409A-3, and if the resulting schedule of payments qualifies as a life annuity under § 1.409A-2(b)(ii), or as a series of installment payments treated as a single payment under § 1.409A-2(b)(2)(iii), the schedule of payments will be treated as a single payment for purposes of the subsequent deferral rules.

V. ANTICIPATED LIMITED VOLUNTARY COMPLIANCE PROGRAM

The Treasury Department and the IRS anticipate issuing guidance in the near future establishing a limited voluntary compliance program that will apply to certain unintentional operational failures to comply with § 409A. The Treasury Department and the IRS anticipate that such guidance will provide methods by which certain unintentional operational failures may be corrected in the same taxable year in which the operational failure occurred to avoid application of § 409A, and other methods by which certain unintentional operational failures may result in only limited amounts becoming includible in income and subject to additional taxes under § 409A.

VI. APPLICATION OF § 409A(b) (RESTRICTIONS ON CERTAIN TRUSTS AND OTHER ARRANGEMENTS)

Section 409A(b)(1) and (2) generally prohibits the use of offshore trusts in connection with amounts payable under a nonqualified deferred compensation plan, and also prohibits the use of restrictions on assets to protect the payment of benefits under a nonqualified deferred compensation plan in connection with a change in the service recipient's financial health. Section 409A(b)(3) generally also prohibits the transfer of assets to a trust or other arrangement for purposes of paying nonqualified deferred compensation to an applicable covered employee during, or the use of restrictions on assets to protect the payment of benefits under a nonqualified deferred compensation plan in connection with, a restricted period with respect to a single-employer defined benefit plan. For this purpose, a restricted period with respect to a single-employer defined benefit plan generally means any period during which the plan is in at-risk status (as defined in § 430(i), which was added by the Pension Protection Act of 2006), any period the plan sponsor is a debtor in a bankruptcy filing, and the 12-month period beginning on the date which is 6 months before the termination of the defined benefit plan if, as of the termination date, the plan is underfunded. Section 409A(b) provides generally that if these requirements are not met, the assets are treated for purposes of § 83 as property transferred in connection with the performance of services whether or not such assets are available to satisfy claims of general creditors, and that the taxpayer is liable for the additional § 409A taxes on the resulting income inclusion.

Notice 2006-33 provides that until further guidance is issued, taxpayers may rely upon a reasonable, good faith interpretation of § 409A(b) to determine whether the use of a trust or other arrangement causes an amount to be included in income under § 409A(b). The Treasury Department and the IRS intend to issue further guidance regarding the application of § 409A(b). Until such guidance is issued, taxpayers may continue to rely upon a reasonable, good faith interpretation of § 409A(b) to determine whether the use of a trust or other arrangement causes an amount to be included in income under § 409A(b), including the application of § 409A(b)(3) to transfers of assets during restricted periods.

Notice 2006-33 also provides that with respect to assets set aside, transferred or restricted on or before March 21, 2006 so as to be subject to inclusion under § 409A(b)(1) or 409A(b)(2) (grace period assets), taxpayers will be treated as not having triggered the inclusion or additional tax provisions of § 409A(b) if the nonqualified deferred compensation plan comes into conformity on or before December 31, 2007, with the requirements of § 409A(b) and any guidance issued before such date. Nothing in this section curtails this relief; however, this relief is not extended beyond December 31, 2007. Accordingly, for grace period assets, a taxpayer will trigger the income inclusion and additional tax provisions of § 409A(b) if the nonqualified deferred compensation plan is not in conformity with a reasonable, good faith interpretation of § 409A(b) on or after December 31, 2007. If with respect to grace period assets the nonqualified deferred compensation plan is not in conformity with a reasonable, good faith interpretation of § 409A(b) on December 31, 2007, the taxpayer will trigger the income inclusion and additional tax provisions of § 409A(b) on January 1, 2008.

VII. DRAFTING INFORMATION

The principal author of this notice is Stephen Tackney of the Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). However, other personnel from the Treasury Department and the IRS participated in its development. For further information regarding this notice, contact Stephen Tackney at (202) 927-9639 (not a toll-free call).

PRESS ROOM

September 11, 2007
2007-9-11-11-59-5-17643

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 $68,093 million as of the end of that week, compared to $67,376 million as of the end of the prior week.

I. Official reserve assets and other foreign currency assets (approximate market value, in US millions)

	September 7, 2007		
A. Official reserve assets (in US millions unless otherwise specified)	Euro	Yen	Total
(1) Foreign currency reserves (in convertible foreign currencies)			68,093
(a) Securities	13,398	11,213	24,611
of which: issuer headquartered in reporting country but located abroad			0
(b) total currency and deposits with:			
(i) other national central banks, BIS and IMF	13,351	5,521	18,872
ii) banks headquartered in the reporting country			0
of which: located abroad			0
(iii) banks headquartered outside the reporting country			0
of which: located in the reporting country			0
(2) IMF reserve position	4,396		
(3) SDRs	9,173		
(4) gold (including gold deposits and, if appropriate, gold swapped)	11,041		
--volume in millions of fine troy ounces	261.499		
(5) other reserve assets (specify)	0		
--financial derivatives			
--loans to nonbank nonresidents			
--other			
B. Other foreign currency assets (specify)			
--securities not included in official reserve assets			
--deposits not included in official reserve assets			
--loans not included in official reserve assets			
--financial derivatives not included in official reserve assets			
--gold not included in official reserve assets			
--other			

II. Predetermined short-term net drains on foreign currency assets (nominal value)

			Maturity breakdown (residual maturity)		
		Total	Up to 1 month	More than 1 and up to 3 months	More than 3 months and up to 1 year
1. Foreign currency loans, securities, and deposits					
--outflows (-)	Principal				
	Interest				
--inflows (+)	Principal				
	Interest				
2. Aggregate short and long positions in forwards and futures in foreign currencies vis-à-vis the domestic currency (including the forward leg of currency swaps)					
(a) Short positions (-)					
(b) Long positions (+)					
3. Other (specify)					
--outflows related to repos (-)					
--inflows related to reverse repos (+)					
--trade credit (-)					
--trade credit (+)					
--other accounts payable (-)					
--other accounts receivable (+)					

III. Contingent short-term net drains on foreign currency assets (nominal value)

		Maturity breakdown (residual maturity, where applicable)		
	Total	Up to 1 month	More than 1 and up to 3 months	More than 3 months and up to 1 year
1. Contingent liabilities in foreign currency				
(a) Collateral guarantees on debt falling due within 1 year				
(b) Other contingent liabilities				
2. Foreign currency securities issued with embedded options (puttable bonds)				
3. Undrawn, unconditional credit lines provided by:				
(a) other national monetary authorities, BIS, IMF, and other international organizations				
--other national monetary authorities (+)				
--BIS (+)				
--IMF (+)				
(b) with banks and other financial institutions headquartered in the reporting country (+)				

(c) with banks and other financial institutions headquartered outside the reporting country (+)				
Undrawn, unconditional credit lines provided to:				
(a) other national monetary authorities, BIS, IMF, and other international organizations				
--other national monetary authorities (-)				
--BIS (-)				
--IMF (-)				
(b) banks and other financial institutions headquartered in reporting country (-)				
(c) banks and other financial institutions headquartered outside the reporting country (-)				
4. Aggregate short and long positions of options in foreign currencies vis-à-vis the domestic currency				
(a) Short positions				
(i) Bought puts				
(ii) Written calls				
(b) Long positions				
(i) Bought calls				
(ii) Written puts				
PRO MEMORIA: In-the-money options [11]				
(1) At current exchange rate				
(a) Short position				
(b) Long position				
(2) + 5 % (depreciation of 5%)				
(a) Short position				
(b) Long position				
(3) - 5 % (appreciation of 5%)				
(a) Short position				
(b) Long position				
(4) +10 % (depreciation of 10%)				
(a) Short position				
(b) Long position				
(5) - 10 % (appreciation of 10%)				
(a) Short position				
(b) Long position				
(6) Other (specify)				
(a) Short position				
(b) Long position				

IV. Memo items

(1) To be reported with standard periodicity and timeliness:	
(a) short-term domestic currency debt indexed to the exchange rate	
(b) financial instruments denominated in foreign currency and settled by other means (e.g., in domestic	

currency)	
--nondeliverable forwards	
--short positions	
--long positions	
--other instruments	
(c) pledged assets	
--included in reserve assets	
--included in other foreign currency assets	
(d) securities lent and on repo	
--lent or repoed and included in Section I	
--lent or repoed but not included in Section I	
--borrowed or acquired and included in Section I	
--borrowed or acquired but not included in Section I	
(e) financial derivative assets (net, marked to market)	
--forwards	
--futures	
--swaps	
--options	
--other	
(f) derivatives (forward, futures, or options contracts) that have a residual maturity greater than one year, which are subject to margin calls.	
--aggregate short and long positions in forwards and futures in foreign currencies vis-à-vis the domestic currency (including the forward leg of currency swaps)	
(a) short positions (–)	
(b) long positions (+)	
--aggregate short and long positions of options in foreign currencies vis-à-vis the domestic currency	
(a) short positions	
(i) bought puts	
(ii) written calls	
(b) long positions	
(i) bought calls	
(ii) written puts	
(2) To be disclosed less frequently:	
(a) currency composition of reserves (by groups of currencies)	68,093
--currencies in SDR basket	68,093
--currencies not in SDR basket	
--by individual currencies (optional)	

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.

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 11, 2007
HP-552

Treasury Secretary Paulson to Visit Chicago This Week

Treasury Secretary Henry M. Paulson, Jr. will travel to Chicago Friday to discuss the importance of trade and investment for U.S. job creation and economic growth. The Secretary also will announce $27.3 million in awards to organizations investing in rural and urban low-income communities in 30 states and the District of Columbia.

The Secretary will tour ATLAS Material Testing Technology, a local business that exports to several countries around the world including Korea, Colombia, Panama, and Peru. Secretary Paulson will note the importance of passing the four pending Free Trade Agreements with those countries for U.S. businesses like ATLAS.

Secretary Paulson will join Community Development Financial Institutions Fund Director Kimberly Reed to announce the national 2007 CDFI Fund Program Awards. The announcement will take place at the Neighborhood Housing Services of Chicago, a counseling agency that helps area homeowners avoid foreclosure. President Bush recently tasked Secretary Paulson and HUD Secretary Alphonso Jackson to reach out to groups that offer foreclosure counseling and refinancing for homeowners with the goal of expanding mortgage financing options, identifying homeowners before they face hardships, helping them understand their financing options, and assisting them in finding a mortgage product that works for them.

The following events are open to media:

What
Community Development Financial Institutions Program Award Announcement
When
10 a.m. CDT
Where
Neighborhood Housing Services of Chicago
1279 North Milwaukee, 5th Floor
Chicago, Ill.

What
Tour and Remarks at ATLAS Material Testing Technology
When
12:30 p.m. CDT
Where
4114 North Ravenswood Avenue
Chicago, Ill.

PRESS ROOM

September 13, 2007
HP-553

Statement by Secretary Paulson
on the
Volcker Report of the World Bank's Department of Institutional Integrity

Washington--Treasury Secretary Henry M. Paulson, Jr. issued the following statement today on the Independent Review Panel's report of the World Bank's Department of Institutional Integrity (INT), chaired by Paul Volcker.

"I join World Bank President Zoellick in welcoming this report and would like to thank Chairman Volcker and his panel for their invaluable contribution to this essential work. The panel's report makes clear that fighting corruption is critical to fulfilling the Bank's core mission of economic development and poverty reduction around the world, that the INT must continue to play a central role in this effort and that more work is needed to integrate its work into the Bank's operations effectively and consistently. I look forward to working closely with other shareholders and President Zoellick as he carries this vital work forward."

PRESS ROOM

September 14, 2007
HP-554

Update: Treasury Secretary Paulson to Visit Paris and London Next Week

Treasury Secretary Henry M. Paulson, Jr. will travel to Europe next week to meet with officials in Paris and London. Secretary Paulson will meet with French President Nicolas Sarkozy, and senior French officials, including Finance Minister Christine Lagarde on Monday, September 17. He will then travel to London to meet with Prime Minister Gordon Brown and Chancellor of the Exchequer Alistair Darling that afternoon.

The following events are open to credentialed media:

Who:
Secretary Henry M. Paulson, Jr.
What:
Press Availability with French Finance Minister Christine Lagarde
Where: Ministry of Finance
139, rue de Bercy
Paris, France
When:
Monday, September 17, 8:50 a.m. CEST

Who:
Secretary Henry M. Paulson, Jr.
What:
Press Availability with Chancellor of the Exchequer Alistair Darling
Where:
11 Downing Street
London, England
When:
Monday, September 17, 5:45 p.m. BST

PRESS ROOM

September 14, 2007
HP-555

U.S. Treasury Secretary Announces $27.3 Million for Organizations Serving Economically Distressed BR>Organizations Serving Economically Distressed Communities

Chicago – U.S. Treasury Secretary Henry M. Paulson, Jr. joined the Treasury's Director of the Community Development Financial Institutions Fund, Kimberly A. Reed, in Chicago today to announce more than $27 million in awards to 68 organizations serving economically distressed communities in 30 states and the District of Columbia. The awards were made under the 2007 round of the CDFI Fund's Community Development Financial Institutions Program.

"The vision of the CDFI Fund is to help give all Americans access to affordable credit, capital, and financial services," said Secretary Paulson. "The President asked Treasury to focus on helping struggling homeowners keep their primary residence, and we will rely on the help of CDFI organizations like Neighborhood Housing Services of Chicago to reach borrowers who are likely to have trouble, and work with them to help them keep their homes."

"Many of the organizations we are awarding today are on the front lines of creating real solutions for those facing foreclosure in our nation's rural and urban low-income communities," said CDFI Fund Director Reed. "The awards we are making today will provide these community-based lenders with the resources to do even more for their communities --such as more foreclosure prevention counseling and capital for market-rate loans to refinance mortgages and keep families in their homes."

Treasury chose Chicago as the site for the national award announcement to highlight one of its award recipients – Neighborhood Housing Services of Chicago – which has been recognized for administering one of most successful anti-foreclosure programs in the country. NHS of Chicago's Home Ownership Preservation Initiative is a unique public-private partnership with the City of Chicago, the Federal Reserve Bank of Chicago, and several leading financial institutions. Since 2003, the program has provided solutions to the many problems associated with predatory lending, loan default, and foreclosure. In the past three years, their counseling and refinancing strategies have saved 1,300 Chicago-area homeowners from foreclosure.

The organizations awarded were selected through a competitive review of 184 applications from organizations nationwide requesting more than $138.4 million in funding under the 2007 round of the CDFI Program. Nationwide, the awards totaled $27,336,573.

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.

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

September 14, 2007
hp-556

**Remarks by Secretary Henry M. Paulson, Jr.
at Atlas Material Testing Technology**

Chicago, Ill. – Thank you, Russell, for the opportunity to learn more about Atlas and your operations.

For those who don't know, Atlas is an innovative company, founded in 1918, that manufactures equipment that simulates weather conditions --- sun, rain, heat and humidity --- for their clients who manufacture products, providing them the data needed to test their products' durability.

Atlas continues to pioneer new methods of durability testing, and from its headquarters here in America's heartland, Atlas sells across the globe. Companies like Atlas, and your employees, form the basis and promise of the American economy.

And we have a healthy U.S. economy today, and the strongest global economy I've seen in my business lifetime. Our unemployment rate remains low and real wages are rising. The United States' businesses and workers are the envy of the world. In industry after industry, we innovate, create and define what's possible.

In order to keep our economy healthy and extend this sixth year of economic expansion, we need to focus on areas that are vital to maintain our economic leadership.

First, international trade and investment, opening markets around the world to U.S. goods and services and keeping our markets open to competition. I see rising protectionist sentiment in the U.S. and around the world. It is ironic that protectionism is rising at a time when the global economy is so strong.

Trade is vital to continued growth in Illinois and throughout the U.S. And the U.S. has long been a leading advocate and beneficiary of global trade and investment and we must keep it that way. Globalization is here to stay and it is important that we continue to benefit from it rather than retreat into isolationism.

Illinois is the fifth largest exporter of the fifty states, selling over $42 billion of goods overseas last year. $12 billion of those goods were machinery manufacturing.

Over the past five years, Atlas has grown its exports by 12% on average each year and this year will export $30 million worth of goods.

About 14,000 Illinois companies, almost 90% of them companies that employ fewer than 500 people, exported goods in 2005. That is clear proof that it's not just multinational and Fortune 500 companies that benefit from trade --- the benefits of free trade spread across the economic landscape, and create jobs in companies of every size.

Congress has the opportunity to act quickly to generate even more opportunities for Illinois and U.S. workers --- by approving four Free Trade Agreements. The Peru Agreement will be the first Congress considers – but it shouldn't be the last. Colombia should follow quickly. And then we need to press for Panama and South Korea, too.

Colombian President Uribe has taken tough steps to improve conditions in his country, and he deserves our support. And, as the 8th largest economy in the world, South Korea is a very significant market for U.S. exports.

Far from creating obstacles for economic growth, these trade agreements will level the playing field and provide greater opportunity for Illinois' companies to sell goods to these countries.

I agree with Russell that lowering trade barriers in Latin America would mean growth for his company and his employees -- it would provide access to large and growing markets in our American neighborhood. Atlas sells products around the world and in each of the four countries where agreements await --- Peru, Colombia, Panama and Korea --- and Russell knows what he's talking about.

Trade with China is also critical to our continued economic growth. Our exports to China are rising rapidly, and there is great potential for more. I recognize that China has become a big political issue --- due, in part, to their own actions and also because China has become a symbol for globalization fears.

Our relationship with China is complex, and that makes the issues more difficult. But keeping our economic relationship on an even keel is critical - maintaining and building trade, and also working to persuade the Chinese to reform their own economy more quickly, because the health of their economy affects the health of the global economy.

I am impatient with the pace of change in China, and I know Congress is impatient. But legislation that would impose unilateral, punitive trade sanctions isn't the answer. I don't want to start a trade war. Punitive trade legislation could have enormous repercussions, especially when we are working to extend our economic expansion and get through a turbulent time in our markets.

Proven economic principles show that nations that open themselves up to competition - in trade, finance, and investment – benefit, while those that don't are left behind. Openness to trade and competition fuels innovation and creates good-paying jobs that raise productivity and standards of living in both rural and urban economies.

In our rapidly changing economy, we see job losses and dislocations in particular companies, industries, and even regions – just as there are new opportunities in others. But making trade a scapegoat and enacting protectionist policies would make us worse off. We should recognize the hardships and work to alleviate them, while keeping in sight the higher living standards Americans enjoy as a result of economic dynamism.

That dynamism will be best served by Congress acting quickly to enact these free trade agreements. The global economy is here to stay. To keep growing and leading the world in innovation and opportunity, the U.S. must trade freely, openly, and according to the principles of the global marketplace.

Thank you for the opportunity to meet with you this afternoon.

PRESS ROOM

September 14, 2007
HP-557

Treasury Department Appoints Michael Duffy
as
Deputy Assistant Secretary for Information Systems and Chief Information Officer

The Treasury Department announced this week the appointment of Michael Duffy as the Department's Deputy Assistant Secretary for Information Systems and Chief Information Officer. Duffy comes to Treasury from the U.S. Department of Justice where he served as Deputy Chief Information Officer, eGovernment for the past four years. The appointment is effective September 10, 2007.

In his 15 years in the Justice Department's CIO office, Duffy directed the development and implementation of the national strategy to exchange criminal investigative and intelligence data across all jurisdictions. Duffy led the implementation of a multi-agency wireless communications system for federal law enforcement and homeland security field operations. He has also worked with the Office of Management and Budget to implement multiple eGovernment initiatives.

The Deputy Assistant Secretary for Information Systems/Chief Information Officer serves as Treasury's principal advisor on information technology issues. This position is responsible for acquiring and managing information resources and provides broad leadership in planning, budgeting, acquiring, and managing Departmental and bureau technology resources.

Duffy will also formulate policies and programs to maximize the value of technology investments and manage investment risks across the Department. In partnership with the CIO Council, the CIO ensures that Department-wide and enterprise-wide corporate systems development, integration, and operational and security issues are addressed.

Duffy has a B.A. from Bowdoin College and a Masters in public administration from the University of Massachusetts.

PRESS ROOM

September 14, 2007
hp-558

Media Advisory:
Treasury Asst. Secretary to Visit Boston

Treasury Assistant Secretary for Financial Markets Anthony W. Ryan will give remarks Tuesday before the Asset Managers Group at the SIFMA Management Conference in Boston, Mass. The Assistant Secretary will discuss risk management, fiduciary responsibility and the Principles and Guidelines for Private Pools of Capital that the President's Working Group on Financial Markets released in February. The following event is open to credentialed media:

Who	Assistant Secretary for Financial Markets Anthony W. Ryan
What	Remarks on Risk Management and Fiduciary Responsibility
When	Tuesday, September 18, 12 p.m. EDT
Where	2007 SIFMA Management Conference, SIFMA Asset Managers Group The Algonquin Club 217 Commonwealth Avenue Boston, Mass.

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PRESS ROOM

September 17, 2007
hp-559

Treasury Assistant Secretary Swagel to Participate in Panel on Outlook for the U.S. Economy

Treasury Assistant Secretary for Economic Policy Phillip Swagel will participate in a panel discussion on the outlook for the U.S economy as part of the Women Impacting Public Policy and Small Business & Entrepreneurship Council Policy and Politics Conference on Tuesday. He will discuss the key indicators driving economic performance and what this means for business conditions both in the short and long-term. Raymond J. Keating, Chief Economist for Small Business & Entrepreneurship Council and Margo Thorning, Senior Vice President and Chief Economist at American Council for Capital Formation will also participate in the panel discussion. The following event is open to all credentialed media:

Who Treasury Assistant Secretary for Economic Policy Phillip Swagel

What Panel on Outlook for the Economy
Women Impacting Public Policy and Small Business & Entrepreneurship Council Policy and Politics Conference

When Tuesday, September 18, 2007, 2:00 p.m. (EDT)

Where Renaissance Mayflower Hotel
State Room
1127 Connecticut Avenue, NW
Washington, DC

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FROM THE OFFICE OF PUBLIC AFFAIRS

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September 18, 2007
HP-560

Treasury International Capital (TIC) 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, which will report on data for August, is scheduled for October 16, 2007.

Net foreign purchases of long-term securities were $19.2 billion.

- Net foreign purchases of long-term U.S. securities were $24.7 billion. Of this, net purchases by foreign official institutions were $4.4 billion, and net purchases by private foreign investors were $20.3 billion.
- U.S. residents purchased a net $5.5 billion of long-term foreign securities.

Net foreign acquisition of long-term securities, taking into account adjustments, is estimated to have been minus $3.0 billion.

Foreign holdings of dollar-denominated short-term U.S. securities, including Treasury bills, and other custody liabilities increased $66.6 billion. Foreign holdings of Treasury bills increased $18.7 billion.

Banks' own net dollar-denominated liabilities to foreign residents increased $40.3 billion.

Monthly net TIC flows were $103.8 billion. Of this, net foreign private flows were $65.4 billion, and net foreign official flows were $38.4 billion.

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TIC Monthly Reports on Cross-Border Financial Flows

(Billions of dollars, not seasonally adjusted)

			12 Months Through					
	2005	2006	Jul-06	Jul-07	Apr-07	May-07	Jun-07	Jul-07
Foreigners' Acquisitions of Long-term Securities								

1	Gross Purchases of Domestic U.S. Securities	17157.5	21066.7	19213.1	25478.5	2028.8	2691.0	2606.8	2473.7
2	Gross Sales of Domestic U.S. Securities	16145.9	19931.7	18116.1	24269.1	1931.2	2534.0	2487.7	2449.0
3	**Domestic Securities Purchased, net** (line 1 less line 2) /1	**1011.5**	**1135.0**	**1096.9**	**1209.4**	**97.6**	**157.0**	**119.1**	**24.7**
4	**Private, net /2**	**891.1**	**938.4**	**959.7**	**993.7**	**72.3**	**145.5**	**91.3**	**20.3**
5	Treasury Bonds & Notes, net	269.4	125.9	188.7	155.1	-8.9	18.1	18.2	-2.4
6	Gov't Agency Bonds, net	187.6	196.0	199.7	154.5	22.4	14.3	23.6	1.2
7	Corporate Bonds, net	353.1	471.8	427.9	474.4	30.6	70.4	22.2	3.2
8	Equities, net	81.0	144.6	143.4	209.8	28.1	42.7	27.2	18.4
9	**Official, net /3**	**120.4**	**196.6**	**137.2**	**215.7**	**25.3**	**11.5**	**27.8**	**4.4**
10	Treasury Bonds & Notes, net	68.7	69.6	39.3	52.2	9.4	-4.6	6.4	-6.9
11	Gov't Agency Bonds, net	31.6	92.6	60.9	128.5	13.7	12.8	16.0	7.5
12	Corporate Bonds, net	19.1	28.6	26.0	35.1	2.9	4.0	3.7	1.0
13	Equities, net	1.0	5.8	10.9	-0.2	-0.7	-0.7	1.7	2.8
14	Gross Purchases of Foreign Securities from U.S. Residents	3700.0	5515.9	4851.3	7085.9	631.9	742.3	730.5	759.3
15	Gross Sales of Foreign Securities to U.S. Residents	3872.4	5766.8	5041.7	7374.0	649.2	780.0	752.2	764.9
16	**Foreign Securities Purchased, net** (line 14 less line 15) /4	**-172.4**	**-250.9**	**-190.5**	**-288.1**	**-17.3**	**-37.6**	**-21.8**	**-5.5**
17	Foreign Bonds Purchased, net	-45.1	-144.5	-72.3	-156.2	-9.7	-21.2	-8.2	0.9
18	Foreign Equities Purchased, net	-127.3	-106.5	-118.1	-131.9	-7.7	-16.5	-13.5	-6.4
19	**Net Long-Term Securities Transactions** (line 3 plus line	**839.1**	**884.1**	**906.5**	**921.3**	**80.2**	**119.4**	**97.3**	**19.2**
20	**Other Acquisitions of Long-term Securities, net /5**	**-143.0**	**-169.9**	**-161.6**	**-188.2**	**-9.8**	**-15.2**	**-15.4**	**-22.2**
21	**Net Foreign Acquisition of Long-Term Securities** (lines 19 and 20):	**696.2**	**714.1**	**744.8**	**733.1**	**70.5**	**104.1**	**81.8**	**-3.0**
22	**Increase in Foreign Holdings of Dollar-denominated Short-U.S. Securities and Other Custody Liabilities: /6**	**-47.6**	**135.2**	**113.0**	**88.9**	**-25.9**	**1.2**	**-27.6**	**66.6**
23	**U.S. Treasury Bills**	**-58.9**	**-9.0**	**-16.9**	**-9.5**	**-28.6**	**-4.5**	**-17.9**	**18.7**
24	Private, net	-15.6	16.0	0.3	0.4	-11.6	0.9	-6.2	3.5
25	Official, net	-43.3	-25.0	-17.2	-9.9	-17.0	-5.5	-11.8	15.3
26	**Other Negotiable Instruments and Selected Other Liabilities: /7**	**11.4**	**144.2**	**129.9**	**98.4**	**2.7**	**5.7**	**-9.7**	**47.8**
27	Private, net	10.6	164.0	125.1	113.0	7.1	5.3	-14.2	46.8
28	Official, net	0.8	-19.8	4.8	-14.6	-4.4	0.4	4.6	1.0
29	**Change in Banks' Own Net Dollar-Denominated Liabilities**	**16.4**	**185.1**	**248.4**	**44.2**	**50.1**	**-6.1**	**-19.8**	**40.3**

30	**Monthly Net TIC Flows** (lines 21,22,29) /8	**665.0**	**1034.4**	**1106.2**	**866.2**	**94.6**	**99.2**	**34.4**	**103.8**
	of which								
31	Private, net	578.0	894.1	978.1	644.4	81.2	101.2	2.5	65.4
32	Official, net	87.0	140.4	128.1	221.8	13.4	-2.0	31.9	38.4

/1 Net foreign purchases of U.S. securities (+)

/2 Includes international and regional organizations

/3 The reported division of net purchases of long-term securities between net purchases by foreign official institutions and net purchases of other foreign investors is subject to a "transaction bias" described in Frequently Asked Questions 7 and 10.a.4 on the TIC web site.

/4 Net transactions in foreign securities by U.S. residents. Foreign purchases of foreign securities = U.S. sales of foreign securities to foreigners. Thus negative entries indicate net U.S. purchases of foreign securities, or an outflow of capital from the United States; positive entries indicate net U.S. sales of foreign securities.

/5 Minus estimated unrecorded principal repayments to foreigners on domestic corporate and agency asset-backed securities +
estimated foreign acquisitions of U.S. equity through stock swaps -
estimated U.S. acquisitions of foreign equity through stock swaps +
increase in nonmarketable Treasury Bonds and Notes Issued to Official Institutions and Other Residents of Foreign Countries.

/6 These are primarily data on monthly changes in banks' and broker/dealers' custody liabilities. Data on custody claims are collected quarterly and published in the Treasury Bulletin and the TIC web site.

/7 "Selected Other Liabilities" are primarily the foreign liabilities of U.S. customers that are managed by U.S. banks or broker/dealers.

/8 TIC data cover most components of international financial flows, but do not include data on direct investment flows, which are collected and published by the Department of Commerce's Bureau of Economic Analysis. In addition to the monthly data summarized here, the TIC collects quarterly data on some banking and nonbanking assets and liabilities. Frequently Asked Question 1 on the TIC web site describes the scope of TIC data collection.

REPORTS

- (PDF) TIC Monthly Reports on Cross-Border Financial Flows (Billions of dollars, not seasonally adjusted)

PRESS ROOM

September 18, 2007
2007-9-18-10-26-13-22122

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 $68,057 million as of the end of that week, compared to $68,093 million as of the end of the prior week.

I. Official reserve assets and other foreign currency assets (approximate market value, in US millions)

	September 14, 2007		
A. Official reserve assets (in US millions unless otherwise specified)	Euro	Yen	Total
(1) Foreign currency reserves (in convertible foreign currencies)			68,057
(a) Securities	13,460	11,047	24,507
of which: issuer headquartered in reporting country but located abroad			0
(b) total currency and deposits with:			
(i) other national central banks, BIS and IMF	13,435	5,438	18,873
ii) banks headquartered in the reporting country			0
of which: located abroad			0
(iii) banks headquartered outside the reporting country			0
of which: located in the reporting country			0
(2) IMF reserve position	4,417		
(3) SDRs	9,218		
(4) gold (including gold deposits and, if appropriate, gold swapped)	11,041		
--volume in millions of fine troy ounces	261.499		
(5) other reserve assets (specify)	0		
--financial derivatives			
--loans to nonbank nonresidents			
--other			
B. Other foreign currency assets (specify)			
--securities not included in official reserve assets			
--deposits not included in official reserve assets			
--loans not included in official reserve assets			
--financial derivatives not included in official reserve assets			
--gold not included in official reserve assets			
--other			

II. Predetermined short-term net drains on foreign currency assets (nominal value)

			Maturity breakdown (residual maturity)		
		Total	Up to 1 month	More than 1 and up to 3 months	More than 3 months and up to 1 year
1. Foreign currency loans, securities, and deposits					
--outflows (-)	Principal				
	Interest				
--inflows (+)	Principal				
	Interest				
2. Aggregate short and long positions in forwards and futures in foreign currencies vis-à-vis the domestic currency (including the forward leg of currency swaps)					
(a) Short positions (-)					
(b) Long positions (+)					
3. Other (specify)					
--outflows related to repos (-)					
--inflows related to reverse repos (+)					
--trade credit (-)					
--trade credit (+)					
--other accounts payable (-)					
--other accounts receivable (+)					

III. Contingent short-term net drains on foreign currency assets (nominal value)

		Maturity breakdown (residual maturity, where applicable)		
	Total	Up to 1 month	More than 1 and up to 3 months	More than 3 months and up to 1 year
1. Contingent liabilities in foreign currency				
(a) Collateral guarantees on debt falling due within 1 year				
(b) Other contingent liabilities				
2. Foreign currency securities issued with embedded options (puttable bonds)				
3. Undrawn, unconditional credit lines provided by:				
(a) other national monetary authorities, BIS, IMF, and other international organizations				
--other national monetary authorities (+)				
--BIS (+)				
--IMF (+)				
(b) with banks and other financial institutions headquartered in the reporting country (+)				

(c) with banks and other financial institutions headquartered outside the reporting country (+)				
Undrawn, unconditional credit lines provided to:				
(a) other national monetary authorities, BIS, IMF, and other international organizations				
--other national monetary authorities (-)				
--BIS (-)				
--IMF (-)				
(b) banks and other financial institutions headquartered in reporting country (-)				
(c) banks and other financial institutions headquartered outside the reporting country (-)				
4. Aggregate short and long positions of options in foreign currencies vis-à-vis the domestic currency				
(a) Short positions				
(i) Bought puts				
(ii) Written calls				
(b) Long positions				
(i) Bought calls				
(ii) Written puts				
PRO MEMORIA: In-the-money options [11]				
(1) At current exchange rate				
(a) Short position				
(b) Long position				
(2) + 5 % (depreciation of 5%)				
(a) Short position				
(b) Long position				
(3) - 5 % (appreciation of 5%)				
(a) Short position				
(b) Long position				
(4) +10 % (depreciation of 10%)				
(a) Short position				
(b) Long position				
(5) - 10 % (appreciation of 10%)				
(a) Short position				
(b) Long position				
(6) Other (specify)				
(a) Short position				
(b) Long position				

IV. Memo items

(1) To be reported with standard periodicity and timeliness:	
(a) short-term domestic currency debt indexed to the exchange rate	
(b) financial instruments denominated in foreign currency and settled by other means (e.g., in domestic	

currency)	
--nondeliverable forwards	
--short positions	
--long positions	
--other instruments	
(c) pledged assets	
--included in reserve assets	
--included in other foreign currency assets	
(d) securities lent and on repo	
--lent or repoed and included in Section I	
--lent or repoed but not included in Section I	
--borrowed or acquired and included in Section I	
--borrowed or acquired but not included in Section I	
(e) financial derivative assets (net, marked to market)	
--forwards	
--futures	
--swaps	
--options	
--other	
(f) derivatives (forward, futures, or options contracts) that have a residual maturity greater than one year, which are subject to margin calls.	
--aggregate short and long positions in forwards and futures in foreign currencies vis-à-vis the domestic currency (including the forward leg of currency swaps)	
(a) short positions (–)	
(b) long positions (+)	
--aggregate short and long positions of options in foreign currencies vis-à-vis the domestic currency	
(a) short positions	
(i) bought puts	
(ii) written calls	
(b) long positions	
(i) bought calls	
(ii) written puts	
(2) To be disclosed less frequently:	
(a) currency composition of reserves (by groups of currencies)	68,057
--currencies in SDR basket	68,057
--currencies not in SDR basket	
--by individual currencies (optional)	

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.

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, 2007
HP-561

Assistant Secretary Ryan Remarks before the SIFMA Asset Managers' Group

Boston- Good afternoon. Thank you for inviting me to join you. It's great to return to Boston and it's my pleasure to be here.

A Historical Perspective

Massachusetts is rich in history and this city is rightly proud of the many contributions it has made to our nation, including those in the fields of finance and asset management.

Massachusetts lays claim to a fundamental concept that serves as a cornerstone to the asset management industry: prudence in the role of a fiduciary. The Prudent Man Rule was established by a Massachusetts court decision in 1830 in which trustees were directed to "observe how men of prudence, discretion and intelligence manage their own affairs, not in regard to speculation, but in regard to the permanent disposition of their funds, considering the probable income, as well as the probable safety of the capital to be invested."

The standard has evolved over time, but after almost two centuries, the principle still resonates. The challenge for fiduciaries is not to avoid risks. Rather, prudence dictates that fiduciaries seek to identify, assess and manage risks. Despite more tools and greater experience the responsibility seems to be becoming harder to fulfill.

The asset management industry is constantly evolving. Its growth and development mirrors the interests of the increasingly broad range of investors and their myriad investment objectives. One group of institutional investors has had a large influence on the asset management industry --- pension plans. Their assets are invested on behalf of millions of beneficiaries. These beneficiaries include retirees and workers. Some are firemen and policemen; others include teachers, factory workers and service providers. These beneficiaries entrust their savings and the important job of investing on their behalf to you and your colleagues in the asset management industry. These workers answer the bell every day -- whether it is the one in a firehouse or schoolhouse -- or the one on their alarm clock. Fiduciaries working on their behalf must do the same.

Fiduciaries to pension plans include trustees and asset managers. We continue to witness pension plans, both private and public, diversifying their investment portfolios. In doing so, they are frequently increasing their allocation to alternative investments. These allocations are meant to complement other investments, an increasing number of which utilize more complex and opaque investment strategies and instruments.

In fulfilling their obligations, fiduciaries must appreciate that they represent the first and most important line of defense for the interests of their beneficiaries. No one should suggest that plan trustees or portfolio managers should not take risks – in fact they must take risks in order to generate desired returns. Investors must have the opportunity to succeed, and in doing so they thus also have the freedom to fail.

However, given the characteristics of many of the strategies and securities defining our markets today, fiduciaries must return to some of the fundamentals of investment management. They must seek to excel in risk management as much as return management. Risk management is not some part-time responsibility – it's a fundamental obligation of a fiduciary's duty.

Every investment strategy introduces risks. As fiduciaries acting in your clients' best interests you play an important role in identifying, assessing and managing risks.

We should acknowledge that the risks are many. They range beyond volatility to include valuation, liquidity, credit, operational risk and reputation risk. Many investment strategies and securities today are very complex and opaque. These characteristics create added challenges including valuation and performance calculations.

A decade ago, investors received holdings statements and performance reports from their custodians who simply relied on having actively-traded securities priced off of independent pricing feeds. That is no longer the case. Today, many investment strategies contain illiquid investments. Assets are often priced by complex quantitative models, in many instances built by the asset managers themselves. In the most disconcerting cases, assets were priced to rating where, in just a few weeks, they went from priced to perfection --- to priced to rejection.

Over the years, marketplace behavior has been influenced by the growth and scale of institutional assets, coupled with the obligations required by laws, such as E.R.I.S.A., and prudent fiduciary practices. The presence of institutional investors has influenced many practices ranging from reporting standards to fees. These trends are well-established within the traditional long only asset management space. More recently, we are witnessing how hedge fund managers are evolving in response to institutional investors' demands for more detailed information, higher quality business standards and operational practices, effective compliance and increased transparency.

These efforts help to define market discipline. Policy makers are very supportive of efforts that strengthen market discipline, since such efforts serve to mitigate systemic risk.

Fiduciaries play two critical roles. Besides contributing to market discipline, fiduciaries -- both trustees and asset managers -- play a powerful and important investor protection role. By continuously evaluating and monitoring their investments, they help protect their beneficiaries' financial interests, and either indirectly or directly, their own interests.

Sound practices on the part of fiduciaries are critical to fulfilling their obligations. Fiduciaries have an ongoing responsibility to perform due diligence and must continually ensure that their investment decisions are prudent and conform to sound practices, including diversification. We therefore need to ensure governance and asset management practices are as robust as possible.

As asset managers, you must appreciate that you are a part of a larger group of stakeholders – each with its own role and responsibilities. Besides yourselves, other stakeholders include your clients, as well as your counterparties and creditors, and the regulators.

Early this year, the President's Working Group on Financial Markets (PWG), which is chaired by Treasury Secretary Paulson and includes the Chairmen of the Federal Reserve, the Securities and Exchange Commission, and the Commodity Futures Trading Commission, issued Principles and Guidelines Regarding Private Pools of Capital for these four groups of stakeholders. Speaking with a unified voice, the PWG advocated for stronger market discipline. The PWG did not wish to endorse the status quo and therefore issued a call to action for each group of stakeholders.

The principles and guidelines address a range of issues including the need to ensure that risk management systems are sufficiently robust and sophisticated to identify, analyze and manage the broad array of risks. The principles also focused on the need for clear and meaningful disclosure so that investors can properly evaluate risk, decision making and performance. The PWG noted that qualitative measures should also be a part of any well designed due-diligence process, including information on the formation and structure of vehicles, reporting, administration, audits, and other factors and terms.

The principles and guidelines also focused on the importance of counterparty risk. As asset managers, you have to appreciate that your counterparty lending institutions must understand the risks inherent in your investment strategies and operations. They must determine appropriate credit terms. In doing so, they must assess liquidity risk and operational risk. They also need to be disciplined and independent in quantifying valuations. Furthermore, they need to guard against the risks to their reputation. Prudential regulators closely monitor the lending institutions' management of these risks and assess whether their performance is in line with expectations set out in supervisory guidance.

To deal with these challenges, asset managers must be part of the solution and maintain appropriate policies, procedures, and protocols. While current practices are in place, they must be reviewed, clearly defined, implemented, and continually enhanced. Besides counterparty risk management, asset managers also have a responsibility to continue to strengthen and enhance the processing, clearing, and settlement arrangements for all securities, and in particular OTC derivatives.

The PWG guidelines serve as an excellent foundation. But now is the time to complement the initial effort with secondary efforts. Along these lines, Secretary Paulson recently announced the establishment of two separate yet complementary private sector committees. The first will be comprised of investors and the second of asset managers.

The first task for each group is to develop detailed guidelines that would define "best practices" for their respective communities. These efforts will help strengthen market discipline, mitigate systemic risk, augment regulatory safeguards regarding investor protection, and complement regulatory efforts to enhance market integrity. These guidelines will have as a foundation and be consistent with the broader principles and guidelines comprising the PWG agreement released in February 2007, and will build on existing industry work where possible.

Conclusion

As fiduciaries and leaders within the asset management community, I want to encourage you to answer the call to action. There is much work to do. The bell is ringing, and you must all take the necessary steps to protect your clients and enhance market discipline.

As stakeholders in the asset management industry you must continually uphold and enhance the highest quality standards of excellence. Failure to do so only compromises an industry with deep roots and a proud legacy. As fiduciaries, you must stand for your clients' interests, for as our first Secretary of the Treasury Alexander Hamilton warned, "Those who stand for nothing fall for anything."

It is a privilege to be entrusted with the public's interest and capital. With such a privilege comes responsibility. To achieve our goals we need to recognize that the responsibility is borne by both the private and public sectors. Building upon the efforts to date, all stakeholders must continue to do more. Collectively, we can strengthen the vitality, stability and integrity of the public's investments and our capital markets. The system works when all stakeholders recognize the benefits, mitigate the risks, and choose to participate.

Thank you again for the opportunity to speak here today.

PRESS ROOM

September 18, 2007
hp-562

Media Advisory:
Treasury Deputy Secretary to Visit Montana

U.S. Treasury Deputy Secretary Robert M. Kimmitt and Treasury's Community Development Financial Institutions (CDFI) Fund Director Kimberly A. Reed will travel to Montana this week to promote community organizations that can help homeowners avoid foreclosure in rural America and to recognize two local organizations receiving more than $200,000 in CDFI Fund awards. The Deputy Secretary will also address the University of Great Falls and announce the establishment of the J. Stanley Kimmitt Public Service Lecture and Internship at the University of Montana.

Deputy Secretary Kimmitt and Director Reed will present an award to the Montana HomeOwnership Network, which works with local service partners throughout the state to provide mortgage education and foreclosure prevention assistance. On Friday they will recognize Sovereign Leasing and Finance Company, Inc., which is receiving an award to expand its mortgage counseling and financial services.

Deputy Secretary Kimmitt will participate Friday in the announcement of the J. Stanley Kimmitt Public Service Lecture and Internship, named in honor of the Deputy Secretary's late father, former Secretary of the Senate Stan Kimmitt, who grew up in Great Falls and attended the University of Montana. The following events are open to credentialed media:

Who:	Deputy Secretary Robert M. Kimmitt CDFI Director Kimberly A. Reed
What:	CDFI Fund Award to Montana HomeOwnership Network
When:	Thursday, September 20, 2:45 p.m. MDT
Where:	422 Fifth Street North Great Falls, Mont.

Who:	Deputy Secretary Robert M. Kimmitt
What:	Remarks
When:	Thursday, September 20, 4:00 p.m. MDT
Where:	University of Great Falls Student Center 1301 20th Street South Great Falls, Mont.

Who:	Deputy Secretary Robert M. Kimmitt CDFI Director Kimberly A. Reed
What:	CDFI Fund Award to Sovereign Leasing and Finance Company, Inc
When:	Friday, September 21, 9:45 a.m. MDT
Where:	Tribal Complex 58141 U.S. Highway 93 Pablo, Mont.

Who:	Deputy Secretary Robert M. Kimmitt
What:	Remarks on Establishment of the J. Stanley Kimmitt Public Service Lecture and Internship
When:	Friday, September 21, 3:00 p.m. MDT
Where:	University of Montana Don Anderson Hall, Room 210 32 Campus Drive Missoula, Mont

PRESS ROOM

September 19, 2007
HP-563

Paulson to Sign Update to U.S-Canada Income Tax Treaty

U.S. Treasury Secretary Henry M. Paulson, Jr. will join Canadian Finance Minister James M. Flaherty in signing a protocol that would amend our income tax treaty with Canada, Friday, September 21, 2007 in Chelsea, Quebec. This will be the fifth updated agreement between the U.S. and Canada since the two countries signed the original treaty in 1980.

Who
Treasury Secretary Henry M. Paulson, Jr.
Canadian Finance Minister James M. Flaherty

What
Signing of Update to Income Tax Treaty and Press Availability

When
Friday, September 21, 12 p.m. (EDT)
Where Willson House
Gatineau Park
654 Meech Lake Road
Chelsea, Quebec

Note Media must RSVP to Fannie Ouellette at (613) 943-3073 or Ouellette.fannie@fin.gc.ca. All media will be required to provide photo identification on site.

PRESS ROOM

September 19, 2007
HP-564

Secretary Paulson Supports Strauss-Kahn for Managing Director of IMF

Washington, DC-- Treasury Secretary Henry M. Paulson, Jr. made the following statement today in support of the candidacy of Dominique Strauss-Kahn for Managing Director at the International Monetary Fund:

"I urge the Board to positively consider the candidacy of Dominique Strauss-Kahn to succeed Rodrigo de Rato. The U.S. is supporting Mr. Strauss-Kahn because we believe he will work to make the bold reforms necessary to lead a strong and relevant Fund into the future. Mr. Strauss-Kahn's experience and drive have prepared him well to vigorously pursue reform of the IMF, including implementation of the Fund's new decision on exchange rate policies and giving a greater voice to emerging market countries."

PRESS ROOM

September 20, 2007
HP-565

**Testimony of Treasury Secretary Henry M. Paulson, Jr.
Before the House Committee on Financial Services
On the Legislative and Regulatory Options
For Minimizing and Mitigating Mortgage Foreclosures**

Washington- Chairman Frank, Ranking Member Bachus, Members of the Committee, good morning. I very much appreciate the opportunity to appear before you today to present the Treasury Department's perspective on the recent events in the credit and mortgage markets and their impact upon consumers and the economy. I am also pleased to be here today with my Cabinet colleague, Secretary Jackson, and with my fellow President's Working Group Member, Chairman Bernanke.

Credit Markets and the Overall Economy

Recently, there has been an adjustment taking place in the overall credit market and the mortgage market in particular. The current market turbulence stems from financial practices, but unlike many previous episodes of market volatility, takes place against a backdrop of a healthy U.S. economy and strong global growth. In the United States, the unemployment rate is at 4.6 percent, close to its lowest reading in 6 years. Growth in real gross domestic product was 4.0 percent at an annual rate in the second quarter, supported by strong gains in business investment and exports. Core inflation is under control. Since August 2003, 8.2 million jobs have been created and over the past 12 months, 1.6 million jobs have been created. Real wages have increased 2.2 percent over the past 12 months. In the corporate sector, earnings continue to outperform expectations and default rates on corporate credits of all kinds are at historically low levels. The Federal government's fiscal deficit is declining and well below long-term averages as a share of the economy, reflecting strong revenue growth and the continued strength of the U.S. economy.

The global economy also remains strong, with annual growth at around 5 percent and with many emerging market economies growing even more rapidly than the global average. The advanced economies also continue to perform well, with unemployment down sharply in Europe, helping to make growth of the last several years the strongest since the early 1970s.

Credit markets play a vitally important role in the efficient operation of our economy by intermediating funds between investors and borrowers. Credit market participants are constantly evaluating their views on risk and their appetite for risk. Larger fundamental reappraisals in the pricing and appetite of risk have taken place numerous times over our nation's history, which is fundamentally the way that markets work. We are in the process of another such reappraisal period today.

As has been well documented, the current credit market reappraisal started in the subprime mortgage market. The performance of subprime mortgages deteriorated, as a result of higher than expected delinquencies and defaults. This introduced greater uncertainty regarding both the future prospects of subprime mortgage-backed securities and the methodologies the credit rating agencies used to rate these securities. These factors led investors fundamentally to reassess the risk of these securities and subsequently to reassess price. Compounding the challenge was the increased complexity and opacity of many of the mortgage backed securities investment strategies and instruments. The combination of uncertainty and complexity resulted in few investors willing to put capital at risk.

Given the interconnectedness of the various components of our capital markets, these concerns over subprime mortgages and related securities had an impact on investors' confidence and assumptions about the credit quality and value of other assets. Consistent with expectations, we have witnessed a reassessment of risk, and hence a subsequent revaluation across capital markets globally. Certain asset classes were able to reassess fairly quickly and investors have greater confidence in their fundamental assessments. In such markets, liquidity has returned and markets are operating in a more customary fashion. Good examples of these would include most world equity markets, sovereign debt markets, and even investment grade corporate debt. Alternatively, certain markets are still operating under stress with impaired liquidity. These would include the jumbo mortgage market, the leveraged loan market, and the asset backed commercial paper market.

Given the importance of credit markets to the functioning of our economy, when we experience a fundamental reappraisal like we have over the last several weeks, it is essential that policymakers evaluate the potential impact on the economy. Chairman Bernanke can provide additional details, but the Federal Reserve undertook several measures – providing additional reserves through open market operations, lowering the discount rate, and changing practices associated with discount rate borrowing – to increase liquidity and promote the orderly functioning of financial markets. Additionally, this week, the Federal Reserve lowered its target for the federal funds rate by 50 basis points and approved another 50-basis-point decrease in the discount rate. The Federal Reserve's actions have helped to stabilize financial markets.

At the Treasury Department, we have been closely analyzing the global capital markets on a daily basis. As Chair of the President's Working Group (PWG) on Financial Markets, I have been in regular contact with members of the of the PWG, which includes Federal Reserve Chairman Bernanke, Securities and Exchange Commission Chairman Cox, and Commodity Futures Trading Commission Acting Chairman Lukken. I also have been in frequent contact with other Federal regulators, including the heads of the OCC, OTS, FDIC, and the Federal Reserve Bank of New York. These contacts complement information gathered from market participants, finance ministers, and other participants in the global marketplace. I have been keeping the President apprised as well. Enhanced communication is vitally important for understanding how markets are operating, where disruptions are occurring, and evaluating what actions, if any, should be considered.

As I have said before, the recent reappraisal of risk could result in some modest penalty to economic growth. However, as I noted at the outset, the economy was in strong condition going into the recent period of volatility, and while certain sectors like housing are undergoing a transition, overall economic fundamentals remain solid. It will take time for the current reappraisal to work itself out, but in my view the underlying strength of the economy should allow for continued growth.

Challenges in the Mortgage Market and the Administration's Plan

While the current reappraisal of risk in the credit markets will work itself out over time, the transition taking place in the mortgage market is causing difficulties for many borrowers and we are quite focused on this issue. This will be especially so for borrowers who took out subprime adjustable rate mortgages in recent years.

We should not lose sight of the fact that the subprime mortgage market improved access to credit and homeownership for millions of Americans. Starting in the early 1990s, consumers with less-than-perfect credit histories were able to gain easier access to mortgage credit at interest rates above prime borrower rates. Individuals and families could use this new source of credit to tap previously illiquid home equity wealth through refinancing or to purchase homes. Subprime mortgage origination volume increased from less than 5 percent, or $35 billion, of total mortgage origination volume in 1994 to nearly 20 percent or $625 billion, in 2005. During this time period homeownership rates also increased, growing from 64 percent in 1994 to 69 percent today, some of which was due to expanded opportunities in the subprime mortgage market.

The growth in the subprime mortgage market (and the mortgage market generally) was facilitated to a large degree by securitization, a process by which individual loans are transformed into securities. In a typical private label mortgage securitization, the mortgage originator transfers loans to a securitization sponsor, who pools together mortgages into mortgage-backed securities, and sells pieces, or tranches, of these securities to investors. In this way, the securitization process allows for the creation of securities that better match investor preferences for particular types of risk, which broadens the availability of capital. The benefits of such development are (1) increased capital for mortgages resulting in more products and lower costs, and (2) greater dispersion of investor risk. While these are net benefits, securitization also has introduced some challenges which are described later and are the focus of additional work for the PWG.

Further expanding the potential investor base was the development of another structured product, the collateralized debt obligation (CDO), which purchases asset-backed instruments, such as mortgage-backed securities. Mortgage-backed CDOs, nearly 40 percent of the entire $500 billion CDO market in 2006, have been one of the major purchasers of mortgage-backed securities, in particular the lower-rated tranches. For both individual mortgage-backed securities and CDOs, the credit rating agencies work closely with the sponsor to rate the credit risk of various pieces of the transaction.

A key challenge in the current subprime mortgage market (and to a lesser extent in the prime market) is the significant amount of hybrid adjustable rate mortgages that will be resetting in the next few years. Hybrid adjustable rate mortgages have a fixed rate of interest, often free of amortization payments, for an initial period, resetting at an adjustable rate for the remaining term of the loan. The most popular hybrid adjustable rate mortgage was the 2/28 – a fixed rate for two years, then an adjustable rate for the remaining 28 years of the mortgage. The fixed rate of interest in the first two-year period was typically lower than the initial adjustable rate in the reset period, and it often had an even lower teaser rate at the outset.

Hybrid adjustable rate mortgages can be a useful product, and, in the past, rising house prices often enabled borrowers with hybrid adjustable rate mortgages to refinance on more attractive terms prior to the first reset. However, the recent trend of a decline in house price appreciation (or depreciation in home values) has made refinancing more difficult. Other problems in the subprime market (and in some cases in the prime market) include lax underwriting standards, especially in 2005 and 2006, which have led to a significant amount of early defaults. Finally, while this is not a new issue, mortgage fraud continues to be a problem and may have increased with growth in the subprime market over the past few years. Some of the most egregious individual stories in the subprime mortgage market involve some type of fraudulent activity that is already illegal. A combination of these factors has led to a significant spike in mortgage delinquencies and foreclosure starts. Much of the increase is concentrated in subprime adjustable rate products, and it is also concentrated in areas of the country that are experiencing some degree of economic difficulty or a decline in housing prices.

To address the current situation, President Bush recently announced an aggressive plan to help as many homeowners as possible stay in their homes and to improve our mortgage finance system for the future – the HomeOwner Protection Effort (HOPE). As part of HOPE, the Treasury Department has, in coordination with the Department of Housing and Urban Development (HUD), started working on a new foreclosure prevention initiative to help struggling borrowers. The goal is to expand mortgage financing options and to identify and reach struggling homeowners before they face hardships, helping them understand their financing options, and helping them to find a mortgage product that keeps them in their home. Community organizations, mortgage servicers, and mortgage finance entities all play key roles in helping borrowers avoid foreclosure. Community organizations, such as mortgage counselors, work with struggling borrowers to help them identify all the options available to them. Mortgage servicers are often the first contact with borrowers and they have tools available to help borrowers who are in trouble. And mortgage finance entities, whether it is the Federal Housing Administration (FHA), government sponsored enterprises (GSEs) such as Fannie Mae and Freddie Mac, or insured depository institutions, all develop mortgage products that borrowers can use to refinance existing obligations. I and other Treasury officials have held important and useful meetings with these organizations to understand the challenges borrowers face and to explore ways to help them. We will continue to do so in an effort to minimize foreclosures.

We are working very hard to try to help as many Americans as possible keep their homes. We have learned several things already, two of which I would like to take an opportunity to share today.

First, it is clear to everyone that the earlier we identify struggling borrowers, the more likely they will be able to modify their mortgage or refinance into a more affordable mortgage. If we wait until borrowers miss several payments, their credit profiles will be tarnished and they will have far fewer refinancing options.

Second, many borrowers mistakenly believe that their lender wants to repossess their house in foreclosure. Foreclosure is tough on families, bad for communities, and very costly for lenders. The vast majority of lenders would rather find a way to help the homeowner stay in their home than foreclose. Yet according to most of the servicers and counselors we have spoken to, 50 percent of those who lose their home to foreclosure never contacted their mortgage servicer or a mortgage counselor for help. Often times borrowers are fearful of foreclosure and not aware that their lender may be able to work out a solution – such as a lowered interest rate or a payment plan. Clearly, we need a concerted effort to reach those who might have trouble meeting their payments and urge them to look for help before they get behind on their payments. There is a public service announcement running now, encouraging homeowners to call for help. I went to Chicago last week and held an event to publicize the availability of homeownership counseling. I plan to do more to urge people to be proactive, and I urge all of you to hold events in your districts, highlighting the availability and importance of mortgage counseling.

In addition, as part of HOPE, the Treasury Department has been working closely with Congress to change temporarily a provision of the federal tax code that currently considers cancelled mortgage debt on a primary residence as taxable income. Today, if borrowers are able to secure a loan modification or refinancing that involves a write down of existing principal, they could be subject to federal income tax liability on the value of the write-down. Moving forward, by providing much-needed tax relief to homeowners that are faced with this situation, we will remove an obstacle to keeping more borrowers in their homes. As President Bush has said, "when your home is losing value and your family is under financial stress, the last thing you need to do is to be hit with higher taxes."

Finally, the President has asked me to lead efforts of the President's Working Group on Financial Markets in examining some of the broader market issues associated with the challenges in the mortgage market, which include: the role of credit rating agencies; and how securitization has changed the mortgage industry and related business practices.

Secretary Jackson can provide additional details on HUD's efforts related to HOPE including FHA modernization legislation, the new FHA-Secure initiative, and reforms to the Real Estate Settlement Procedures Act (RESPA).

Considering Other Issues to Address Mortgage Market Issues

The Role of Government Sponsored Enterprises (GSEs)

The President directed Secretary Jackson and me to work with all mortgage market participants to see what can be done to help struggling homeowners stay in their homes. Given that the GSEs play a significant role in the mortgage market, we believe they can be helpful in assisting many homeowners in this period. In fact, Fannie Mae and Freddie Mac were created in part to assist in these types of situations.

Fannie Mae and Freddie Mac were established in part to help provide a degree of liquidity to the secondary market for home mortgages to increase the capital available for home mortgage financing. To perform that mission, Congress granted the GSEs benefits and imposed constraints. The benefits include exemptions from state and local taxes, conditional lines of credit with the Treasury Department, and the ability of banks to make unlimited investments in GSE debt securities. But the most important benefit is the market's perception that they are somehow backed by the Federal government, even though this is not the case. This benefit, unfortunately referred to as the "implicit" government guarantee, is the one that provides the GSEs with a funding advantage over other mortgage market participants.

The constraints imposed on the GSEs include that they: are limited to operating in the secondary mortgage market; can only purchase or guarantee loans below the conforming loan limit set by Congress (currently $417,000 or lower); and must have credit enhancements if the loan-to-value ratio exceeds 80 percent. In addition, they are also subject to safety and soundness oversight, and they must meet affordable housing goals.

Fannie Mae and Freddie Mac operate in the secondary mortgage market by providing credit guarantees on mortgage-backed securities (MBS) or by directly investing in mortgages and mortgage-related securities through their retained mortgage portfolios. In the credit guarantee business, Fannie Mae and Freddie Mac generally enter into to swap agreements with mortgage lenders under which individual mortgages are transformed into MBS guaranteed by the GSEs. Fannie Mae and Freddie Mac also have the ability to purchase mortgages and package them into MBS. In the mortgage investment business, Fannie Mae and Freddie Mac issue debt securities to fund an investment portfolio of mortgage-related securities. In comparison to the credit guarantee business where credit risk is the main exposure, the mortgage investment business involves both credit and interest rate risk. The mortgage investment businesses of Fannie Mae and Freddie Mac presents the greatest potential risks, while at the same time having a much less clear connection to their housing mission than the credit guarantee business.

The GSEs are an unusual construct – they are government-sponsored with a public service mission, but they are also publicly held companies that have to answer to boards of directors and shareholders. If we knew then what we know now, we likely would not have designed entities like the GSEs that have private ownership but are required to undertake a public mission. These competing interests are too difficult to manage, and the potential long-term market distortions and public policy concerns are too significant. The tension born by this construct is highlighted in the current situation in the subprime mortgage market. On the one hand, assisting subprime borrowers is at the heart of their affordable housing mission. On the other hand, these mortgages do pose greater risks, which if not managed correctly could lead to less return for shareholders.

We all understand that the GSEs have had some accounting and risk management problems in recent years. To some extent these problems are a result of their unusual construct – the private sector goal of increasing earnings led to the rapid growth in the GSEs' retained mortgage portfolios, and contributed to a lack of focus on internal controls and risk management. I see no benefit in restating these issues which have been well publicized and documented. It is worth noting, however, that the new managements at both institutions have improved their operations. Despite these improvements, however, there are still legitimate concerns about the systemic risk posed by the GSEs' retained portfolios due to their large size and the lack of ordinary and effective market discipline.

Turning to current market conditions, the conforming loan market, which is the segment of the mortgage market in which the GESs primarily operate, has continued to function well during periods of market stress. This should not be a surprise. Investors do not take on the credit risk of the underlying mortgages when they purchase GSE-guaranteed mortgage backed securities. In contrast, in the non-GSE mortgage market, the securitizing, packaging, and trading of credit risk have created an increased amount of complexity. As we have seen, market participants are growing more cautious and deliberative in evaluating credit risk in non-GSE securitized instruments.

We are starting to see encouraging signs that other markets, such as the jumbo mortgage market (loans greater than $417,000), are loosening up but these markets are not functioning as normal. While some financial institutions are more willing to take these loans onto their balance sheets than they were weeks ago, others are in a sense compelled to do so because the demand for jumbo and other non-conforming mortgage backed securities (and other asset backed securities) has broken down and liquidity concerns remain. Over time, we expect market conditions to improve. In other areas, such as subprime, this process will take even longer. Market liquidity will adjust as investors reassess risks and return, relative to the underlying fundamentals. But all of this will take time as markets digest new information.

As we work to alleviate stress in these markets, we naturally must ask what the GSEs can do toward that end. And to the extent we see room for them to do more, any consideration of a change in policy must find a balance between competing and distinct concerns, including: the temporary needs of today's market; the legitimate public policy question of how much of the mortgage market should be directly or indirectly influenced by GSEs, which the market perceives as being backed by the federal government; and the issues of size, systemic risk and longer-term market distortions that will occur by inserting perceived government intervention.

And, just as important, how will we change market participants' expectations and behavior if they assume, rightly or wrongly, that there is a risk that their own market functions would be displaced by the GSEs at any point in time? The existence of government influence certainly helps when confidence in credit quality is causing marketplace stress. However, this "benefit" is not without cost in the form of a reduction in market discipline and competition, innovation, and efficiency.

Some have suggested that the GSEs should be permitted to inject some liquidity into the jumbo mortgage market. There is little question that allowing the GSEs to securitize jumbo mortgages would give a short term lift which would be helpful to a segment of the housing market that has shown some recent improvement but is not functioning as normal. GSE entry into this sector would improve liquidity. The jumbo mortgage market traditionally has been a very profitable part of the mortgage market, with low default rates. For that reason it seems logical that this market will right itself in the weeks and months ahead. Therefore, consideration of this issue should be limited to a provision that is temporary and is part of legislation strengthening the regulatory structure. If it goes beyond that, it raises difficult public policy issues and could be seen as detracting from the GSEs' affordable housing mission and displacing private sector participation, which the Administration does not support.

The borrowers who are facing the greatest stress today are those who have less-than-perfect credit, and also those who have little equity in their homes, due to a decline in house price appreciation or a depreciation in home values. These difficulties are not limited solely to subprime mortgages, but are also surfacing among some prime jumbo mortgage holders. Anything the GSEs do to provide liquidity in this area, then, would mean taking on more risk. Therefore, such steps, and any additional authority permitting such steps, must be contemplated only in conjunction with legislation that addresses the inadequate regulatory structure of the GSEs.

The current GSE regulator has less authority than a federal bank regulator. Many argue that a good solution would be for the GSEs to be regulated in a manner consistent with regulation of large national banks. However, in our view, the GSE regulator should have more tools available than does a bank regulator to take into account the unique characteristics and tensions of the GSEs.

This Committee and the House of Representatives worked very hard to pass a meaningful GSE regulatory reform bill. In our view, the House bill is not perfect, but it goes a long way in addressing the issues that must be considered. The Senate now must act. The case cannot be stronger for the Senate to take up GSE reform legislation.

It would be unreasonable and irresponsible to expand the GSEs' businesses without addressing the fundamental problems of their regulatory structure. I would welcome this debate and repeat our request for the Congress to send the President a strong GSE reform bill. I frankly am disappointed that we have not had further engagement on these important issues.

Helping Struggling Homeowners

We also have been discussing with the GSEs how they might play a meaningful role to help struggling borrowers keep their homes. Of course, there are a number of constraints on the GSEs ability to help, especially where struggling homeowners have little equity in their homes. Many mortgages were originated with high loan-to-value ratios, and the declines in house price appreciation (or depreciation in home values) have put additional pressure on the current loan-to-value ratios of all types of mortgages. The GSE charters require that they have adequate credit enhancement on any loans they securitize or purchase that have a high loan-to-value ratio (greater than 80 percent LTVs). Changing this would require legislation. Again, I would welcome the debate in Congress about whether the GSEs should have the ability to go deeper into the credit spectrum to help current homeowners and to support further their affordable housing mission. This debate should be part of the broader regulatory reform discussion because allowing the GSEs to take on more risk elevates the importance of having adequate regulatory oversight.

Another, perhaps larger, constraint on their ability to assist borrowers is their own internal underwriting standards. Many of these borrowers represent significant credit risk, and present greater risk management issues for the GSEs in comparison to the traditional prime market. To undertake more business to assist these borrowers, the GSEs would have to reevaluate their own underwriting standards and develop new products that can help reach troubled homebuyers. By guaranteeing these types of products they would increase the flow of liquidity available to refinance some subprime borrowers into mortgages they can afford. We are encouraging the GSEs to do more. However, we recognize that the GSE management teams must also answer to their boards of directors and their shareholders in making these business decisions. We would expect the GSEs to evaluate fully the risks associated with any new initiatives in that context along with their public purpose mission.

In financing mortgages for either of these two types of struggling homeowners – those with credit problems or those with little equity in their homes – the GSEs would be taking on greater risk. Legislation that encourages them to assume more risk must also create an appropriate regulator to provide the proper regulatory oversight. We should not create tomorrow's problem as we construct today's solution.

Portfolio Caps

Recently, there have been calls on the Administration and the Office of Federal Housing Enterprise Oversight (OFHEO), the GSEs' independent regulator, from some policymakers and market participants to undertake certain actions to expand the market segments in which the GSEs may operate. Most prominently, the Administration has been asked to lift the temporary caps on the GSEs' retained portfolios.

It is important to note that the portfolio caps were imposed by the GSEs' independent regulator because of the well-publicized and documented concerns that I referred to earlier. It is also important to note that this regulatory decision does not affect their securitization activities at all.

I view the GSEs' requests for an increase in their investment portfolio as legitimate from a business perspective, but less so from a public policy perspective. From a business perspective, when mortgage spreads widen, growth in the GSEs' retained mortgage portfolio provides enhanced profit opportunities given the GSEs' debt funding advantage. Thus, the business motivation for this request is clear and sound.

Whether this request will have a positive impact on the mortgage market is much less clear. There is already ample liquidity in the prime conforming marketplace, the marketplace in which the GSEs concentrate their investment portfolio business. The securitization efforts of Fannie Mae and Freddie Mac have been a huge contributor to this liquidity. The more efficient use of their capital to ease current market strains is in the guarantee business, where each dollar of capital goes further in adding liquidity.

Given that the prime conforming market is functioning well, I would largely characterize the portfolio cap debate as misplaced. It is easy for some to point to lifting the portfolio caps as a "solution" to a complicated problem that, regrettably, needs more time to work out. This portfolio cap issue is something that the regulator should look at and continue to evaluate. Just yesterday, OFHEO announced steps to adjust Fannie Mae's investment portfolio cap and to provide more flexibility to both enterprises with regard to the management of their investment portfolios. I hope that both GSEs will use this new flexibility to provide liquidity to parts of the market experiencing the most strain.

This matter is not something that requires Congressional action. This is a regulatory decision, and it is being addressed where it should be, at OFHEO. Generally speaking, the caps may be lifted, at OFHEO's discretion, when each GSE becomes up-to-date and current in their filings with the SEC. My understanding is that because of the good work of the new management teams, both enterprises likely will complete their restatements some time in 2008. Because this regulatory matter does not impose negative consequences on the overall economy, I see no reason for legislative intervention.

At the Treasury Department, we are very open to ways to enable the GSEs to do more to relieve the strains in the mortgage markets. Our discussions have been thoughtful and constructive. They understand that this is a critical moment for them to demonstrate their ability to make a meaningful difference in the affordable housing market.

Mortgage Origination Issues

As noted earlier, securitization has fundamentally altered the process of obtaining a mortgage. Securitization has led to innovation in product design and increased capital availability. Of course, the decentralized nature of the mortgage market also presents certain challenges as many different participants – mortgage brokers, mortgage banks, insured depository institutions, investment banks, and ratings agencies – play a role in the mortgage process.

As we evaluate ways to improve the mortgage process in the future, we must look broadly across all participants in the process. While there are many issues that can be considered, I would arrange them in three broad segments: (1) disclosure provided to the borrower; (2) market practices; and (3) capital markets aspects. A thorough evaluation will require looking at each of the segments.

Importance of Disclosure

Adequate disclosures are a key component in fully empowering consumers to shop for the best mortgage product and promoting competition among mortgage originators. Our current system provides a voluminous amount of disclosure, but still consumers are confused about key aspects of their mortgage loans.

We need to work toward simplified disclosures that provide consumers information about key features of their mortgage. The key is not more disclosure, the key is better disclosure and this might be a case where less is more. Taking it as a given that many people will not read all (or even most) of the disclosure documents, we should try to evaluate what type of information is most critical for a lending decision to be consummated. Some of the proposals to create a one-page mortgage disclosure have been designed with this goal in mind.

As we consider new legislative proposals for enhanced or simplified disclosures, we should be fully aware of the efforts that are currently underway to improve disclosures. The Federal Reserve is engaged in a comprehensive review of the disclosure regime underlying the Truth in Lending Act, with the goal of developing disclosures that more effectively help consumers understand their loan terms. Chairman Bernanke and I have discussed this issue and I have confidence that he and the Federal Reserve will work diligently to achieve this goal. I am sure that Chairman Bernanke can provide additional details on the scope of the Federal Reserve's efforts.

Similarly, as described in Secretary Jackson's testimony HUD is engaged in an effort to propose RESPA reforms that would promote comparative shopping by consumers for the best loan terms, provide clearer disclosures, limit settlement cost increases, and require fee disclosures.

Simplified and meaningful disclosures should be in everyone's interest. The question is not whether we should strive for this goal, but more so the best way to achieve this goal.

Market Practices

Many of the most egregious problems related to mortgage fraud – such as falsifying income, inflating appraisals, or deceiving customers – are currently illegal under existing statutes. Federal agencies such as HUD, the Department of Justice, and the Federal Trade Commission are aggressively pursuing perpetrators of mortgage fraud. State authorities have also taken numerous actions. At the most basic level, we must ensure that our law enforcement agencies have the resources necessary to fight mortgage fraud at all levels.

Another issue that should be considered is inconsistency in the practices of participants in the mortgage market. Mortgage brokers have often been singled out as the main problem, and it appears that many of the mortgages that are currently under stress were arranged by mortgage brokers. But that is not the complete story as in many cases mortgage brokers were arranging loans based on lax underwriting standards developed by mortgage originators who could then fund these loans through securitization transactions arranged by investment banks. Nonetheless, issues of mortgage fraud, whether committed by mortgage brokers or other mortgage originators, have been a long-standing problem, and much of the focus has been on entities that are licensed at the state-level, where the degree of regulation varies.

Unfortunately, this is not a new problem, although the scale of the problem we are facing today is larger. It is especially difficult for States to monitor the actions of individuals that move their operations across state boundaries. In response to this problem, State regulators have started an effort geared toward uniform licensing and education requirements for mortgage brokers. We support this effort, but it remains unclear whether State regulators will be able to complete successfully this task on a national basis. Additional efforts to encourage the development of a more consistent licensing, education, and monitoring system for mortgage originators are worth considering and such a system could help to weed out some of the bad actors.

As we take a closer look at what caused some of the problems in the subprime market we should look at all aspects of the transaction. Much of the focus has been on practices of mortgage brokers and originators. I have no doubt that some mortgage brokers and originators engaged in deceptive and predatory practices in marketing loans to people that they did not understand or have the ability to repay. Just as important, and not said as often, I have no doubt that there was an abundance of borrower-level fraud as well. Some people chose to inflate their income or mislead a lender into thinking the property was to be owner occupied as opposed to being an investment property. Both of these practices have a profoundly negative effect on the mortgage market.

There are legitimate calls for creating a uniform national predatory lending standard. This is a very important issue that is quite complex. Great care must be taken when considering a national predatory lending standard or banning certain practices so as to not overly constrain credit availability. What some people consider a predatory practice or loan could be a useful product for some borrowers as long as they fully understand it. Achieving the right balance here is critically important.

The Federal Reserve is engaged in a comprehensive review of its authority under the Home Ownership and Equity Protection Act (HOEPA), including its authority to define broadly unfair and deceptive practices that would apply to the entire mortgage industry. I have spoken with Chairman Bernanke and I have confidence that he will carefully consider what actions to take in this area. It is clear that the Federal Reserve has the ability to reach all mortgage loan originators through a rulemaking under HOEPA. This provides the Federal Reserve with the opportunity to inject greater uniformity and objective standards into the mortgage origination process.

Capital Markets Issues

As I noted earlier, capital markets generally, and mortgage markets more specifically, have changed dramatically in the last 25 years. We at the Treasury Department are committed to being a leading force in better understanding some of the important issues raised during the recent period of market disruption. The PWG has already begun reviewing four important issues. First is financial institutions' liquidity, market and credit risk practices, including treatment of complex credit products and conduits. The second is accounting and valuation procedures for financial derivative instruments, particularly for complex, narrowly traded products that become difficult to price in times of stress. Third is basic supervisory oversight principles for regulated financial entities, especially given exposures to off-balance sheet, contingent claims. And fourth is the role of credit rating agencies in evaluating structured finance products. In addition, because these issues have global consequences, we have asked the Financial Stability Forum (FSF) – a body of finance ministries, central banks and regulatory bodies from leading financial centers created after the Asian financial crisis – to also examine these issues.

Conclusion

Mr. Chairman, in conclusion, I want to thank you for holding this hearing. Under the President's leadership, the Administration is working diligently to help mitigate the impact of rising foreclosures on homeowners and the economy. I appreciate having the opportunity to present the Treasury Department's perspectives on these important issues and look forward to working with this Committee and the Congress in the weeks and months ahead. Thank you and I welcome your questions.

September 20, 2007
HP-566

**Remarks Prepared for Delivery by
Under Secretary McCormick
Peking University on
Rebalancing the U.S.-China Economic Relationship**

Beijing--Thank you very much. I am very happy to be back in Beijing, and I appreciate your warm welcome.

Just over a year ago, Presidents George Bush and Hu Jintao established the Strategic Economic Dialogue, under the leadership of Vice Premier Wu Yi and Secretary Paulson, to address the fundamental strategic challenges and opportunities that lay ahead in our bilateral economic relationship. One thing that has emerged from this dialogue is an even greater recognition of the huge interest each of our countries has in the continued growth and prosperity of the other. When China succeeds, the United States succeeds.

The United States and China have accounted for over 40 percent of total global economic growth in the past five years, and each is a critically important market for the other. For example, U.S. exports of services to China support some 37,000 jobs in high-paying, high-productivity sectors of the U.S. economy. And imports from China provide U.S. consumers and companies with far richer consumer choices and access to more efficient global supply chains than they could hope for in the absence of trade with China. For China, access to the U.S. and international markets – and openness to international investment – has helped to create a world-class export sector and to drive the spectacular rates of economic growth that have turned this country into the global economic leader it is today.

We owe much of the strength and vitality of our economic relationship today to the remarkable success of China's economic development over the last three decades: growth of almost 10 percent per year, a more than eightfold increase in per capita income, and over 250 million people lifted out of poverty. No one here should have any doubt about our admiration for what China has achieved.

But China's economy has changed fundamentally over the past 30, and even 10 years, and you now face a set of new and different challenges in sustaining future economic growth.

The growth model that has transformed China from a largely homogeneous, agricultural economy into a dynamic, increasingly technologically sophisticated economy has been hugely successful to this point. But some of the policies developed for a far different China are now responsible for the buildup of large and rising imbalances.

China's most senior leaders have clearly identified these imbalances. They include imbalances in growth between rural and urban areas, between the coast and the interior, between economic and social advancement, between reliance on internal and external demand, between rich and poor households, and between economic development and environmental protection.

Current growth model creating increasingly difficult challenges

Based on China's current growth model, these challenges are likely to grow. China's growth model for the past several decades has featured high levels of investment in physical inputs to production, such as plants for producing manufacturing exports, but has done comparatively less to foster innovation, entrepreneurship, and the development of the deep and competitive markets. The current growth model has served China well to this point, but it is now exacerbating some of the challenges in achieving balanced growth.

First, growth has been increasingly energy-intensive, causing environmental degradation to accelerate despite Chinese leaders' efforts to strengthen and enforce environmental regulations. Since 2001, the ratio of growth in energy demand to GDP growth in China – a good measure of the energy-intensity of growth – has tripled relative to its level between 1978 and 2000 – putting more pressure on energy supply and increasing the environmental damage from growth.

Second, growth has been highly capital-intensive, reducing the rate at which incremental growth creates new employment opportunities for the Chinese people. Capital and labor are substitutes in economic production, and in an environment of cheap money, Chinese firms have had strong incentives to use more capital and less labor despite China's need to provide jobs for many workers who are now seeking to move from the state and agricultural sectors to the private manufacturing and services sectors.

Third, recent growth has gone hand-in-hand with a decline in both consumption as a share of GDP and household income as a share of GDP. National saving has risen to its highest rate since the beginning of market reforms, and the share of wages in GDP has fallen more than 10 percentage points in less than 10 years. As a result, the Chinese people are capturing a smaller and smaller share of the benefits of growth.

These features of the current growth model are mutually reinforcing. The capital-intensive nature of China's economic growth has been fueled by high national saving, which has both provided the resources for capital investment and encouraged the use of capital-intensive techniques. The pattern of prices – maintained by an inflexible exchange rate – has encouraged production in export industries, many of which are highly resource-intensive. At the same time, as Chinese production has increasingly targeted foreign consumers, domestic consumption has remained low, and the resulting high saving has been channeled back into investment in export sectors, perpetuating the cycle.

High and increasing national saving – and its counterpart, the slow growth of domestic demand – has led to increasing trade surpluses and made Chinese growth increasingly dependent on external demand.

Meeting the challenges

China's leaders understand these issues well and are right to be turning their attention now – rather than later – to reforms aimed at achieving economic growth that stems more from domestic demand, innovation, and high quality investment.

Those reforms include efforts to rebuild the social safety net and address the causes of precautionary household saving, efforts to make education less costly and more widely available, efforts to improve environmental safeguards, and efforts to build a more robust services sector.

The development of the financial services sector – including increased access to consumer finance for Chinese households – will be particularly important to ensuring that strong Chinese growth continues. Access to capital is key to ensuring that Chinese entrepreneurs are able to capitalize on their capacity for innovation. And access to a wider range of higher-yielding savings instruments would provide all Chinese households with the tools they need to build assets more rapidly, allowing for higher consumption and living standards both today and in retirement. Developing a modern financial sector is not an easy thing, but investment by foreign firms – and the advanced risk management skills and market expertise that comes with it – can play an important role in expediting the process.

While rebalancing growth will require a number of the major structural measures that I have mentioned, price measures – including exchange rate adjustment – must also play a role. Flexible prices play a critical function of allocating resources on the basis of accurately-matched costs and benefits, and they fulfill this function with great effectiveness and at very low cost.

The exchange rate has become a highly charged issue in U.S.-China economic relations. This is unfortunate, because as many non-official and non-American observers have argued, exchange rate flexibility is extremely important to China. I therefore want to be very clear about what increased currency flexibility in China will, and will not do, for the United States and China.

For the United States, what it will not do is cause a significant reduction in the U.S. trade deficit, nor will it provide a magic bullet for solving the problems of American industries facing overseas competition. What increase currency flexibility will do is remove a major cause of the perceived unfairness in our bilateral relationship, allowing us to move on to the important long term challenges the United States and China jointly face.

For China, more currency flexibility will not restrain growth, nor will it lead to deflation. We have already seen the resilience of China's exporters to currency appreciation, with many enjoying higher profit margins today than they did two years ago. In East Asia, Korea, Indonesia, and Australia have all had currency appreciations far larger than China's, while maintaining strong growth and price stability. So did Japan in the 1970s, an example more relevant to China than Japan in the 1990s.

What currency flexibility will do for China is support – and in fact be a necessary component of – a growth strategy that brings higher consumption to Chinese households and more balanced, harmonious, and sustainable growth. This transition will occur through a decrease in the price of imports and the introduction of stronger incentives for Chinese companies to produce for Chinese consumers. What currency reform will also do is provide Chinese policymakers with greater freedom to use monetary policy to maintain price stability and avoid asset bubbles. This is of particular significance given China's recent acceleration of inflation. All of this will lead to growth that is more stable, more China-centered, and more effective in raising the living standards of the Chinese people than China's current growth model now is.

I know there are many in China who have expressed concern that more rapid currency appreciation will hurt low income workers in some sectors. To the contrary, by encouraging employment growth in less capital-intensive domestic-oriented industries, exchange rate appreciation will open up new opportunities for low- and un-skilled workers. Even more important for the poor is that industries serving domestic consumption demand will create new jobs at a much faster rate. According to a recent study by Robert Feenstra (an economist from the University of California) growth in domestic demand has proven three times more effective in generating employment in China than growth in exports

Building a mutually beneficial and politically sustainable relationship

I have said a great deal about the current challenges for China. What about for the United States?

We have emphasized that the U.S. trade deficit and China's trade surplus are outcomes that are primarily driven by domestic rather than international economic factors. For the United States, our trade deficit can only be reduced through decisive measures to increase both private and public saving – the opposite problem China faces in its efforts to reduce a large trade surplus. To meet this challenge, we are committed to continuing to improve our fiscal outlook, particularly through measures to address the challenge of entitlement spending reform. We have already taken steps to increase incentives for private saving through tax reforms affecting capital income, and we are striving to broaden these tax reforms to further boost personal saving.

The United States must also continue to strive to avoid the siren song of protectionism. We must not sacrifice the long-term gains of openness by pursuing short-term and misguided responses to the challenges presented by global international markets. President Bush and Secretary Paulson are committed to ensuring America's open trade and investment climate.

Before concluding, I would like to emphasize the importance of re-energizing bilateral investment, a critical aspect of our economic relationship. Talk of protectionism can easily invoke national passions, and it is important for both our countries to keep in mind the tremendous benefits that openness to foreign investment has brought to our economies. It is critical that we promote better mutual understanding. Both sides could benefit from sharing information on and discussing our respective policies to foreign direct investment. On our side, we warmly welcome investment from all of our international economic partners, and China is a very important partner to us.

Conclusion

Ensuring that both the U.S. and Chinese economies continue to grow strongly – in ways that do not worsen global or domestic imbalances – is vital to each of us and to the global economy. In today's dynamic and transforming economy, recipes for past success do not guarantee success in the future. China and the United States need to adjust their policies to ensure vibrant economies as well as harmonious societies, both at home and globally.

Out mutual commitment to overcoming these challenges is critical to the well-being of the people of both our countries and will shape the broader global economic landscape for generations to come.

Thank you very much.

PRESS ROOM

September 20, 2007
HP-567

Testimony of Chief Information Officer Michael D. Duffy Before the U.S. Senate Committee on Homeland Security and Governmental Affairs Subcommittee on Federal Financial Management, Government Information, Federal Services, and International Security

Mr. Chairman and Members of the Subcommittee, I appreciate the opportunity to appear before you to discuss the management of information technology (IT) investments. Like the other Federal agencies represented here today, the Department of the Treasury is diligently working to improve the management of information technology and especially, those investments considered to be "high risk." The Department has experienced its share of IT challenges in recent years. In response, Secretary Henry Paulson made IT management one of his top priorities when he took over the Department last year. And as the most recent addition to the Secretary's senior management team, I am fully committed to improving our ability to effectively manage our IT investments and receiving value from these investments on behalf of the Congress and the American Taxpayer. I hope by discussing some of Treasury's recent and planned actions, and by offering some of my own perspectives, I can contribute to the discussion today. With your permission, I will summarize my remarks and submit my complete written testimony for the record.

My Personal Background

Today, I appear before you honored to serve as the Chief Information Officer (CIO) of the U.S. Department of the Treasury. I began working in this position on September 10th of this year. Since I am relatively new to my position, I would like to preface my comments today by briefly sharing a synopsis of my IT and general management experience. Prior to joining the Treasury Department, I served at the Department of Justice (DOJ) for 15 years, the past 4 as the Deputy CIO for e-Government. In this role, I directed the development of the Justice information sharing strategy, and I led the deployment of a tactical wireless communications system used by federal field agents from multiple agencies. Prior to my tenure as a Deputy CIO, I managed DOJ's telecommunications program, led the DOJ information security and information technology planning efforts, and architected a department-wide office automation system. In sum, I had a broad array of IT management experiences at DOJ. I will draw on that experience as I undertake my new role as CIO at Treasury.

Strengthening Treasury's Investment Management Capability through Executive Leadership

The Department of the Treasury has a significant IT investment portfolio that totals $2.958 in FY08 billion – about 25 percent of its budget – funding 285 discrete investments. Of the total, $2.398 billion (81%) funds Treasury's 63 major investments, and the remaining $560 million support 222 "non-major" investments (i.e., those that cost less than $5 million annually).

The Department and its bureaus rely significantly on information technology to carry out its extensive and varied mission. Our largest investments are at the Internal Revenue Service (IRS), which relies on IT to administer its tax programs. But the Department also relies on technology for other critical purposes, such as assisting Treasury to analyze financial intelligence information to combat terrorism.

Given the importance and nature of Treasury's IT investments, the Government Accountability Office (GAO) reviewed and issued a report on Treasury's IT management. The July 2007, GAO report found that while Treasury had established many of the capabilities needed to select, control, and evaluate its IT investments, the Department had significant weaknesses. Due to these findings, the GAO identified the need for Treasury to implement an executive level review board to monitor the progress of IT investments through the entire life cycle of the projects. The GAO also recommended that Treasury implement a comprehensive process by which to manage all IT investments, irrespective of size, scope or dollar value.

The Department concurred with the GAO recommendations and began to immediately address the key issues raised. I strongly support these steps and believe this is a clear indication of the commitment of the Department's leadership to rapidly and comprehensively improve Treasury's overall management of IT.

As the new CIO, I have taken a particular interest in the GAO's findings and recommendations. I believe regular engagement of our Department and bureau executives and continuous attention to the progress of Treasury IT investments are integral to Treasury's successful planning, implementation and use of IT. Indeed, effective management of IT is a prerequisite for effective use of IT to facilitate accomplishment of Treasury's mission. I am committed to working collaboratively across the Department – as well as with the Office of Management and Budget and the Congress – to ensure Treasury IT expenditures provide value for the Department and the citizens we serve.

In the coming months, the Department intends to make several key changes to address its IT management issues. Per the GAO's recommendation, we will revitalize the Executive Investment Review Board during the first quarter of FY 2008, in order to bring greater executive and leadership involvement in Treasury's management of IT. We will also use this forum to further ensure our IT portfolio decisions are driven by our business requirements and strategies. Additionally, we will be reviewing our existing IT management organizations and processes to assess their maturity and effectiveness. Finally, we intend to better leverage existing management tools and processes that can be used coincidently to improve investment management capabilities across Treasury.

As we work towards addressing our IT management issues in the coming months, the Treasury Investment Review Board, which is comprised of the Department's senior-level IT executives, will continue to perform oversight assessments of IT investments consistent with our continued commitment to the Clinger-Cohen Act. Additionally, I will be offering to participate in governance and investment review boards at the bureau level.

Notwithstanding the planned changes I just mentioned, I note that the Department has already taken a number of steps to improve Treasury IT management. To ensure that all IT investments receive comprehensive oversight, the Department began implementing process changes in June 2007 to ensure that "non-major" investments are formally selected by the appropriate Treasury Governance Board and reviewed quarterly to validate cost, schedule, and performance goals. The Department established a Capital Planning and Investment Control Working Group which will convene shortly to implement changes needed to ensure that the Department and its bureaus perform in a comprehensive manner the four core disciplines of IT capital planning: the Pre-Select, Select, Control and Evaluate functions.

Recognizing the importance of managing IT from an enterprise perspective, the Department currently collaborates with bureau executives from both the IT and business side. This collaboration ensures active stakeholder engagement which helps validate the alignment of IT investments with the Department's business requirements. Finally, the Department currently interacts with industry users through its Chairmanship role on the Federal User Group for its portfolio management tool "Prosight." In this capacity, the Department participates in a variety of discussions on best practices and emerging strategies in effective IT portfolio management.

Conclusion

In summary, the Department has made significant strides in the past year to improve the management and performance of its information technology resources. We believe these efforts and the actions through which we plan to fully engage executive stakeholders across the Department will result in significant progress towards implementing comprehensive IT investment management at Treasury. In so doing, Treasury IT programs will provide value-added services to the bureaus and offices performing Treasury mission functions, and we will do so in a manner mindful of the citizen taxpayer's investments in those programs.

Thank you for the opportunity to participate on this panel. I would be happy to answer any questions that you have at this time.

PRESS ROOM

September 20, 2007
HP-568

Update: Treasury Deputy Secretary to Visit Montana

U.S. Deputy Secretary Robert M. Kimmitt and Treasury's Community Development Financial Institutions (CDFI) Fund Director Kimberly A. Reed will travel to Montana this week to promote community organizations that can help homeowners avoid foreclosure in rural America and to recognize two local organizations receiving more than $200,000 in CDFI Fund awards. The Deputy Secretary will also address the University of Great Falls and announce the establishment of the J. Stanley Kimmitt Public Service Lecture and Internship at the University of Montana.

Deputy Secretary Kimmitt and Director Reed will present an award to the Montana HomeOwnership Network, which works with local service partners throughout the state to provide mortgage education and foreclosure prevention assistance. On Friday they will recognize Sovereign Leasing and Finance Company, Inc., which is receiving an award to expand its mortgage counseling and financial services.

Deputy Secretary Kimmitt will participate Friday in the announcement of the J. Stanley Kimmitt Public Service Lecture and Internship, named in honor of the Deputy Secretary's late father, former Secretary of the Senate Stan Kimmitt, who grew up in Great Falls and attended the University of Montana. The following events are open to credentialed media:

Who:
Deputy Secretary Robert M. Kimmitt
CDFI Director Kimberly A. Reed
What:
CDFI Fund Award to Montana HomeOwnership Network; Remarks to Students
When:
Thursday, September 20, 4:00 p.m. MDT
Where:
University of Great Falls
Student Center
1301 20th Street South
Great Falls, Mont
Who:
Deputy Secretary Robert M. Kimmitt
CDFI Director Kimberly A. Reed
What:
CDFI Fund Award to Sovereign Leasing and Finance Company, Inc
When:
Friday, September 21, 9:45 a.m. MDT
Where:
Tribal Complex
58141 U.S. Highway 93
Pablo, Mont.

Who:
Deputy Secretary Robert M. Kimmitt
What:
Remarks on Establishment of the J. Stanley Kimmitt Public Service Lecture and Internship
When:
Friday, September 21, 3:00 p.m. MDT
Where:

University of Montana
Don Anderson Hall, Room 210
32 Campus Drive
Missoula, Mont.

PRESS ROOM

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September 21, 2007
HP-569

Paulson Remarks on Signing of Update to U.S.-Canada Income Tax Treaty

Chelsea, Quebec--Thank you for your kind remarks, Minister Flaherty. It is a pleasure to join you in marking this important day.

Today, we are signing a protocol that is the fifth update to the tax treaty originally signed in 1980. Mutually beneficial tax agreements between the United States and Canada have a long tradition, dating back at least to 1928 when our countries signed an agreement on the taxation of income from shipping.

Our existing tax treaty is a significant part of the U.S. – Canada relationship. It strengthens our economic relations. It promotes growth and investment. These treaties have evolved as the ties between our nations have grown stronger.

We share not only a 5,500 mile border, we share a commitment to trade and open investment. By further reducing barriers to cross-border activities for U.S. and Canadian taxpayers, this updating of our treaty enables us to move even more swiftly in the dynamic global economy.

Our countries have the largest bilateral trade relationship in the world, with total exports and imports exceeding $530 billion in 2006. Canada is the United States' largest single-country trading partner. The Ambassador Bridge that links Detroit and Windsor is the largest trade link in the world --- 7,000 trucks cross daily, carrying goods worth more than $120 billion per year.

The vast majority of our cross-border trade flows without difficulty. We share Canada's commitment to a "safe, secure and efficient" border, and we have learned that security and efficient flow of legitimate trade and travelers are not mutually exclusive.

This robust economic relationship with Canada is vital to continued growth in America, and the U.S. Congress has the opportunity to generate even more opportunities by approving the pending Free Trade Agreements with Peru, Colombia, Panama and South Korea. Our deep, beneficial ties with Canada clearly demonstrate the value of global trade and investment.

This updating of our treaty represents the welcome culmination of many years of dedicated work by officials in both Canada and the United States, and it is an honor to be here on behalf of those whose efforts made this possible. Both countries worked very hard to find a balance of priorities and goals that will benefit our citizens.

I want to express my appreciation for Minister Flaherty's advancement of a mutually respectful and productive collaboration between our countries. He was instrumental in our ability to reach agreement on this treaty and, during the recent turbulence in financial markets has proven to be a sure and steady hand on Canada's economic keel.

As Minister Flaherty mentioned, this protocol includes several important provisions. It eliminates the withholding tax on cross-border interest payments and updates tax rules on pensions for workers who cross the U.S. - Canada border. It also updates and clarifies the existing treaty in areas such as the treatment of partnerships.

There is also a provision for arbitration of unresolved double-taxation cases; this will lead to more expedient and efficient resolutions of these cases. The inclusion of an arbitration provision is a new development for the United States.

I look forward to working with the Senate Foreign Relations Committee to have this protocol ratified by the full Senate as soon as possible. I also appreciate the work the Foreign Relations Committee has done in reviewing the other four tax agreements that President Bush has sent to the Senate, and I am hopeful that they will be ratified very soon.

The U.S. – Canada economic relationship is also characterized by substantial mutual investment; 11 percent of U.S. direct investment abroad is invested in Canada. In turn, Canada is a dominant investor in the United States, representing 9 percent of total foreign direct investment in our country. We welcome Canadian investment; it is the ultimate vote of confidence in the U.S. economy.

We reciprocate that confidence --- the natural result when we are committed to economic cooperation.

Minster Flaherty and I also share a commitment to environmentally sound business practices, and to preserving our abundant natural heritage for generations to come. So it is particularly appropriate that we are here in beautiful Gatineau Park.

Thank you for your hospitality today. I look forward to working in partnership with you to bring this agreement into force, and on economic issues that will surely arise in the future.

REPORTS

- ifth Protocol to the U.S.-Canada Income Tax Treaty of 1980

PROTOCOL
AMENDING THE CONVENTION BETWEEN
THE UNITED STATES OF AMERICA AND CANADA
WITH RESPECT TO TAXES ON INCOME AND ON CAPITAL
DONE AT WASHINGTON ON 26 SEPTEMBER 1980
AS AMENDED BY THE PROTOCOLS DONE ON 14 JUNE 1983,
28 MARCH 1984, 17 MARCH 1995 AND 29 JULY 1997

The United States of America and Canada, hereinafter referred to as the "Contracting States",

DESIRING to conclude a Protocol amending the Convention between the United States of America and Canada with Respect to Taxes on Income and on Capital done at Washington on 26 September 1980, as amended by the Protocols done on 14 June 1983, 28 March 1984, 17 March 1995 and 29 July 1997 (hereinafter referred to as the "Convention"), Paragraph 1 of Article III (General Definitions) of the Convention shall be amended by deleting the word "and" at the end of subparagraph (i), by replacing the period at the end of subparagraph (j) with "; and", and by adding the following subparagraph:

(k) The term "national" of a Contracting State means:

(i) Any individual possessing the citizenship or nationality of that State; and

(ii) Any legal person, partnership or association deriving its status as such from the laws in force in that State.

Article 2

1. Paragraph 3 of Article IV (Residence) of the Convention shall be deleted and replaced by the following:

3. Where by reason of the provisions of paragraph 1, a company is a resident of both Contracting States, then

(a) If it is created under the laws in force in a Contracting State, but not under the laws in force in the other Contracting State, it shall be deemed to be a resident only of the first-mentioned State; and

(b) In any other case, the competent authorities of the Contracting States shall endeavor to settle the question of residency by mutual agreement and determine the mode of application of this Convention to the company. In the absence of such agreement, the company shall not be considered a resident of either Contracting State for purposes of claiming any benefits under this Convention.

2. Article IV (Residence) of the Convention shall be amended by adding the following

a person who is a resident of a Contracting State where:

(a) The person is considered under the taxation law of that State to have derived the amount through an entity (other than an entity that is a resident of the other Contracting State); and

(b) By reason of the entity being treated as fiscally transparent under the laws of the first-mentioned State, the treatment of the amount under the taxation law of that State is the same as its treatment would be if that amount had been derived directly by that person.

7. An amount of income, profit or gain shall be considered not to be paid to or derived by a person who is a resident of a Contracting State where:

(a) The person is considered under the taxation law of the other Contracting State to have derived the amount through an entity that is not a resident of the first-mentioned State, but by reason of the entity not being treated as fiscally transparent under the laws of that State, the treatment of the amount under the taxation law of that State is not the same as its treatment would be if that amount had been derived directly by that person; or

(b) The person is considered under the taxation law of the other Contracting State to have received the amount from an entity that is a resident of that other State, but by reason of the entity being treated as fiscally transparent under the laws of the first-mentioned State, the treatment of the amount under the taxation law of that State is not the same as its treatment would be if that entity were not treated as fiscally transparent under the laws of that State.

1. The first sentence of paragraph 6 of Article V (Permanent Establishment) of the Convention shall be amended by deleting the word "and" preceding the first reference to paragraph 5, inserting a comma, and adding the words "and 9," following that reference to paragraph 5.

2. Paragraph 9 of Article V (Permanent Establishment) of the Convention shall be deleted and replaced by the following two paragraphs:

> 9. Subject to paragraph 3, where an enterprise of a Contracting State provides services in the other Contracting State, if that enterprise is found not to have a permanent establishment in that other State by virtue of the preceding paragraphs of this Article, that enterprise shall be deemed to provide those services through a permanent establishment in that other State if and only if:
>
> > (a) Those services are performed in that other State by an individual who is present in that other State for a period or periods aggregating 183 days or more in any twelve-month period, and, during that period or periods, more than 50 percent of the gross active business revenues of the enterprise consists of income derived from the services performed in that other State by that individual; or
> >
> > (b) The services are provided in that other State for an aggregate of 183 days or more in any twelve-month period with respect to the same or connected project for customers who are either residents of that other State or who maintain a permanent establishment in that other State and the services are provided in respect of that permanent establishment.
>
> 10. For the purposes of this Convention, the provisions of this Article shall be applied in determining whether any person has a permanent establishment in any State.

Paragraph 2 of Article VII (Business Profits) of the Convention shall be deleted and replaced by the following:

> 2. Subject to the provisions of paragraph 3, where a resident of a Contracting State carries on, or has carried on, business in the other Contracting State through a permanent establishment situated therein, there shall in each Contracting State be attributed to that permanent establishment the business profits which it might be expected to make if it were a distinct and separate person engaged in the same or similar activities under the same or similar conditions and dealing wholly independently with the resident and with any other person related to the resident (within the meaning of paragraph 2 of Article IX (Related Persons)).

Article 5

1. Subparagraph 2(a) of Article X (Dividends) of the Convention shall be deleted and replaced by the following:

> (a) 5 percent of the gross amount of the dividends if the beneficial owner is a company which owns at least 10 percent of the voting stock of the company paying the dividends (for this purpose, a company that is a resident of a Contracting State shall be considered to own the voting stock owned by an entity that is considered fiscally transparent under the laws of that State and that is not a resident of the Contracting State of which the company paying the dividends is a resident, in proportion to the company's ownership interest in that entity);

2. Paragraph 3 of Article X (Dividends) of the Convention shall be deleted and replaced by the following.

from shares or other rights, not being debt-claims, participating in profits, as well as income that is subjected to the same taxation treatment as income from shares under the laws of the State of which the payer is a resident.

3. Paragraph 4 of Article X (Dividends) of the Convention shall be deleted and replaced by the following:

4. The provisions of paragraph 2 shall not apply if the beneficial owner of the dividends, being a resident of a Contracting State, carries on, or has carried on, business in the other Contracting State of which the company paying the dividends is a resident, through a permanent establishment situated therein, and the holding in respect of which the dividends are paid is effectively connected to such permanent establishment. In such case, the provisions of Article VII (Business Profits) shall apply.

4. Paragraph 5 of Article X (Dividends) of the Convention shall be amended by deleting the words "or a fixed base" following the words "effectively connected with a permanent establishment".

5. Subparagraph 7(c) of Article X (Dividends) of the Convention shall be deleted and replaced by the following:

(c) Subparagraph 2(a) shall not apply to dividends paid by a resident of the United States that is a Real Estate Investment Trust (REIT), and subparagraph 2(b) shall apply only if:

(i) The beneficial owner of the dividends is an individual holding an interest of not more than 10 percent in the REIT;

(ii) The dividends are paid with respect to a class of stock that is publicly traded and the beneficial owner of the dividends is a person holding an interest of not more than 5 percent in any class of the REIT's stock; or interest of not more than 10 percent in the REIT and the REIT is diversified.

Otherwise, the rate of tax applicable under the domestic law of the United States shall apply. Where an estate or testamentary trust acquired its interest in a REIT as a consequence of an individual's death, for purposes of this subparagraph the estate or trust shall for the five-year period following the death be deemed with respect to that interest to be an individual.

Article 6

Article XI (Interest) of the Convention shall be deleted and replaced by the following:

Article XI

Interest

1. Interest arising in a Contracting State and beneficially owned by a resident of the other Contracting State may be taxed only in that other State.

2. The term "interest" as used in this Article means income from debt-claims of every kind, whether or not secured by mortgage, and whether or not carrying a right to participate in the debtor's profits, and in particular, income from government securities and income from bonds or debentures, including premiums or prizes attaching to such securities, bonds or debentures, as well as income assimilated to income from money lent by the taxation laws of the Contracting State in which the income arises. However, the term "interest" does not include income dealt with in Article X (Dividends).

3. The provisions of paragraph 1 shall not apply if the beneficial owner of the interest, being a resident of a Contracting State, carries on, or has carried on, business in the other Contracting State in which the interest arises, through a

In such case the provisions of Article VII (Business Profits) shall apply.

4. For the purposes of this Article, interest shall be deemed to arise in a Contracting State when the payer is that State itself, or a political subdivision, local authority or a resident of that State. Where, however, the person paying the interest, whether he is a resident of a Contracting State or not, has in a State other than that of which he is a resident a permanent establishment in connection with which the indebtedness on which the interest is paid was incurred, and such interest is borne by such permanent establishment, then such interest shall be deemed to arise in the State in which the permanent establishment is situated and not in the State of which the payer is a resident.

5. Where, by reason of a special relationship between the payer and the beneficial owner or between both of them and some other person, the amount of the interest, having regard to the debt-claim for which it is paid, exceeds the amount which would have been agreed upon by the payer and the beneficial owner in the absence of such relationship, the provisions of this Article shall apply only to the last-mentioned amount. In such case the excess part of the payments shall remain taxable according to the laws of each Contracting State, due regard being had to the other provisions of this Convention.

6. Notwithstanding the provisions of paragraph 1:

(a) Interest arising in the United States that is contingent interest of a type that does not qualify as portfolio interest under United States law may be taxed by the United States but, if the beneficial owner of the interest is a resident of Canada, the gross amount of the interest may be taxed at a rate not exceeding the rate prescribed in subparagraph (b) of paragraph 2 of Article X (Dividends);

(b) Interest arising in Canada that is determined with reference to receipts, sales, income, profits or other cash flow of the debtor or a payment made by the debtor to a related person may be taxed by Canada, and according to the laws of Canada, but if the beneficial owner is a resident of the United States, the gross amount of the interest may be taxed at a rate not exceeding the rate prescribed in subparagraph (b) of paragraph 2 of Article X (Dividends); and

(c) Interest that is an excess inclusion with respect to a residual interest in a real estate mortgage investment conduit may be taxed by each State in accordance with its domestic law.

7. Where a resident of a Contracting State pays interest to a person other than a resident of the other Contracting State, that other State may not impose any tax on such interest except insofar as it arises in that other State or insofar as the debt-claim in respect of which the interest is paid is effectively connected with a permanent establishment situated in that other State.

Article 7

1. Paragraph 5 of Article XII (Royalties) of the Convention shall be deleted and replaced by the following:

5. The provisions of paragraphs 2 and 3 shall not apply if the beneficial owner of the royalties, being a resident of a Contracting State, carries on, or has carried on, business in the other Contracting State in which the royalties arise, through a permanent establishment situated therein, and the right or property in respect of which the royalties are paid is effectively connected to such permanent establishment. In such case the provisions of Article VII (Business Profits) shall apply.

2. Subparagraph 6(a) of Article XII (Royalties) of the Convention shall be deleted and

is a resident of that State. Where, however, the person paying the royalties, whether he is a resident of a Contracting State or not, has in a State a permanent establishment in connection with which the obligation to pay the royalties was incurred, and such royalties are borne by such permanent establishment, then such royalties shall be deemed to arise in the State in which the permanent establishment is situated and not in any other State of which the payer is a resident; and

3. Paragraph 8 of Article XII (Royalties) of the Convention shall be amended by deleting the words "or a fixed base" following the words "effectively connected with a permanent establishment".

Article 8

1. Paragraph 2 of Article XIII (Gains) of the Convention shall be deleted and replaced by the following:

> 2. Gains from the alienation of personal property forming part of the business property of a permanent establishment which a resident of a Contracting State has or had (within the twelve-month period preceding the date of alienation) in the other Contracting State, including such gains from the alienation of such a permanent establishment, may be taxed in that other State.

2. Paragraph 5 of Article XIII (Gains) of the Convention shall be deleted and replaced by the following:

> 5. The provisions of paragraph 4 shall not affect the right of a Contracting State to levy, according to its domestic law, a tax on gains from the alienation of any property derived by an individual who is a resident of the other Contracting State if:

(i) For at least 120 months during any period of 20 consecutive years preceding the alienation of the property; and

(ii) At any time during the 10 years immediately preceding the alienation of the property; and

(b) The property (or property for which such property was substituted in an alienation the gain on which was not recognized for the purposes of taxation in the first-mentioned State):

(i) Was owned by the individual at the time the individual ceased to be a resident of the first-mentioned State; and

(ii) Was not a property that the individual was treated as having alienated by reason of ceasing to be a resident of the first-mentioned State and becoming a resident of the other Contracting State.

3. Paragraph 7 of Article XIII (Gains) of the Convention shall be deleted and replaced by the following:

7. Where at any time an individual is treated for the purposes of taxation by a Contracting State as having alienated a property and is taxed in that State by reason thereof, the individual may elect to be treated for the purposes of taxation in the other Contracting State, in the year that includes that time and all subsequent years, as if the individual had, immediately before that time, sold and repurchased the property for an amount equal to its fair market value at that time.

4. Subparagraph 9(c) of Article XIII (Gains) of the Convention shall be amended by deleting the words "or pertained to a fixed base" following the words "permanent establishment".

Article XIV (Independent Personal Services) of the Convention shall be deleted and the succeeding Articles shall not be renumbered.

Article 10

1. The title of Article XV (Dependent Personal Services) of the Convention shall be deleted and replaced by "Income from Employment".

2. Paragraphs 1 and 2 of renamed Article XV (Income from Employment) of the Convention shall be deleted and replaced by the following:

> 1. Subject to the provisions of Articles XVIII (Pensions and Annuities) and XIX (Government Service), salaries, wages and other remuneration derived by a resident of a Contracting State in respect of an employment shall be taxable only in that State unless the employment is exercised in the other Contracting State. If the employment is so exercised, such remuneration as is derived therefrom may be taxed in that other State.
>
> 2. Notwithstanding the provisions of paragraph 1, remuneration derived by a resident of a Contracting State in respect of an employment exercised in the other Contracting State shall be taxable only in the first-mentioned State if:
>
> > (a) Such remuneration does not exceed ten thousand dollars ($10,000) in the currency of that other State; or
> >
> > (b) The recipient is present in that other State for a period or periods not exceeding in the aggregate 183 days in any twelve-month period commencing or ending in the fiscal year concerned, and the remuneration is not paid by, or on behalf of, a person who is a resident of that other State and is not borne by a permanent establishment in that

1. Paragraph 1 of Article XVI (Artistes and Athletes) shall be amended by deleting the words "XIV (Independent Personal Services)" following the words "Notwithstanding the provisions of Articles" and replacing them with the words "VII (Business Profits)" and by deleting the words "XV (Dependent Personal Services)" and replacing them with the words "XV (Income from Employment)'

2. Paragraph 2 of Article XVI (Artistes and Athletes) shall be amended by deleting the words "XIV (Independent Personal Services)" following the words "notwithstanding the provisions of Articles VII (Business Profits)," and by deleting the words "XV (Dependent Personal Services)" and replacing them with the words "XV (Income from Employment)".

3. Paragraph 4 of Article XVI (Artistes and Athletes) shall be amended by deleting the words "XIV (Independent Personal Services)" following the words "Notwithstanding the provisions of Articles" and replacing them with the words "VII (Business Profits)" and by deleting the words "(Dependent Personal Services)" in both places they appear in the paragraph and replacing them with the words "(Income from Employment)'

Article 12

Article XVII (Withholding of Taxes in Respect of Personal Services) of the Convention shall be deleted and the succeeding Articles shall not be renumbered.

Article 13

1. Paragraphs 3 and 4 of Article XVIII (Pensions and Annuities) of the Convention shall be deleted and replaced by the following:

3. For the purposes of this Convention:

superannuation, pension or other retirement arrangement, Armed Forces retirement pay, war veterans pensions and allowances and amounts paid under a sickness, accident or disability plan, but does not include payments under an income-averaging annuity contract or, except for the purposes of Article XIX (Government Service), any benefit referred to in paragraph 5; and

(b) The term "pensions" also includes a Roth IRA, within the meaning of section 408A of the Internal Revenue Code, or a plan or arrangement created pursuant to legislation enacted by a Contracting State after September 21, 2007 that the competent authorities have agreed is similar thereto. Notwithstanding the provisions of the preceding sentence, from such time that contributions have been made to the Roth IRA or similar plan or arrangement, by or for the benefit of a resident of the other Contracting State (other than rollover contributions from a Roth IRA or similar plan or arrangement described in the previous sentence that is a pension within the meaning of this subparagraph), to the extent of accretions from such time, such Roth IRA or similar plan or arrangement shall cease to be considered a pension for purposes of the provisions of this Article.

4. For the purposes of this Convention:

(a) The term "annuity" means a stated sum paid periodically at stated times during life or during a specified number of years, under an obligation to make the payments in return for adequate and full consideration (other than services rendered), but does not include a payment that is not a periodic payment or any annuity the cost of which was deductible for the purposes of taxation in the Contracting State in which it was acquired; and annuity contract (including a withdrawal in respect of the cash value thereof) shall be deemed to arise in a Contracting State if the person paying the annuity or other amount (in this subparagraph referred to as the "payer") is a resident of that State. However, if the payer, whether a resident of a Contracting State or not, has in a State other than that of which the payer is a resident a permanent establishment in connection with which the obligation giving rise to the annuity or other amount was incurred, and the annuity or other amount is borne by the permanent establishment, then the annuity or other amount shall be deemed to arise in the State in which the permanent establishment is situated and not in the State of which the payer is a resident.

2. Paragraph 7 of Article XVIII (Pensions and Annuities) of the Convention shall be deleted and replaced by the following:

7. A natural person who is a citizen or resident of a Contracting State and a beneficiary of a trust, company, organization or other arrangement that is a resident of the other Contracting State, generally exempt from income taxation in that other State and operated exclusively to provide pension or employee benefits may elect to defer taxation in the first-mentioned State, subject to rules established by the competent authority of that State, with respect to any income accrued in the plan but not distributed by the plan, until such time as and to the extent that a distribution is made from the plan or any plan substituted therefor.

3. Article XVIII (Pensions and Annuities) of the Convention shall be amended by adding the following paragraphs:

8. Contributions made to, or benefits accrued under, a qualifying retirement plan in a Contracting State by or on behalf of an individual shall be deductible or excludible in computing the individual's taxable income in the other

that other State, where:

(a) The individual performs services as an employee in that other State the remuneration from which is taxable in that other State;

(b) The individual was participating in the plan (or another similar plan for which this plan was substituted) immediately before the individual began performing the services in that other State;

(c) The individual was not a resident of that other State immediately before the individual began performing the services in that other State;

(d) The individual has performed services in that other State for the same employer (or a related employer) for no more than 60 of the 120 months preceding the individual's current taxation year;

(e) The contributions and benefits are attributable to the services performed by the individual in that other State, and are made or accrued during the period in which the individual performs those services; and

(f) With respect to contributions and benefits that are attributable to services performed during a period in the individual's current taxation year, no contributions in respect of the period are made by or on behalf of the individual to, and no services performed in that other State during the period are otherwise taken into account for purposes of determining the individual's entitlement to benefits under, any plan that would be a qualifying retirement plan in that other State if paragraph 15 of this Article were read without reference to subparagraphs (b) and (c) of that paragraph.

This paragraph shall apply only to the extent that the contributions or benefits would qualify for tax relief in the first-mentioned State if the individual was a resident of and performed the services in that State.

paragraph 8 to a citizen of the United States shall not exceed the benefits that would be allowed by the United States to its residents for contributions to, or benefits otherwise accrued under, a generally corresponding pension or retirement plan established in and recognized for tax purposes by the United States.

10. Contributions made to, or benefits accrued under, a qualifying retirement plan in a Contracting State by or on behalf of an individual who is a resident of the other Contracting State shall be deductible or excludible in computing the individual's taxable income in that other State, where:

(a) The individual performs services as an employee in the first-mentioned state the remuneration from which is taxable in that State and is borne by an employer who is a resident of that State or by a permanent establishment which the employer has in that State; and

(b) The contributions and benefits are attributable to those services and are made or accrued during the period in which the individual performs those services.

This paragraph shall apply only to the extent that the contributions or benefits qualify for tax relief in the first-mentioned State.

11. For the purposes of Canadian taxation, the amount of contributions otherwise allowed as a deduction under paragraph 10 to an individual for a taxation year shall not exceed the individual's deduction limit under the law of Canada for the year for contributions to registered retirement savings plans remaining after taking into account the amount of contributions to registered retirement savings plans deducted by the individual under the law of Canada for the year. The amount deducted by an individual under paragraph 10 for a taxation year shall be taken into account in computing the individual's deduction

registered retirement savings plans.

12. For the purposes of United States taxation, the benefits granted under paragraph 10 shall not exceed the benefits that would be allowed by the United States to its residents for contributions to, or benefits otherwise accrued under, a generally corresponding pension or retirement plan established in and recognized for tax purposes by the United States. For purposes of determining an individual's eligibility to participate in and receive tax benefits with respect to a pension or retirement plan or other retirement arrangement established in and recognized for tax purposes by the United States, contributions made to, or benefits accrued under, a qualifying retirement plan in Canada by or on behalf of the individual shall be treated as contributions or benefits under a generally corresponding pension or retirement plan established in and recognized for tax purposes by the United States.

13. Contributions made to, or benefits accrued under, a qualifying retirement plan in Canada by or on behalf of a citizen of the United States who is a resident of Canada shall be deductible or excludible in computing the citizen's taxable income in the United States, where:

(a) The citizen performs services as an employee in Canada the remuneration from which is taxable in Canada and is borne by an employer who is a resident of Canada or by a permanent establishment which the employer has in Canada; and

(b) The contributions and benefits are attributable to those services and are made or accrued during the period in which the citizen performs those services.

This paragraph shall apply only to the extent that the contributions or benefits qualify for tax relief in Canada.

14. The benefits granted under paragraph 13 shall not exceed the benefits

retirement plan established in and recognized for tax purposes by the United States. For purposes of determining an individual's eligibility to participate in and receive tax benefits with respect to a pension or retirement plan or other retirement arrangement established in and recognized for tax purposes by the United States, contributions made to, or benefits accrued under, a qualifying retirement plan in Canada by or on behalf of the individual shall be treated as contributions or benefits under a generally corresponding pension or retirement plan established in and recognized for tax purposes by the United States.

15. For purposes of paragraphs 8 to 14, a qualifying retirement plan in a Contracting State means a trust, company, organization or other arrangement:

(a) That is a resident of that State, generally exempt from income taxation in that State and operated primarily to provide pension or retirement benefits;

(b) That is not an individual arrangement in respect of which the individual's employer has no involvement; and

(c) Which the competent authority of the other Contracting State agrees generally corresponds to a pension or retirement plan established in and recognized for tax purposes by that other State.

16. For purposes of this Article, a distribution from a pension or retirement plan that is reasonably attributable to a contribution or benefit for which a benefit was allowed pursuant to paragraph 8, 10 or 13 shall be deemed to arise in the Contracting State in which the plan is established.

17. Paragraphs 8 to 16 apply, with such modifications as the circumstances require, as though the relationship between a partnership that carries on a business, and an individual who is a member of the partnership, were that of employer and employee.

Article XIX (Government Service) of the Convention shall be amended by deleting the words "XIV (Independent Personal Services)" and replacing them with the words "VII (Business Profits)" and by deleting the words "XV (Dependent Personal Services)" and replacing them with the words "XV (Income from Employment)".

Article 15

Article XX (Students) of the Convention shall be deleted and replaced by the following:

> Payments received by an individual who is a student, apprentice, or business trainee, and is, or was immediately before visiting a Contracting State, a resident of the other Contracting State, and who is present in the first-mentioned State for the purpose of the individual's full-time education or full-time training, shall not be taxed in that State, provided that such payments arise outside that State, and are for the purpose of the maintenance, education or training of the individual. The provisions of this Article shall apply to an apprentice or business trainee only for a period of time not exceeding one year from the date the individual first arrives in the first-mentioned State for the purpose of the individual's training.

Article 16

1. Paragraphs 4, 5 and 6 of Article XXI (Exempt Organizations) of the Convention shall be renumbered as paragraphs 5, 6 and 7 respectively.

2. Paragraphs 1 through 3 of Article XXI (Exempt Organizations) of the Convention shal be deleted and replaced by the following four paragraphs:

> 1. Subject to the provisions of paragraph 4, income derived by a religious,

to the extent that such income is exempt from tax in that other State.

2. Subject to the provisions of paragraph 4, income referred to in Articles X (Dividends) and XI (Interest) derived by a trust, company, organization or other arrangement that is a resident of a Contracting State, generally exempt from income taxation in a taxable year in that State and operated exclusively to administer or provide pension, retirement or employee benefits shall be exempt from income taxation in that taxable year in the other Contracting State.

3. Subject to the provisions of paragraph 4, income referred to in Articles X (Dividends) and XI (Interest) derived by a trust, company, organization or other arrangement that is a resident of a Contracting State, generally exempt from income taxation in a taxable year in that State and operated exclusively to earn income for the benefit of one or more of the following:

(a) An organization referred to in paragraph 1; or

(b) A trust, company, organization or other arrangement referred to in paragraph 2;

shall be exempt from income taxation in that taxable year in the other Contracting State.

4. The provisions of paragraphs 1, 2 and 3 shall not apply with respect to the income of a trust, company, organization or other arrangement from carrying on a trade or business or from a related person other than a person referred to in paragraphs 1, 2 or 3.

Article 17

Article XXII (Other Income) of the Convention shall be amended by adding the following paragraph:

a resident of a Contracting State in respect of the provision of a guarantee of indebtedness shall be taxable only in that State, unless such compensation is business profits attributable to a permanent establishment situated in the other Contracting State, in which case the provisions of Article VII (Business Profits) shall apply.

Article 18

Paragraph 2 of Article XXIII (Capital) of the Convention shall be amended by deleting the phrase ", or by personal property pertaining to a fixed base available to a resident of a Contracting State in the other Contracting State for the purpose of performing independent personal services,".

Article 19

Subparagraph 2(b) of Article XXIV (Elimination of Double Taxation) of the Convention shall be deleted and replaced with the following:

(b) In the case of a company which is a resident of Canada owning at least 10 percent of the voting stock of a company which is a resident of the United States from which it receives dividends in any taxable year, Canada shall allow as a credit against the Canadian tax on income the appropriate amount of income tax paid or accrued to the United States by the second company with respect to the profits out of which the dividends are paid.

1. Paragraph 1 of Article XXV (Non-Discrimination) of the Convention shall be deleted and replaced by the following:

> 1. Nationals of a Contracting State shall not be subjected in the other Contracting State to any taxation or any requirement connected therewith that is more burdensome than the taxation and connected requirements to which nationals of that other State in the same circumstances, particularly with respect to taxation on worldwide income, are or may be subjected. This provision shall also apply to individuals who are not residents of one or both of the Contracting States.

2. Paragraph 2 of Article XXV (Non-Discrimination) of the Convention shall be deleted, and paragraphs 3 to 10 of Article XXV shall be renumbered accordingly.

3. Renumbered paragraph 3 of Article XXV (Non-Discrimination) of the Convention shall be amended by deleting the words "Article XV (Dependent Personal Services)" and replacing them with the words "Article XV (Income from Employment)".

Article 21

1. Paragraph 6 of Article XXVI (Mutual Agreement Procedure) of the Convention shall be deleted and replaced by the following:

> 6. Where, pursuant to a mutual agreement procedure under this Article, the competent authorities have endeavored but are unable to reach a complete agreement in a case, the case shall be resolved through arbitration conducted in the manner prescribed by, and subject to, the requirements of paragraph 7 and any rules or procedures agreed upon by the Contracting States by notes to be exchanged through diplomatic channels, if:

States with respect to the taxable years at issue in the case;

(b) The case:

(i) Is a case that:

(A) Involves the application of one or more Articles that the competent authorities have agreed in an exchange of notes shall be the subject of arbitration; and

(B) Is not a particular case that the competent authorities agree, before the date on which arbitration proceedings would otherwise have begun, is not suitable for determination by arbitration; or

(ii) Is a particular case that the competent authorities agree is suitable for determination by arbitration; and

(c) All concerned persons agree according to the provisions of subparagraph 7(d).

7. For the purposes of paragraph 6 and this paragraph, the following rules and definitions shall apply:

(a) The term "concerned person" means the presenter of a case to a competent authority for consideration under this Article and all other persons, if any, whose tax liability to either Contracting State may be directly affected by a mutual agreement arising from that consideration;

(b) The "commencement date" for a case is the earliest date on which the information necessary to undertake substantive consideration for a mutual agreement has been received by both competent authorities;

(c) Arbitration proceedings in a case shall begin on the later of:

(i) Two years after the commencement date of that case, unless both competent authorities have previously agreed to a subparagraph (d) has been received by both competent authorities;

(d) The concerned person(s), and their authorized representatives or agents, must agree prior to the beginning of arbitration proceedings not to disclose to any other person any information received during the course of the arbitration proceeding from either Contracting State or the arbitration board, other than the determination of such board;

(e) Unless a concerned person does not accept the determination of an arbitration board, the determination shall constitute a resolution by mutual agreement under this Article and shall be binding on both Contracting States with respect to that case; and

(f) For purposes of an arbitration proceeding under paragraph 6 and this paragraph, the members of the arbitration board and their staffs shall be considered "persons or authorities" to whom information may be disclosed under Article XXVII (Exchange of Information) of this Convention.

Article 22

1. Subparagraph 8(a) of Article XXVI A (Assistance in Collection) of the Convention shall be deleted and replaced by the following:

(a) Where thc taxpayer is an individual, the revenue claim relates either to a taxable period in which the taxpayer was a citizen of the requested State or, if the taxpayer became a citizen of the requested State at any time before November 9, 1995 and is such a citizen at the time the applicant State applies for collection of the claim, to a taxable period that ended before November 9, 1995;

shall be deleted and replaced by the following:

9. Notwithstanding the provisions of Article II (Taxes Covered), the provisions of this Article shall apply to all categories of taxes collected, and to contributions to social security and employment insurance premiums levied, by or on behalf of the Government of a Contracting State.

Article 23

Article XXVII (Exchange of Information) of the Convention shall be deleted and replaced by the following:

Article XXVII

Exchange of Information

1. The competent authorities of the Contracting States shall exchange such information as may be relevant for carrying out the provisions of this Convention or of the domestic laws of the Contracting States concerning taxes to which this Convention applies insofar as the taxation thereunder is not contrary to this Convention. The exchange of information is not restricted by Article I (Personal Scope). Any information received by a Contracting State shall be treated as secret in the same manner as information obtained under the taxation laws of that State and shall be disclosed only to persons or authorities (including courts and administrative bodies) involved in the assessment or collection of, the administration and enforcement in respect of, or the determination of appeals in relation to the taxes to which this Convention applies or, notwithstanding paragraph 4, in relation to taxes imposed by a political subdivision or local authority of a Contracting State that are substantially similar to the taxes covered by this Convention under Article II

in judicial decisions. The competent authorities may release to an arbitration board established pursuant to paragraph 6 of Article XXVI (Mutual Agreement Procedure) such information as is necessary for carrying out the arbitration procedure; the members of the arbitration board shall be subject to the limitations on disclosure described in this Article.

2. If information is requested by a Contracting State in accordance with this Article, the other Contracting State shall use its information gathering measures to obtain the requested information, even though that other State may not need such information for its own tax purposes. The obligation contained in the preceding sentence is subject to the limitations of paragraph 3 but in no case shall such limitations be construed to permit a Contracting State to decline to supply information because it has no domestic interest in such information.

3. In no case shall the provisions of paragraph 1 and 2 be construed so as to impose on a Contracting State the obligation:

(a) To carry out administrative measures at variance with the laws and administrative practice of that State or of the other Contracting State;

(b) To supply information which is not obtainable under the laws or in the normal course of the administration of that State or of the other Contracting State; or

(c) To supply information which would disclose any trade, business, industrial, commercial or professional secret or trade process, or information the disclosure of which would be contrary to public policy (ordre public).

4. For the purposes of this Article, this Convention shall apply, notwithstanding the provisions of Article II (Taxes Covered):

(a) To all taxes imposed by a Contracting State; and applies, but only to the extent that the information may be relevant for the purposes of the application of that provision.

5. In no case shall the provisions of paragraph 3 be construed to permit a Contracting State to decline to supply information because the information is held by a bank, other financial institution, nominee or person acting in an agency or a fiduciary capacity or because it relates to ownership interests in a person.

6. If specifically requested by the competent authority of a Contracting State, the competent authority of the other Contracting State shall provide information under this Article in the form of depositions of witnesses and authenticated copies of unedited original documents (including books, papers, statements, records, accounts, and writings).

7. The requested State shall allow representatives of the requesting State to enter the requested State to interview individuals and examine books and records with the consent of the persons subject to examination.

Article 24

1. Paragraph 2 of Article XXIX (Miscellaneous Rules) of the Convention shall be deleted and replaced by the following:

2. (a) Except to the extent provided in paragraph 3, this Convention shall not affect the taxation by a Contracting State of its residents (as determined under Article IV (Residence)) and, in the case of the United States, its citizens and companies electing to be treated as domestic corporations.

(b) Notwithstanding the other provisions of this Convention, a accordance with the laws of the United States with respect to income from sources within the United States (including income deemed under the domestic law of the United States to arise from such sources).

2. Subparagraph 3(a) of Article XXIX (Miscellaneous Rules) shall be deleted and replaced by the following:

(a) Under paragraphs 3 and 4 of Article IX (Related Persons), paragraphs 6 and 7 of Article XIII (Gains), paragraphs 1, 3, 4, 5, 6(b), 7, 8, 10 and 13 of Article XVIII (Pensions and Annuities), paragraph 5 of Article XXIX (Miscellaneous Rules), paragraphs 1, 5, and 6 of Article XXIX B (Taxes Imposed by Reason of Death), paragraphs 2, 3, 4, and 7 of Article XXIX B (Taxes Imposed by Reason of Death) as applied to estates of persons other than former citizens referred to in paragraph 2 of this Article, paragraphs 3 and 5 of Article XXX (Entry into Force), and Articles XIX (Government Service), XXI (Exempt Organizations), XXIV (Elimination of Double Taxation), XXV (Non-Discrimination) and XXVI (Mutual Agreement Procedure);

Article 25

Article XXIX A (Limitation on Benefits) of the Convention shall be deleted and replaced by the following:

Article XXIX A

Limitation on Benefits

1. For the purposes of the application of this Convention by a Contracting State,

(a) a qualifying person shall be entitled to all of the benefits of this not a qualifying person shall not be entitled to any benefits of this Convention.

2. For the purposes of this Article, a qualifying person is a resident of a Contracting State that is:

(a) a natural person;

(b) a Contracting State or a political subdivision or local authority thereof, or any agency or instrumentality of any such State, subdivision or authority;

(c) a company or trust whose principal class of shares or units (and any disproportionate class of shares or units) is primarily and regularly traded on one or more recognized stock exchanges;

(d) a company, if five or fewer persons each of which is a company or trust referred to in subparagraph (c) own directly or indirectly more than 50 percent of the aggregate vote and value of the shares and more than 50 percent of the vote and value of each disproportionate class of shares (in neither case including debt substitute shares), provided that each company or trust in the chain of ownership is a qualifying person;

(e) (i) a company, 50 percent or more of the aggregate vote and value of the shares of which and 50 percent or more of the vote and value of each disproportionate class of shares (in neither case including debt substitute shares) of which is not owned, directly or indirectly, by persons other than qualifying persons; or

(ii) a trust, 50 percent or more of the beneficial interest in which and 50 percent or more of each disproportionate interest in which, is not owned, directly or indirectly, by persons other than qualifying persons;

determined in the State of residence of the company or trust) that are paid or payable by the company or trust, as the case may be, for its preceding fiscal period (or, in the case of its first fiscal period, that period) directly or indirectly, to persons that are not qualifying persons is less than 50 percent of its gross income for that period;

(f) an estate;

(g) a not-for-profit organization, provided that more than half of the beneficiaries, members or participants of the organization are qualifying persons;

(h) a trust, company, organization or other arrangement described in paragraph 2 of Article XXI (Exempt Organizations) and established for the purpose of providing benefits primarily to individuals who are qualifying persons, or persons who were qualifying persons within the five preceding years; or

(i) a trust, company, organization or other arrangement described in paragraph 3 of Article XXI (Exempt Organizations) provided that the beneficiaries of the trust, company, organization or other arrangement are described in subparagraph (g) or (h).

3. Where a person is a resident of a Contracting State and is not a qualifying person, and that person, or a person related thereto, is engaged in the active conduct of a trade or business in that State (other than the business of making or managing investments, unless those activities are carried on with customers in the ordinary course of business by a bank, an insurance company, a registered securities dealer or a deposit-taking financial institution), the benefits of this Convention shall apply to that resident person with respect to income derived from the other Contracting State in connection with or incidental to that trade or business (including any such income derived directly or indirectly by

activity carried on in that other State giving rise to the income in respect of which benefits provided under this Convention by that other State are claimed.

4. A company that is a resident of a Contracting State shall also be entitled to the benefits of Articles X (Dividends), XI (Interest) and XII (Royalties) if:

(a) Its shares that represent more than 90 percent of the aggregate vote and value of all of its shares and at least 50 percent of the vote and value of any disproportionate class of shares (in neither case including debt substitute shares) are owned, directly or indirectly, by persons each of whom is a qualifying person or a person who:

(i) Is a resident of a country with which the other Contracting State has a comprehensive income tax convention and is entitled to all of the benefits provided by that other State under that convention;

(ii) Would qualify for benefits under paragraphs 2 or 3 if that person were a resident of the first-mentioned State (and, for the purposes of paragraph 3, if the business it carried on in the country of which it is a resident were carried on by it in the first-mentioned State); and

(iii) Would be entitled to a rate of tax in the other Contracting State under the convention between that person's country of residence and that other State, in respect of the particular class of income for which benefits are being claimed under this Convention, that is at least as low as the rate applicable under this Convention; and

(b) The amount of the expenses deductible from gross income (as determined in the company's State of residence) that are paid or payable by the company for its preceding fiscal period (or, in the case of its first income for that period.

5. For the purposes of this Article,

(a) The term "debt substitute share" means:

(i) A share described in paragraph (e) of the definition "term preferred share" in the Income Tax Act, as it may be amended from time to time without changing the general principle thereof; and

(ii) Such other type of share as may be agreed upon by the competent authorities of the Contracting States.

(b) The term "disproportionate class of shares" means any class of shares of a company resident in one of the Contracting States that entitles the shareholder to disproportionately higher participation, through dividends, redemption payments or otherwise, in the earnings generated in the other State by particular assets or activities of the company;

(c) The term "disproportionate interest in a trust" means any interest in a trust resident in one of the Contracting States that entitles the interest holder to disproportionately higher participation in, or claim to, the earnings generated in the other State by particular assets or activities of the trust;

(d) The term "not-for-profit organization" of a Contracting State means an entity created or established in that State and that is, by reason of its not-for-profit status, generally exempt from income taxation in that State, and includes a private foundation, charity, trade union, trade association or similar organization;

(e) The term "principal class of shares" of a company means the ordinary or common shares of the company, provided that such class of shares represents the majority of the voting power and value of the majority of the aggregate voting power and value of the company, the "principal class of shares" are those classes that in the aggregate represent a majority of the aggregate voting power and value of the company; and

(f) The term "recognized stock exchange" means:

(i) The NASDAQ System owned by the National Association of Securities Dealers, Inc. and any stock exchange registered with the Securities and Exchange Commission as a national securities exchange for purposes of the Securities Exchange Act of 1934;

(ii) Canadian stock exchanges that are "prescribed stock exchanges" or "designated stock exchanges" under the Income Tax Act; and

(iii) Any other stock exchange agreed upon by the Contracting States in an exchange of notes or by the competent authorities of the Contracting States.

6. Where a person that is a resident of a Contracting State is not entitled under the preceding provisions of this Article to the benefits provided under this Convention by the other Contracting State, the competent authority of that other State shall, upon that person's request, determine on the basis of all factors including the history, structure, ownership and operations of that person whether:

(a) Its creation and existence did not have as a principal purpose the obtaining of benefits under this Convention that would not otherwise be available; or

(b) It would not be appropriate, having regard to the purpose of this Article, to deny the benefits of this Convention to that person.

where the competent authority determines that subparagraph (a) or (b) applies.

7. It is understood that this Article shall not be construed as restricting in any manner the right of a Contracting State to deny benefits under this Convention where it can reasonably be concluded that to do otherwise would result in an abuse of the provisions of this Convention.

Article 26

1. Paragraph 1 of Article XXIX B (Taxes Imposed by Reason of Death) of the Convention shall be deleted and replaced by the following:

1. Where the property of an individual who is a resident of a Contracting State passes by reason of the individual's death to an organization that is referred to in paragraph 1 of Article XXI (Exempt Organizations) and that is a resident of the other Contracting State,

(a) If the individual is a resident of the United States and the organization is a resident of Canada, the tax consequences in the United States arising out of the passing of the property shall apply as if the organization were a resident of the United States; and

(b) If the individual is a resident of Canada and the organization is a resident of the United States, the tax consequences in Canada arising out of the passing of the property shall apply as if the individual had disposed of the property for proceeds equal to an amount elected on behalf of the individual for this purpose (in a manner specified by the competent authority of Canada), which amount shall be no less than the individual's cost of the property as determined for purposes of Canadian tax and no greater than the fair market value of the property.

shall be deleted and replaced by the following:

5. Where an individual was a resident of the United States immediately before the individual's death, for the purposes of subsections 70(5.2) and (6) of the Income Tax Act, both the individual and the individual's spouse shall be deemed to have been resident in Canada immediately before the individual's death. Where a trust that would be a trust described in subsection 70(6) of that Act, if its trustees that were residents or citizens of the United States or domestic corporations under the law of the United States were residents of Canada, requests the competent authority of Canada to do so, the competent authority may agree, subject to terms and conditions satisfactory to such competent authority, to treat the trust for the purposes of that Act as being resident in Canada for such time and with respect to such property as may be stipulated in the agreement.

Article 27

This Protocol shall be subject to ratification in accordance with the applicable procedures in the United States and Canada. The Contracting States shall notify each other in writing, through diplomatic channels, when their respective applicable procedures have been satisfied.

2. This Protocol shall enter into force on the date of the later of the notifications referred to in paragraph 1, or January 1, 2008, whichever is later. The provisions of this Protocol shall have effect:

(a) In respect of taxes withheld at source, for amounts paid or credited on or after the first day of the second month that begins after the date on which this Protocol enters into force;

notifications referred to in paragraph 1 is dated in 2007, taxable years that begin in and after) the calendar year in which this Protocol enters into force.

3. Notwithstanding paragraph 2,

(a) Paragraph 1 of Article 2 of this Protocol shall have effect with respect to corporate continuations effected after September 17, 2000;

(b) New paragraph 7 of Article IV (Residence) of the Convention as added by Article 2 of this Protocol shall have effect as of the first day of the third calendar year that ends after this Protocol enters into force;

(c) Article 3 of this Protocol shall have effect as of the third taxable year that ends after this Protocol enters into force, but in no event shall it apply to include, in the determination of whether an enterprise is deemed to provide services through a permanent establishment under paragraph 9 of Article V (Permanent Establishment) of the Convention, any days of presence, services rendered, or gross active business revenues that occur or arise prior to January 1, 2010;

(d) In applying Article 6 of this Protocol to interest paid or credited during the first two calendar years that end after entry into force of this Protocol, paragraph 1 of Article XI (Interest) of the Convention shall be read as follows:

> 1. Interest arising in a Contracting State and beneficially owned by a resident of the other Contracting State may be taxed only in that other State. However, if the interest is not exempt under paragraph 3 of Article XI (Interest) as it read on January 1, 2007, and the payer of the interest and the beneficial owner of the interest are related, or would be deemed to be related if the provisions of paragraph 2 of Article IX (Related Persons) applied for this purpose, such interest may also be taxed in the Contracting State in which it arises, and according to the laws of that State, but the tax so charged shall not exceed the following percentage of the gross amount of the interest:
>
> > (a) If the interest is paid or credited during the first calendar year that

that ends after entry into force of this paragraph, 4 percent;

(e) Paragraphs 2 and 3 of Article 8 of this Protocol shall have effect with respect to alienations of property that occur (including, for greater certainty, those that are deemed under the law of a Contracting State to occur) after September 17, 2000;

(f) Article 21 of this Protocol shall have effect with respect to

(i) Cases that are under consideration by the competent authorities as of the date on which this Protocol enters into force; and

(ii) Cases that come under such consideration after that time,

and the commencement date for a case described in subparagraph (f)(i) shall be the date on which the Protocol enters into force; and

(g) Article 22 of this Protocol shall have effect for revenue claims finally determined by an applicant State after November 9, 1985.

IN WITNESS WHEREOF the undersigned, being duly authorized thereto by their respective Governments, have signed this Protocol.

DONE in duplicate at Chelsea this twenty-first day of September 2007 in the English and French languages, each text being equally authentic.

FOR THE GOVERNMENT OF THE UNITED STATES OF AMERICA:	FOR THE GOVERNMENT OF CANADA:

PRESS ROOM

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September 24, 2007
hp-570

Treasury Assistant Secretary Ryan
Remarks at Real Return USA:
The Euromoney Inflation Linked Products Conference

New York City- Good morning. It is a pleasure to be here in New York City, and I appreciate you inviting me to join you.

As Assistant Secretary for Financial Markets at the Department of the Treasury, I have a number of responsibilities ranging from supporting Secretary Paulson in his capacity as Chairman of the President's Working Group on Financial Markets, to working on efforts that serve to enhance the competitiveness of our capital markets, to overseeing the U.S. Treasury debt issuance and management. Our first Secretary of the Treasury, Alexander Hamilton, appreciated the value of effective debt management. Hamilton understood that though the United States was a young nation, it had to repay in full the debt incurred from the Revolutionary War having once remarked that "The debt of the United States ... was the price of liberty."

Our nation's debt has grown since the first days of our republic and today, we have nearly $9 trillion in debt outstanding, issue over $4 trillion in marketable debt annually, monitor over $500 billion in daily secondary market turnover, maintain and invest an average daily cash balance of over $20 billion, and hold auctions nearly every single business day of the year.

Included within those figures are Treasury Inflation Protected Securities, or TIPS. They too possess impressive underlying numbers: over $450 billion outstanding, nearly $70 billion in new issuance per year, and over $8 billion in average turnover daily. These statistics make our Treasury market the largest and most efficient government debt market in the world.

We are in an enviable position, but we cannot take our leadership for granted. Every day, the U.S. Treasury, like other issuers, must compete for capital in the global marketplace. With our well defined mission, prudent operating principles and robust, yet flexible issuance and management strategy, we remain committed to ensuring that the U.S. Treasury market remains the preeminent sovereign debt market in the world.

Let me take a few moments to give you some background on our debt management efforts, then discuss TIPS, and finally address a strategic issue that looms on the horizon.

Objective, Constraints and Operating Principles

As the largest issuer in the world of sovereign debt, our objective is clear and unambiguous. We seek to achieve the lowest cost of borrowing over time.

Achieving the lowest cost of borrowing necessitates the management of two other variables: constraints and risks. If issuers and investors have learned anything over the past few months it is that one must address risk in its many dimensions. From Treasury's perspective, our constraints and risks are numerous, and, once again, very large.

One constraint we face is: uncertainty. Uncertainty emanates from a number of sources. These include: significant forecast errors, unexpected legislation, issues related to the debt limit, and fluctuations in the issuance of non-marketable debt all impact our marketable borrowing.

Let me give you a specific example. The best and brightest on Wall Street, the Office of Management and Budget (OMB), and the Congressional Budget Office (CBO), each publish forecasts of the annual deficit. Despite their best efforts over the past decade, forecast errors have on average varied by $120 billion one year ahead of the upcoming fiscal year end.

Realizing the nature and presence of uncertainty requires Treasury to be as flexible as possible in our issuance decisions. However, here too we face a competing constraint, namely: size. Simply put, Treasury is too large to behave opportunistically.

Given our size, our debt issuance effectively sets the yield curve. We are unable to quickly alter issuance to take advantage of rate changes. Hence, we do not attempt to time the market or issue opportunistically.

Not surprisingly, our short term cash needs are also dynamic and effective liquidity management is critical. Our cash balances are extremely volatile and can range from $5 billion to $125 billion on a given day. While some expenditures such as Social Security and Medicare are fairly predictable, others are much more difficult to forecast both in terms of timing or scale. Similarly, tax revenues can shift dramatically in size and direction with little warning. Other non-marketable activities such as an abrupt increase in State and Local Government Securities (SLGS) may also force Treasury to reconsider our financing needs.

Like any liquidity manager, we need an array of tools and capabilities in order to most effectively manage cash balances. Some we have, others we seek. Enhancing our cash management capabilities is one of the major priorities of the Cash and Debt Management modernization initiative announced by Secretary Paulson in July.

Operating Principles

Given our objective, and in recognition of our constraints and risks, our debt management team has developed and operates with the following core principles:

We seek to be regular market participants and are committed to regular and predictable issuance;

We seek to maintain flexibility;

We seek to be transparent;

We support efforts that seek to ensure marketplace integrity, liquidity, and openness.

These operating principles guide Treasury in our debt management, and result in what we believe is the lowest cost of borrowing over time. By reducing uncertainty regarding supply through regular and predictable issuance, investors are free to focus more closely on the demand side, thus mitigating their – and our – risk. Moreover, by being transparent, we believe we exact a liquidity premium – a direct result of certainty of supply - which lowers the cost of borrowing for Treasury over the long run.

Because our operating principles and practices are well established, buyers of Treasury securities come to us in greater numbers, bid with more confidence, and in larger amounts. Our predictability, coupled with our unitary financing approach to debt issuance and support of practices that enhance market integrity and openness, all serve to increase the depth and liquidity of the Treasury marketplace, and lower our borrowing costs.

The development of our marketplace has been strongly supported by efforts undertaken by market participants. Recently, the introduction of the principles-based framework outlined by the Treasury Market Practices Group (TMPG), a private sector initiative, is encouraging. Their principles and guidelines provide a framework for market participants to evaluate and enhance their current activities in the secondary markets and to fulfill their responsibilities as stakeholders in the Treasury market. The guidelines are practical, and possess the flexibility to deal with the global and dynamic environment in which stakeholders operate.

Risk Management

In fulfilling our mission, the Debt Management Office--like any prudent asset manager--must successfully identify, assess and manage risk exposures. There are many risk measures to consider and no single metric is ideal. Risk management must be approached from multiple perspectives.

Quantitative measures of risk are simply a starting point and raise some interesting questions. Should we as an issuer, look at a cost at risk model (CaR)? If so, what time period should we utilize? How should we weight certain risks versus others? Does an efficient frontier really apply for an issuer, and if so, how should we react? Do duration and convexity really apply to an issuer given our seemingly infinite asset base (i.e. tax revenues)? Can risk measures readily be applied that are consistent with our policy of regular and predictable issuance yet accommodate the huge potential variances in future fiscal environments?

A multidimensional framework helps fulfill our objective. We answer these questions by addressing the challenge from several perspectives as we assess risks, cost, and time.

Some risks increase over time, such as the probability of default on subprime mortgages the longer credit remained cheap and lending standards lax. Alternatively, some risks decrease over time such as the probability of an investor buying subprime asset backed commercial paper just because it was rated AAA.

We can approach costs in a similar perspective. Some costs, such as the price of an option as it approaches expiration, decrease over time. Other costs increase over time, and as a father of four, I can attest that one is tuition.

Applying this framework over time provides us with constructive and complementary perspectives. By identifying risks – including rollover risk, liquidity risk, duration risk, and inflation risk, we more effectively identify and mitigate potential costs. Including portfolio composition, diversification of funding sources, and demand dynamics as potential metrics also enhances Treasury's ability to measure, and ideally reduce overall costs. Such measures provide us with some perspective, but we also appreciate the limitations of such quantifiable models, and are cognizant of the underlying assumptions. We therefore supplement such perspectives with sound judgment that is informed by experience, and reviewed via routine consultation with the marketplace. Here we are fortunate to have access to the Treasury Borrowing Advisory Committee (TBAC), the primary dealer community, and other participants in our global marketplace.

Inflation and Treasury Inflation Protected Securities

Let me take a moment to focus on the topic du jour – inflation indexed securities. Treasury Inflation-Protected Securities (TIPS) have become a core portion of our overall debt portfolio. Having started the program 10 years ago, we have seen liquidity slowly build, and greater interest develop amongst various investor groups.

Just as the Federal Reserve must constantly be on guard for inflation, so must investors. Inflation remains a constant foe. TIPS offer investors an instrument to protect against inflation risk by offering real --- rather than nominal returns. From a capital preservation perspective, managing risk from a real return basis is essential.

As would be expected, TIPS are negatively correlated to equities over shorter to medium term horizons. Moreover, TIPS' low correlations with other asset classes including corporate bonds may serve to reduce a portfolio's volatility and potentially improve overall returns.

From a debt issuer's perspective, TIPS offer potential benefits, including a broader investor base and a more diversified portfolio of liabilities. Over the past decade, Treasury has grown the inflation indexed portion of our portfolio nearly five times faster than that of nominal debt. Today, it represents almost 10% of our marketable debt portfolio.

As mentioned earlier, portfolio composition and diversification are among the many factors considered when measuring lowest cost versus risk. Given the improvement of our fiscal deficit from over $400 billion in 2003 to well less than one half of that amount in fiscal year 2007, Treasury has needed to make numerous adjustments to our portfolio, while all the while remaining true to our core operating principles.

Reducing issuance remains more challenging than increasing issuance given liquidity threshold constraints and the potential uncertainty surrounding deficit forecasts. However, as our net marketable borrowing needs decline, we generally follow the following guidelines:

Initially, we seek to reduce issuance size;

If necessary, we subsequently seek to adjust issuance cycle and finally;

If deemed appropriate, we seek to discontinue or eliminate a security.

Consistent with these guidelines, we have made decisions to pare issuance over the past year. This included reducing the sizes of bills outstanding, lowering coupon issuance sizes, lowering the issuance size of TIPS, and most recently, discontinuing the issuance of the 3-year note. In keeping with one of our well established principles, we attempt to make such decisions in as transparent a fashion as possible such that the market impact is minimal.

While our TIPS issuance sizes have been reduced in response to smaller borrowing needs, we remain very committed to TIPS. Treasury – as well as investors and broker-dealers – have made significant investments in this market, and inflation indexed securities will remain a core component of our overall portfolio. Moreover, recent comments by the TBAC suggesting adjustments to the TIPS program are simply one of a broad set of alternative ideas.

Evaluating the proper number, type and mix of securities in our portfolio is an ongoing effort. We will continue to evaluate our financing needs in light of economic conditions and fiscal forecasts. We will make necessary adjustments as needed bearing in mind our overarching debt management principles.

Longer Term Risks

I have spoken this morning about risks and fiscal challenges. But no review would be complete without addressing the most significant fiscal challenge taxpayers and future generations of Americans face: the escalating costs of entitlements.

No better example exists of a risk and cost that grows over time than the risk and cost of inaction. No panacea exists, but procrastination is not the answer to the untenable fiscal situation that we as a nation face over the long term.

I'd like to offer an alternative perspective to those made by other policy makers in addressing entitlement reform.

The perspective I offer is that of the issuer who finances the programs. Our Debt Management Office recently asked the TBAC to provide an analysis of the costs of inaction. The results were sobering. Using estimates and scenarios provided by the Congressional Budget Office, the TBAC report to Secretary Paulson concluded that, "In spite of the relatively conservative assumptions used, the results of the analysis were disturbing to all members of the Committee and highlighted quite strongly that without significant reform to entitlement programs, the strains on Treasury to finance the projected deficits over the next 40 years are dramatic and would undoubtedly result in a significant increase in 'real' borrowing costs by the U.S. Government."

In relation to the size of the economy, it is estimated that current gross coupon issuance will need to be between four and fifteen times larger by 2050. The sharp elevation in the financing needs starts to become apparent as early as 2020.

More concerning, the TBAC estimated that, under the most optimistic scenario, Treasury auction sizes in the two-year note could approach $380 billion *per month* by 2050, while issuance of 10-year notes could approach $1.9 trillion *per quarter.* Just as a reference, today we auction $18 billion in 2-year notes each month and we issue $21 billion in 10-year notes each quarter. Interest costs would rise to over 4% of GDP by 2050 from just under 1.5% currently. The repercussions of inaction are simply too big to ignore.

Conclusion

I am optimistic that we can address both our short term and longer term fiscal challenges with the same framework with which we approach debt management – define the objective, identify and quantify the risks, evaluate the costs, and take action. This approach is applicable not just in the realm of finance, but also to public policy. I look forward to working with my colleagues in Washington, D.C., as well as continuing to work with market participants to address these critical issues.

Thank you.

For more information on the Office of Debt Management, see *http://www.treas.gov/offices/domestic-finance/debt-management/index.shtml*

To review the Treasury Borrowing Advisory Committee Presentation to the US Treasury July 31, 2007 "The Costs of Inaction Regarding Entitlement Reform: Potential Implications for Treasury Debt Issuance, Interest Costs, and Overall Market Dynamics", see *http://www.treas.gov/offices/domestic-finance/debt-management/quarterly-refunding/08-01-2007/discussion-charts.pdf*

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PRESS ROOM

September 24, 2007
hp571

Statement by Secretary Henry M. Paulson, Jr. on First in Series of Treasury Social Security Papers on Common Ground

"I have had many conversations with members of Congress in both parties, inviting them to discuss Social Security reform with no preconditions. While differences over personal accounts and taxes dominate the public debate over this issue, in my conversations I found that there are many other things on which people agree. Everyone I talked with recognizes the seriousness of the problem, and most agreed on some of the principles and policies that must be part of the solution.

"To build on these discussions, Treasury will release a series of issue briefs that will focus on areas of common ground, and provide straightforward analysis of the challenges facing Social Security and the implications of potential reforms.

"By focusing first on areas of agreement, I hope these issue briefs will narrow the divide and spur further discussions of reform."

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LINKS

- Issue Brief No. 1 Social Security Reform: The Nature of the Problem

PRESS ROOM

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September 24, 2007
HP-572

Issue Brief No. 1 Social Security Reform: The Nature of the Problem

This is the first in a series of issue briefs that the Treasury will release on Social Security reform topics. This brief explains the magnitude of the financial challenge facing Social Security and why acting sooner and spreading the burden of reform across more generations is fairer to future generations.

LINKS

- Paulson Statement on First in Series of Social Security Papers on Common Ground

REPORTS

- Issue Brief No. 1 Social Security Reform: The Nature of the Problem (View Full Report)

ISSUE BRIEF NO. 1

SOCIAL SECURITY REFORM: THE NATURE OF THE PROBLEM

INTRODUCTION

This is the first in a series of issue briefs that the Treasury will release on Social Security reform topics. This brief explains the magnitude of the financial challenge facing Social Security and why acting sooner and spreading the burden of reform across more generations is fairer to future generations.

THE KEY POINTS IN THIS ISSUE BRIEF ARE:

- Social Security faces a shortfall over the indefinite future of $13.6 trillion in present-value terms, an amount equal to 3.5 percent of future taxable payrolls. Looking at the gap over a shorter horizon provides only limited information on the financial status of the program.

- Social Security can be made permanently solvent only by reducing the present value of scheduled benefits and/or increasing the present value of scheduled tax revenues. Other changes to the program might be desirable, but only these changes can restore solvency permanently.

- Delaying changes to Social Security reduces the number of cohorts over which the burden of reform can be spread. Not taking action is thus unfair to future generations. This is a significant cost of delay.

- By itself, faster economic growth will not solve Social Security's financial imbalance—realistically, there is no way to "grow out of the problem."

OVERVIEW OF THE SOCIAL SECURITY PROGRAM

The Social Security Act of 1935—which became the basis for the current Social Security system—created a program to provide lifetime payments to retired workers beginning at age 65. In signing the Social Security Act, President Roosevelt stated that the law sought to "give some measure of protection to the average citizen...against poverty-ridden old age." Although the modest benefits provided for by the original program were not intended to be the sole source of income for retirees, Social Security has become a *de facto* retirement plan for many Americans.

Social Security has grown to become by far the single largest social program of the federal government, with expansions in coverage, increases in benefits, and the extension of the program to provide benefits to workers' spouses and minor children, the survivors of deceased workers, and disabled workers. Currently, more than 49 million retired or disabled workers, their families, and their survivors receive monthly Social Security benefits. Total benefits in 2007 will amount to approximately $576 billion—about 20 percent of the entire federal budget—comprising roughly 40 percent of all income received by individuals aged 65 and older.[1]

Social Security includes two parts: old age and survivors insurance (OASI), for which the federal government began collecting taxes in 1937 and which provides retirement benefits; and disability insurance (DI), for which the government began collecting taxes in 1957. The programs together are referred to as OASDI; this issue brief will refer to them collectively as "Social Security."

Both OASI and DI are financed with payroll taxes levied on earnings up to a maximum that grows every year in line with average economy-wide wages. In 2007, maximum taxable earnings are $97,500 with payroll tax rates of 10.6 percent for OASI and 1.8 percent for DI, implying a total tax rate of 12.4 percent. For individuals employed by others, half of payroll taxes are paid by the employer and half are paid by the employee. Nearly all economists agree, however, that the employer's portion of the tax reduces employees' take-home wages one-for-one, so the employee bears the entire burden of the tax regardless of how it is ostensibly divided between employers and employees. Self-employed individuals pay both halves of the tax, though half of a self-employed worker's tax payment is deducted from his or her adjusted gross income.[2]

Social Security taxes are used to pay benefits; the program is self-financing in the sense that revenues collected from other parts of the government are not directly used to finance benefit payments. To the extent that taxes exceed current benefit payments, the resulting surpluses are used to purchase special-issue federal securities that are held in the Social Security trust funds (technically, the separate OASI and DI trust funds) and that are redeemed as needed to pay benefits. The trust fund is credited with interest comparable to interest paid on federal debt issued to the public. Social Security benefit payments are automatically authorized provided sufficient funds are present in the pertinent trust fund.

Individuals can begin collecting retirement benefits as early as age 62, although the normal retirement age—when a full benefit can be claimed—is currently 66 years. Benefits are calculated in three steps.

- First, the Social Security Administration calculates a special average of an individual's taxable wages while working—called "average indexed monthly earnings," or AIME. This measure uses data on national wage growth to scale up earnings throughout a worker's lifetime so that the wages a worker earned at, say, age 25 are more closely comparable to the wages a worker earns later in life.[3]

- Second, a progressive formula is used to convert AIME into a baseline benefit or "primary insurance amount" (PIA). In general, workers with higher lifetime earnings receive benefits that are larger than those received by workers with low lifetime earnings, so benefits rise with earnings. However, workers with low lifetime earnings receive a benefit that represents a higher *percentage* of their lifetime earnings relative to high-earning workers, implying that the benefit formula is progressive. For example, if one worker has lifetime earnings that are twice as high as another's, the first worker will receive retirement benefits that are higher, but not *twice* as high. It is important to note that benefits are derived from *lifetime* earnings, not what a person makes in a single year. Box 1 considers one confusion that can arise from the use of lifetime income.

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1 Current population survey data for 2005 tabulated by the U.S. Census Bureau (http://pubdb3.census.gov/macro/032006/perinc/new09_006.htm)

2 This mimics the treatment of the employer's share of the payroll tax, which is not considered individual income for tax purposes.

3 Technically, only earnings up to age 60 are wage-indexed; earnings after age 60 are included in the AIME measure in nominal terms.

- Finally, the actual amount of initial benefits is determined by 1) adjusting the primary insurance amount (PIA) for retirement before or after the normal retirement age and 2) adjusting for price inflation between age 62 and the time the individual begins collecting benefits. These adjustments ensure that people receive lower benefits if they retire before the normal retirement age or higher benefits if they retire after it, and that they are compensated for inflation based on when they retire. After benefit payments commence, they are adjusted for price inflation each January.

BOX 1
LIFETIME VERSUS SINGLE-YEAR EARNINGS

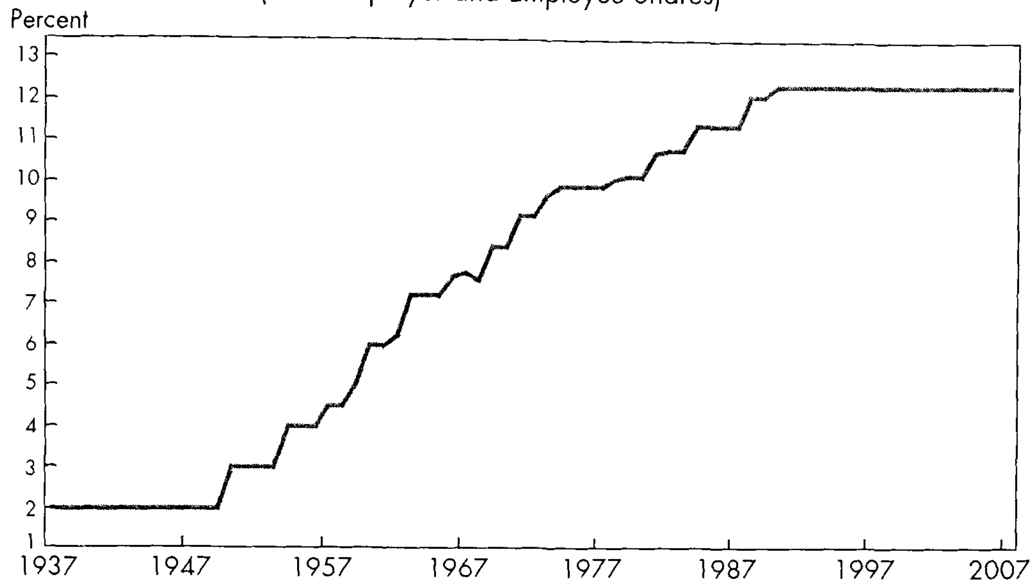
Social Security benefits are computed on the basis of *lifetime* earnings, and thus do not relate directly to earnings in a particular year. While this appropriately ensures that benefits reflect contributions to the system over the course of a person's working years (in practice, the top 35 years of earnings are used), the computation can prove confusing in some contexts. For example, only 15 percent of all workers have average *lifetime* annual taxable earnings of at least $60,000 (average indexed monthly earnings of at least $5,000), even though a considerably larger fraction of workers earn more than $60,000 in a given year. Intuitively, workers with average lifetime earnings of $60,000 per year were typically making much less than this at the start of their career. In addition, wages above the taxable maximum do not count in the calculation of lifetime earnings for Social Security; people making six-figure incomes in 2007, for example, would be counted as making $97,500.

This point about lifetime earnings should be kept in mind when assessing the consequences of reform proposals that include benefit adjustments. A hypothetical proposal that reduces the benefits of the top 15 percent of earners might be seen as affecting workers with Social Security lifetime earnings of "only" $60,000. Without understanding that the $60,000 figure is calculated in a particular way, one might mistakenly believe that this hypothetical reform proposal is affecting middle-class workers rather than being limited to workers in the top 15 percent of the lifetime earnings distribution.

Disability benefits are computed in a similar fashion. The principal difference, however, is that the number of years used to compute the AIME amount is reduced to take into account the person's shorter work history.

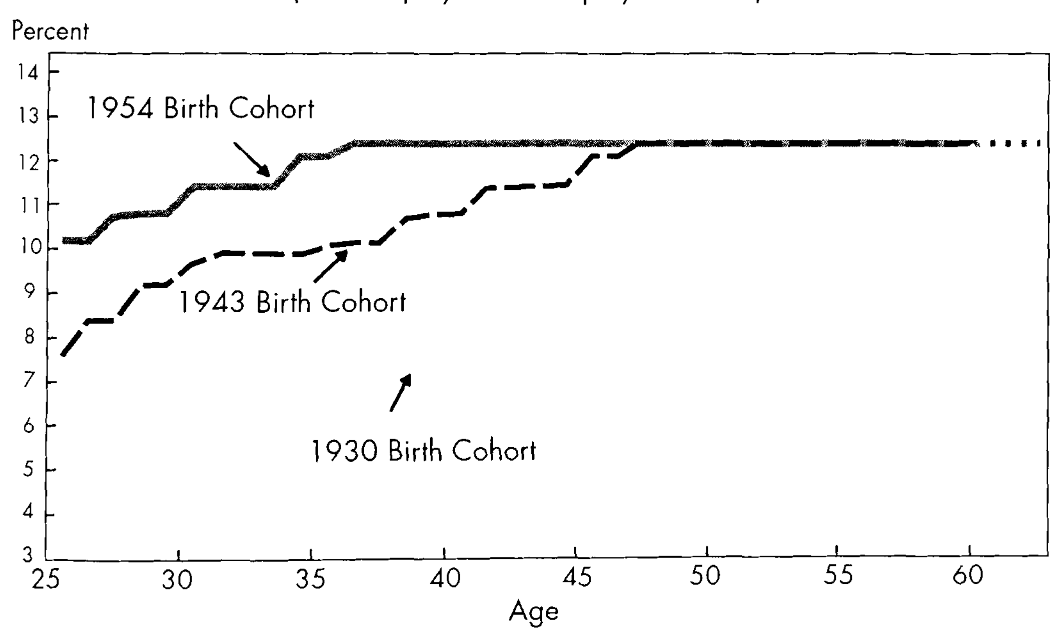
Social Security has been very generous to early birth cohorts who were in the middle or later part of their working life either at the time the program began or on the several occasions when the program's taxes and real benefit levels were increased. (Figure 1 shows how the OASDI tax rate has been raised numerous times over the history of the program.) It was decided from the outset that birth cohorts in mid-to-late working life at the time of the program's inception would be paid large benefits relative to the taxes they had paid in. In addition, each time new legislation has ratcheted up taxes and real benefits, substantial windfalls have been conveyed to individuals in mid-to-late working life at the time of the change, as these individuals face increased taxes for only a relatively few years but are entitled to receive the full advantage of the benefit increases. For example, people born in 1954 faced tax rates between the ages of 25 and 46 that were 1.6 percentage points higher on average than the tax rates faced at the same ages by people born in 1943 (Figure 2). This is so even though the benefit formula is equally generous on average to both cohorts. People born before 1943, such as the 1930 birth cohort shown in the figure, were still more advantaged, as the tax rates they faced were even lower than those faced by people born in 1943 and beyond.

Figure 1: OASDI Tax Rates by Year
(Total Employer and Employee Shares)



Source: Social Security Administration

Figure 2: OASDI Tax Rates Paid by 1930, 1943 and 1954 Birth Cohorts
(Total Employer and Employee Shares)

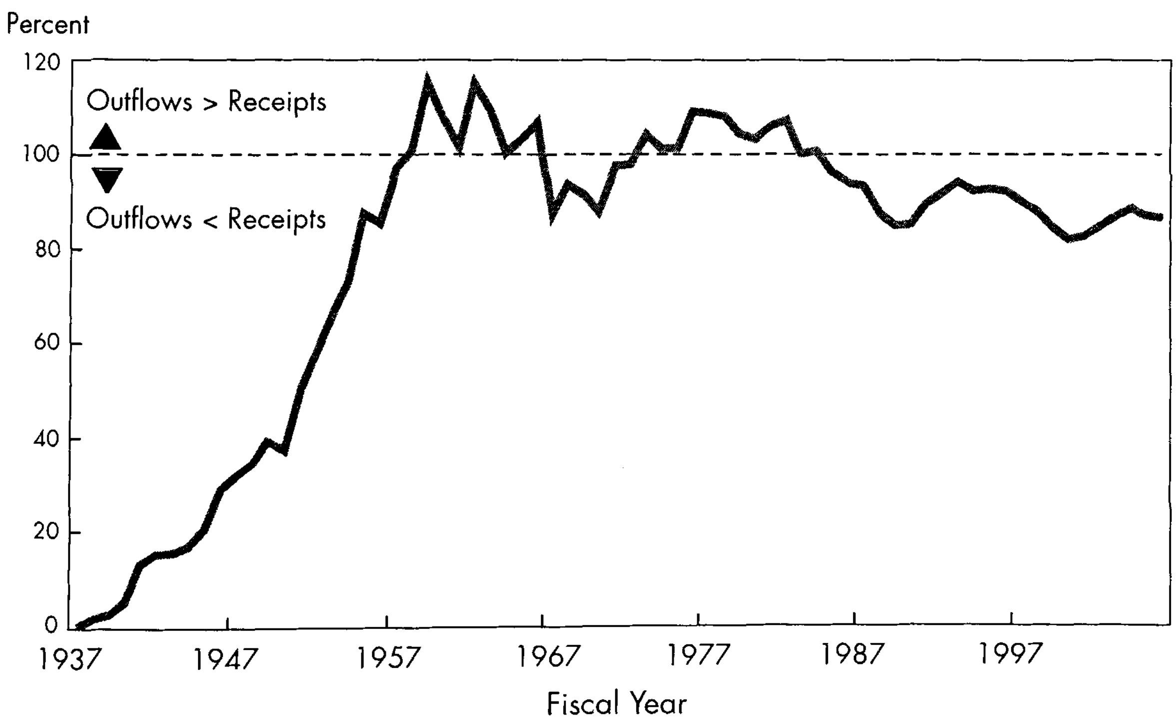


Sources: Social Security Administration and Department of the Treasury

Because Social Security benefits paid to the earliest Social Security beneficiaries were more generous than what could be financed out of the proceeds from their own contributions, those benefits were largely financed with taxes paid by younger birth cohorts. And because the younger birth cohorts' taxes were paid out rather than saved, their benefits must in turn be financed by the taxes of still younger birth cohorts. This method of financing benefits is referred to as "pay-as-you-go," in which each generation's taxes finance the benefits of the generation that preceded it. The alternative to pay-as-you-go finance is pre-funding, in which each generation accumulates assets to be drawn upon to pay that generation's future benefits.[4]

Figure 3 shows that Social Security has been financed almost entirely on a pay-as-you-go basis for most of its history (currently, a small amount of potential pre-funding of benefits is also involved). As a share of tax revenues, program outlays rose very rapidly in the early years of the program, reaching 100 percent in 1958 and staying near 100 percent through 1983. Social Security's cash surpluses since 1983 reflect reforms that resulted in the large baby-boom generations paying more taxes than were needed to finance the benefits of earlier birth cohorts. Whether these surpluses resulted in true pre-funding of future benefits is discussed in Treasury's second issue brief. Between the end of 1983 and the end of 2006, Social Security costs averaged 88 percent of non-interest income, and the inflation-adjusted trust fund balance rose from $50 billion to $2 trillion (in 2006 dollars). In 2006, Social Security brought in $87 billion more revenue than it paid out in benefits and administrative costs. As shown in Figure 4, Social Security's annual cash surplus is projected to peak in 2009, and then to decline steadily, reaching zero in 2017. After that point, Social Security's cash flows are negative, as costs will exceed revenues. Even so, full benefits will be paid under current law until the trust fund is exhausted. These benefits will be funded from non-Social Security taxes or by issuing new public debt to redeem debt held by the trust fund.

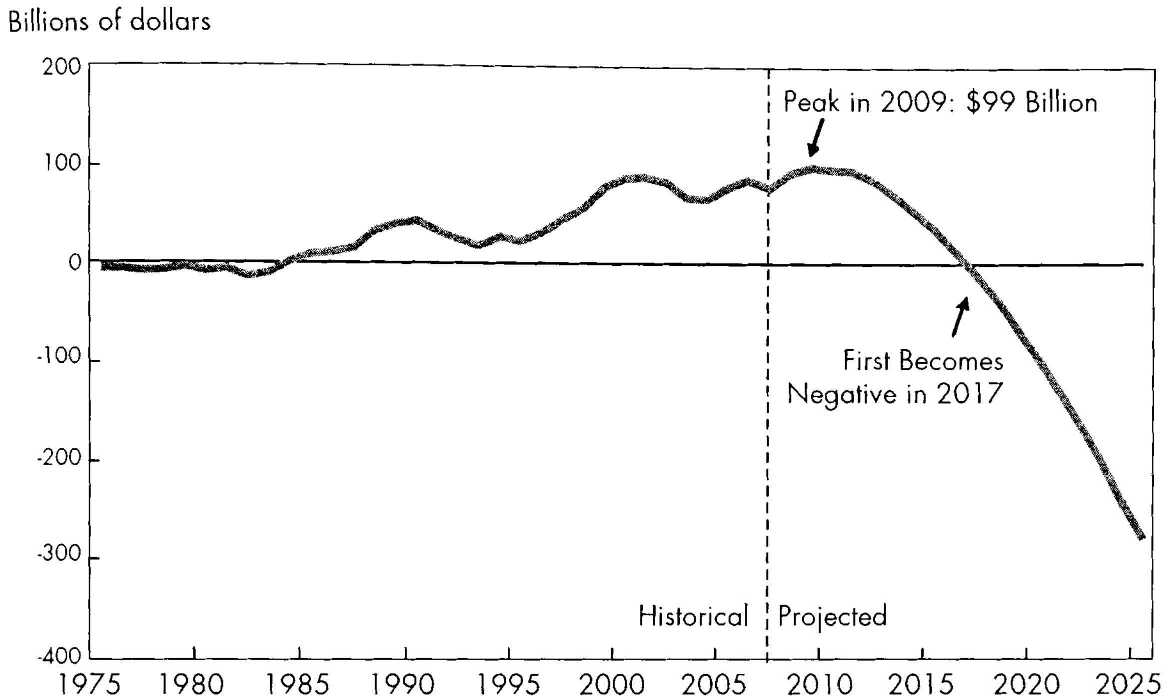
Figure 3: OASDI Cash Outflow as a Share of Non-Interest Receipts



Source: Office of Management and Budget

4 The special Treasury securities in the present trust funds represent claims on the government and—ultimately—the public, in the form of future general tax revenues. Whether these trust fund accumulations constitute *true* pre-funding is an open question, and is discussed in Treasury's second issue brief.

Figure 4: Actual and Projected Social Security Balances



Source: Social Security Administration

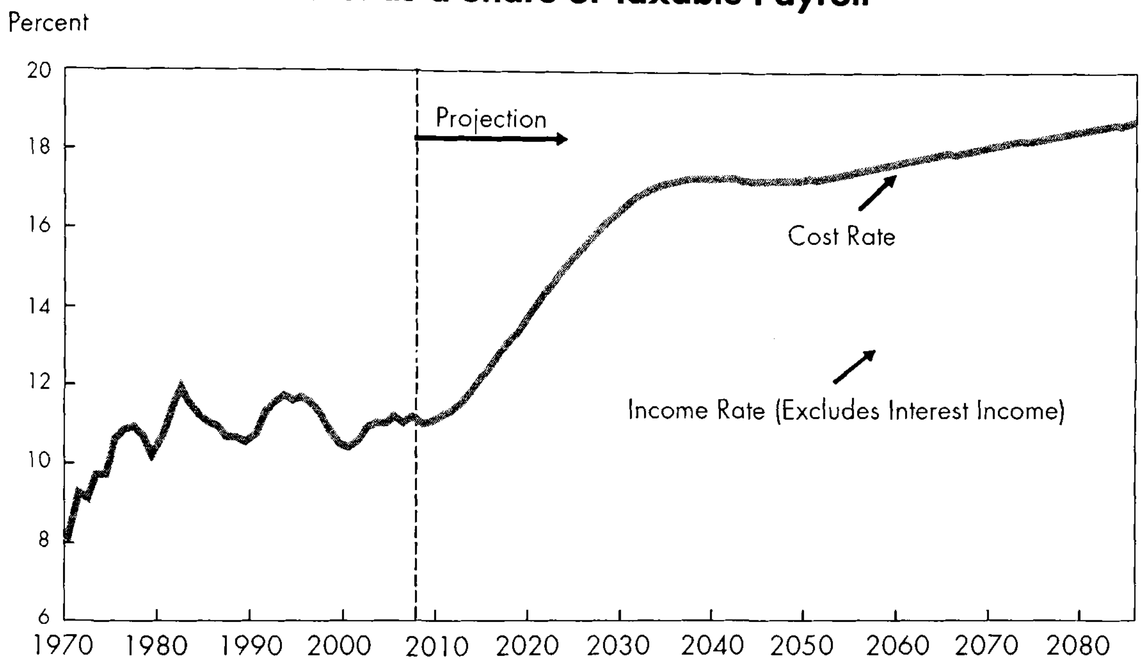
SOCIAL SECURITY'S FINANCIAL IMBALANCE

Social Security is officially solvent so long as the trust fund balance is positive. Based on economic and demographic assumptions from the Social Security Board of Trustees, the Social Security Administration projects that the OASDI trust fund (the combined OASI and DI trust funds) will have insufficient funds to pay currently scheduled benefits beginning in 2041. The projected trust fund exhaustion date can change from year to year as new data and assumptions are introduced into the Social Security Administration's calculations. For example, the 2000 Trustees Report projected a trust fund exhaustion date of 2037; since then, the date has been pushed back four years, to 2041. That said, if the current projections prove accurate and if no program changes are made, then current law mandates that benefits actually paid be scaled back to a level that is consistent with then-current payroll tax income when the trust fund is depleted. In other words, if no action is taken, current projections imply that all beneficiaries will have their benefits reduced in 2041 by 25 percent compared to what is promised. The share of scheduled benefits that would be payable would then slowly decline from 75 percent in 2041 to 70 percent in 2081.

The financial challenge Social Security faces has implications for the federal budget even before 2041. As shown in Figure 4, Social Security cash flows become increasingly negative after 2017; as a result, Social Security will have a larger and larger impact on the rest of the federal budget, as general revenues and/or greater public debt issuance are needed in order to redeem trust fund bond holdings and fund full benefit payments until 2041.

The projected time path for the trust fund balance reflects projected future cash flows. Figure 5 shows historical and projected values for income (excluding interest) and costs expressed as shares of projected taxable payroll; these concepts are referred to as the income rate and the cost rate, respectively. In 2006, the income rate was 12.73 percent, the cost rate was 11.02 percent, and the difference—the surplus rate—was 1.71 percent. The surplus rate is projected to peak in 2008 at 1.74 percent and then to decline steadily; the rate becomes negative starting in 2017, reaching –5.35 percent in 2085.

Figure 5: Historical and Projected OASDI Income and Cost as a Share of Taxable Payroll



Source: Social Security Administration

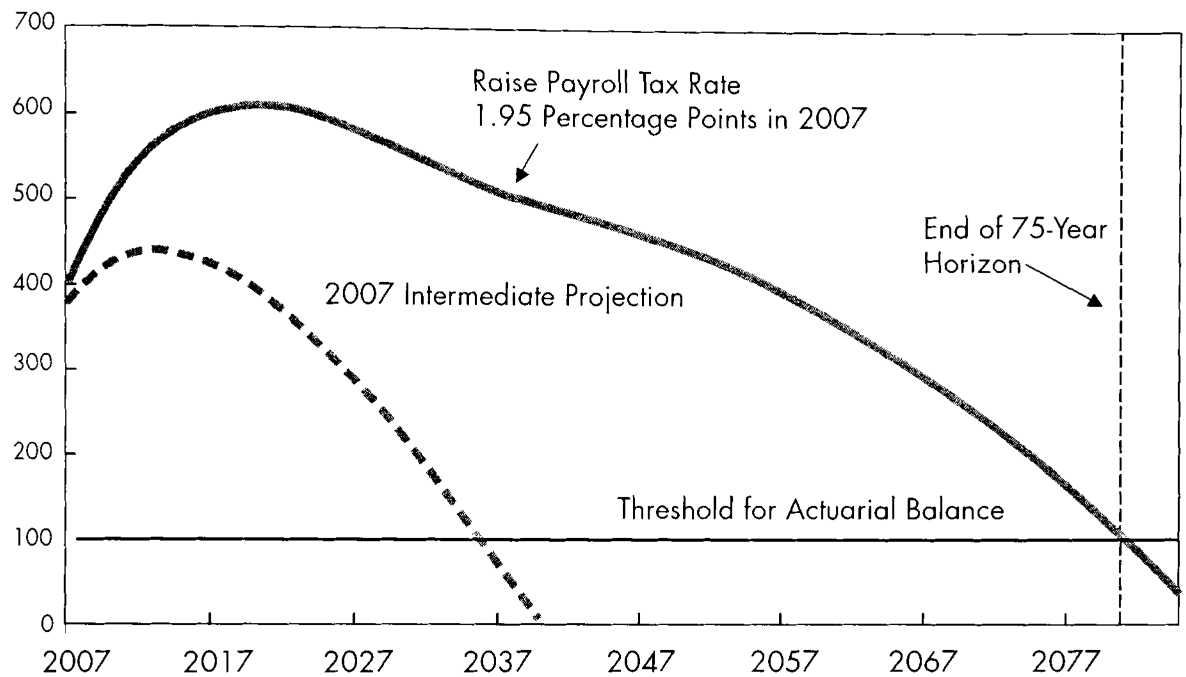
The most widely cited single measure of Social Security's financing shortfall is the 75-year actuarial deficit, which is currently estimated at $5.1 trillion in present-value terms, or 1.95 percent of the present value of taxable payroll over the 2007 to 2081 period.[5] This estimate implies that Social Security can achieve actuarial balance by reducing the present value of Social Security's 75-year net outflow (benefits less taxes) by $5.1 trillion. One way to do this would be to immediately raise the payroll tax rate by 1.95 percentage points (*i.e.*, to 14.35 percent); alternatively, scheduled benefits could be immediately reduced by 13 percent.

Either of these two steps would bring Social Security into 75-year balance, but it would not make the system permanently solvent. Under a hypothetical tax increase of this size, Social Security could pay scheduled benefits through to the end of the 75-year projection period, but continuing cash deficits would imply that the trust fund would drop below the threshold required for actuarial balance in the following year (see Figure 6). Put differently, just one year after implementing such a reform, Social Security would again be out of 75-year actuarial balance—that is, if reform were implemented in 2007, the system would fall out of balance in 2008. Moreover, with each passing year the Trustees would report

5 This measure requires the trust fund balance to be sufficient to pay 100 percent of program costs in the final year of the 75-year period; without this requirement the unfunded obligation would equal $4.7 trillion. Note that all present values referred to in this brief are computed as of the start of 2007.

an ever-larger financial imbalance as the 75-year scoring window moves forward to include years with ever-larger gaps between expected system costs and income.

Figure 6: Projected OASDI Trust Fund Balance as a Share of Cost



Sources: Social Security Administration and Department of the Treasury

As this example makes clear, estimates made over a 75-year horizon do not fully capture the financial status of the Social Security program. In fact, no finite forecast period completely embodies the financial status of the program because people pay taxes in advance of receiving benefits; at any finite cutoff date, people will have been promised benefits that have not yet been paid. For example, the current 75-year projections include nearly all of the taxes that people born in 2010 are expected to pay over their working lifetimes but virtually none of the benefits that they will receive in retirement. In order to get a complete picture of Social Security's financial problem, the time horizon for calculating income and costs must be extended to the indefinite future. Such a calculation is provided in the 2007 Trustees Report, where it is estimated that the present value of scheduled benefits exceeds the present value of scheduled tax income by $13.6 trillion; this is the financing gap that program reforms must ultimately close. To put this figure in perspective, eliminating the permanent deficit could be accomplished with an immediate and permanent 3.5 percentage point increase in the payroll tax rate (to 15.9 percent), or with roughly a 20 percent reduction in current-law scheduled benefits.[6]

It is important to understand that the magnitude of the infinite-horizon actuarial deficit is not driven by the use of distant or speculative long-range projections. Rather, the smaller size of the 75-year (or any finite-period) deficit results from its use of a truncated time horizon. The Trustees Report indicates that Social Security's unfunded obligation for *only* past and current workers equals $14.4 trillion, which is actually

6 The benefit reduction to achieve infinite horizon balance is calculated assuming that the ratio of income to taxable payroll is the same between 2081 and the infinite future as it is between 2007 and 2081.

slightly greater than the infinite-horizon shortfall. As soon as one accounts for the full amount of benefit obligations that have been promised to past and current participants, it becomes apparent that Social Security's $13.6 trillion financing gap is already "on the books" in an important sense, and does not merely arise from looking far beyond a 75-year horizon.

PERMANENT SOLVENCY AND THE INFINITE-HORIZON ACTUARIAL BALANCE

Having a non-negative infinite-horizon actuarial balance does not by itself assure that Social Security is permanently solvent. For Social Security to be technically solvent over a given period, it must have a trust fund balance that is sufficient to pay scheduled benefits over that period. By contrast, a non-negative actuarial balance could be achieved even if the trust fund were insolvent during certain periods, so long as the program's revenues were to exceed its payments *on average*.

The Trustees Report has for many years made reference to an approximate test for permanent solvency called "sustainable solvency." Sustainable solvency is said to be achieved if the ratio of the trust fund balance to projected annual benefit payments (the "trust fund ratio") is positive throughout the 75-year projection period and is stable or rising at the end of the period. Implicitly, the idea is that if trends at the end of the 75-year projection period persist, then sustainable solvency implies that the trust fund ratio will be forever positive.

A fully satisfactory solution to Social Security's long-term solvency problem will both meet the criterion of sustainable solvency and include a mechanism for *ensuring* that trends at the end of the projection period are in fact sustained. For example, ensuring Social Security remains permanently solvent could mean taking into account that increasing longevity is likely to forever increase the gap between Social Security's benefits and revenues unless benefit levels, tax rates, or both are somehow indexed to longevity. This is because increased longevity means that retirees are collecting benefits for additional years but not paying additional taxes (if workers continue to retire at the same age). Also, sustainable solvency does not necessarily provide for permanent solvency if past demographic changes such as changes in fertility or immigration rates cause the age distribution of the population to be unstable at the end of 75 years.

THE ORIGINS OF SOCIAL SECURITY'S FINANCIAL SHORTFALL AND ITS IMPLICATIONS

The fundamental reason Social Security must be reformed is that the benefits promised to the public have a present value that is $13.6 trillion greater than the present value of the revenues that the system is projected to receive. Relative to scheduled benefits and taxes, therefore, the present value of benefits less taxes (what might be referred to as "net payments to the public") must be reduced by $13.6 trillion. This can be done by increasing revenues relative to what is provided for under current law and/or by lowering benefits relative to what is currently promised (but not actually payable given that the system is insolvent). There is no alternative to these two choices.

It might be surprising that Social Security promises to pay out so much more than it takes in. As is well known, the program promises current and future workers a below-market rate of return on contributions in the sense that most workers would do better by directly investing their contributions (*i.e.*, the taxes they pay into the system) into U.S. Treasury bonds.[7] Why must the system increase net receipts by $13.6 trillion if it is already requiring current and future workers to pay in more than they will receive? The answer relates to the system's generosity to early birth cohorts—generations of workers now either retired or deceased. Social Security paid these previous cohorts benefits that exceeded their lifetime contributions by *more than* $13.6 trillion. In order to finance this gap, later birth cohorts must receive benefits whose value (relative to the value of the taxes they pay in) is lower by the same amount—that is, they must pay a net tax (again, the difference between the present value of taxes and benefits) of more than $13.6 trillion. Under current law, a portion of this net tax is being levied already; in order to make the system solvent, the net tax needs to be increased by an additional $13.6 trillion.

These observations are supported by estimates made by the Social Security Administration and the Congressional Budget Office (CBO). The Social Security Administration has broken down the infinite-horizon actuarial imbalance into imbalances attributable to net payments to two broad generational groupings. Generations born after 1992—those aged zero to 14 years in 2007 and those not yet born in that year—are estimated to receive net payments (the difference between their lifetime benefits and taxes) from Social Security with a present value that is slightly *negative* (the shortfall is $0.8 trillion). This implies that the excess of benefits over taxes made to generations born before 1993 accounts for essentially all of the $13.6 trillion infinite-horizon actuarial imbalance. In addition, estimates made by the CBO and others suggest that generations born between 1940 and 2000 will receive less in lifetime benefits than they pay in as taxes (that is, their net benefits from Social Security over their lifetime will have a negative present value).[8] The bottom-line implication of these estimates (which are summarized in the last two rows of the first column of figures in Table 1) is that cohorts subject to reform—roughly people born in 1953 or later—will receive net lifetime scheduled benefits under current law that are negative.[9] The value of these net lifetime benefits is given as –X trillion dollars in the table (their exact magnitude is not known). This in turn implies that cohorts *not* subject to reform—that is, current and near retirees and earlier cohorts—receive positive net lifetime benefits of $13.6 + X trillion under current law.

The second column of figures in Table 1 shows the implications of these findings for the ultimate generational breakdown of Social Security's net benefits. In the end, the present value of all Social Security cash flows must be zero, with the present value of revenues equal to the present value of benefits. In addition, most proposals for Social Security reform start with the assurance that those in and near retirement will not be affected (again, this is assumed to include persons born in 1952 or earlier); hence, net lifetime benefits for these individuals are unlikely to change much from scheduled current-law levels. The $13.6 trillion-plus net benefit received by current and near retirees and the generations preceding them thus must be financed by later birth cohorts. Relative to current law, therefore, these later cohorts—the "reform cohorts"—will face an *additional* net tax of $13.6 trillion in the form of either lower benefits than promised under current law or higher taxes. There is no escaping this budget arithmetic.

7 Technically, this implies that the program as currently constituted levies a "net tax" on current and future workers: The present value of their benefits is less than the present value of their contributions.

8 See Congressional Budget Office, "Is Social Security Progressive?" December 15, 2006.

9 In defining the cohorts subject to reform to be those born in 1953 and later, only those aged 55 or younger at the time the reforms take place are counted as being subject to their provisions.

Table 1

Estimates of Net Social Security Payments Made to Birth Cohort Groups
(Trillions of 2007 Present Value Dollars)

Birth cohort	Value of payments under: Current law	Ultimate program
Estimates		
All birth cohorts, total	13.6	- 0 -
Cohorts born 1993 and later (total)	–0.8	
Cohorts born 1992 and earlier (total)	14.4	
Cohorts born 1940 to 2000 (each cohort)	< 0	
Inferred totals		
Cohorts subject to reform (born 1953 and later)	–X	– (13.6 + X)
Cohorts exempt from reform (born 1952 and before)	13.6 + X	13.6 + X

Source: Lines 1 to 3 are derived from the infinite-horizon actuarial imbalance reported in the 2007 Trustees Report, Table IV.B7. Line 4 is based on a December 15, 2006 paper by the Congressional Budget Office (CBO) entitled "Is Social Security Progressive?"

REFORMING THE SYSTEM: SOONER IS BETTER THAN LATER

Viewing Social Security from the perspective of how it affects current and future individuals and generations explains why reform can be fairer to future generations the sooner it is implemented. Delay reduces the options for distributing the financial burden of reform across generations because delay exempts additional generations from sharing in the financial consequences of reform.

To make this point more concretely, consider a policy of closing Social Security's permanent financing gap by immediately increasing the payroll tax rate by 3.5 percentage points. This policy would affect all current and future workers. If the tax increase were instead delayed until 2041, when the trust fund is projected to be depleted, the requisite tax increase would be 5.8 percentage points rather than only 3.5 percentage points—the difference being that there are fewer cohorts (and therefore less resources) to tax the longer one waits. Similarly, all retirees' benefits would have to be cut by 20.4 percent in 2007 to make Social Security permanently solvent—but this would rise to a benefit adjustment of 30.4 percent if reform were initiated in 2041. These examples show that fairness to future generations requires that action be taken sooner rather than later.

FAIRNESS TO FUTURE GENERATIONS REQUIRES TRUE PRE-FUNDING

An issue that will be discussed in Treasury's second issue brief is whether trust fund accumulations (*i.e.*, Social Security surpluses) increase the government's capacity to pay future Social Security benefits and the implications that the answer to this question has for Social Security reform. Social Security surpluses increase the government's capacity to pay future benefits only to the extent that they result in less debt issued to the public than would have been issued in the absence of Social Security surpluses. In that case, near-term surpluses increase the government's capacity to issue public debt in the future to finance Social Security benefits.

Many analysts believe Social Security surpluses do not result in smaller levels of publicly held debt, but instead result in some combination of higher spending or lower taxes in the non-Social Security budget. To the extent that this is true, attempting to make Social Security fairer to future generations by running near-term Social Security surpluses would not succeed; only if pre-funding is "real" can this goal of fairness be achieved.

INCREASED ECONOMIC GROWTH BY ITSELF CANNOT HELP SOLVE THE PROBLEM

More rapid economic growth cannot, by itself, close Social Security's infinite-horizon financing gap. Realistic increases in productivity or population growth are simply not sufficient to have more than a modest effect on the program's long-range shortfall, especially over the very long term.

In this context, it is important to note that the ultimate effect of faster growth on Social Security's financing gap will be overstated by the 75-year estimates that are given in the Trustees Report. Because each person's taxes precede their benefit payments by about 30 years on average, the 75-year horizon captures a large share of the increased revenues that come about because of increased real wage growth or fertility, but a relatively smaller share of the resulting future increase in benefit payments. Hence, a finite-horizon measure will capture only a portion of the effect that faster economic growth has on future benefit promises; by contrast, an infinite-horizon calculation fully captures both the tax and benefit implications of Social Security reforms.

INCREASED ECONOMIC GROWTH *DOES* MAKE REFORM EASIER

While increased economic growth cannot solve the problem of Social Security's current-law financial shortfall, it does make the reform burden easier to bear. Higher fertility and/or immigration means that there are more people over whom to distribute the $13.6 trillion burden of reform. And higher real wage growth means that disposable income (income after taxes) will be higher for future generations. This increase in disposable income makes it easier for them to shoulder the burden of reforming Social Security, since what they have left after the reform is greater than it would otherwise be.

CONCLUSION

Because Social Security paid or promised more to early birth cohorts than they paid in, and because it is neither feasible nor desirable to go back on those promises, the burden of ensuring the system's solvency can only fall on current and future workers. This burden will be imposed one way or another—under current law, when the trust fund reaches its projected exhaustion date in 2041, benefits will be automatically cut to a level that is consistent with then-current payroll tax income. However, the manner in which this would occur will be drastic and unfair, with low-earning retirees facing benefit reductions in the same proportion as high earners. By contrast, taking action now will allow people who most depend on Social Security for their retirement income to be shielded, and will allow a more gradual transition to a sustainable system. The sooner that reform is implemented, the more birth cohorts there will be that can contribute to making Social Security solvent, and the fairer Social Security will be to future generations.

September 24, 2007
2007-9-24-14-22-15-12258

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 $68,519 million as of the end of that week, compared to $68,057million as of the end of the prior week.

Official reserve assets and other foreign currency assets (approximate market value, in US millions)

	September 21, 2007		
A. Official reserve assets (in US millions unless otherwise specified)	Euro	Yen	Total
(1) Foreign currency reserves (in convertible foreign currencies)			68,519
(a) Securities	13,677	11,016	24,693
of which: issuer headquartered in reporting country but located abroad			0
(b) total currency and deposits with:			
(i) other national central banks, BIS and IMF	13,667	5,425	19,092
ii) banks headquartered in the reporting country			0
of which: located abroad			0
(iii) banks headquartered outside the reporting country			0
of which: located in the reporting country			0
(2) IMF reserve position	4,436		
(3) SDRs	9,257		
(4) gold (including gold deposits and, if appropriate, gold swapped)	11,041		
--volume in millions of fine troy ounces	261.499		
(5) other reserve assets (specify)	0		
--financial derivatives			
--loans to nonbank nonresidents			
--other			
B. Other foreign currency assets (specify)			
--securities not included in official reserve assets			
--deposits not included in official reserve assets			
--loans not included in official reserve assets			
--financial derivatives not included in official reserve assets			
--gold not included in official reserve assets			
--other			

II. Predetermined short-term net drains on foreign currency assets (nominal value)

			Maturity breakdown (residual maturity)		
		Total	Up to 1 month	More than 1 and up to 3 months	More than 3 months and up to 1 year
1. Foreign currency loans, securities, and deposits					
--outflows (-)	Principal				
	Interest				
--inflows (+)	Principal				
	Interest				
2. Aggregate short and long positions in forwards and futures in foreign currencies vis-à-vis the domestic currency (including the forward leg of currency swaps)					
(a) Short positions (-)					
(b) Long positions (+)					
3. Other (specify)					
--outflows related to repos (-)					
--inflows related to reverse repos (+)					
--trade credit (-)					
--trade credit (+)					
--other accounts payable (-)					
--other accounts receivable (+)					

III. Contingent short-term net drains on foreign currency assets (nominal value)

		Maturity breakdown (residual maturity, where applicable)		
	Total	Up to 1 month	More than 1 and up to 3 months	More than 3 months and up to 1 year
1. Contingent liabilities in foreign currency				
(a) Collateral guarantees on debt falling due within 1 year				
(b) Other contingent liabilities				
2. Foreign currency securities issued with embedded options (puttable bonds)				
3. Undrawn, unconditional credit lines provided by:				
(a) other national monetary authorities, BIS, IMF, and other international organizations				
--other national monetary authorities (+)				
--BIS (+)				
--IMF (+)				
(b) with banks and other financial institutions headquartered in the reporting country (+)				

(c) with banks and other financial institutions headquartered outside the reporting country (+)				
Undrawn, unconditional credit lines provided to:				
(a) other national monetary authorities, BIS, IMF, and other international organizations				
--other national monetary authorities (-)				
--BIS (-)				
--IMF (-)				
(b) banks and other financial institutions headquartered in reporting country (-)				
(c) banks and other financial institutions headquartered outside the reporting country (-)				
4. Aggregate short and long positions of options in foreign currencies vis-à-vis the domestic currency				
(a) Short positions				
(i) Bought puts				
(ii) Written calls				
(b) Long positions				
(i) Bought calls				
(ii) Written puts				
PRO MEMORIA: In-the-money options [11]				
(1) At current exchange rate				
(a) Short position				
(b) Long position				
(2) + 5 % (depreciation of 5%)				
(a) Short position				
(b) Long position				
(3) - 5 % (appreciation of 5%)				
(a) Short position				
(b) Long position				
(4) +10 % (depreciation of 10%)				
(a) Short position				
(b) Long position				
(5) - 10 % (appreciation of 10%)				
(a) Short position				
(b) Long position				
(6) Other (specify)				
(a) Short position				
(b) Long position				

IV. Memo items

(1) To be reported with standard periodicity and timeliness:	
(a) short-term domestic currency debt indexed to the exchange rate	
(b) financial instruments denominated in foreign currency and settled by other means (e.g., in domestic	

currency)	
--nondeliverable forwards	
--short positions	
--long positions	
--other instruments	
(c) pledged assets	
--included in reserve assets	
--included in other foreign currency assets	
(d) securities lent and on repo	
--lent or repoed and included in Section I	
--lent or repoed but not included in Section I	
--borrowed or acquired and included in Section I	
--borrowed or acquired but not included in Section I	
(e) financial derivative assets (net, marked to market)	
--forwards	
--futures	
--swaps	
--options	
--other	
(f) derivatives (forward, futures, or options contracts) that have a residual maturity greater than one year, which are subject to margin calls.	
--aggregate short and long positions in forwards and futures in foreign currencies vis-à-vis the domestic currency (including the forward leg of currency swaps)	
(a) short positions (–)	
(b) long positions (+)	
--aggregate short and long positions of options in foreign currencies vis-à-vis the domestic currency	
(a) short positions	
(i) bought puts	
(ii) written calls	
(b) long positions	
(i) bought calls	
(ii) written puts	
(2) To be disclosed less frequently:	
(a) currency composition of reserves (by groups of currencies)	68,519
--currencies in SDR basket	68,519
--currencies not in SDR basket	
--by individual currencies (optional)	

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.

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 24, 2007
HP-573

Treasury Secretary Paulson Meets with Indian Finance Minister Chidambaram

Washington, DC – Treasury Secretary Henry M. Paulson, Jr. welcomes Indian Finance Minister Palaniappan Chidambaram to the Department of the Treasury on Tuesday, September 25, 2007. They will discuss the Secretary's upcoming trip to India, as well as the importance of developing Mumbai into an international financial center and boosting private financing for the country's infrastructure needs. Additionally, they will discuss how the United States and financial regulators can best assist India in achieving its economic and development goals.

PRESS ROOM

September 25, 2007
HP-574

Today: Steel, Ryan to Host Capital Markets Briefing

Under Secretary for Domestic Finance Robert K. Steel and Assistant Secretary for Financial Markets Anthony W. Ryan will hold a press conference today at 11 a.m. in the Treasury Department Gallatin Room to discuss the next steps in part of Treasury's capital markets competitiveness initiative announced in June. The following event is open to credentialed media:

Who
Under Secretary for Domestic Finance Robert K. Steel
Assistant Secretary for Financial Markets Anthony W. Ryan
What
Press Conference on Capital Markets
When
Tuesday, September 25, 2007 11 a.m. (EDT)
Where
U.S. Treasury Department
Gallatin Room (2124)
1500 Pennsylvania Ave., NW
Washington, D.C.
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.

PRESS ROOM

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February 22, 2007
HP-272

**President's Working Group Releases
Common Approach to Private Pools of Capital
Guidance on hedge fund issues
focuses on systemic risk, investor protection**

Washington, DC- The President's Working Group on Financial Markets (PWG) released a set of principles and guidelines today that will guide U.S. financial regulators as they address public policy issues associated with the rapid growth of private pools of capital, including hedge funds. The agreement among the PWG and U.S. agency principals, which will serve as a framework for evaluating market developments, specifically concentrates on investor protection and systemic risk concerns.

"The President's Working Group believes that public policy toward private pools of capital should be governed by consistent principles that set out a uniform approach to specific policy objectives," said Secretary Henry M. Paulson, chair of the group. "These principles demonstrate that U.S. regulators and policymakers have a unified perspective and are committed to providing forward-leaning guidance for the industry and its participants. These guidelines should serve as a foundation to enhance vigilance and market discipline further, which will strengthen investor protection and guard against systemic risk. We will continue to monitor developments in this ever-evolving market with these principles in mind."

The group has designed the principles to endure as financial markets continue to evolve. They provide a clear but flexible principles-based approach to address the issues presented by the growth and dynamism of these investment vehicles.

The principles are intended to reinforce the significant progress that has been made since the PWG last issued a report on hedge funds in 1999 and to encourage continued efforts along those same lines:

- **Private Pools of Capital**: maintain and enhance information, valuation, and risk management systems to provide market participants with accurate, sufficient, and timely information.
- **Investors**: consider the suitability of investments in a private pool in light of investment objectives, risk tolerances, and the principle of portfolio diversification.
- **Counterparties and Creditors**: commit sufficient resources to maintain and enhance risk management practices.
- **Regulators and Supervisors**: work together to communicate and use authority to ensure that supervisory expectations regarding counterparty risk management practices and market integrity are met.

The PWG, chaired by the Treasury Secretary and composed of the chairmen of the Federal Reserve Board, the Securities and Exchange Commission, and the Commodity Futures Trading Commission, was formed in 1988 to further the goals of enhancing the integrity, efficiency, orderliness, and competitiveness of financial markets and maintaining investor confidence. The PWG worked with the Federal Reserve Bank of New York and the Office of the Comptroller of the Currency in developing the guidance.

Click here for the agreement among PWG and U.S. agency principals on principles and guidelines regarding private pools of capital

PRESS ROOM

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September 25, 2007
HP-575

PWG Announces Private Sector Groups to Address Market Issues for Private Pools of Capital

Washington - The President's Working Group on Financial Markets announced the chairs, members and mission statements for two private sector committees, one comprised of investors and the other comprised of asset managers. These private sector committees will assess and foster a private sector dialogue on issues of significance to their industry and the market. The first task of the committees will be to develop best practices using the PWG's principles-based guidance released in February. The committees will create and publicly release the best practices so market participants may enhance investor protection and systemic risk safeguards consistent with the PWG principles and guidelines.

"These groups are drawn from among the industry's finest in their respective areas," said Treasury Secretary and PWG Chairman Henry M. Paulson, Jr. "The market will benefit if experienced participants develop and implement best practices."

The President's Working Group is encouraging market participants to move beyond the status quo as they work to strengthen market discipline. The committees represent a milestone toward a more competitive U.S. marketplace with the world's highest standards for protecting investors and safeguarding against systemic risks.

Russell Read, Chief Investment Officer of the California Public Employees Retirement System, will serve as the chair of the Investors' Committee. Eric Mindich, CEO of Eton Park Capital Management, will serve as the chair of the Asset Managers' Committee.

The PWG and the committee chairmen sought a broad range of experienced members, listed below, to participate on the Committees. The Investors' Committee includes representatives from labor organizations, endowments, foundations, corporate and public pension funds, investment consultants, and non-U.S. investors. The Asset Managers' Committee includes representatives from a diverse group of hedge fund managers representing many different strategies.

The groups will make the best practices available for public comment before they are finalized.

The PWG first discussed the establishment of these groups in June, with the announcement of the second stage of Treasury's capital markets competitiveness plan. The PWG created the groups to complement the work underway between the global regulators and the financial institutions they regulate that serve as creditors, lenders and counterparties to these private pools of capital.

Asset Managers' Committee	Investors' Committee
Mission Statement	Mission Statement
Eric Mindich, Chair Eton Park Capital Management	**Russell Read, Chair** CalPERS
Anne Casscells	**Sandra Urie, Vice-Chair**

AETOS Capital, LLC	Cambridge Associates, LLC
James S. Chanos Kynikos Associates LP	**Gary Bruebaker** Washington State Investment Board
Anne Dinning D. E. Shaw & Co., L.P.	**Myra Drucker** Commonfund
Jonathon S. Jacobson Highfields Capital Management	**Tom Dunn** New Holland Capital
Marc Lasry Avenue Capital Group	**Peter Gilbert** Lehigh University Endowment Fund
Edward A. Mulé Silver Point Capital	**Andrew Golden** Princeton University Investment Company
Daniel S. Och Och-Ziff Capital Management	**George Main** Diversified Global Asset Management Corporation
Daniel H. Stern Reservoir Capital Group	**Ellen Shuman** Carnegie Corporation of New York
William Von Mueffling Cantillon Capital	**Damon Silvers** AFL-CIO
Michael Vranos Ellington Management Group LLC	**Greg Williamson** BP America Inc.

-30-

Agreement among PWG and U.S. Agency Principals on Principles and Guidelines regarding Private Pools of Capital

Preamble

The President's Working Group on Financial Markets, in the course of our ongoing review of market practices and events, has set forth the following fundamental principles that will inform our approach to private pools of capital. Since we last made a statement on these issues in 1999, the market has matured and expanded considerably, and these fundamental principles have increasingly been reflected in best practices. The current regulatory structure, which is also based on these principles, is working well. As we noted in 1999, "[i]n our market-based economy, market discipline of risk-taking is the rule and government regulation is the exception." We look forward to further progress as these principles continue to inform our actions and strengthen our vibrant capital markets.

Overarching Principles

1. **Private pools of capital bring significant benefits to the financial markets. However, these pools of capital also present challenges for market participants and policymakers. Investors, creditors, counterparties, pool managers, and supervisors must be aware of these challenges, including those related to some over-the-counter derivatives, and work to address them. Public policies that support market discipline, participant awareness of risk, and prudent risk management are the best means of protecting investors and limiting systemic risk.**

2. **The vitality, stability and integrity of our capital markets are a shared responsibility between the private and public sectors. Market discipline most effectively addresses systemic risks posed by private pools of capital. Supervisors should use their existing authorities with respect to creditors, counterparties, investors, and fiduciaries to foster market discipline on private pools of capital. Investor protection concerns can be addressed most effectively through a combination of market discipline and regulatory policies that limit direct investment in such pools to more sophisticated investors.**

Investor Protection Principles

3. **Private pools of capital can be an appropriate investment vehicle for more sophisticated investors. Because these pools can involve complex, illiquid or opaque investments and investment strategies that are not fully disclosed, the risks associated with direct investment in these pools are**

most appropriately borne by investors with the sophistication to identify, analyze and bear these risks.

3.1 Investors should understand their investments and the corresponding risks, and should not expose themselves to risk levels they cannot tolerate.

3.2 Sophisticated investors that determine to invest in a private pool of capital should ensure that the size of their investment is consistent with their investment objectives and the principle of portfolio diversification.

4. Investors in private pools of capital should obtain accurate and timely historical and ongoing material information necessary to perform due diligence regarding the pool's strategies, terms, conditions, and risk management, thereby enabling such investors to make informed investment decisions.

4.1 As with all investment products and vehicles, clear and meaningful disclosure is essential for investors to evaluate properly their investment decisions.

4.2 Investors should evaluate the investment objectives, strategies, risks, fees, liquidity, performance history, and other relevant characteristics of a private pool.

4.3 Investors should evaluate the pool's managers and personnel, including background, experience, and disciplinary history. Investors also should assess the pool's service providers and evaluate their independence from the pool's managers.

4.4 Investors should consider the private pool's manager's conflicts-of-interest and whether the manager has appropriate controls in place to manage those conflicts.

4.5 Investors should conduct an appropriate analysis regarding the valuation methodology and performance calculation processes and business and operational risk management systems employed by a private pool, including the extent of independent audit evaluation of such processes and systems.

5. Concerns that less sophisticated investors are exposed indirectly to private pools through holdings of pension funds, fund-of-funds, or other similar pooled investment vehicles can best be addressed through sound practices on the part of the fiduciaries that manage such vehicles. These fiduciaries have a duty under applicable law to act in the best interest of the beneficiaries. They have an ongoing responsibility to perform due diligence to ensure that their investment decisions are prudent and conform to sound practices for fiduciaries. Such pooled investment vehicles should address any special issues relating to investment in private

pools of capital, including the availability of relevant, accurate, and timely historical and ongoing material information.

5.1 Fiduciaries should consider the suitability of an investment in a private pool within the context of the overall portfolio and in light of the investment objectives and risk tolerances. Fiduciary evaluation should include the investment objectives, strategies, risks, fees, liquidity, performance history, and other relevant characteristics of a private pool.

5.2 Fiduciaries should evaluate the pool's manager and personnel, including background, experience, and disciplinary history. Fiduciaries also should assess the pool's service providers and evaluate their independence from the pool's managers. Fiduciaries should consider the private pool's manager's conflicts-of-interest and whether the manager has appropriate controls in place to manage those conflicts.

5.3 Fiduciaries should conduct the appropriate due diligence regarding valuation methodology and performance calculation processes and business and operational risk management systems employed by a private pool, including the extent of independent audit evaluation of such processes and systems.

5.4 Fiduciaries that determine to invest in a private pool of capital should ensure that the size of their investment is consistent with their investment objectives and the principle of portfolio diversification.

SYSTEMIC RISK PRINCIPLES

6. **Market discipline by creditors, counterparties, and investors is the most effective mechanism for limiting systemic risk from private pools of capital, which is the possibility that losses at one or more entities could threaten the stability of the broader financial system.**

6.1 Creditors and counterparties of private pools of capital are generally large, sophisticated financial firms that have the incentives and the expertise to provide effective market discipline. As institutional investors have become an increasingly important source of capital to private pools, the potential for market discipline from investors has increased.

6.2 By limiting their own exposures to losses from a default by a private pool, creditors and counterparties can better protect their own solvency from losses at a private pool. Moreover, the financing terms provided by creditors and counterparties can be an important constraint on leverage employed by private pools of capital.

7. **Key creditors and counterparties must commit resources and maintain appropriate policies, procedures, and protocols to define, implement, and continually enhance best risk management practices. Those policies, procedures, and protocols should address how the quality of information**

from a private pool of capital should affect margin, collateral, and other credit terms and other aspects of counterparty risk management.

7.1 Creditors and counterparties should undertake appropriate and effective due diligence before extending credit to a private pool of capital and on an ongoing basis thereafter. Due diligence should include a review of the counterparty's ability to measure and manage its exposures to market, credit, liquidity, and operational risks. Due diligence should establish the information flows that will occur during the course of the credit relationship.

7.2 Creditors and counterparties should measure their credit exposures to a private pool of capital frequently, taking into account the availability of collateral to mitigate both current and potential future exposures, and should assess the range of uncertainty around their exposure estimates. Rigorous stress testing should be used to quantify the impact of adverse market events, both at the level of an individual counterparty and aggregated across counterparties. Stress tests should take into account potential adverse market liquidity events in which multiple market participants seek to unwind trades simultaneously.

7.3 The amount of credit exposure to a private pool of capital that creditors or counterparties assume should reflect the level quantity and quality of available information about the pool, the extent to which exposures to the pool can be mitigated through margin and other credit terms, and the amount of capital that the creditors or counterparties have allocated to support the exposure.

7.4 Information that creditors and counterparties should seek to obtain from a private pool includes both quantitative and qualitative indicators of a private pool's net asset value, performance, market and credit risk exposure, and liquidity. The level of detail expected should respect the legitimate interest of the private pool in protecting its proprietary trading strategies. Where sufficient information is not forthcoming from a particular private pool, creditors and counterparties should tighten margin, collateral, and other credit terms.

7.5 Creditors and counterparties should implement and comply with industry sound practices to strengthen processing, clearing, and settlement arrangements for credit derivatives and other over-the-counter derivatives. These practices include protocols for issuing and completing trade confirmations, obtaining prior written consent for assignments, and using cash-settlement procedures for over-the-counter credit derivatives following a credit event.

7.6 Large exposures to private pools of capital are among the risks that should be reported to senior management periodically. Senior management should ensure that its firm's aggregate exposure to such pools is consistent with approved risk tolerance for bearing losses in adverse markets.

8. Investors in a private pool of capital should carefully evaluate the strategies and risk management capabilities of the private pool to ensure that the pool's risk profile is compatible with their own appetites for risk.

8.1 Such investors should undertake appropriate and effective due diligence before investing in a private pool of capital and on an ongoing basis. Due diligence should include a review of the counterparty's ability to manage its exposures to market, credit, liquidity, and operational risks. Due diligence should establish the information flows that will occur during the course of the relationship.

8.2 Such investors should seek assurances that the private pool in which they invest complies with industry sound practices, including practices for risk management, reporting, and internal controls.

8.3 Such investors should evaluate the extent to which similarities in strategies pursued by multiple private pools in which they invest undermine efforts to limit their risks through diversification.

9. Managers of private pools of capital should have information, valuation, and risk management systems that meet sound industry practices and enable them to provide accurate information to creditors, counterparties, and investors with appropriate frequency, breadth, and detail.

9.1 Managers must devote sufficient resources to the creation and maintenance of information, valuation, and risk management systems to ensure that high quality, material information can be delivered to creditors, counterparties, and investors in a timely fashion.

9.2 Risk management and valuation policies employed by private pools of capital should comply with the industry sound practices. Such pools also should implement and comply with industry sound practices to strengthen processing, clearing, and settlement arrangements for credit derivatives and other over-the-counter derivatives. These practices include protocols for issuing and completing trade confirmations, obtaining prior written consent for assignments, and using cash-settlement procedures for over-the-counter credit derivatives following a credit event.

9.3 The information provided by managers of private pools to their creditors, counterparties, and investors should adhere to the sound practices articulated in industry guidance. Managers of private pools of capital should provide information frequently enough and with sufficient detail that creditors, counterparties, and investors stay informed of strategies, the amount of risk being taken by the pool, and any material changes.

10. Supervisors should clearly communicate their expectations regarding prudent management of counterparty credit exposures, including those to private pools of capital and other leveraged counterparties, who are increasingly utilizing complex instruments, including certain over-the-counter derivatives and structured securities, such as collateralized debt obligations. Because key creditors and counterparties to pools are organized in various jurisdictions, international policy collaboration and coordination are essential.

10.1 Supervisors' expectations with respect to prudent risk management practices should take into account developments in financial markets and advances in best practices for counterparty credit risk management. Supervisors should actively monitor such developments and revise their policies and associated guidance as appropriate in a timely manner. In turn, supervisors should actively monitor and assess whether policies and procedures measure up to regulatory guidance and industry efforts to identify best practices.

10.2 Supervisors should take full advantage of both formal and informal channels of coordination and cooperation across financial industry sectors and international borders when carrying out their responsibilities related to internationally active financial institutions' management of exposures to private pools and leveraged counterparties.

PRESS ROOM

June 27, 2007
HP-476

Paulson Announces Next Steps to Bolster U.S. Markets' Global Competitiveness

Washington- Treasury Secretary Henry M. Paulson, Jr. announced the next steps of his capital markets competitiveness action plan today, focusing on maintaining the global leadership of America's capital markets. The plan follows Treasury's first set of capital markets initiatives announced in May to strengthen financial reporting and seek a more sustainable and transparent auditing profession.

"To maintain our capital markets' leadership, we need a modern regulatory structure complemented by market leaders embracing best practices," Secretary Paulson said. "The steps we are announcing today will help to strengthen our global competitiveness."

The second stage of the capital markets competitiveness plan seeks a rationalized regulatory structure with improved oversight, increased efficiency, reduced overlap and the ability to adapt to market participants' constantly-changing strategies and tools. The plan will suggest improvements for all financial market participants, including the Treasury Department itself.

Experts at Treasury's March Conference on U.S. Capital Markets Competitiveness noted that the right regulatory balance would combine high standards of market integrity, stability and investor protection with a strong foundation for innovation, growth, and competitiveness.

The next steps of the plan will include:

- **Pursuing a Modernized Regulatory Structure.** The Treasury Department is examining the structure of the regulatory system for all financial services providers and will release its blueprint for reforms by early next year.
- **Encourage Development and Adoption of Industry Best Practices for Asset Managers and Investors in Hedge Funds.** The President's Working Group on Financial Markets will work with asset managers and investors to help these two groups define separate sets of best practices that address investor protection, enhance market discipline and mitigate systemic risk. This effort, based on the PWG principles and guidelines released earlier this year, will complement the ongoing reviews of counterparties' and creditors' practices by supervisors globally.
- **Modernize Treasury's Cash Management and Debt Management.** The Department will strengthen the U.S. Government's cash and debt management systems through a broad series of public initiatives in the coming year, further improving the efficiency, integrity, transparency and competitiveness of the U.S. Treasury market.
- **Complete Basel II Rulemaking.** Treasury will work with U.S. regulators to move the Basel II capital requirements forward. These new rules will reduce uncertainty, relieve burdens for both domestic and foreign banks, and enhance the United States' competitive position.
- **Empower All Investors through Financial Education.** Any effort to improve the oversight of the financial services industry to protect investors must be coupled with empowering investors to better understand their options and decisions. Treasury will lead the President's inter-agency public initiative to help all Americans better understand money and personal finance. By encouraging saving and better access to financial services, Treasury can help broaden America's investor class.
- **Encourage International Investment Opportunities with Recognition of Comparable Regulatory Regimes.** Mutual recognition between countries with regulatory schemes comparable to the United States could increase international investment opportunities and enhance risk diversification while preserving investor protection. Treasury supports SEC consideration of

mutual recognition for foreign broker-dealers and foreign stock exchanges offering services to U.S. investors.

PRESS ROOM

September 25, 2007
HP-576

Paulson to Meet with Mexican Finance Minister Agustin Carstens

Washington, DC – Treasury Secretary Henry M. Paulson, Jr. will welcome Mexican Finance Minister Agustin Carstens to the U.S. Department of the Treasury today, September 25, 2007. This meeting is a continuation of their regular dialogue and close cooperation on a range of issues, including global and regional economic and financial developments, the effectiveness of international financial institutions, efforts to combat money laundering and terrorist finance, and tax issues.

PRESS ROOM

September 26, 2007
HP-577

Paulson and Gutierrez Call for Permanent Moratorium on Internet Taxes

WASHINGTON, DC--U.S. Treasury Secretary Henry M. Paulson and Commerce Secretary Carlos M. Gutierrez issued a statement today calling for the Senate to make permanent the moratorium on Internet access taxes and on multiple or discriminatory taxes on electronic commerce. The Senate Commerce Committee will mark up S. 1453, the Internet Tax Freedom Extension Act of 2007, on Thursday.

"The Internet is an innovative force that opens up the vast potential economic and social benefits of electronic commerce. Preventing the taxation of Internet access will help sustain an environment for innovation, ensure that consumers continue to have affordable access to the Internet, especially high-speed Internet, and strengthen the foundations of electronic commerce as a vital and growing part of our economy.

"Congress has an opportunity to demonstrate bipartisan leadership by passing essential legislation before the current moratorium expires on November 1 of this year. We urge the Congress to expedite passage of a permanent extension so that President Bush can sign it into law before the current moratorium expires.

"The Administration has worked hard, in a bipartisan fashion, to promote innovation and the economic benefits that come from electronic commerce. We look forward to working with Congress on this important issue."

PRESS ROOM

September 27, 2007
hp-578

Treasury Action Targets Violent Burmese Suppression

The U.S. Department of the Treasury today is designating 14 senior Burmese Government officials in the wake of that government's longstanding oppression of the Burmese people and its recent use of violence against peaceful demonstrators. Treasury's action follows President George W. Bush's announcement of plans for tightening U.S. sanctions against the military regime in Burma, made before the UN General Assembly on September 25, 2007.

"We are today imposing sanctions against senior officials of the Government of Burma," said Adam Szubin, Director of the Office of Foreign Assets Control (OFAC). "The President has made clear that we will not stand by as the regime tries to silence the voices of the Burmese people through repression and intimidation."

The designations were made pursuant to Executive Order 13310, which authorizes the Secretary of the Treasury, in consultation with the Secretary of State, to designate senior officials of the Government of Burma, the State Peace and Development Council of Burma (the military regime that rules Burma), the Union Solidarity and Development Association of Burma, or any of their successor organizations, as well as any individuals or entities that are owned or controlled by, or acting for or on behalf of, any person, whose property or interests in property are blocked pursuant to the order. Executive Order 13310 also blocked property and interests in property of the four entities listed on its Annex, the State Peace and Development Council of Burma and three banks controlled by the Government of Burma.

The Burmese government leaders designated today by OFAC include Senior General Than Shwe, Minister of Defense and Chairman of the State Peace and Development Council (SPDC); Vice Senior General Maung Aye, Commander of the Army and Vice Chairman of the SPDC; Lieutenant General Thein Sein, Acting Prime Minister and First Secretary of the SPDC; and General Thura Shwe Mann, Joint Chief of Staff, Armed Forces and Member of the SPDC. The other senior officials of the Government of Burma named include other members of the State Peace and Development Council, key military officials, and other government ministers.

As a result of Treasury's designations, any assets these individuals and entities may have that are within U.S. jurisdiction must be frozen, and U.S. persons are prohibited from transacting or doing business with them.

PRESS ROOM

September 27, 2007
HP-579

Prepared for Delivery
Remarks by Treasury Secretary Paulson
at the Major Economies Meeting

Washington, D.C.-- This evening marks the half-way point of two important days. President Bush has convened senior officials from the world's major economies to launch the necessary next phase towards achieving our common objective of reducing global greenhouse gas emissions. The nations that produce more than 80 percent of the world's emissions are here. This broad participation is evidence that collectively we take our stewardship responsibilities seriously and recognize that addressing climate challenge is a global public good. Our work is intended to support and contribute to a global agreement under the UN Framework Convention on Climate Change. If the major economies can agree on a way forward, that could accelerate the prospects of a broader agreement on a way forward in the UN.

I am particularly honored to have the chance to speak with you tonight because I care deeply about the protection of our planet. Over time, my love of nature has grown into appreciation for how fragile our environment is and how urgent is the need to protect and conserve it. And so I laud the President's leadership that began the major economies meeting process.

Last May, he asked the world's major nations to work to develop a post-2012 framework that will encompass the environmental, energy security and economic aspects of climate change. The purpose of the President's initiative is to make sure all the major economies, not just a select few, work together as equals to develop a way forward.

In this regard, I am especially pleased to see our friends from the large, emerging economies here --- particularly China, Brazil and India --- since we will accomplish this effort only if we all take an active part. Pitting the developed and the developing countries against each other will not lead to economic development and environmental sustainability.

Cost effective policy tools are needed to provide incentives for the necessary building blocks for reducing emissions. These include deployment of advanced technologies, increased energy efficiency, investment in research and development, market-based solutions and eliminating tariff and non-tariff barriers.

Governments can and should do more to work together to advance the adoption of clean technologies. We need strong research and development incentives for commercialization of new technologies. But we must realize the vast scale of our challenge.

The International Energy Agency has estimated that between 2005 and 2030 the world will need to invest $20 trillion in energy-supply infrastructure. Public sector investment will matter only to the extent that it leverages clean technology investments by the private sector, where most of this investment will occur. This will mean working closely with the private sector and adopting market-based solutions to increase the adoption rate for proven, cleaner technologies. Under UN Secretary General Ban Ki-Moon's leadership, the United Nations is addressing the important issue of climate change and we look forward to working with him on these critical issues.

Progress requires the rapid development and deployment of clean and efficient energy technology across the globe. Developing countries today have access to technologies that didn't exist a century ago when we in the industrialized world developed. We must tear down artificial barriers that impede the spread of today's clean technologies. There is no moral or economic reason for tariffs or non-tariff barriers on environmental goods or services. Countries need to act quickly to eliminate these trade restrictions and increase access to these crucial environmental technologies --- technologies that will allow nations to pursue a path that embraces both economic growth and clean energy development.

The future will be built by leaders who recognize that economic growth and responsible environmental stewardship are not incompatible. Just as America recognizes that our prosperity is linked to the strength of your economies, we also recognize that the long-term environmental health of our planet depends on the success of the actions each of our nations take to limit greenhouse gas emissions. Globalization and interdependence are here to stay, so we all have a role to play protecting our environment for our own children and the children of the world.

Thank you for the opportunity to share my thoughts with you.

PRESS ROOM

September 28, 2007
HP-580

Statement of Secretary Paulson on the Debt Limit

"The Senate's swift action on the debt limit today helps to protect the full faith and credit of the United States and avoids creating unnecessary uncertainty in the U.S. Treasuries market. I commend Congress for passing legislation that ensures the U.S. government can deliver on promises already made, such as Social Security and Medicare payments."

PRESS ROOM

September 26, 2007
HP-581

Assistant Secretary for Financial Markets Anthony W. Ryan Remarks on Financial Evolution and Innovation Before the International Swaps and Derivatives Association Regional Member Conference

New York City - Good morning. Thank you for inviting me to join you. It is a privilege to be here in New York City, the capital of global financial markets.

Dramatic changes have occurred in capital markets in recent years. Globalization and innovation are two of the most significant forces driving that evolution. Today, I would like to focus my remarks not just on the benefits and challenges resulting from the remarkable wave of financial innovation that is sweeping across global markets, but also to remind all participants that markets and practices must continue to evolve in order to remain competitive.

The pace of financial innovation has gathered momentum in recent years as information technology and financial engineering have significantly changed the global capital market environment. The influence of these catalysts is evidenced by the increased diversity of investment instruments such as structured credit, investment vehicles such as exchange traded funds and by the array of innovative investment strategies, many of which are deployed by hedge fund managers.

Rapid change is not constrained to the financial landscape. Scientists observe similar events in the natural world. The scientific theory of "punctuated equilibrium" suggests that lengthy periods of relative stability, or stasis are periodically interrupted or "punctuated" by shorter, rapid bursts of change. These rapid changes often result in specialization, increased complexity, and after some period of acclimation or adjustment, eventual integration into the larger system. The same is true in finance, as sudden "environmental" changes often result in specialized or customized products and business models, increased complexity and after a period of adjustment, eventual integration into the global marketplace.

Recently, market stress emanating from the subprime mortgage sector, a relatively minor segment of the overall financial markets, has sparked discussions about securitization as a whole, even causing some to question the benefits of such financial innovation. This questioning is not only fair, it is appropriate. Policy makers and market participants must continually assess the myriad implications of financial innovation.

Just as some species become extinct in nature, some new financing techniques may prove to be less successful than others. But let's recognize that over the long-term, financial innovation is integral to enhancing capital markets' competitiveness. Innovative markets become more efficient, ultimately strengthening the economies they serve by facilitating job growth and improving productivity.

A Case of Financial Innovation

One example of innovation as it relates to financial instruments is the development of structured credit products. At their inception, the buyers of products such as credit derivatives were banks, who purchased protection from traditional insurers to manage their exposures to the corporate loans they retained on their balance sheets. Spurred largely by the 1988 Basel Accord, demand for credit derivatives grew as banks realized that they could transfer the credit risk of borrowers to entities not subject to bank capital requirements while at the same time retain the ownership of and revenue from such loans.

The market evolved from primarily a bank/insurer market to one with a much broader range of non-bank participants, including asset managers, hedge funds, pension funds, and securities firms. There are many additional positive externalities associated with this development. For example, market makers of corporate issuances can reduce their exposure to single name credits but at the same time increase their role as liquidity providers to particular issuances without taking on too much concentration risk in a single entity. As a result, users and providers of capital gain more efficient pricing. Moreover, through credit derivatives investors (or protection sellers) can isolate their investment solely to an entity's credit risk as opposed to risks associated with investing in a single debenture, such as liquidity risk.

The range of products also evolved from more traditional-type credit protection to single-name credit default swaps (CDS), to multi-name CDS, and more recently, to more complex securitized asset-backed instruments such as credit derivative indices (including those backed by commercial mortgages, subprime residential mortgages, and leveraged loans), collateralized debt obligations (CDOs), and collateralized loan obligations (CLOs). Whereas credit derivatives initially were hedging instruments whose prices were derived directly from the price of a single, less complex underlying asset (a corporate loan and its implied credit risk/default probability), credit derivatives now increasingly include more complex instruments whose prices are derived from a basket of underlying assets, securitized assets, or tranched assets.

Benefits of Financial Innovation

Credit derivatives are just one example of financial innovation. But before discussing the benefits of structured credit or other specific instruments, it is useful to recognize the broader benefits of such innovation at the market level from the perspective of capital providers and capital users.

Financial innovation benefits both suppliers of capital, or investors, as well as users of capital. Suppliers of capital benefit from the greater flexibility afforded by more choices. This ultimately facilitates greater diversification. Today, investors have a host of investment instruments, vehicles and strategies from which to choose.

Investors also benefit from the ability to more explicitly target their capital. For example, securitization enables investors to improve their risk management, achieve better risk adjusted returns, access more liquidity, and lower the cost of implementation.

Users of capital, therefore also benefit from securitization. Historically, users of capital had only a few instruments that they could issue or choose from to access capital. Today, they can access capital from a broad array of investors, each with unique return and risk objectives. Thus, investors can be more optimally matched to meet the needs of each user's specific needs and objectives. Users of capital, therefore, benefit from a lower cost of capital, which in turn results in higher returns. Innovation makes the movement of capital more efficient, risk management more targeted, and trading less costly.

That is all true at the broader market level. Yet, as we focus our assessment to the impact of a specific set of instruments such as credit derivatives, the many benefits of innovation remain clear. Credit derivatives have improved the management and transfer of credit risk, the unbundling and tranching of risk, enhanced liquidity, created greater portfolio diversification, and broadened credit risk dispersion. Users of capital hold that these instruments enhance the efficiency and stability of the credit markets and the resiliency of the broader financial markets.

Over time, there can be little doubt that consumers and market participants around the world benefit from financial innovation in the area of securitization and the corresponding increases in credit availability. The ability to securitize credit has expanded the sources of capital and credit for homeowners, business owners, and other borrowers throughout the global economy.

For example, if one evaluates mortgage securitization, even in spite of recent market challenges which I will address in a moment, it would be difficult to suggest that the net benefits are not real. Securitization has fundamentally improved the mortgage industry. Over the past few decades, instead of holding a mortgage and collecting payments every month from the homeowner, originators have used capital markets to pool mortgages into mortgage-backed securities, selling tranches to investors. This activity distributed the risks across a broader spectrum of investors, and freed originators to issue new loans. The result has been an increased availability of capital at lower cost and today, more Americans have access to homeownership - up from 64% in 1994 to 69% today. The same process of securitization has targeted other asset classes such as credit card receivables, auto loans, home equity loans, which in turn reduces risk as well as benefits the ultimate end users of capital.

Challenges of Financial Innovation

While there are numerous benefits to financial innovation such as securitized credit, we must also recognize the real challenges such innovation poses to investors, regulators and other market participants. Recall, that while rapid changes often result in increased specialization and increased complexity, they are often followed by a period of acclimation, prior to becoming accepted in the mainstream marketplace.

Financial incentives, coupled with advancements in technology and financial engineering skills, can result in situations where new instruments, vehicles and strategies outpace the existing market and regulatory infrastructures. Such developments have the potential to present challenges for both market participants and supervisors.

Challenges often emerge during periods of change, as participants acclimate to the specialization and increased complexity. When these traits emerge in a relatively benign environment the adjustment period may appear smooth, but as we know, environments change. Just as in nature, when the environment changes, the success of a species can alter dramatically.

The development of some instruments such as credit derivatives illustrates how innovation leads to greater complexity. As we have witnessed, the rapid growth of complex new products can strain not just the infrastructure for processing, clearing and settling trades, but also introduce additional challenges for market participants including valuation and risk management.

Many investors are grappling with this increasing complexity in the markets, and in particular securitized products. In some cases, risk evaluation can be difficult. While complexity may be a very legitimate reason a potential investor decides not to invest, it can be no excuse for an existing investor or buyer of such a security to justify a loss. Investors and their fiduciaries must understand the risks associated with a potential investment. This is true of any investment – whether it is an underlying asset, such as an equity, or a derivative product, such as a CDO.

Insufficient understanding or failure to perform independent and adequate due diligence prior to making an investment decision is simply unacceptable. That's not investing.....that's gambling.

Investors must also monitor their holdings and exposures, which includes reassessing their risks after making their initial investments. Recently, many of these assets have gone from AAA: alluring, attractive and acceptable to CCC, complicated, challenged and contaminated. Could such a change in so short a period of time suggest the need for stronger market discipline?

Responding to the Challenges

In recent years, we have witnessed fundamental change in capital markets. In order to continue to strengthen our markets and secure the tangible benefits of such financial innovation, we must acknowledge the challenges. As markets evolve, market participants and public policies must also adapt. As leaders, we must possess both judgment and confidence: judgment to recognize when additional changes are necessary and confidence to make needed changes.

Already, encouraging signs of improvement are emerging. Impressive progress has been made in addressing some of these challenges. International Swaps and Derivatives Association, Depository Trust and Clearing Corporation, Federal Reserve Bank of New York, the Counterparty Risk Management Policy Group, and others should all be commended for their leadership and efforts towards ensuring such progress. ISDA's novation protocol, cash settlement auction protocol, and documentation efforts contributed significantly to resolving processing backlogs, physical shortages, and other issues facing these markets. Still, we must not be complacent. Further collective and cooperative action is necessary to prevent and resolve other challenges. Some of the necessary adaptations will take additional time to implement. Some will be easier to implement than others, but none will be easy.

Capital markets are a microcosm of the natural world, rich in history and ever adapting in response to changing environmental conditions. In the financial world, while we are already beginning to see some positive adaptation in the wake of recent market issues, we need to do more. With respect to addressing complexity, both issuers, investors, and rating agencies all have important roles and responsibilities. We should encourage more transparency, better information and disclosure, less complacency, and stronger fiduciary practices. Financial industry bodies around the world are now launching initiatives to address some of the challenges including calls for transparency and encouraging disclosure so investors have the information they need to make more informed decisions.

A process of investor education or "adaptation" should also be encouraged. The importance of investor diligence cannot be overemphasized in the context of financial innovation and the need for strong market discipline. As new instruments and strategies emerge, investors need to evaluate new opportunities through rigorous due diligence. Following the crowds or accepting conventional practice and investing in something they do not fully understand is a recipe for failure.

Hedge Funds

Financial innovation has manifested itself not just in regard to new instruments, but also in the emergence of new investment strategies, many of which are often deployed by hedge fund managers. Here too, the growth and development of such pools of capital has brought many benefits and yes, some challenges. In February, the President's Working Group on Financial Markets (PWG) released principles and guidelines to address the challenges these strategies pose; namely investor protection and systemic risk.

Yesterday, Secretary Paulson announced the next steps in the formation of two separate, yet complementary private sector committees. One is comprised of asset managers and the other is made up of investors. Each committee will define a set of "best practices" that will help to strengthen market discipline, mitigate systemic risk, augment regulatory safeguards regarding investor protection, and complement regulatory efforts to enhance market integrity. These "best practices" will have as a foundation and be consistent with the PWG principles and guidelines, and will complement the ongoing reviews of counterparties' and creditors' practices by supervisors globally.

I should note that the PWG stated that investors, creditors, counterparties, asset managers, and supervisors must be aware of the challenges, including those related to over-the-counter derivatives and must work to address them. Public policies that support market discipline, participant awareness of risk, and prudent risk management are the best means of protecting investors and limiting systemic risk. All stakeholders should implement and comply with industry sound practices to strengthen processing, clearing, and settlement arrangements for credit derivatives and other over-the-counter derivatives. These practices include protocols for issuing and completing trade confirmations, obtaining prior written consent for assignments, and using cash-settlement procedures for over-the-counter credit derivatives following a credit event.

The PWG has also commenced an examination of some of the issues underlying the recent market events, including the impact of securitization and the role of rating agencies in the credit and mortgage markets. These efforts were included as part of a broader initiative President Bush recently announced to help homeowners facing mortgage delinquencies and foreclosures.

Conclusion

We must continually evaluate changing market conditions and practices. And while being ever prepared to adapt, we should do so with prudence, examining root causes and considering possible unintended consequences, before making lasting changes.

It is a privilege to be entrusted with the public's interest and capital. And with such a privilege comes responsibility. To achieve our goals we need to recognize that the responsibility is borne by both the private and public sectors. Building upon the efforts to date, all stakeholders must continue to do more. Collectively, we can strengthen the vitality, stability and integrity of the public's investments and our capital markets. The system works when all stakeholders recognize the benefits, mitigate the risks, and choose to participate.

Thank you for the opportunity to speak here today.

PRESS ROOM

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September 28, 2007
HP-582

Preliminary Annual Report on US Holding of Foreign Securities

Preliminary data from an annual survey of U.S. portfolio holdings of foreign securities at year-end 2006 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 reported on November 30, 2007.

The survey was undertaken jointly by the U.S. Treasury Department, 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, 2007, are currently being processed. Preliminary results are expected to be reported on February 29, 2008.

Overall Preliminary Results

The survey measured U.S. holdings at year-end 2006 of approximately $6.0 trillion, with $4.3 trillion held in foreign equities, $1.3 trillion in foreign long-term debt securities (original term-to-maturity in excess of one year), and $0.4 trillion held in foreign short-term debt securities. The previous such survey, conducted as of year-end 2005, measured U.S. holdings of $4.6 trillion, with $3.3 trillion held in foreign equities, $1.0 trillion in foreign long-term debt securities, and $0.3 trillion held in foreign short-term debt securities.

REPORTS

- Table

Table 1. U.S. holdings of foreign securities, by type of security, as of survey dates[1]
(Billions of dollars)

Type of Security	Dec. 31, 2005	Dec. 31, 2006
Long-term Securities	4,346	5,623
Equity	3,318	4,329
Long-term debt	1,028	1,294
Short-term debt securities	263	368
Total	4,609	5,991

U.S. Portfolio Investment by Country

Table 2. U.S. holdings of foreign securities, by country of issuer and type of security, for the countries attracting the most U.S. portfolio investment, as of December 31, 2006
(Billions of dollars, except as noted)

	Country	Total	Equity	LT Debt	ST Debt
1	United Kingdom	1,076	674	245	156
2	Japan	596	544	46	7
3	Canada	478	298	162	18
4	France	402	307	63	32
5	Cayman Islands	376	161	178	37
6	Germany	292	220	62	10
7	Switzerland	264	263	1	*
8	Netherlands	234	161	68	5
9	Bermuda	208	192	14	3
10	Australia	173	102	62	10
11	Korea, South	124	114	10	*
12	Ireland	121	48	38	34
13	Spain	111	86	24	1
14	Brazil	110	92	18	*
15	Mexico	108	85	24	*
16	Italy	106	94	12	1
17	Sweden	102	59	24	19
18	Hong Kong	88	86	2	*
19	China, mainland[2]	75	74	1	*
20	Taiwan	74	74	*	*
21	Luxembourg	60	16	37	7
22	Finland	60	56	4	*
23	Netherlands Antilles	58	56	2	*
24	Singapore	53	44	9	*
25	Norway	51	32	15	4
	Rest of world	592	393	174	24
	Total	5,991	4,329	1,294	368

[1] The stock of foreign securities for December 31, 2006 reported in this survey may not, for a number of reasons, correspond to the stock of foreign securities on December 31, 2005, plus cumulative flows reported in Treasury's transactions reporting system. The final report on U.S. holdings of foreign securities as of end-year 2006 will contain an analysis of the relation between the stock and flow data.
[2] Excludes Hong Kong and Macau, which are reported separately.
* Greater than zero but less than $500 million.