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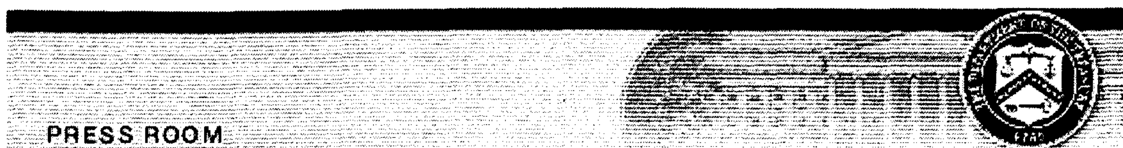

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October 1, 2007
HP-583

Agencies Propose Joint Rule to Implement Unlawful Internet Gambling Enforcement Act

The Department of the Treasury (Treasury) and the Board of Governors of the Federal Reserve System (Board) on Monday announced the release of a joint proposed rule to implement the Unlawful Internet Gambling Enforcement Act (the Act). The Act prohibits gambling businesses from accepting payments in connection with unlawful Internet gambling, including payments made through credit cards, electronic funds transfers, and checks.

The proposed rule would require U.S. financial firms that participate in designated payment systems to have policies and procedures that are reasonably designed to prevent payments being made to gambling businesses in connection with unlawful Internet gambling. The proposed rule would provide examples of such policies and procedures. For purposes of the proposed rule, unlawful Internet gambling generally would cover the making of a bet or wager that involves use of the Internet and that is unlawful under any applicable federal or state law in the jurisdiction where the bet or wager is made.

The Board and Treasury are required by the Act to develop jointly the proposed rule in consultation with the Department of Justice. Comments on the proposed rule are requested by December 12, 2007. The agencies request comment on all aspects of the proposed rule. The Federal Register notice is attached.

Media Contacts:

Treasury Jennifer Zuccarelli 202-622-8657
Federal Reserve Susan Stawick 202-452-2955

REPORTS

- Federal Register Notice of Proposed Joint Rule

FEDERAL RESERVE SYSTEM

12 CFR Part 233

Regulation GG; Docket No. R-1298

DEPARTMENT OF THE TREASURY

31 CFR Part 132

RIN 1505-AB78

PROHIBITION ON FUNDING OF UNLAWFUL INTERNET GAMBLING

AGENCIES: Board of Governors of the Federal Reserve System and Departmental Offices, Department of the Treasury.

ACTION: Notice of Joint Proposed Rulemaking.

SUMMARY: This notice is published jointly by the Departmental Offices of the Department of the Treasury (the "Treasury") and the Board of Governors of the Federal Reserve System (the "Board") (collectively, the "Agencies") and proposes rules to implement applicable provisions of the Unlawful Internet Gambling Enforcement Act of 2006 (the "Act"). In accordance with the requirements of the Act, the proposed rule designates certain payment systems that could be used in connection with unlawful Internet gambling transactions restricted by the Act. The proposed rule requires participants in designated payment systems to establish policies and procedures reasonably designed to identify and block or otherwise prevent or prohibit transactions in connection with unlawful Internet gambling. As required by the Act, the proposed rule also exempts certain participants in designated payment systems from the requirements to establish such policies and procedures because the Agencies believe it is not reasonably practical for those participants to identify and block, or otherwise prevent or prohibit, unlawful Internet gambling transactions restricted by the Act. Finally, the proposed rule describes the types of policies and procedures that non-exempt participants in each type of designated payment system may adopt in order to comply with the Act and includes non-exclusive examples of policies and procedures which would be deemed to be reasonably designed to prevent or prohibit unlawful Internet gambling transactions restricted by the Act. The proposed rule does not specify which gambling activities or transactions are legal or illegal because the Act itself defers to underlying State and Federal gambling laws in that regard and determinations under those laws may depend on the facts of specific activities or transactions (such as the location of the parties).

DATES: Comments must be received on or before December 12, 2007.

ADDRESSES: You may submit comments by any of the following methods:

BOARD: You may submit comments, identified by Docket Number R-1298, by any of the following methods:

- Agency Web site: http://www.federalreserve.gov. Follow the instructions for submitting comments at http://www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm.

- Federal eRulemaking Portal: http://www.regulations.gov. Follow the instructions for submitting comments.

- E-mail: regs.comments@federalreserve.gov. Include docket number in the subject line of the message.

- Fax: (202) 452-3819 or (202) 452-3102.

- Mail: Jennifer J. Johnson, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, N.W., Washington, DC 20551. All public comments are available from the Board's Web site at http:// www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm, as submitted, unless modified for technical reasons. Accordingly, your comments will not be edited to remove any identifying or contact information. Public comments may also be viewed electronically or in paper in Room MP-500 of the Board's Martin Building (20th and C Streets, NW) between 9 a.m. and 5 p.m. on weekdays.

TREASURY:

- **Federal eRulemaking Portal – "Regulations.gov":** Go to http://www.regulations.gov, select "Department of the Treasury – All" from the agency drop-down menu, then click "Submit." In the "Docket ID" column, select "Treas-DO-2007-0015" to submit or view public comments and to view supporting and related materials for this notice of proposed rulemaking. The "User Tips" link at the top of the Regulations.gov home page provides information on using Regulations.gov, including instructions for submitting or viewing public comments, viewing other supporting and related materials, and viewing the docket after the close of the comment period.

- **Mail:** Department of the Treasury, Office of Critical Infrastructure Protection and Compliance Policy, Room 1327, Main Treasury Building, 1500 Pennsylvania Avenue, N.W., Washington, D.C. 20220.
  Instructions: You must include "Treas-DO" as the agency name and "Docket Number Treas-DO-2007-0015" in your comment. In general, the Treasury will enter all comments received into the docket and publish them without change, including any business or personal information that you provide such as name and address information, e-mail addresses, or phone numbers. Comments, including attachments and other supporting materials, received are part of the public record and subject to public disclosure. Do not enclose any information in your

comment or supporting materials that you consider confidential or inappropriate for public disclosure.
You may view comments and other related materials by any of the following methods:

- **Viewing Comments Electronically:** Go to http://www.regulations.gov, select "Department of the Treasury-All" from the agency drop-down menu, then click "Submit." In the "Docket ID" column, select "Treas-DO-2007-0015" to view public comments for this notice of proposed rulemaking.

- **Viewing Comments Personally:** You may personally inspect and photocopy comments at the Department of the Treasury Library, Room 1428, Main Treasury Building, 1500 Pennsylvania Avenue, N.W., Washington, D.C. You can make an appointment to inspect comments by calling (202) 622-0990.

Commenters are requested to submit copies of comments to both Agencies.

FOR FURTHER INFORMATION CONTACT:
BOARD: Christopher W. Clubb, Senior Counsel (202/452-3904), Legal Division; Jack K. Walton, II, Associate Director (202/452-2660), Jeffrey S. Yeganeh, Manager, or Joseph Baressi, Financial Services Project Leader (202/452-3959), Division of Reserve Bank Operations and Payment Systems; for users of Telecommunication Devices for the Deaf (TDD) only, contact 202/263-4869.

TREASURY: Charles Klingman, Deputy Director , Office of Critical Infrastructure Protection and Compliance Policy; Steven D. Laughton, Senior Counsel , or Amanda Wise, Attorney-Advisor, Office of the Assistant General Counsel (Banking & Finance), 202/622-9209.

SUPPLEMENTARY INFORMATION:

I. Background and Introduction

The Act prohibits any person engaged in the business of betting or wagering (as defined in the Act) from knowingly accepting payments in connection with the participation of another person in unlawful Internet gambling. Such transactions are termed "restricted transactions." The Act generally defines "unlawful Internet gambling" as placing, receiving, or otherwise knowingly transmitting a bet or wager by any means which involves the use, at least in part, of the Internet where such bet or wager is unlawful under any applicable Federal or State law in the State or Tribal lands in which the bet or wager is initiated, received, or otherwise made.[1] The Act states that its

[1] From the general definition, the Act exempts three categories of transactions: (i) intrastate transactions (a bet or wager made exclusively within a single State, whose State law or regulation contains certain safeguards regarding such transactions and expressly authorizes the bet or wager and the method by which the bet or wager is made, and which does not violate any provision of applicable Federal gaming statutes);

provisions should not be construed to alter, limit, or extend any Federal or State law or Tribal-State compact prohibiting, permitting, or regulating gambling within the United States.[2] The Act does not spell out which activities are legal and which are illegal, but rather relies on the underlying substantive Federal and State laws.[3]

The Act requires the Agencies (in consultation with the U.S. Attorney General) to designate payment systems that could be used in connection with or to facilitate restricted transactions. Such a designation makes the payment system, and financial transaction providers participating in the system, subject to the requirements of the regulations.[4] The Act further requires the Agencies (in consultation with the U.S. Attorney General) to prescribe regulations requiring designated payment systems and financial transaction providers participating in each designated payment system to establish policies and procedures reasonably designed to identify and block or otherwise prevent or prohibit restricted transactions. The regulations must identify types of policies and procedures that would be deemed to be reasonably designed to achieve this objective, including non-exclusive examples. The Act also requires the Agencies to exempt certain restricted

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(ii) intratribal transactions (a bet or wager made exclusively within the Indian lands of a single Indian tribe or between the Indian lands of two or more Indian tribes as authorized by Federal law, if the bet or wager and the method by which the bet or wager is made is expressly authorized by and complies with applicable Tribal ordinance or resolution (and Tribal-State Compact, if applicable) and includes certain safeguards regarding such transaction, and if the bet or wager does not violate applicable Federal gaming statutes); and (iii) interstate horseracing transactions (any activity that is allowed under the Interstate Horseracing Act of 1978, 15 U.S.C. 3001 *et seq.*).

The Department of Justice has consistently taken the position that the interstate transmission of bets and wagers, including bets and wagers on horse races, violates Federal law and that the Interstate Horseracing Act (the "IHA") did not alter or amend the Federal criminal statutes prohibiting such transmission of bets and wagers. The horse racing industry disagrees with this position. While the Act provides that the definition of "unlawful Internet gambling" does not include "activity that is allowed under the Interstate Horseracing Act of 1978," 31 U.S.C. 5362(10)(D)(i), Congress expressly recognized the disagreement over the interplay between the IHA and the Federal criminal laws relating to gambling and determined that the Act would not take a position on this issue. Rather, the Sense of Congress provision, codified at 31 U.S.C. 5362(10)(D)(iii), states as follows:

> It is the sense of Congress that this subchapter shall not change which activities related to horse racing may or may not be allowed under Federal law. This subparagraph is intended to address concerns that this subchapter could have the effect of changing the existing relationship between the Interstate Horseracing Act and other Federal statutes in effect on the date of enactment of this subchapter. This subchapter is not intended to resolve any existing disagreements over how to interpret the relationship between the Interstate Horseracing Act and other Federal statutes.

[2] 31 U.S.C. 5361(b).

[3] See H. Rep. No. 109-412 (pt. 1) p.10.

[4] The Act defines "financial transaction provider" as a creditor, credit card issuer, financial institution, operator of a terminal at which an electronic fund transfer may be initiated, money transmitting business, or international, national, regional, or local payment network utilized to effect a credit transaction, electronic fund transfer, stored value product transaction, or money transmitting service, or a participant in such network or other participant in a designated payment system.

transactions or designated payment systems from any requirement imposed by the regulations if the Agencies jointly determine that it is not reasonably practical to identify and block, or otherwise prevent or prohibit the acceptance of, such transactions.

Under the Act, a participant in a designated payment system is considered to be in compliance with the regulations if it relies on and complies with the policies and procedures of the designated payment system and such policies and procedures comply with the requirements of the Agencies' regulations. The Act also directs the Agencies to ensure that transactions in connection with any activity excluded from the Act's definition of "unlawful Internet gambling," such as qualifying intrastate transactions, intratribal transactions, or interstate horseracing transactions, are not blocked or otherwise prevented or prohibited by the prescribed regulations.

The regulation being proposed by the Agencies in this notice (i) sets out definitions for terms used in the regulation; (ii) designates payment systems that could be used by participants in connection with, or to facilitate, a restricted transaction; (iii) exempts certain participants in certain designated payment systems from requirements of the regulation; (iv) requires the participants performing non-exempt functions in a designated payment system to establish and implement policies and procedures reasonably designed to prevent or prohibit restricted transactions, such as by identifying and blocking such transactions; (v) provides non-exclusive examples of policies and procedures for non-exempt participants in each designated payment system; and (vi) sets out the regulatory enforcement framework. Comments on all aspects of the proposed regulation are welcome; however, the Agencies are, in particular, seeking comment on the issues noted in the section-by-section analysis below.

The Agencies desire to achieve the purposes of the Act as soon as is practical, while also providing designated payment systems and their participants sufficient time to adapt their policies and practices as needed to comply with the regulation. The Agencies propose that the final regulations take effect six months after the joint final rules are published, and request comment on whether this period is reasonable. Commenters requesting a shorter period should explain why they believe payment system participants would be able to modify their policies and procedures, as required, in the shorter period. Similarly, commenters requesting a longer period should explain why the longer period would be necessary to comply with the regulations, particularly if the need for additional time is based on any system or software changes required to comply with the regulations.

II. Section by Section Analysis

A. Definitions

The proposed regulation provides definitions for terms used in the regulation. Many of the definitions (such as "bet or wager," "financial transaction provider," "Internet," "money transmitting business," "restricted transaction," and "unlawful Internet gambling") follow or refer to the Act's definitions. The proposed rule does not attempt to further define gambling-related terms because the Act itself does not specify which gambling activities are legal or illegal and the Act does not require the Agencies to do so. The Act focuses on payment transactions and relies on prohibitions on gambling contained in other statutes under the jurisdiction of other agencies. Further, application of some of the terms used in the Act may depend significantly on the facts of specific transactions and could vary according to the location of the particular parties to the transaction or based on other factors unique to an individual transaction. The purpose of the proposed regulations is to implement the provisions of the Act that instruct the Agencies to require participants in designated payment systems to establish policies and procedures reasonably designed to identify and block or otherwise prevent or prohibit restricted transactions. For these reasons, and in consultation with the Department of Justice, the Agencies' preliminary view is that issues regarding the scope of gambling-related terms should be resolved by reference to the underlying substantive State and Federal gambling laws and not by a general regulatory definition.

The proposed rule includes definitions for some payment system terms (such as "automated clearing house system," "card system," "check collection system," "check clearing house," "money transmitting business," "money transmitting service," and "wire transfer system") because they relate to the designated payment systems, exemptions, and required policies and procedures. The definitions of most of these payment system terms are based on existing regulatory or statutory definitions, such as the Board's Regulation CC (12 CFR Part 229) or the Uniform Commercial Code (UCC).[5] Terms used in the context of particular payment systems are intended to be consistent with how those terms are used in those systems. The proposed rule incorporates by reference relevant definitions of terms regarding the automated clearing house (ACH) system as published in "2007 ACH Rules: A Complete Guide To Rules & Regulations Governing the ACH Network" (the ACH Rules) by the National Automated Clearing House Association (NACHA). In accordance with the Act, the definitions of "money transmitting business" and "money transmitting service" have the meanings given the terms in the Bank Secrecy

[5] The Uniform Commercial Code is a model commercial law developed by the National Conference of Commissioners on Uniform State Law (NCCUSL) in conjunction with the American Law Institute. NCCUSL is a non-profit organization that promotes the principles of uniformity by drafting and proposing specific statutes in areas of law where uniformity between the States is desirable. No uniform statute is effective until a State legislature adopts it as part of its State law.

Act,[6] determined without regard to any regulations prescribed by the Treasury thereunder.[7]

In addition, the proposed regulation defines the term "participant in a designated payment system" as an operator of a designated payment system, or a financial transaction provider that is a member of, has contracted for services with, or is otherwise participating in, a designated payment system. The proposed regulatory definition clarifies that an end-user customer of a financial transaction provider is not included in the definition of "participant," unless the customer is also a financial transaction provider otherwise participating in the designated payment system on its own behalf.

The Agencies request comment on all of the terms and definitions set out in this section. In particular, the Agencies request comment on any terms used in the proposed regulation that a commenter believes are not sufficiently understood or defined.

B. Designated Payment Systems

Section 3 of the proposed regulation designates the following payment systems as systems used by a financial transaction provider that could be used in connection with, or to facilitate, a restricted transaction: automated clearing house systems; card systems (including credit, debit, and pre-paid cards or stored value products); check collection systems; money transmitting businesses; and wire transfer systems. The broad range of the payment systems designated by the regulation reflects the fact that a restricted transaction may be made through many different payment systems. The designated payment systems are described in more detail below.

1. Automated clearing house system

The ACH system is a funds transfer system, primarily governed by the rules and guidelines published by NACHA, that provides for the clearing and settlement of batched electronic entries for participating financial institutions.[8] ACH transfers can be either credit or debit transfers and can be either recurring or one-time transfers. Recurring ACH transfers typically occur on a set schedule and are pre-authorized by the individual or entity whose account is being credited or debited. Recurring credit transfers include payroll direct deposit payments, while recurring debit transfers include mortgage and other bill payments. One-time ACH transfers are authorized at the time the payment is initiated. One-time credit transfers include bill payments made through the bill payer's bank, while one-time debit transfers include bill payments made through the biller's payment site.

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[6] 31 U.S.C. 5330(d).

[7] The Agencies believe that this cross-reference does not otherwise require the Act and the Bank Secrecy Act to be interpreted in light of each other.

[8] A primer on the ACH network is provided in the ACH Rules.

The designation of the originating and receiving institution in ACH terminology is based on the participants that initiate and receive the ACH entries, rather than the direction of the flow of funds. The originator of an ACH transfer generally sends the payment instruction to its bank, the originating depository financial institution (ODFI), so that the payment instruction can be entered into the ACH system. The ODFI combines the payment instructions with payment instructions from its other customers and sends them to an ACH operator for processing. The ACH operator will then sort and deliver the payments to the appropriate receiving depository financial institutions (RDFIs) and complete the interbank settlement process. The RDFIs then post the payments, either credits or debits, to the receivers' accounts. The fundamental difference between the ACH credit and debit transfers is that for ACH credit transfers funds are "pushed" to an account at the institution receiving the message, while in ACH debit transfers funds are "pulled" from an account at the institution receiving the message. In other words, for credit transfers, the originator is requesting that funds be credited to the receiver (the funds move in the same direction as the payment instruction), while for debit transfers, the originator is requesting that funds be debited from the receiver (the funds move in the opposite direction from the payment instruction).

In some instances, a "third-party sender" acts as an intermediary between an originator and an ODFI with respect to the initiation of ACH transactions where there is no contractual agreement between the originator and the ODFI. Under the ACH Rules, a third-party sender assumes the responsibilities of an originator and is obligated to provide the ODFI with any information the ODFI reasonably deems necessary to identify each originator for which the third-party sender transmits entries. The use of third-party senders in ACH transactions poses particular risks because the ODFI does not have a direct relationship with the originators.

The ACH Rules also include particular provisions governing cross-border ACH payments made in cooperation with another country's national payment system. Under the ACH Rules, the U.S. segment of a cross-border ACH transaction is settled separately between the U.S. participants and the U.S. gateway operator. The interface between the two national payment systems is commonly accomplished through an "originating gateway operator" in the originator's country and a "receiving gateway operator" in the receiver's country. Both the originating and receiving gateway operators are participants in their respective national payment systems and capable of clearing and settling payments in their respective systems. In the United States, the gateway operator can be an ODFI (for "inbound" transactions), an RDFI (for "outbound" transactions), or, with the appropriate agreements in place, an ACH operator. Additionally, a third-party sender may have proprietary arrangements with a foreign counterparty and accept instructions to submit cross-border ACH entries to the appropriate ACH operator or ODFI.

In the case of inbound transactions, the "originating gateway operator" in the country of the originator receives the entry from its national payments network and then transmits the entry to a receiving gateway operator in the receiving country. The receiving gateway operator then transmits the entry into its national payments system for delivery to the intended RDFI. If a U.S. ODFI acts as a receiving gateway operator, it

would be the first U.S. institution involved in the transaction and would submit the transaction to its U.S. ACH operator for further processing. Under the ACH Rules, a U.S. receiving gateway operator for a particular cross-border transaction must make warranties expected of an ODFI for that transaction and assumes liability for breaches of those warranties to every RDFI and ACH operator, so in effect it becomes the ODFI for the U.S. segment of the transaction.[9] Similarly, a U.S. depository financial institution or third-party sender receiving instructions to originate cross-border ACH entries directly from a foreign counterparty would be the first U.S. participant involved in the transaction and would originate the ACH entry in the U.S. ACH system.

2. Card systems

Card systems are systems for clearing and settling transactions in which credit cards, debit cards, pre-paid cards, or stored value products are used to purchase goods or services or to obtain a cash advance. In a typical card system transaction, there are three components to the transaction: authorization, clearance, and settlement.

The transaction begins when the payor provides his card or card number to the payee, either in person or through the Internet or telephone. The payee uses that information to create a card payment authorization request, which it sends to its bank (the "merchant acquirer") or the bank's agent. The merchant acquirer sends an authorization request through the card system network to the bank that issued the payor's card (the "card issuer") or its agent.[10] The authorization request includes, amongst other information, the card number, the transaction amount, a merchant category code, and a transaction code. The merchant category code describes generally the nature of the payee's business and the transaction code describes whether the card was present at the point of transaction (i.e., a point-of-sale transaction) or not present (i.e., a transaction over the Internet or telephone). The card issuer or its agent either authorizes or declines the transaction and the payee is immediately notified of the decision through the card network. If authorization is granted, then the payee completes the underlying transaction with the payor; otherwise, the transaction is cancelled.

After the transactions have been authorized, they must then be cleared. The clearing process for personal identification number (PIN)-based debit card transactions is different from the process for credit card and signature-based debit card transactions. For PIN-based debit card transactions, the authorization and clearing occur at the same time and thus a separate clearing transmission by the payee to the merchant acquirer is not necessary. For credit cards and signature-based debit cards, the payee batches its authorized transactions and transmits them, typically at the end of the business day, to the merchant acquirer to be cleared through the card network. Depending on the card type,

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[9] See ACH Rules, Operating Rules §§ 11.6 and 11.7.

[10] This discussion generally relates to the card processing model of Visa and MasterCard, in which the merchant acquirer, the card network, and the card issuer are separate entities. Other card companies, such as American Express, may employ a model in which one company owns the card processing network and performs all major functions involved in issuing cards and acquiring merchants to accept its cards.

card issuer banks memo-post or charge transactions to their customers' accounts when the transactions are either authorized or cleared. Once the transactions have been cleared, they are settled at a time specified by the card network and the merchant acquirer and the card issuer are, respectively, credited and debited.

3. Check collection systems

A check collection system is an interbank system for collecting, presenting, returning, and settling checks or an intrabank system for settling checks deposited and drawn on the same bank (i.e., "on-us checks"). A typical check transaction is initiated by the payor writing a check to the order of a payee and giving the signed check to the payee as payment. The payee deposits the check with its bank (the bank of first deposit or the "depositary bank"). Except for on-us checks, the depositary bank will then send the check to the bank on which it is drawn (the "paying bank") for payment.

The depositary bank may present the check for payment directly to the paying bank, may use a check clearing house, or may use the services of an intermediary bank, such as a Federal Reserve Bank or another correspondent bank (a "collecting bank").[11] These intermediaries handle large volumes of checks daily and typically rely on three pieces of information: the routing number of the bank from which it received the check; the routing number of the bank to which the check is destined (i.e. the paying bank); and the amount of the check. Upon presentment, the paying bank settles with the presenting bank for the amount of the check and debits the amount of the check from the account of the payor.

Checks may be cleared cross-border through correspondent banking relationships. If a U.S. payor writes a check to the order of an offshore payee, the payee will likely deposit the check in its home country bank. The home country bank may have a correspondent relationship with a U.S. bank for check collection and deposit the check with its U.S. correspondent bank. The U.S. bank will then collect the check through the U.S. check collection system. The first banking office located in the United States that receives a check from outside the United States for forward collection inside the United States is defined as the depositary bank for that check.[12] Accordingly, if a foreign office of a U.S. or foreign bank sends checks to its U.S. correspondent for forward collection, the U.S. correspondent is the depositary bank for those checks.

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[11] Check clearing houses generally provide a facility or mechanism for banks to exchange checks for collection and return. The services provided by check clearing houses vary. Some merely provide space for banks to exchange checks. Others provide the capability to exchange between banks in electronic form. A check clearing house generally also facilitates settlement of the checks exchanged through it. Check clearing houses are not considered collecting or returning banks.

[12] 12 CFR 229.2(o) commentary. Foreign offices of U.S. and foreign banks are not included in Regulation CC's definition of "bank." 12 CFR 229.2(e) commentary.

4. Money transmitting businesses

A money transmitting business is a person (other than a depository institution) that engages as a business in the transmission of funds, including any person that engages as a business in an informal money transfer system or any network of people that engage as a business in facilitating the transfer of money domestically or internationally outside of the conventional financial institutions system. Money transmitters commonly will facilitate money transmissions through agent locations, by phone, or through an Internet website and can be used for payments to some businesses as well as money transfers to individuals. This term includes networks such as Western Union and MoneyGram, on-line payment systems such as PayPal, and other electronic systems that engage in the business of transmitting funds.

Money transmitting businesses use various operational models. In networks with operations similar to Western Union and MoneyGram, the payor initiates the transaction in person at the money transmitting business's location, by phone, or through the money transmitting business's Internet site and generally can use cash, a credit card, or a debit card to fund a transfer. The money transmitter obtains identification from the payor, as well as identifying information for the intended payee and the location to which the payment should be sent. The money transmitter may provide the payor with a reference number that the payee will need in order to pick up the payment. Large money transmitters, such as Western Union or, MoneyGram, typically transmit the payment instructions through an internal proprietary system. The payor or the money transmitter notifies the payee of the availability of the payment. The payee goes to one of the money transmitting business's physical locations, provides the necessary information (such as personal identification and perhaps the transaction reference number), and receives the funds. Alternatively, some money transmitting businesses will transfer money directly into a payee's bank account in certain circumstances, such as when the recipient is a business that has been approved to receive funds through the money transmitting business (a "commercial subscriber"). Settlement between the sending and receiving accounts or locations is effected based on rules established by the money transmitting business.

Other money transmitters may follow the PayPal-type operational model and provide Internet electronic payment services to facilitate purchases over the Internet, either from vendors or through auctions. In such a model, a consumer establishes an account with the money transmitting business and uses a debit card, credit card, or ACH transfer to fund the account. In order to fund a purchase from a vendor with an account with the same money transmitting business, the consumer instructs the money transmitting business to transfer the funds to the vendor, identifying the vendor by e-mail address. The money transmitting business sends an e-mail notification to the vendor and transfers the funds from the consumer's account to the vendor's account. The vendor may keep the funds in its account with the money transmitting business (and subsequently use them to effect payments through the system) or may transfer the funds from its account to its bank account, such as through an ACH credit transaction.

Other money transmitting businesses may use operational models different than those set out above. The Agencies intend to apply the term "money transmitting business" to cover businesses that meet the definition of the term as used in the Act, regardless of operational model.

5. Wire transfer systems

A wire transfer system is a system through which the sender of a payment transmits an unconditional order to a bank to pay a fixed or determinable amount of money to a beneficiary upon receipt (or on a day stated in the order) by electronic or other means through a network, between banks, or on the books of a bank. Wire transfer systems are generally designed for large-value transfers between financial institutions, but financial institutions also send lower-value, consumer-initiated payment orders through wire transfer systems.

In a typical consumer-initiated wire transfer transaction, the consumer would initiate the transfer after obtaining wire transfer instructions from the intended beneficiary (such as the bank to which the beneficiary would like the funds transferred and the beneficiary's account number at the bank). The consumer provides that information in the payment order to its bank (the "originator's bank") to initiate the wire transfer. The originator's bank may transfer the payment directly to the beneficiary's bank if the banks have an account relationship.

Alternatively, the originator's bank may use the services of a wire transfer network, such as the Federal Reserve Banks' Fedwire system or The Clearing House's CHIPS system, to send the transfer either to the beneficiary's bank or to an intermediary bank that has an account relationship with the beneficiary's bank. In an automated wire transfer system such as Fedwire or CHIPS, typically the information used in processing the payment order is the routing information of the sending bank, the routing information of the receiving bank, and the amount of the wire transfer. Although additional information may be, and in some cases is required to be, included in fields of the payment order message format (such as the names of the originator and the beneficiary, their account numbers, and addresses), this information is not relied upon by the intermediary bank to process the transfer.

Wire transfer transaction proceeds may be sent cross-border through correspondent banking relationships. The last U.S. bank in the outgoing transaction may either have a correspondent banking relationship with the beneficiary's foreign bank or a foreign intermediary bank for further delivery to the beneficiary's bank. Alternatively, the U.S. bank may have a branch in the home country of the beneficiary and can make an "on-us" transfer to the branch for further processing through the beneficiary's home country national payment system.

6. Other payment systems

The Agencies request comment on whether the list of designated payment systems in the proposed regulation is too broad or too narrow. In particular, the Agencies request comment on whether there are non-traditional or emerging payment systems not represented in the proposed regulation that could be used in connection with, or to facilitate, any restricted transaction. If a commenter believes that such a payment system should be designated in the final rule, the commenter should describe policies and procedures that might be reasonably designed to identify and block, or otherwise prevent or prohibit, restricted transactions through that system.

C. Exemptions

The Act directs the Agencies to exempt certain restricted transactions or designated payment systems from any requirements imposed under the regulations if the Agencies find that it is not reasonably practical to identify and block, or otherwise prevent or prohibit the acceptance of, such transactions. Section 4 of the proposed rule provides such an exemption for certain participants in ACH systems, check collection systems, and wire transfer systems. The proposed regulation is structured to impose requirements on participants in designated payments systems with respect to the segments of particular transactions that those participants handle. Therefore, rather than exempting entire categories of restricted transactions or entire payment systems, the Agencies have structured the exemptions to apply to particular participants in particular payment systems as described in greater detail below. The Agencies believe that this limited application of their exemption authority better serves the Act's purposes of preventing the processing of restricted transactions.

The Agencies are proposing to exempt all participants in the ACH systems, check collection systems, and wire transfer systems, except for the participant that possesses the customer relationship with the Internet gambling business (and certain participants that receive certain cross-border transactions from, or send certain such transactions to, foreign payment service providers, as discussed further below). The exemptions for these participants reflect the fact that these systems currently do not enable the exempted participants to reasonably identify and block, or otherwise prevent or prohibit, restricted transactions under the Act. While other systems, such as the card systems, have developed merchant category and transaction codes that identify the business line of the payee (e.g., the gambling business) and how the transfer was initiated (such as via the Internet), so that the systems are able to identify and block certain types of payments in real time, the ACH systems, check collection systems, and wire transfer systems do not use such codes. Moreover, as a general matter, a consumer can make payment by check, ACH, or wire transfer to any business with an account at a depository institution. This is in contrast to card systems and money transmitting businesses, in which consumers can make direct payments only to those businesses that have explicitly agreed to participate in those payment systems. As a result, the preliminary view of the Agencies is that it is not reasonably practical for the exempted participants in ACH systems, check collection systems, and wire transfer systems discussed below to identify and block, or otherwise

prevent or prohibit, restricted transactions under the Act. The Agencies intend to monitor technological developments in these payment systems and will consider amending the exemptions if, in the future, the technology prevalent in these payment systems permits such participants to identify and block, or otherwise prevent and prohibit, those restricted transactions.

No designated payment system is completely exempted by the proposed rule. The Agencies intend that the participant with the customer relationship with the Internet gambling business would have the responsibility in the ACH systems, check collection systems, or wire transfer systems to prevent or prohibit restricted transactions from being credited to the account of the gambling business through that particular payment system. The Agencies request comment on all aspects of the exemptions, but in particular, whether the exemptions for certain participants in the ACH systems, check collection systems, and wire transfer systems discussed in more detail below are appropriate. Commenters that believe that these participants should not be exempted from the requirements of the regulation should provide specific examples of policies and procedures that such participants could establish and implement that would be reasonably designed to identify and block, or otherwise prevent or prohibit, restricted transactions.

1. ACH systems

With regard to an ACH system, the proposal provides an exemption from the regulation's requirements for the ACH system operator, the originating depository financial institution (ODFI) in an ACH credit transaction, and the receiving depository financial institution (RDFI) in an ACH debit transaction (except with respect to certain cross-border transactions discussed below). The proposal does not exempt the institution serving as the ODFI in an ACH debit transaction or the RDFI in an ACH credit transaction because these institutions typically have a pre-existing relationship with the customer receiving the proceeds of the ACH transaction and could, with reasonable due diligence, take steps to ascertain the nature of the customer's business and ensure that the customer relationship is not used to receive restricted transactions.

The proposal would provide an exemption for the ACH system operator because it is not reasonably practical for the operator to identify and block a particular ACH transfer as a restricted transaction. The ACH system operator's function is to act as the central clearing facility for ACH entries. The ACH operator sorts the entries by RDFI routing information and transmits the payment information to the appropriate RDFI for posting. The ACH system operator would not have any direct interaction with either the gambler or the Internet gambling business and would not be in a position to obtain the necessary information to analyze individual transactions to determine whether they are restricted transactions. In addition, ACH operators use highly-automated systems to sort large volumes of ACH entries without manual intervention. A requirement to analyze each ACH entry manually to determine whether it is a restricted transaction would substantially increase processing times for all ACH entries, including entries that are not restricted transactions, and reduce the efficiency of the ACH system. Moreover, even if

the payee information on an ACH entry is analyzed manually, it is very difficult for an ACH operator to determine whether the ACH entry is related to a restricted transaction.

The proposal also would provide an exemption for the RDFI in an ACH debit transaction. In this case, the exempted participant would not have any direct interaction with its customer prior to processing the transaction. In a restricted transaction using an ACH debit transaction, a gambler could authorize the unlawful Internet gambling business to debit his account for the restricted transaction and the RDFI would not have an opportunity to obtain information from its customer (the gambler in this case) to determine whether the entry was in connection with a restricted transaction. Also, as discussed below, information obtained from the customer may be of limited value.

In addition, the proposal would provide an exemption for the ODFI in an ACH credit transaction. The Agencies carefully considered whether such an exemption would be warranted. Typically, a consumer would initiate an ACH credit transaction on-line with the ODFI, so there could be an opportunity for the ODFI to design a procedure to obtain information on an outgoing ACH credit transaction to determine whether it is a restricted transaction. For example, for each ACH credit transaction, the ODFI could require the originator to submit a statement that the ACH credit transaction is not a restricted transaction and/or a description of the nature and purpose of the transaction.

The Agencies' preliminary view, however, is that, while it may be possible at least in some cases for an ODFI in an ACH credit transaction to obtain information from the originator regarding whether the ACH credit transaction is a restricted transaction under the Act, any associated benefits would likely be outweighed by the associated costs that would be borne by ODFIs. Specifically, any process requiring the customer to describe the nature of the transaction and/or state that the transaction does not involve unlawful Internet gambling may be of limited value, either because a customer may knowingly mischaracterize the actual nature of the transaction in order to avoid the transaction being rejected or blocked, or because the customer may not actually know whether an Internet gambling transaction is a restricted transaction under the Act. The Agencies also believe that the ODFI would generally be unable to determine whether the originator's characterization of the transaction is accurate. Moreover, the burden on ODFIs in developing the necessary systems to obtain the information and determine whether to reject or block a transaction would likely be substantial.

The Agencies specifically request comment on whether it is reasonably practical to implement policies and procedures (including, but not limited to, those discussed above) for an ODFI in an ACH credit transaction, whether such policies and procedures would likely be effective in identifying and blocking restricted transactions, and whether the burden imposed by such policies and procedures on an originator and an ODFI would outweigh any value provided in preventing restricted transactions and a description of such burdens and benefits. If a commenter believes that an ODFI in an ACH credit transaction should not be exempted, the Agencies request that the commenter provide examples of policies and procedures reasonably designed for an ODFI in an ACH credit

transaction to identify and block or otherwise prevent or prohibit restricted transactions in the ACH system.

2. Check collection systems

With regard to check collection systems, the proposed rule would provide an exemption from the regulation's requirements for a check clearing house, the paying bank (unless it is also the depositary bank), any collecting bank (other than the depositary bank), and any returning bank. The proposal does not exempt the institution serving as the depositary bank (i.e., the first U.S. institution to which a check is transferred, in this case the institution receiving the check deposit from the gambling business) in a check transaction. The depositary bank is typically in a position, through reasonable due diligence, to take steps to ascertain the nature of the customer's business and ensure that the customer relationship is not used for receiving restricted transactions.

The proposed rule would provide an exemption for the check clearing house because the check clearing house generally does not have a direct relationship with either the payor or the payee and would not be in a position to obtain information from either party regarding the transaction that would permit the check clearing house to determine whether a particular check was a restricted transaction.

For similar reasons, the proposal would provide an exemption for a collecting bank (other than the depositary bank) and a returning bank in a check collection transaction. Collecting banks (other than the depositary bank) and returning banks are intermediary banks that generally do not have a direct relationship with either the payor or the payee in the check transaction and would not be in a position to obtain information from either party that would permit them to determine whether a particular check was a restricted transaction.

The proposal would also provide an exemption for the paying bank (unless the paying bank is also the depositary bank). The paying bank is generally the bank by or through which a check is payable and to which the check is sent for payment or collection. In a restricted transaction, this would generally be the bank holding the gambler's checking account. While the paying bank would have a direct relationship with the payor, it would not be in a position to obtain information from the payor prior to the transaction being settled. Checks are processed and paid by a paying bank's automated systems according to the information contained in the magnetic ink character recognition (MICR) line printed near the bottom of the check. The MICR line commonly includes the bank's routing number, the customer's account number, the check number, and the check amount, but does not contain any information regarding the payee. A requirement to analyze manually each check with respect to the payee would substantially increase processing times for all checks, including checks that are not restricted transactions, and reduce the efficiency of the check collection systems. Moreover, even if the payee information on checks is analyzed manually, it is very difficult for a paying bank to determine whether the check is related to a restricted

transaction. If the paying bank is also the depositary bank (i.e., an "on-us" transaction), the institution would still be required to comply with the regulations as a depositary bank.

3. Wire transfer systems

With regard to wire transfer systems, the proposal provides an exemption from the regulation's requirements for the originator's bank (i.e., the depository institution sending the wire transfer on behalf of the gambler) and intermediary banks (other than the bank that sends the transfers to a foreign respondent bank as discussed below). The proposal does not exempt the institution serving as the beneficiary's bank (i.e., the institution receiving the wire transfer on behalf of the gambling business) in a particular wire transfer system. The beneficiary's bank typically has a pre-existing relationship with the customer receiving a particular wire transfer and, accordingly, is in a position, through reasonable due diligence, to take steps to ascertain the nature of the customer's business and assess the risk that the customer may be involved in restricted transactions.

The proposal would provide an exemption for intermediary banks because it is not reasonably practical for institutions serving in this capacity in a wire transfer system to identify and block a particular wire transfer as a restricted transaction under the Act. The information normally relied upon by intermediary banks' automated systems in processing a wire transfer does not typically include information that would enable those systems to identify and block individual transfers as restricted transactions under the Act. In addition, intermediary banks process tremendous volumes of wire transfers in seconds or less on an automated basis, without manual intervention. A requirement to analyze each transaction manually to determine whether it is a restricted transaction would substantially increase processing times for all wire transfers, including transfers that are not restricted transactions, and reduce the efficiency of the wire transfer systems. Moreover, even if the beneficiary information in a wire transfer payment message is analyzed manually, it is very difficult for an intermediary bank to determine whether the wire transfer is related to a restricted transaction.

The Agencies also carefully considered whether to grant an exemption for portions of a wire transfer system involving the originator's bank. Similar to an ODFI in an ACH credit transaction, the originating customer in a particular wire transfer generally has some direct interaction with the originating institution, so there could be an opportunity for the originating institution to design a procedure to review an outgoing wire transfer to determine whether it is a restricted transaction. For example, for each wire transfer (or for each transfer originated by a consumer), the originator's bank could require the originator to submit a statement that the wire transfer is not a restricted transaction and a description of the nature and purpose of the transaction. This two-part submission could be made in writing for in-person originations, orally for phone originations, or on-line for automated originations. For the casual or impulse gambler, requiring such a statement may cause the gambler to consider carefully (or to investigate) whether the payment is legal and even whether engaging in gambling is prudent in light of the gambler's personal circumstances.

The Agencies' preliminary view is that, while it may be possible, at least in some cases, for an originating bank to obtain such a submission from the originator, any associated benefits would likely be outweighed by the associated costs for reasons similar to those described above regarding the exemption for ODFIs in ACH credit transactions.

The Agencies specifically request comment on whether it is reasonably practical for an originator's bank and an intermediary bank in a wire transfer system to implement policies and procedures (including, but not limited to, those discussed above) that would likely be effective in identifying and blocking or otherwise prevent or prohibit restricted transactions; whether the burden imposed by such policies and procedures on an intermediary bank, an originator, and an originator's bank would outweigh any value provided in preventing restricted transactions and a description of such burdens and benefits; and whether any policies and procedures could reasonably be limited only to consumer-initiated wire transfers and, if so, a description of any costs or benefits of so limiting the requirement. If a commenter believes that the originator's bank or an intermediary bank should not be exempted, the Agencies request that the commenter provide examples of policies and procedures reasonably designed for institutions serving in those functions to identify and block or otherwise prevent or prohibit restricted transactions in a wire transfer system.

D. Processing of Restricted Transactions Prohibited

Section 5 of the proposed regulations expressly requires all non-exempt participants in the designated payment systems to establish and implement policies and procedures in order to identify and block, or otherwise prevent or prohibit, restricted transactions. In accordance with the Act, section 5 states that a participant in a designated payment system shall be considered in compliance with this requirement if the designated payment system of which it is a participant has established policies and procedures to prevent or prohibit restricted transactions and the participant relies on, and complies with, the policies and procedures of the designated payment system. In other words, the Act and the proposed rule permit non-exempt participants in a designated payment system to either (i) establish their own policies and procedures to prevent or prohibit restricted transactions; or (ii) rely on and comply with the policies and procedures established by the designated payment system, so long as such policies and procedures comply with the regulation.

Section 5 also imports the Act's liability provisions, which state that a person that identifies and blocks, prevents, prohibits, or otherwise fails to honor a transaction is not liable to any party for such action if (i) the transaction is a restricted transaction; (ii) such person reasonably believes the transaction to be a restricted transaction; or (iii) the person is a participant in a designated payment system and prevented the transaction in reliance on the policies and procedures of the designated payment system in an effort to comply with the regulation.

Finally, section 5 implements the Act's requirement that the Agencies ensure that transactions in connection with any activity excluded from the Act's definition of

unlawful Internet gambling are not blocked or otherwise prevented or prohibited by the regulations (the "overblocking" provision). Section 5 makes clear that nothing in the regulation requires or is intended to suggest that non-exempt participants should block or otherwise prevent or prohibit any transaction in connection with any activity that is excluded from the definition of "unlawful Internet gambling" in the Act, such as qualifying intrastate or intratribal transactions, or a transaction in connection with any activity that is allowed under the Interstate Horseracing Act of 1978 (15 U.S.C. 3001 et seq.).[13] As noted above, it also seems clear that the Act was not intended to change the legality of any gambling-related activity in the United States.[14] Consequently, the proposed regulations neither require nor are intended to suggest that participants in designated payment systems should establish policies and procedures to prevent any Internet gambling transactions that are legal under applicable Federal and State law.

Some payment system operators have indicated that, for business reasons, they have decided to avoid processing any gambling transactions, even if lawful, because, among other things, they believe that these transactions are not sufficiently profitable to warrant the higher risk they believe these transactions pose.[15] The Agencies believe that the Act does not provide the Agencies with the authority to require designated payment systems or participants in these systems to process any gambling transactions, including those transactions excluded from the Act's definition of unlawful Internet gambling, if a system or participant decides for business reasons not to process such transactions. The Agencies request comment on the proposed approach to implementing the Act's overblocking provision.

E. Reasonably Designed Policies and Procedures

Section 6 of the proposed regulations sets out for each designated payment system examples of policies and procedures the Agencies believe are reasonably designed to prevent or prohibit restricted transactions for non-exempt participants in the system. Generally, under the proposed rule, non-exempt participants in each designated payment system should have policies and procedures that (i) address methods for conducting due diligence in establishing and maintaining a commercial customer relationship designed to ensure that the commercial customer does not originate or receive restricted transactions through the customer relationship; and (ii) include procedures reasonably designed to prevent or prohibit restricted transactions, including procedures to be followed with respect to a customer if the participant discovers the customer has been engaging in restricted transactions through its customer relationship. These procedures are discussed in more detail below.

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[13] See the discussion of the interplay between the Interstate Horseracing Act and federal gambling statutes contained in Footnote 1.

[14] 31 U.S.C. 5361(b).

[15] Designated payment system representatives have informally indicated to the Agencies that many participants in their systems prefer not to process gambling-related transactions because they have experienced higher-than-usual losses due, for example, to assertions that gambling transactions were "unauthorized."

1. Due diligence

The Agencies would expect non-exempt participants' policies and procedures addressing due diligence to be consistent with their regular account-opening practices. The Agencies anticipate that participants would use a flexible, risk-based approach in their due diligence procedures in that the level of due diligence performed would match the level of risk posed by the customer. The due diligence is intended to apply to a participant when the participant is directly establishing or maintaining a customer relationship, but not with respect to entities with which the participant does not have a direct relationship. For example, if a card network operator does not act as the merchant acquirer in the network, the operator would not be expected to conduct due diligence on the merchant customers. This function should be performed by the member institutions of the network that are acting as merchant acquirers. However, if a card network operator also acted as the merchant acquirer, it should conduct the appropriate due diligence on its merchants in establishing or maintaining the customer relationship. The Agencies expect that the most efficient way for participants to implement the due diligence procedures in the proposed rule would be to incorporate them into existing account-opening due diligence procedures (such as those required of depository institutions under Federal banking agencies' anti-money laundering compliance program requirements).[16]

The due diligence requirements for a participant establishing a customer relationship in an ACH system also apply to the establishment of a relationship with any third-party sender. Before establishing a relationship with a third-party sender, a participant should conduct appropriate due diligence with respect to the third-party sender. A third-party sender should conduct due diligence on its customers to ensure that it is not transmitting restricted transactions through an ODFI, and the ODFI should confirm that the third-party sender conducts such due diligence on its originators. In maintaining the customer relationship with the third-party sender, the participant should ensure that there is a process to monitor the operations of the third-party sender, such as by audit.

The Agencies request comment as to the appropriateness of participants incorporating into their existing account-opening procedures the due diligence provisions of the proposed rule. The Agencies also request comment on whether, and to what extent, the proposed rule's examples of due diligence methods should explicitly include periodic confirmation by the participants of the nature of their customers' business.

2. Remedial action

The Agencies also would expect a non-exempt participant to have policies and procedures to be followed if the participant becomes aware that one of its customer relationships was being used to process restricted transactions. These policies and procedures could include a broad range of remedial options, such as imposing fines, restricting the customer's access to the designated payment system or the participant's facilities, and terminating the customer relationship by closing the account. In addition,

[16] See, e.g., 12 CFR 208.63.

as provided in section 5(e) of the proposed rule, nothing in the proposed rule modifies any existing legal requirement relating to the filing of suspicious activity reports with the appropriate authorities. The Agencies request comment on the appropriateness of the proposed rule's examples of a participant's procedures upon determining that a customer is engaging in restricted transactions through the customer relationship, and whether any additional such procedures should be included as examples.

A participant also would be expected to take appropriate remedial action with respect to a business engaged in unlawful Internet gambling with which it does not have a customer relationship if the participant becomes aware that the gambling business is using the participant's trademark on its website to promote restricted transactions. For example, the participant could consider taking legal action to prevent the unauthorized use of its trademark by an unlawful Internet gambling business.

3. Monitoring

The policies and procedures of non-exempt participants in card systems and money-transmitting businesses are expected to address ongoing monitoring or testing to detect possible restricted transactions. Examples of such monitoring or testing include (1) monitoring and analyzing payment patterns to detect suspicious patterns of payments to a recipient, and (2) monitoring of web sites to detect unauthorized use of the relevant designated payment system, including unauthorized use of the relevant designated payment system's trademarks. Unlawful Internet gambling businesses may be able to access a designated payment system (such as a money transmitting business) that would otherwise deny them a commercial subscriber account, by using individuals as agents to receive restricted transactions and may advertise the use of these systems on their website. Certain money transmitting businesses have developed monitoring procedures to detect suspicious payment volumes to an individual recipient in order to address this risk.[17] In addition, certain money transmitting businesses subscribe to a service that will search the Internet for unauthorized use of the money transmitting business's trademark.

The proposed rule does not include ongoing monitoring and testing within the examples of the policies and procedures for ACH systems, check collection systems, and wire transfer systems because these systems currently do not have the same level of functionality for analyzing patterns of specific payments being processed through the system. Moreover, as mentioned above, these three systems are open, universal systems that do not require businesses to explicitly sign up in order to receive payments through them. The Agencies request comment on whether ongoing monitoring and testing should be included within the examples for the ACH, check collection, and wire transfer systems, and, if so, how such functionality could reasonably be incorporated into those systems. As a general matter, the Agencies will continue to monitor technological developments in all payment systems, and, as those developments warrant, will engage in

[17] As provided in the Act and the proposed rule, participants that are part of a money transmitting network may be able to rely on the network's procedures in this regard if the participants determine that the network's procedures comply with the requirements of the regulation as applied to the participant.

future rulemakings to address emerging means of identifying and blocking or otherwise preventing or prohibiting restricted transactions in the designated payment systems.

4. Coding

The policies and procedures of participants in a card system are expected to address methods for identifying and blocking restricted transactions as they are processed, such as by establishing one or more transaction codes and merchant/business category codes that are required to accompany the authorization request from the merchant for a transaction and creating the operational functionality to enable the card system or the card issuer to identify and deny authorization for a restricted transaction. Card systems may be able to develop one or more merchant category codes for gambling transactions that are not restricted transactions under the Act. For example, in certain cases it may be reasonably practical for card systems to develop merchant category codes for particular types of lawful Internet gambling transactions. The Agencies specifically seek comment on the practicality, effectiveness, and cost of developing such additional merchant codes.

The proposed rule does not include specific methods for identifying and blocking restricted transactions as they are being processed within the examples of procedures for any designated payment system other than card systems because the Agencies believe that only the card systems have the necessary capabilities and processes in place. The Agencies request comment on whether the procedural examples for the other designated payment systems should encompass identifying and blocking restricted transactions as they are being processed, and, if so, how such functionality could reasonably be incorporated into the systems. Again, the Agencies will monitor technological developments in all payment systems, and engage in future rulemakings as warranted to address emerging means of identifying and blocking or otherwise preventing or prohibiting restricted transactions in the designated payment systems.

5. Cross-border relationships

Based on the Agencies' research and statements by industry representatives, the Agencies believe that most unlawful Internet gambling businesses do not have direct account relationships with U.S. financial institutions. In most cases, their accounts are held at offshore locations of foreign institutions that are not subject to the Act, and restricted transactions enter the U.S. payment system through those foreign institutions. In two of the designated payment systems (card systems and money transmitting businesses), the proposed rule does not provide exemptions for any participants and the proposed rule's requirements would apply to all U.S. participants in both domestic and cross-border transactions. In the case of ACH, check collection, and wire transfer systems, exemptions are provided for certain participants and examples of special policies and procedures for cross-border transactions are provided.

In general, in the case of U.S.-only transactions, for the ACH, check collection, and wire transfer systems, the proposed rule would require the participant in a particular

payment system that has the direct relationship with the gambling business to have policies and procedures to prevent or prohibit restricted transactions through these systems. The other participants in each of these systems would otherwise be exempt from the requirements of the regulation. In the case of payment transactions for the benefit of offshore gambling businesses, none of the participants in the United States that process the transaction would have a direct relationship with the gambling business that receives the payment and would, under the general regulatory requirements, be exempt and not required to have policies and procedures to prevent or prohibit restricted transactions.

In the case of incoming cross-border ACH debit and check collection transactions, the proposed rule places responsibility on the first participant in the United States that receives the incoming transaction directly from a foreign institution (i.e., an ACH debit transaction from a foreign gateway operator, foreign bank, or a foreign third-party processor or a check for collection directly from a foreign bank) to take reasonable steps to ensure that their cross-border relationship is not used to facilitate restricted transactions.[18] Participants in such arrangements should take steps to prevent their foreign counterparty from sending restricted transactions through the participant, such as including as a term of its contractual agreement with the foreign institution a requirement that the foreign institution have policies and procedures in place to avoid sending restricted transactions to the U.S. participant. In addition, the U.S. participant's policies and procedures would be deemed compliant with the regulation if they also include procedures to be followed with respect to a foreign bank or foreign third-party processor that is found to have transmitted restricted transactions to, or received restricted transactions through, the participant. These policies and procedures might address (i) when access through the cross-border relationship should be denied and (ii) the circumstances under which the cross-border relationship should be terminated.

In the case of outgoing wire transfers and ACH credit transactions, a transfer by a U.S. gambler to a foreign Internet gambling business would be initiated in the United States and be sent or credited to an account at the gambling business's foreign bank. In this case, the originator's bank or the intermediary bank in the U.S. that sends the wire transfer transaction, or the gateway operator that sends the ACH credit entry, directly to a foreign bank should have policies and procedures in place to be followed if such transfers to a particular foreign bank are subsequently determined to be restricted transactions.[19]

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[18] In an incoming cross-border ACH debit transaction, if the first participant in the United States is an ACH operator (not an ODFI), the proposed rule makes clear that, while serving in the capacity of a receiving gateway operator, the ACH operator is not exempt from the general requirement to have policies and procedures reasonably designed to identify and block, or otherwise prevent or prohibit, restricted transactions.

[19] The proposed rule makes clear that the originator's bank or the intermediary bank in the United States that directly sends a cross-border wire transfer to a foreign bank, while acting in that capacity, is not exempt from the general requirement to have policies and procedures reasonably designed to identify and block or otherwise prevent or prohibit restricted transactions. Similarly, in an outgoing cross-border ACH credit transaction, the ACH operator in the United States, acting as the originating gateway operator, that directly sends the transaction to a foreign gateway operator is not exempt from the general policies and procedures requirement while acting in that capacity.

For example, some Internet gambling businesses indicate on their websites the U.S. correspondent bank through which wire transfers to them must be made. In such cases, the U.S. participant should consider whether wire transfer services or the correspondent arrangement should continue.

The Agencies recognize that the issue of the extent of a bank's responsibility to have knowledge of its respondent banks' customers is a difficult one, which also arises in the context of managing money laundering and other risks that may be associated with correspondent banking operations. The Agencies specifically request comment on the likely effectiveness and burden of the proposed rule's due diligence and remedial action provisions for cross-border arrangements, and whether alternative approaches would increase effectiveness with the same or less burden.

6. List of unlawful Internet gambling businesses

The Act does not mention the creation of a list of unlawful Internet gambling businesses. However, the Agencies are aware that there is some interest in exploring this idea. The Agencies considered including in the proposed rule's examples of reasonably designed policies and procedures, examination of a list that would be established by the U.S. Government of businesses known to be engaged in the business of unlawful Internet gambling. Some have suggested that the obligation of financial institutions with respect to such a list might be similar in effect to their obligations under certain other U.S. laws, such as those administered by the Office of Foreign Assets Control (OFAC), albeit in a different context.[20] Some have also suggested that the list could be either available publicly in its entirety, so that financial transaction providers could check transactions against the list themselves, or maintained confidentially at a central location, so that financial transaction providers could submit transactions to the entity operating the central database, which would inform the financial transaction providers whether the transaction involved an unlawful Internet gambling business on its list. Proponents of the list suggest that under either of these approaches, certain restricted transactions directed to unlawful Internet gambling accounts could be blocked.

Any government agency compiling and providing public access to such a list would need to ensure that the particular business was, in fact, engaged in activities deemed to be unlawful Internet gambling under the Act. This would require significant investigation and legal analysis. Such analysis could be complicated by the fact that the legality of a particular Internet gambling transaction might change depending on the location of the gambler at the time the transaction was initiated, and the location where the bet or wager was received. In addition, a business that engages in unlawful Internet gambling might also engage in lawful activities that are not prohibited by the Act. The government would need to provide an appropriate and reasonable process to avoid inflicting unjustified harm to lawful businesses by incorrectly including them on the list without adequate review. The high standards needed to establish and maintain such a list likely would make compiling such a list time-consuming and perhaps under-inclusive.

[20] H. Rep. No. 109-412, Part 1, p.11.

To the extent that Internet gambling businesses can change the names they use to receive payments with relative ease and speed, such a list may be outdated quickly.

The Agencies do not enforce the gambling laws, and interpretations by the Agencies in these areas may not be determinative in defining the Act's legal coverage. As noted above, the Act does not comprehensively or clearly define which activities are lawful and which are unlawful, but rather relies on underlying substantive law.[21] In order to compile a list of businesses engaged in unlawful Internet gambling under the Act, the Agencies would have to formally interpret the various Federal and State gambling laws in order to determine whether the activities of each business that appears to conduct some type of gambling-related function are unlawful under those statutes.

The Agencies request comment on whether establishment and maintenance of such a prohibited list by the Agencies is appropriate, and whether examining or accessing such a list should be included in the regulation's examples of policies and procedures reasonably designed to identify and block or otherwise prevent or prohibit restricted transactions. The Agencies also request comment on whether, if it were practical to establish a fairly comprehensive list and a participant routinely checked the list to make sure the indicated payee of each transaction the participant processed on a particular designated payment system is not on the list, the participant should be deemed to have, without taking any other action, policies and procedures reasonably designed to prevent or prohibit restricted transactions with respect to that designated payment system. Similarly, the Agencies also request comment on whether, if such a list were established and a participant routinely checked the list to make sure a prospective commercial customer was not included on the list (as well as perhaps periodically screening existing commercial customers), the participant should be deemed to have, without taking any other action, policies and procedures reasonably designed to prevent or prohibit restricted transactions. Finally, assuming such a list were established and became available to all participants in the designated payment systems, the Agencies request comment on the extent to which the exemptions provided in section 4 of the proposed rule should be narrowed.

Any commenter that believes that such a list should be included in the regulation's examples of policies and procedures is requested to address the issues discussed above regarding establishing, maintaining, updating, and using such a list. The Agencies also request comment on any other practical or operational aspects of establishing, maintaining, updating, or using such a list. Finally, the Agencies request comment on whether relying on such a list would be an effective means of carrying out the purposes of the Act, if unlawful Internet gambling businesses can change their corporate names with relative ease.

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[21] See H.R. Rep. No. 109-412, at 10 (2006).

F. Regulatory Enforcement

As provided in the Act, section 7 of the proposed rule indicates that the requirements of the Agencies' rule would be subject to the exclusive regulatory enforcement of (1) the Federal functional regulators, with respect to the designated payment systems and participants therein that are subject to the respective jurisdiction of such regulators under section 505(a) of the Gramm-Leach-Bliley Act and section 5g of the Commodity Exchange Act; and (2) the Federal Trade Commission, with respect to designated payment systems and financial transaction providers not otherwise subject to the jurisdiction of any Federal functional regulators.

III. Administrative Law Matters

A. Executive Order 12866

It has been determined that this regulation is a significant regulatory action as defined in E.O. 12866. Accordingly, this proposed regulation has been reviewed by the Office of Management and Budget. The Regulatory Assessment prepared by the Treasury for this regulation is provided below.

1. Description of Need for the Regulatory Action

The rulemaking is required by the Act, the applicable provisions of which are designed to interdict the flow of funds between gamblers and unlawful Internet gambling businesses. To accomplish this, the Act requires the Agencies, in consultation with the Attorney General, to jointly prescribe regulations requiring designated payment systems (and their participants) to establish policies and procedures that are reasonably designed to prevent or prohibit such funding flows (hereafter "unlawful Internet gambling transactions").[22]

In accordance with the Act, section 3 of the proposed rule designates five payment systems that could be used in connection with unlawful Internet gambling transactions. Sections 5 and 6 of the proposed rule require designated payment systems and participants in those payment systems to establish reasonably designed policies and procedures to identify and block or otherwise prevent or prohibit unlawful Internet gambling transactions. As required by the Act, section 4 of the proposed rule exempts certain participants in designated payment systems from the requirement to establish policies and procedures because the Agencies believe that it is not reasonably practical for those participants to prevent or prohibit unlawful Internet gambling transactions. As required by the Act, section 6 of the proposed rule also contains a "safe harbor" provision by including non-exclusive examples of policies and procedures which would be deemed to be reasonably designed to prevent or prohibit unlawful Internet gambling transactions within the meaning of the Act.

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[22] 31 U.S.C. 5364.

2. Assessment of Potential Benefits and Costs

a. Potential Benefits

Congress determined that Internet gambling is a growing cause of debt collection problems for insured depository institutions and the consumer credit industry.[23] Further, Congress determined that there is a need for new mechanisms for enforcing Internet gambling laws because traditional law enforcement mechanisms are often inadequate for enforcing gambling prohibitions or regulations on the Internet, especially where such gambling crosses State or national borders.[24] Sections 5 and 6 of the proposed rule address this by requiring participants in designated payment systems, which include insured depository institutions and other participants in the consumer credit industry, to establish reasonably designed policies and procedures to identify and block or otherwise prevent or prohibit unlawful Internet gambling transactions in order to stop the flow of funds to unlawful Internet gambling businesses. This funds flow interdiction is designed to inhibit the accumulation of consumer debt and to reduce debt collection problems for insured depository institutions and the consumer credit industry. Moreover, the proposed rule carries out the Act's goal of implementing new mechanisms for enforcing Internet gambling laws. The proposed rule will likely provide other benefits. Specifically, the proposed rule could restrict excesses related to unlawful Internet gambling by under-age, addicted or compulsive gamblers.

The Treasury also examined the potential benefits of the establishment by the U.S. Government of a list of entities that it determines are engaged in the business of "unlawful Internet gambling." While the Treasury understands that interest exists in such a list, we have tentatively concluded that the benefits of the list as an effective tool for use by regulated entities to identify and block or otherwise prevent or prohibit unlawful Internet gambling transactions is uncertain relative to the likely costs involved in creating such a list.

Establishing a list of unlawful Internet gambling businesses would be a time consuming process given the fact-finding and legal analysis that would be required. For example, the names of the businesses directly receiving unlawful Internet gambling payments are often not readily identifiable from their gambling websites. As a result, the Government would have to engage in fact-finding to identify the name of each unlawful Internet gambling business and its associated bank account numbers and bank. In addition, to avoid inflicting unjustified harm on lawful businesses by erroneously including them on the list, the Government would likely need to provide businesses with advance notice and a reasonable opportunity to contest their potential inclusion on the list. This process could result in a considerable lag time between the U.S. Government first identifying a gambling website and ultimately adding the name of an unlawful Internet gambling business to the list. Because it is possible for unlawful Internet

[23] 31 U.S.C. 5361(a)(3).

[24] 31 U.S.C. 5361(a)(4).

gambling businesses, particularly those located in foreign countries with foreign bank accounts, to change with relative ease the business names and bank accounts of entities directly receiving restricted transactions, the list of unlawful Internet gambling businesses could be quickly outdated and thus have limited practical utility as an effective tool for regulated entities to prevent unlawful Internet gambling transactions.

b. Potential Costs

Treasury believes that the costs of implementing the Act and the proposed rule are lower than they would be if the Act and the proposed rule were to require a prescriptive, one-size-fits-all approach with regard to regulated entities. First, both the Act and section 5 of the proposed rule provide that a financial transaction provider shall be considered to be in compliance with the regulations if it relies on and complies with the policies and procedures of the designated payment system of which it is a participant. This means that regulated entities will not be required to establish their own policies and procedures but can instead follow the policies and procedures of the designated payment system, thereby resulting in lower costs.

Second, with regard to regulated entities that establish their own policies and procedures, both the Act and sections 5 and 6 of the proposed rule provide maximum flexibility. Specifically, neither the Act nor the proposed rule contain specific performance standards but instead require that such policies and procedures be "reasonably designed" to identify and block or otherwise prevent or prohibit unlawful internet gambling. In addition, the proposed rule expressly authorizes each regulated entity to use policies and procedures that are "specific to its business" which will enable it to efficiently tailor its policies and procedures to its needs. Because the Act and the proposed rule provide flexibility for regulated entities in crafting their policies and procedures, allowing them to tailor their policies and procedures to their individual circumstances, the costs imposed by the Act on regulated entities should be lower than if the Act and the proposed rule were to take a prescriptive one-size-fits-all approach.

Third, the "safe harbor" provision, with its nonexclusive examples of policies and procedures deemed to be "reasonably designed," provides regulated entities with specific guidance on how to structure the policies and procedures required by the Act. As a result, costs associated with formulating policies and procedures should be lower because the safe harbor provision provides guidance on how to so structure the policies and procedures.

Because the Treasury does not have sufficient information to quantify reliably the costs of developing specific policies and procedures, the Treasury seeks information and comment on any costs, compliance requirements, or changes in operating procedures arising from the application of the proposed rule. Moreover, the Treasury anticipates that the Agencies will contact trade groups representing participants, particularly those that qualify as small entities, and encourage them to provide comments during the comment period to ascertain, among other things, the costs imposed by this rulemaking.

Once the policies and procedures have been developed, however, the Treasury believes the burden of this rulemaking will be relatively low. It is estimated that the recordkeeping requirement required by the Act and the proposed rule will take approximately one hour per recordkeeper per year to maintain the policies and procedures required by this rulemaking. It is estimated that the total annual cost to regulated entities to maintain the policies and procedures will be approximately $4 million.[25]

The Treasury also considered the potential costs to the U.S. Government of establishing a list of unlawful Internet gambling businesses, and has initially determined that such costs would likely be significant. This is because establishing a list would require considerable fact-finding and legal analysis once the U.S. Government identifies a gambling website. The Government must engage in an extensive legal analysis to determine whether the gambling website is used, at least in part, to place, receive or otherwise knowingly transmit unlawful bets or wagers. This legal analysis would entail interpreting the various Federal and State gambling laws, which could be complicated by the fact that the legality of a particular Internet gambling transaction might change depending on the location of the gambler at the time the transaction was initiated and the location where the bet or wager was received. The U.S. Government would at the same time also need to identify the business name and the bank account number and bank of the entity directly receiving payments on behalf of the Internet gambling business, which is often not readily ascertainable from the website. Identifying the business name and bank account number of the entity directly receiving unlawful Internet gambling payments might be challenging, especially where the Internet gambling business is located in and maintains its bank accounts in a foreign country. Once the fact-finding and legal analysis are concluded successfully, the U.S. Government might then need to afford the business advance notice and an opportunity to object to its potential inclusion on the list in order to ensure that lawful businesses are not harmed by being erroneously included on the list. These due process safeguards would result in considerable added costs to the U.S. Government.

2. Interference with State, Local, and Tribal Governments

The Act does not alter State, local or tribal gaming law.[26] In addition, the Act exempts from the definition of the term "unlawful Internet gambling," intrastate, intratribal, and intertribal gambling transactions.[27] Because the proposed rule does not

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[25] This estimate is based on an estimate of 270,721 recordkeepers. The hourly cost of the person who would be responsible for maintaining the policies and procedures is estimated to be $14.60 per hour (based on the U.S. Department of Labor, Bureau of Labor Statistics' occupational employment statistics for office and administrative support occupations, dated May 2006).

[26] Specifically, the Act defines the term "unlawful Internet gambling" as a bet or wager, which involves at least in part the use of the Internet, where such bet or wager is unlawful under any applicable Federal or State law in the State or Tribal lands in which the bet or wager is initiated, received, or otherwise made. 31 U.S.C. 5362(10)(A).

[27] 31 U.S.C. 5362(10)(B) and (C).

alter these defined terms, it avoids undue interference with State, local, and tribal governments in the exercise of their governmental functions.

B. Regulatory Flexibility Act Analysis

Congress enacted the Regulatory Flexibility Act (RFA) (5 U.S.C. 601 et seq.) to address concerns related to the effects of agency rules on small entities and the Agencies are sensitive to the impact their rules may impose on small entities. In this case, the Agencies believe that the proposed rule likely would not have a "significant economic impact on a substantial number of small entities." 5 U.S.C. 605(b). The Act mandates that the Agencies jointly prescribe regulations requiring designated payment systems, and all participants therein, to identify and block or otherwise prevent or prohibit restricted transactions through the establishment of reasonably designed policies and procedures. Comments are requested on whether the proposed rule would have a significant economic impact on a substantial number of small entities and whether the costs are imposed by the Act itself, and not the proposed rule.

The RFA requires agencies either to provide an initial regulatory flexibility analysis with a proposed rule or to certify that the proposed rule will not have a significant economic impact on a substantial number of small entities. In accordance with section 3(a) of the RFA, the Agencies have reviewed the proposed regulation. While the Agencies believe that the proposed rule likely would not have a significant economic impact on a substantial number of small entities (5 U.S.C. 605(b)), the Agencies do not have complete data at this time to make this determination. Therefore, an Initial Regulatory Flexibility Analysis has been prepared in accordance with 5 U.S.C. 603. The Agencies will, if necessary, conduct a final regulatory flexibility analysis after consideration of comments received during the public comment period.

1. Statement of the need for, objectives of, and legal basis for, the proposed rule.

The Agencies are proposing a regulation to implement the Act, as required by the Act. The Act prohibits any person in the business of betting or wagering (as defined in the Act) from knowingly accepting payments in connection with the participation of another person in unlawful Internet gambling. Section 802 of the Act (codified at 31 U.S.C. 5361 et seq.) requires the Agencies jointly (in consultation with the Attorney General) to designate payment systems that could be used in connection with, or to facilitate, restricted transactions and to prescribe regulations requiring designated payment systems, and financial transaction providers participating in each designated payment system, to establish policies and procedures reasonably designed to identify and block or otherwise prevent or prohibit restricted transactions. The proposed regulation sets out necessary definitions, designates payment systems that could be used in connection with restricted transactions, exempts participants providing certain functions in designated payment systems from certain requirements imposed by the regulation, provides nonexclusive examples of policies and procedures reasonably designed to identify and block, or otherwise prevent and prohibit, restricted transactions, and reiterates the enforcement regime set out in the Act for designated payment systems and

non-exempt participants therein. The Agencies believe that the proposed regulation implements Congress's requirement that the Agencies prescribe regulations that carry out the purposes of the Act.

2. Small entities affected by the proposed rule

The proposed rule would affect non-exempt financial transaction providers participating in the designated payment systems, regardless of size. The Agencies estimate that 4,792 small banks (out of a total of 8,192 banks), 420 small savings associations (out of a total of 838), 7,609 small credit unions (out of a total of 8,477), and 240,547 small money transmitting businesses (out of a total of 253,208) would be affected by this proposed rule. Pursuant to regulations issued by the Small Business Administration (13 CFR 121-201), a "small entity" includes a commercial bank, savings association or credit union with assets of $165 million or less. For money transmitting businesses, a "small entity" would include those with assets of $6.5 million or less. The Agencies propose that the requirements in this rule be applicable to all entities subject to the Act, as implemented, regardless of their size because an exemption for small entities would significantly diminish the usefulness of the policies and procedures required by the Act by permitting unlawful Internet gambling operations to evade the requirements by using small financial transaction providers. The Agencies anticipate, however, that, as provided in the Act and the proposed regulations, small non-exempt participants in some designated payment systems, to a large extent, should be able to rely on policies and procedures established and implemented by the designated payment systems of which they are participants or other existing systems. The Agencies seek information and comment on the number of small entities to which the proposed rule would apply.

3. Projected reporting, recordkeeping, and other compliance requirements

Section 802 of the Act requires the Agencies to prescribe regulations requiring each designated payment system, and all financial transaction providers participating in the designated payment system, to identify and block or otherwise prevent or prohibit restricted transactions through the establishment of policies and procedures reasonably designed to identify and block or otherwise prevent or prohibit the acceptance of restricted transactions. The proposed rule implements this requirement by requiring all non-exempt participants in designated payment systems to establish and implement policies and procedures reasonably designed to identify and block or otherwise prevent or prohibit restricted transactions. Because the Agencies do not have sufficient information to quantify reliably the effects the Act and the proposed rule would have on small entities, the Agencies seek information and comment on any costs, compliance requirements, or changes in operating procedures arising from the application of the proposed rule and the extent to which those costs, requirements, or changes are in addition to or different from those arising from the application of the Act generally. Moreover, the Agencies anticipate contacting trade groups representing participants that qualify as small entities and encouraging them to provide comments during the comment period to ascertain, among other things, the costs imposed on regulated small entities.

4. Identification of duplicative, overlapping, or conflicting Federal rules

The Agencies have not identified any Federal rules that duplicate, overlap, or conflict with the proposed rule. The Agencies seek comment regarding any statutes or regulations that would duplicate, overlap, or conflict with the proposed rule.

5. Significant alternatives to the proposed rule

Other than as noted above, the Agencies are unaware of any significant alternatives to the proposed rule that accomplish the stated objectives of the Act and that minimize any significant economic impact of the proposed rule on small entities. The Agencies request comment on additional ways to reduce regulatory burden associated with this proposed rule.

C. Paperwork Reduction Act Analysis

The collection of information requirement contained in this notice of joint proposed rulemaking has been submitted by the Agencies to the Office of Management and Budget (OMB) for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on the collection of information should be sent to the Office of Management and Budget, Attention: Desk Officer for the Department of the Treasury and the Board of Governors of the Federal Reserve System, Office of Information and Regulatory Affairs, Washington, D.C., 20503, with copies to Treasury's Office of Critical Infrastructure Protection and Compliance Policy and the Board's Secretary at the addresses previously specified. Because OMB must complete its review of the collection of information between 30 and 60 days after publication, comments on the information collection should be submitted not later than [insert 30 days from date of publication]. Comments are specifically requested concerning:

(1) Whether the proposed information collection is necessary for the proper performance of Agency functions, including whether the information will have practical utility;

(2) The accuracy of the estimated burden associated with the proposed collection of information (see below);

(3) How to enhance the quality, utility, and clarity of the information required to be maintained;

(4) How to minimize the burden of complying with the proposed information collection, including the application of automated collection techniques or other forms of information technology; and

(5) Estimates of capital or start-up costs and costs of operation, maintenance, and purchase of services to maintain the information.

The collection of information in the proposed rule is in sections 5 and 6. This information is required by section 802 of the Act, which requires the Agencies to prescribe joint regulations requiring each designated payment system, and all participants in such systems, to identify and block or otherwise prevent or prohibit restricted transactions through the establishment of policies and procedures reasonably designed to identify and block or otherwise prevent or prohibit the acceptance of restricted transactions. The proposed rule implements this requirement by requiring all non-exempt participants in designated payment systems to establish and implement written policies and procedures reasonably designed to identify and block or otherwise prevent or prohibit restricted transactions. The proposed rule does not include a specific time period for record retention, however, non-exempt participants would be required to maintain the policies and procedures for a particular designated payment system as long as they participate in that system.

The Agencies anticipate that, as provided in the Act and the proposed regulations, small non-exempt participants in designated payment systems, for the most part, should be able to rely on policies and procedures established and implemented by the designated payment systems of which they are participants. For example, certain money transmitting business operators may have their own centralized procedures to prevent unlawful gambling transactions. Small money transmitters, acting as agents in these large systems, may be able to rely on the system's policies, and therefore would not have to create their own.

Many of the payment systems used by depository institutions, such as check clearing, do not have centralized system operators. Therefore, depository institutions would likely have to create their own policies for check clearing.

The likely recordkeepers are businesses or other for-profits and not-for-profit institutions and include commercial banks, savings associations, credit unions, card servicers, and money transmitting businesses. The Agencies have agreed to split equally for burden calculations the total number of recordkeepers not subject to examination and supervision by either the Board or the Treasury's Office of the Comptroller of the Currency and Office of Thrift Supervision.

Board:
Estimated number of recordkeepers: 134,451.
Estimated average annual burden hours per recordkeeper: 25 hours for depository institutions and card servicers, 1 hour for money transmitting businesses.
Estimated frequency: annually.
Estimated total annual recordkeeping burden: 322,779 hours.

Treasury:
Estimated number of recordkeepers: 136,270.
Estimated average annual burden hours per recordkeeper: 25 hours for depository institutions and card servicers, 1 hour for money transmitting businesses.
Estimated frequency: annually.

Estimated total annual recordkeeping burden: 368,254 hours.

The initial burden is imposed by the Act which requires non-exempt participants to establish policies and procedures. The Agencies estimate that this initial burden will average 24 hours per recordkeeper for depository institutions and card servicers. The Agencies also estimate that the annual burden of maintaining the policies and procedures once they are established will be 1 hour per recordkeeper. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by OMB.

D. Plain Language

Each Federal banking agency, such as the Board, is required to use plain language in all proposed and final rulemakings published after January 1, 2000. 12 U.S.C. 4809. In addition, in 1998, the President issued a memorandum directing each agency in the Executive branch, such as Treasury, to use plain language for all new proposed and final rulemaking documents issued on or after January 1, 1999. The Agencies have sought to present the proposed rule, to the extent possible, in a simple and straightforward manner. The Agencies invite comment on whether there are additional steps that could be taken to make the proposed rule easier to understand, such as with respect to the organization of the materials or the clarity of the presentation.

IV. Statutory Authority

Pursuant to the authority set out in the Act and particularly section 802 (codified at 31 U.S.C. 5361 et seq.), the Board and the Treasury jointly propose the common rules set out below.

V. Text of Proposed Rules

List of Subjects

12 CFR Part 233

[Banks, Banking, Electronic Funds Transfers, Incorporation by Reference, Internet Gambling, Payments, Recordkeeping]

31 CFR Part 132

[Banks, Banking, Electronic Funds Transfers, Incorporation by Reference, Internet Gambling, Payments, Recordkeeping]

Federal Reserve System
Authority and Issuance

For the reasons set forth in the preamble, the Board proposes to amend Title 12, Chapter II of the Code of Federal Regulations by adding a new part 233 as set forth under Common Rules at the end of this document:

PART 233 - PROHIBITION ON FUNDING OF UNLAWFUL INTERNET GAMBLING (REGULATION GG)

Sec.

233.1 Authority, Purpose, and Incorporation by Reference.

233.2 Definitions.

233.3 Designated Payment Systems.

233.4 Exemptions.

233.5 Processing of Restricted Transactions Prohibited.

233.6 Policies and Procedures.

233.7 Regulatory Enforcement.

Authority: 31 U.S.C. 5364.

Department of the Treasury
Authority and Issuance

For the reasons set forth in the preamble, Treasury proposes to amend Title 31, Chapter I of the Code of Federal Regulations by adding a new part 132 as set forth under Common Rules at the end of this document:

PART 132 - PROHIBITION ON FUNDING OF UNLAWFUL INTERNET GAMBLING

Sec.

132.1 Authority, Purpose, and Incorporation by Reference.

132.2 Definitions.

132.3 Designated Payment Systems.

132.4 Exemptions.

132.5 Processing of Restricted Transactions Prohibited.

132.6 Policies and Procedures.

132.7 Regulatory Enforcement.

Authority: 31 U.S.C. 321 and 5364.

Common Rules

The common rules that are proposed to be adopted by the Board as part 233 of Title 12, Chapter II of the Code of Federal Regulations and by Treasury as part 132 of Title 31, Chapter I of the Code of Federal Regulations follow:

§__.1 Authority, Purpose, and Incorporation by Reference.

(a) Authority. This part is issued jointly by the Board of Governors of the Federal Reserve System (Board) and the Secretary of the Department of the Treasury (Treasury) under section 802 of the Unlawful Internet Gambling Enforcement Act of 2006 (Act) (enacted as Title VIII of the Security and Accountability For Every Port Act of 2006, Pub. L. No. 109-347, 120 Stat. 1884, and codified at 31 U.S.C. 5361 - 5367).

(b) Purpose. The purpose of this part is to issue implementing regulations as required by the Act. The part sets out necessary definitions, designates payment systems subject to the requirements of this part, exempts certain participants in designated payment systems from certain requirements of this part, provides nonexclusive examples of policies and procedures reasonably designed to identify and block, or otherwise prevent and prohibit, restricted transactions, and sets out the Federal entities that have exclusive regulatory enforcement authority with respect to the designated payments systems and non-exempt participants therein.

(c) Incorporation by reference—relevant definitions from ACH rules.
(1) This part incorporates by reference the relevant definitions of ACH terms as published in the "2007 ACH Rules: A Complete Guide to Rules & Regulations Governing the ACH Network" (the "ACH Rules"). The Director of the Federal Register approves this incorporation by reference in accordance with 5 U.S.C. 552(a) and 1 CFR part 51. Copies of the "2007 ACH Rules" are available from the National Automated Clearing House Association, Suite 100, 13450 Sunrise Valley Drive, Herndon, Virginia 20171 (703/561-1100). Copies also are available for public inspection at the Department of Treasury Library, Room 1428, Main Treasury Building, 1500 Pennsylvania Avenue, N.W., Washington, D.C. 20220, and the National Archives and Records Administration (NARA). Before visiting the Treasury library, you must call (202) 622-0990 for an appointment. For information on the availability of this material at NARA, call 202-741-6030, or go to: http://www.archives.gov/federal_register/code_of_federal_regulations/ibr_locations.html 20002.

(2) Any amendment to definitions of the relevant ACH terms in the ACH Rules shall not apply to this part unless the Treasury and the Board jointly accept such amendment by publishing notice of acceptance of the amendment to this part in the Federal Register. An amendment to the definition of a relevant ACH term in the ACH Rules that is accepted by the Treasury and the Board shall apply to this part on the effective date of the rulemaking specified by the Treasury and the Board in the joint Federal Register notice expressly accepting such amendment.

§__.2 Definitions.

(a) Automated clearing house system or ACH system means a funds transfer system, primarily governed by the ACH Rules, which provides for the clearing and settlement of batched electronic entries for participating financial institutions. When referring to ACH systems, the terms in this regulation (such as "originating depository financial institution," "operator," "originating gateway operator," "receiving depository financial institution," "receiving gateway operator," and "third-party sender") are defined as those terms are defined in the ACH Rules.

(b) Bet or wager

(1) Means the staking or risking by any person of something of value upon the outcome or a contest of others, a sporting event, or a game subject to chance, upon an agreement or understanding that the person or another person will receive something of value in the event of a certain outcome;

(2) Includes the purchase of a chance or opportunity to win a lottery or other prize (which opportunity to win is predominantly subject to chance);

(3) Includes any scheme of a type described in 28 U.S.C. 3702;

(4) Includes any instructions or information pertaining to the establishment or movement of funds by the bettor or customer in, to, or from an account with the business of betting or wagering (which does not include the activities of a financial transaction provider, or any interactive computer service or telecommunications service); and

(5) Does not include –

(i) Any activity governed by the securities laws (as that term is defined in section 3(a)(47) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(47)) for the purchase or sale of securities (as that term is defined in section 3(a)(10) of that act (15 U.S.C. 78c(a)(10));

(ii) Any transaction conducted on or subject to the rules of a registered entity or exempt board of trade under the Commodity Exchange Act (7 U.S.C. 1 et seq.);

(iii) Any over-the-counter derivative instrument;

(iv) Any other transaction that—

(A) Is excluded or exempt from regulation under the Commodity Exchange Act (7 U.S.C. 1 et seq.); or

(B) Is exempt from State gaming or bucket shop laws under section 12(e) of the Commodity Exchange Act (7 U.S.C. 16(e)) or section 28(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78bb(a));

(v) Any contract of indemnity or guarantee;

(vi) Any contract for insurance;

(vii) Any deposit or other transaction with an insured depository institution;

(viii) Participation in any game or contest in which participants do not stake or risk anything of value other than—

(A) Personal efforts of the participants in playing the game or contest or obtaining access to the Internet; or

(B) Points or credits that the sponsor of the game or contest provides to participants free of charge and that can be used or redeemed only for participation in games or contests offered by the sponsor; or

(ix) Participation in any fantasy or simulation sports game or educational game or contest in which (if the game or contest involves a team or teams) no fantasy or simulation sports team is based on the current membership or an actual team that is a member of an amateur or professional sports organization (as those terms are defined in 28 U.S.C. 3701) and that meets the following conditions:

(A) All prizes and awards offered to winning participants are established and made known to the participants in advance of the game or contest and their value is not determined by the number of participants or the amount of any fees paid by those participants.

(B) All winning outcomes reflect the relative knowledge and skill of the participants and are determined predominantly by accumulated statistical results of the performance of individuals (athletes in the case

of sports events) in multiple real-world sporting or other events.

(C) No winning outcome is based—

(1) On the score, point-spread, or any performance or performances of any single real-world team or any combination of such teams, or

(2) Solely on any single performance of an individual athlete in any single real-world sporting or other event.

(c) Card issuer means any person who issues a credit card, debit card, pre-paid card, or stored value product, or the agent of such person with respect to such card or product.

(d) Card system means a system for clearing and settling transactions in which credit cards, debit cards, pre-paid cards, or stored value products, issued or authorized by the operator of the system, are used to purchase goods or services or to obtain a cash advance.

(e) Check clearing house means an association of banks or other payors that regularly exchange checks for collection or return.

(f) Check collection system means an interbank system for collecting, presenting, returning, and settling checks or intrabank system for settling checks deposited in and drawn on the same bank. When referring to check collection systems, the terms in this regulation (such as "paying bank," "collecting bank," "depositary bank," "returning bank," and "check") are defined as those terms are defined in 12 CFR 229.2. For purposes of this part, "check" also includes an electronic representation of a check that a bank agrees to handle as a check.

(g) Consumer means a natural person.

(h) Designated payment system means a system listed in §__.3.

(i) Electronic fund transfer has the same meaning given the term in section 903 of the Electronic Fund Transfer Act (15 U.S.C. 1693a), except that such term includes transfers that would otherwise be excluded under section 903(6)(E) of that act (15 U.S.C. 1693a(6)(E)), and includes any funds transfer covered by Article 4A of the Uniform Commercial Code, as in effect in any State.

(j) Financial institution means a State or national bank, a State or Federal savings and loan association, a mutual savings bank, a State or Federal credit union, or any other person that, directly or indirectly, holds an account belonging to a consumer. The term does not include a casino, sports book, or other business at or through which bets or wagers may be placed or received.

(k) Financial transaction provider means a creditor, credit card issuer, financial

institution, operator of a terminal at which an electronic fund transfer may be initiated, money transmitting business, or international, national, regional, or local payment network utilized to effect a credit transaction, electronic fund transfer, stored value product transaction, or money transmitting service, or a participant in such network, or other participant in a designated payment system.

(l) Interactive computer service means any information service, system, or access software provider that provides or enables computer access by multiple users to a computer server, including specifically a service or system that provides access to the Internet and such systems operated or services offered by libraries or educational institutions.

(m) Internet means the international computer network of interoperable packet switched data networks.

(n) Intrastate transaction means placing, receiving, or otherwise transmitting a bet or wager where -

(1) The bet or wager is initiated and received or otherwise made exclusively within a single State;

(2) The bet or wager and the method by which the bet or wager is initiated and received or otherwise made is expressly authorized by and placed in accordance with the laws of such State, and the State law or regulations include –

(i) Age and location verification requirements reasonably designed to block access to minors and person located out of such State; and

(ii) Appropriate data security standards to prevent unauthorized access by any person whose age and current location has not been verified in accordance with such State's law or regulations; and

(3) The bet or wager does not violate any provision of –

(i) The Interstate Horseracing Act of 1978 (15 U.S.C. 3001 et seq.);

(ii) 28 U.S.C. chapter 178 (professional and amateur sports protection);

(iii) The Gambling Devices Transportation Act (15 U.S.C. 1171 et seq.); or

(iv) The Indian Gaming Regulatory Act (25 U.S.C. 2701 et seq.).

(o) Intratribal transaction means placing, receiving or otherwise transmitting a bet or wager where –

(1) The bet or wager is initiated and received or otherwise made exclusively –

(i) Within the Indian lands of a single Indian tribe (as such terms are defined under the Indian Gaming Regulatory Act (25 U.S.C. 2703)); or
(ii) Between the Indian lands of two or more Indian tribes to the extent that intertribal gaming is authorized by the Indian Gaming Regulatory Act (25 U.S.C. 2701 et seq.);

(2) The bet or wager and the method by which the bet or wager is initiated and received or otherwise made is expressly authorized by and complies with the requirements of –

(i) The applicable tribal ordinance or resolution approved by the Chairman of the National Indian Gaming Commission; and

(ii) With respect to class III gaming, the applicable Tribal-State compact;

(3) The applicable tribal ordinance or resolution or Tribal-State compact includes –

(i) Age and location verification requirements reasonably designed to block access to minors and person located out of the applicable Tribal lands; and
(ii) Appropriate data security standards to prevent unauthorized access by any person whose age and current location has not been verified in accordance with the applicable tribal ordinance or resolution or Tribal-State Compact; and

(4) The bet or wager does not violate any provision of –

(i) The Interstate Horseracing Act of 1978 (15 U.S.C. 3001 et seq.);

(ii) 28 U.S.C. chapter 178 (professional and amateur sports protection);

(iii) The Gambling Devices Transportation Act (15 U.S.C. 1171 et seq.); or

(iv) The Indian Gaming Regulatory Act (25 U.S.C. 2701 et seq.).

(p) Money transmitting business and money transmitting service have the meanings given the terms in 31 U.S.C. 5330(d) (determined without regard to any regulations prescribed by the Secretary of the Treasury thereunder).

(q) Participant in a designated payment system means an operator of a designated payment system, or a financial transaction provider that is a member of or, has contracted for financial transaction services with, or is otherwise participating in, a designated payment system. This term does not include a customer of the financial transaction provider if the customer is not a financial transaction

provider otherwise participating in the designated payment system on its own behalf.

(r) Restricted transaction means any of the following transactions or transmittals involving any credit, funds, instrument, or proceeds that the Act prohibits any person engaged in the business of betting or wagering (which does not include the activities of a financial transaction provider, or any interactive computer service or telecommunications service) from knowingly accepting, in connection with the participation of another person in unlawful Internet gambling –

(1) Credit, or the proceeds of credit, extended to or on behalf of such other person (including credit extended through the use of a credit card);

(2) An electronic fund transfer, or funds transmitted by or through a money transmitting business, or the proceeds of an electronic fund transfer or money transmitting service, from or on behalf of such other person; or

(3) Any check, draft, or similar instrument that is drawn by or on behalf of such other person and is drawn on or payable at or through any financial institution.

(s) State means any State of the United States, the District of Columbia, or any commonwealth, territory, or other possession of the United States, including the Commonwealth of Puerto Rico, the Commonwealth of the Northern Mariana Islands, American Samoa, Guam, and the Virgin Islands.

(t) Unlawful Internet gambling means to place, receive, or otherwise knowingly transmit a bet or wager by any means that involves the use, at least in part, of the Internet where such bet or wager is unlawful under any applicable Federal or State law in the State or Tribal lands in which the bet or wager is initiated, received, or otherwise made. The term does not include placing, receiving, or otherwise transmitting a bet or wager that is excluded from the definition of this term by the Act as an intrastate transaction or an intra-tribal transaction, and does not include any activity that is allowed under the Interstate Horseracing Act of 1978 (15 U.S.C. 3001 et seq.). The intermediate routing of electronic data shall not determine the location or locations in which a bet or wager is initiated, received, or otherwise made.

(u) Wire transfer system means a system through which an unconditional order to a bank to pay a fixed or determinable amount of money to a beneficiary upon receipt, or on a day stated in the order, is transmitted by electronic or other means through the network, between banks, or on the books of a bank. When referring to wire transfer systems, the terms in this regulation (such as "bank," "originator's bank," "beneficiary's bank," and "intermediary bank") are defined as those terms are defined in 12 CFR part 210, appendix B.

§__.3 Designated Payment Systems. The following payment systems could be used

by participants in connection with, or to facilitate, a restricted transaction:
(a) Automated clearing house systems;
(b) Card systems;
(c) Check collection systems;
(d) Money transmitting businesses; and
(e) Wire transfer systems.

§__.4 Exemptions.

(a) Automated clearing house systems. The participants providing the following functions of an automated clearing house system with respect to a particular ACH transaction are exempt from this regulation's requirements for establishing written policies and procedures reasonably designed to prevent or prohibit restricted transactions –

(1) The ACH system operator, except as provided in §___.6(b)(2) and §___.6(b)(3);

(2) The originating depository financial institution in an ACH credit transaction; and

(3) The receiving depository financial institution in an ACH debit transaction.

(b) Check collection systems. The participants providing the following functions of a check collection system with respect to a particular check transaction are exempt from this regulation's requirements for establishing written policies and procedures reasonably designed to prevent or prohibit restricted transactions —

(1) A check clearing house; and

(2) The paying bank (unless it is also the depositary bank), any collecting bank (other than the depositary bank), and any returning bank.

(c) Wire transfer systems. The participants providing the following functions of a wire transfer system with respect to a particular wire transfer are exempt from this regulation's requirements for establishing written policies and procedures reasonably designed to prevent or prohibit restricted transactions—

(1) The operator of a wire transfer network; and

(2) The originator's bank and any intermediary bank, except as provided in §___.6(f)(2).

§__.5 Processing of Restricted Transactions Prohibited.

(a) All non-exempt participants in designated payment systems shall establish and

implement written policies and procedures reasonably designed to identify and block or otherwise prevent or prohibit restricted transactions.

(b) A non-exempt financial transaction provider participant in a designated payment system shall be considered to be in compliance with the requirements of paragraph (a) of this section if it –

(1) Relies on and complies with the written policies and procedures of the designated payment system that are reasonably designed to –

(i) Identify and block restricted transactions; or

(ii) Otherwise prevent or prohibit the acceptance of the products or services of the designated payment system or participant in connection with restricted transactions; and

(2) Such policies and procedures of the designated payment system comply with the requirements of this part.

(c) As provided in the Act, a person that identifies and blocks a transaction, prevents or prohibits the acceptance of its products or services in connection with a transaction, or otherwise refuses to honor a transaction, shall not be liable to any party for such action if –

(1) The transaction is a restricted transaction;

(2) Such person reasonably believes the transaction to be a restricted transaction; or

(3) The person is a participant in a designated payment system and blocks or otherwise prevents the transaction in reliance on the policies and procedures of the designated payment system in an effort to comply with this regulation.

(d) Nothing in this regulation requires or is intended to suggest that designated payment systems or participants therein must or should block or otherwise prevent or prohibit any transaction in connection with any activity that is excluded from the definition of "unlawful Internet gambling" in the Act as an intrastate transaction, an intratribal transaction, or a transaction in connection with any activity that is allowed under the Interstate Horseracing Act of 1978 (15 U.S.C. 3001 et seq.).

(e) Nothing in this regulation modifies any requirement imposed on a participant by other applicable law or regulation to file a suspicious activity report to the appropriate authorities.

§__.6 Policies and Procedures.

(a) The examples of policies and procedures to identify and block or otherwise prevent or prohibit restricted transactions set out in this section are non-exclusive. In establishing and implementing written policies and procedures to identify and block or otherwise prevent or prohibit restricted transactions, a non-exempt participant in a designated payment system may design and use other policies and procedures that are specific to its business and may use different policies and procedures with respect to different types of restricted transactions.

(b) Automated clearing house system examples.

(1) Except as provided in paragraphs (b)(2) and (b)(3) of this section, the policies and procedures of the originating depository financial institution and any third-party sender in an ACH debit transaction, and the receiving depository financial institution in an ACH credit transaction, are deemed to be reasonably designed to prevent or prohibit restricted transactions if they —

(i) Address methods for conducting due diligence in establishing or maintaining a customer relationship designed to ensure that the customer will not originate restricted transactions as ACH debit transactions or receive restricted transactions as ACH credit transactions through the customer relationship, such as –

(A) Screening potential commercial customers to ascertain the nature of their business; and

(B) Including as a term of the commercial customer agreement that the customer may not engage in restricted transactions; and

(ii) Include procedures to be followed with respect to a customer if the originating depository financial institution or third-party sender becomes aware that the customer has originated restricted transactions as ACH debit transactions or if the receiving depository financial institution becomes aware that the customer has received restricted transactions as ACH credit transactions, such as procedures that address –

(A) When fines should be imposed;

(B) When the customer should not be allowed to originate ACH debit transactions; and

(C) The circumstances under which the account should be closed.

(2) The policies and procedures of a receiving gateway operator and third-party sender that receives instructions to originate an ACH debit transaction directly from a foreign sender (which could include a foreign bank, a foreign third-

party processor, or a foreign originating gateway operator) are deemed to be reasonably designed to prevent or prohibit restricted transactions if they –

(i) Address methods for conducting due diligence in establishing or maintaining the relationship with the foreign sender designed to ensure that the foreign sender will not send instructions to originate ACH debit transactions representing restricted transactions to the receiving gateway operator or third-party sender, such as including as a term in its agreement with the foreign sender requiring the foreign sender to have reasonably designed policies and procedures in place to ensure that the relationship will not be used to process restricted transactions; and

(ii) Include procedures to be followed with respect to a foreign sender that is found to have sent instructions to originate ACH debit transactions to the receiving gateway operator or third-party sender that are restricted transactions, which may address –

(A) When ACH services to the foreign sender should be denied; and

(B) The circumstances under which the cross-border arrangements with the foreign sender should be terminated.

(3) The policies and procedures of an originating gateway operator that receives an ACH credit transaction containing instructions to send or credit a transaction to a foreign bank directly or through a foreign receiving gateway operator are deemed to be reasonably designed to prevent or prohibit restricted transactions, if they include procedures to be followed with respect to a foreign bank that is found to have received from the originating gateway operator either directly or indirectly transactions that are restricted transactions, which may address –

(i) When ACH credit transactions for the foreign bank or through the foreign gateway operator should be denied; and

(ii) The circumstances under which the cross-border arrangements with the foreign bank should be terminated.

(c) Card system examples. The policies and procedures of a card system operator, a merchant acquirer, and a card issuer, are deemed to be reasonably designed to prevent or prohibit restricted transactions, if they –

(1) Address methods for conducting due diligence in establishing or maintaining a merchant relationship designed to ensure that the merchant will not receive restricted transactions through the card system, such as –

(i) Screening potential merchant customers to ascertain the nature of their

business; and

(ii) Including as a term of the merchant customer agreement that the merchant may not receive restricted transactions through the card system;

(2) Include procedures reasonably designed to identify and block or otherwise prevent or prohibit restricted transactions, such as –

(i) Establishing transaction codes and merchant/business category codes that are required to accompany the authorization request for a transaction and creating the operational functionality to enable the card system or the card issuer to identify and deny authorization for a restricted transaction;

(ii) Ongoing monitoring or testing to detect potential restricted transactions, including –

(A) Conducting testing to ascertain whether transaction authorization requests are coded correctly;

(B) Monitoring of web sites to detect unauthorized use of the relevant card system, including its trademark; or

(C) Monitoring and analyzing payment patterns to detect suspicious payment volumes from a merchant customer; and

(3) Include procedures to be followed with respect to a merchant customer if the card system, card issuer, or merchant acquirer becomes aware that a merchant has received restricted transactions through the card system, such as --

(i) When fines should be imposed; and

(ii) When access to the card system should be denied.

(d) Check collection system examples.

(1) Except as provided in paragraph (d)(2) of this section, the policies and procedures of a depositary bank are deemed to be reasonably designed to prevent or prohibit restricted transactions if they —

(i) Address methods for conducting due diligence in establishing or maintaining a customer relationship designed to ensure that the customer will not receive restricted transactions through the customer relationship, such as –

(A) Screening potential commercial customers to ascertain the nature of their business; and

(B) Including as a term of the commercial customer agreement that the customer may not deposit checks that constitute restricted transactions; and

(ii) Include procedures to be followed with respect to a customer if the depositary bank becomes aware that the customer has deposited checks that are restricted transactions, such as procedures that address –

(A) When checks for deposit should be refused; and

(B) The circumstances under which the account should be closed.

(2) The policies and procedures of a depositary bank that receives a check for collection directly from a foreign bank are deemed to be reasonably designed to prevent or prohibit restricted transactions if they –

(i) Address methods for conducting due diligence in establishing or maintaining the correspondent relationship with the foreign bank designed to ensure that the foreign bank will not send checks representing restricted transactions to the depositary bank for collection, such as including as a term in its agreement with the foreign bank requiring the foreign bank to have reasonably designed policies and procedures in place to ensure that the correspondent relationship will not be used to process restricted transactions; and

(ii) Include procedures to be followed with respect to a foreign bank that is found to have sent checks to the depositary bank that are restricted transactions, which may address –

(A) When check collection services for the foreign bank should be denied; and

(B) The circumstances under which the correspondent account should be closed.

(e) Money transmitting business examples. The policies and procedures of a money transmitting business are deemed to be reasonably designed to prevent or prohibit restricted transactions if they –

(1) Address methods for conducting due diligence in establishing or maintaining commercial subscriber relationships designed to ensure that the commercial subscriber will not receive restricted transactions through the money transmitting business, such as -

(i) Screening potential commercial subscribers to ascertain the nature of their business; and

(ii) Including as a term of the commercial subscriber agreement that the subscriber may not receive restricted transactions; and

(2) Include procedures regarding ongoing monitoring or testing to detect potential restricted transactions, such as –

(i) Monitoring and analyzing payment patterns to detect suspicious payment volumes to any recipient; or

(ii) Monitoring web sites to detect unauthorized use of the relevant money transmitting business, including their trademarks; and

(3) Include procedures to be followed with respect to recipients that are found to have engaged in restricted transactions, that address –

(i) When fines should be imposed;

(ii) When access should be denied; and

(iii) The circumstances under which an account should be closed.

(f) <u>Wire transfer system examples</u>.

(1) The policies and procedures of the beneficiary's bank in a wire transfer are deemed to be reasonably designed to prevent or prohibit restricted transactions if they –

(i) Address methods for conducting due diligence in establishing or maintaining a commercial customer relationship designed to ensure that the commercial customer will not receive restricted transactions through the customer relationship, such as -

(A) Screening potential commercial customers to ascertain the nature of their business; and

(B) Including as a term of the commercial customer agreement that the customer may not receive restricted transactions.

(ii) Include procedures to be followed with respect to a commercial customer if the beneficiary's bank becomes aware that the commercial customer has received restricted transactions, such as procedures that address –

(A) When access to the wire transfer system should be denied; and

(B) The circumstances under which an account should be closed.

(2) An originator's bank or intermediary bank that sends or credits a wire transfer transaction directly to a foreign bank is deemed to have policies and procedures reasonably designed to identify and block, or otherwise prevent or prohibit restricted transactions, if the policies and procedures include procedures to be followed with respect to a foreign bank that is found to have received from the originator's bank or intermediary bank wire transfers that are restricted transactions, which may address –

(i) When wire transfer services for the foreign bank should be denied; and

(ii) The circumstances under which the correspondent account should be closed.

§__.7 **Regulatory Enforcement**. The requirements under this regulation are subject to the exclusive regulatory enforcement of –

(a) The Federal functional regulators, with respect to the designated payment systems and participants therein that are subject to the respective jurisdiction of such regulators under section 505(a) of the Gramm-Leach-Bliley Act (15 U.S.C. 6805(a)) and section 5g of the Commodity Exchange Act (7 U.S.C. 7b-2) ; and

(b) The Federal Trade Commission, with respect to designated payment systems and financial transaction providers not otherwise subject to the jurisdiction of any Federal functional regulators (including the Commission) as described in paragraph (a) of this section.

[THIS SIGNATURE PAGE PERTAINS TO THE NOTICE TITLED, "PROHIBITION ON FUNDING OF UNLAWFUL INTERNET GAMBLING"]

By order of the Board of Governors of the Federal Reserve System, October 1, 2007.

Jennifer J. Johnson (signed)
Jennifer J. Johnson,
Secretary of the Board.

[THIS SIGNATURE PAGE PERTAINS TO THE NOTICE TITLED, "PROHIBITION ON FUNDING OF UNLAWFUL INTERNET GAMBLING"]

Dated: October 1, 2007

By the Department of the Treasury.

Valerie A. Abend (signed)

Valerie A. Abend
Deputy Assistant Secretary for Critical Infrastructure Protection and Compliance Policy.

October 2, 2007
HP-584

Today: Paulson to Host Capital Markets Competitiveness Briefing

Secretary Henry M. Paulson, Jr. and Under Secretary for Domestic Finance Robert K. Steel will hold a press conference today at 1 p.m. in the Treasury Department media room to discuss the next steps in Treasury's capital markets competitiveness initiative announced in May. The following event is open to media:

Who
Secretary Henry M. Paulson, Jr.
Under
Secretary for Domestic Finance Robert K. Steel
What
Press Conference on Capital Markets
When
Tuesday, October 2, 2007 1 p.m. (EDT)
Where
U.S. Treasury Department
Media Room
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

October 2, 2007
2007-10-2-11-47-56-26456

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 $68,977 million as of the end of that week, compared to $68,519 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 28, 2007		
A. Official reserve assets (in US millions unless otherwise specified)	Euro	Yen	Total
(1) Foreign currency reserves (in convertible foreign currencies)			68,977
(a) Securities	13,831	11,076	24,907
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	13,817	5,455	19,272
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	4,457		
(3) SDRs	9,301		
(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)

		Total	Maturity breakdown (residual maturity)		
			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)	68,977
--currencies in SDR basket	68,977
--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.

October 2, 2007
hp-585

Paulson Announces Auditing Committee Members to Make Recommendations for a More Sustainable, Transparent Industry

Washington, DC- Secretary Henry M. Paulson, Jr. announced the members of the Treasury Advisory Committee on the Auditing Profession today. The public committee, which Secretary Paulson first announced in May, will make recommendations to encourage a more sustainable auditing profession. The Treasury Department worked with Committee Chairmen Arthur Levitt, Jr., former Securities and Exchange Commission Chairman, and Donald T. Nicolaisen, former SEC Chief Accountant, to choose members through a public nomination process and based on their diverse experiences and perspectives.

"Investor trust in the integrity of our capital markets is vital to the strength of the U.S. economy. Investor trust is based on accurate financial reporting, and a vibrant auditing profession is essential for a well-functioning financial reporting system," said Secretary Paulson. "This Committee has been chartered to develop recommendations as to what can best be done to sustain a vibrant auditing profession, a profession whose work is critical to investor confidence in our capital markets."

Secretary Paulson announced a series of initiatives this year to enhance U.S. capital markets competitiveness, one of his top priorities since taking office. Areas of focus include strengthening financial reporting and seeking a more sustainable auditing profession.

The committee will examine auditing industry concentration, financial soundness, audit quality, employee recruitment and retention, in addition to other topics. Treasury expects the committee to produce findings and recommendations by early summer 2008.

The committee structure will encourage an open and public discussion, with no predetermined outcomes. Meetings will be open to public attendance and comment at the Committee website. The committee members represent a broad range of perspectives, including investors, auditors, large and small public companies, insurance companies, lawyers and regulators. Treasury also selected official observers representing the domestic and international regulatory and policy bodies.

The first meeting will be held at the Treasury Department on Monday, October 15 at 10:00 a.m. in the Cash Room.

Committee members include:

Arthur Levitt, Jr. (Co-Chair) was the 25th Chairman of the SEC. First appointed by President Clinton in July 1993, and reappointed in May 1998, he was the longest serving SEC Chairman when he left on February 9, 2001. He is presently Senior Advisor to The Carlyle Group and Wisdom-Tree, on the Board of Bloomberg LLP as well as a member of the American Academy of Arts & Sciences.

Donald T. Nicolaisen (Co-Chair) was the Chief Accountant at the SEC from September 2003 to November 2005. He serves on the Board of Directors of Morgan Stanley, MGIC Investment Corporation, Verizon Communications Inc. and Zurich Financial Services. In addition, Mr. Nicolaisen is on the Board of Advisors for the University of Southern California, Leventhal School of Accounting. Mr. Nicolaisen also serves in a variety of advisory capacities to other Fortune 25 companies.

Alan L. Beller is a partner at Cleary Gottlieb Steen & Hamilton LLP. Mr. Beller was the Director of the Division of Corporation Finance of the SEC and Senior Counselor to the SEC from 2002 until 2006.

Amy Woods Brinkley is the Global Risk executive for Bank of America. She serves on the Risk & Capital Committee, which oversees allocation of capital to all business lines, and is a member of the bank's Management Operating Committee.

Mary K. Bush is President of Bush International and serves on the Boards of four publicly traded companies--Briggs and Stratton (Audit Committee), Discover Financial Services, ManTech Corporation and United Air Lines (Audit Committee)--and the Pioneer Family of Mutual Funds.

H. Rodgin Cohen is Chairman of Sullivan & Cromwell LLP. He has acted in most of the major U.S. bank acquisitions as well as in numerous leading cross-border and cross-industry acquisitions.

Timothy P. Flynn is Chairman and Chief Executive Officer of KPMG LLP. He is a member of the Governing Board of the Center for Audit Quality, and the Boards of Trustees of the Financial Accounting Foundation (FAF), FAF's Audit, Development and Strategic Planning committees, and the University of St. Thomas.

Robert Glauber is a Lecturer at Harvard's Kennedy School of Government. Previously, he served as Chairman and Chief Executive Officer of NASD (now FINRA) from September 2001 to September 2006, after becoming NASD's CEO and President in November 2000 and a member of NASD's Board in 1996.

Ken Goldman is Chief Financial Officer of Fortinet, Inc. He is a member and former President of The Financial Executive Institute, Santa Clara chapter, and served as an advisory council member of the Financial Accounting Standards Board from 2000 to 2004.

Gaylen R. Hansen is an audit partner at Ehrhardt Keefe Steiner & Hottman PC and serves on the Colorado State Board of Accountancy and the board of directors of the National Association of State Boards of Accountancy. He is also a member of the Standing Advisory Group that advises the Public Company Accounting Oversight Board.

Barry C. Melancon is the President and Chief Executive Officer of the American Institute of Certified Public Accountants. Prior to joining the AICPA, Mr. Melancon served for eight years as Executive Director of the Society of Louisiana CPAs.

Anne M. Mulcahy is Chairman and Chief Executive Officer of Xerox Corporation. In addition to the Xerox Board, Ms. Mulcahy serves on the Boards of Citigroup Inc., Fuji Xerox Co. Ltd., Target Corporation, and is the Chairman of the Corporate Governance Task Force of the Business Roundtable.

Richard H. Murray is Managing Director and Chief Claims Strategist of Swiss Re. Mr. Murray serves on the Supervisory Board of the Centre for the Study of Financial Innovation, the Advisory Board of Oxford Analytica, the Advisory Board of the Northeast Business Law Center, as a member of the Commission on the U.S. Capital Markets in the 21st Century, and the Institute of International Finance.

Gary John Previts is a Professor of Accountancy at Case Western Reserve University. He is a member of the Accountability Advisory Council of the U.S. Government Accountability Office and President of the American Accounting Association.

Damon A. Silvers is an Associate General Counsel for the AFL-CIO. Mr. Silvers led the AFL-CIO legal team that won severance payments for laid off Enron and WorldCom workers.

Richard A. Simonson is Executive Vice President and Chief Financial Officer of Nokia Corporation. Mr. Simonson has been a member of the Group Executive Board of Nokia since 2004 and the Board of Nokia Siemens Networks since April 1,

2007.

Sarah E. Smith is the Controller and Chief Accounting Officer of Goldman Sachs. She also serves on the firm's Risk Committee, the Commitments Committee, the Partnership Committee and the Private Equity Investment Committee and has oversight of Operational Risk. She is a member of the Washington-based Committee for Economic Development.

William D. Travis has been President and Chief Executive Officer of Bailiwick Data Systems, Inc. since 2007 and currently serves on the Board of Directors of McGladrey & Pullen, LLP, where he was previously Managing Director and Chairman.

Lynn E. Turner served as the Chief Accountant at the SEC from 1998 to 2001. He serves as a senior advisor to Kroll Zolfo Copper and is a member of the Standards Advisory Group of the Public Company Accounting Oversight Board and the Financial Accounting Standards Board Investor Technical Advisory Committee.

Paul A. Volcker served as Chairman of the Board of Governors of the Federal Reserve System. He is former Chairman of Wolfensohn & Co., Inc., as well as Professor Emeritus of International Economic Policy at Princeton University. He was recently Chairman of the Board of Trustees of the International Accounting Standards Committee.

Ann Yerger, CFA, is the Executive Director of the Council of Institutional Investors. She joined the Council in early 1996 as the Director of the Council's Research Service. She was named Executive Director in January 2005.

Committee observers include:

Robert H. Herz, Chairman of the Financial Accounting Standards Board

Mark W. Olson, Chairman of the Public Company Accounting Oversight Board

Zoe-Vonna Palmrose, Deputy Chief Accountant for Professional Practice in the Office of the Chief Accountant at the Securities and Exchange Commission

Michel Prada, Chairman of the Autorité des Marches Financiers in France

Sir David Tweedie, Chairman of the International Accounting Standards Board

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REPORTS

- Paulson's Remarks at Announcement of Committee

October 2, 2007
HP-586

Statement by Secretary Henry M. Paulson, Jr. at Press Conference on Advisory Committee on the Auditing Profession

Washington, DC--During my time at Treasury the competitiveness of our capital markets has been one of my highest priorities. Investor trust in the integrity of our capital markets is vital to the strength of the U.S. economy.

Investor trust is based on accurate and transparent financial reporting, and a vibrant auditing profession is essential for a well-functioning financial reporting system. The auditor's role is key: to examine financial statements and express an opinion that conveys reasonable, but not absolute, assurance as to the truth and fairness of those statements.

The Sarbanes-Oxley Act of 2002 enhanced financial reporting integrity, including mandating major changes affecting the auditing profession. The act created the Public Company Accounting Oversight Board to replace self-regulation of the public company auditing profession, and mandated auditor independence requirements. The Act also fundamentally altered the interactions between auditors and corporate management and boards of directors in a number of ways, some of which are not constructive.

As part of our overall effort on capital markets competitiveness, we have recognized the many changes that have impacted the auditing profession in recent years and some of the challenges it still faces. And so, in May, I asked Arthur Levitt, former SEC chairman, and Donald Nicolaisen, former SEC chief accountant, to co-chair a committee to examine key issues facing the auditing industry. I want to thank Arthur and Don for their willingness to lead this important effort.

The Committee will be a public forum, and its members represent a wide range of views – including small and large investors, auditors, financial institutions, public company executives, international regulators and universities.

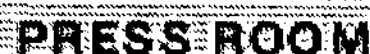
The Committee has been chartered to develop recommendations as to what can best be done to sustain a vibrant auditing profession, a profession whose work is critical to investor confidence in our capital markets. We have asked for this Committee's views and look forward to receiving their recommendations.

One of the great strengths of our markets is their dynamism – that they change to serve the needs of investors and businesses. Yet, our markets are not immune to challenges. We need to understand whether our markets are producing the high-quality audits and attracting the talented auditors we need. There are legitimate questions about the sustainability of the auditing profession's business model and concern about the high degree of auditor concentration among the largest public companies.

Our goal is to help ensure that U.S. capital markets remain efficient, innovative and continue to drive capital to its most productive uses. Our markets must retain the integrity and efficiency that has contributed greatly to prosperity in America and around the globe. Through its work, the Committee will help sustain a vibrant auditing profession, and contribute to the broader examination of U.S. competitiveness.

REPORTS

- Press Release Announcing the Committee



October 2, 2007
HP-587

Deputy Secretary Kimmitt to Announce $3.9 Billion in Tax Credits for Low-Income Community Investment

U.S. Treasury Deputy Secretary Robert M. Kimmitt and Treasury's Community Development Financial Institutions (CDFI) Fund Director Kimberly A. Reed will travel to New Orleans, La., this week to award $3.9 billion in tax credits to organizations investing in rural and urban low-income communities across the United States. The awards are being made under the 2007 round of the New Markets Tax Credit (NMTC) Program and will include $400 million allocated specifically for the redevelopment and reconstruction of the Hurricane Katrina Gulf Opportunity Zone (GO Zone).

Deputy Treasury Secretary Kimmitt and CDFI Fund Director Reed also will focus on the area's recovery after Hurricane Katrina and see how the CDFI Fund's NMTC Program is making an impact, including by helping to expand the National World War II Museum. Tourism and tourism related activities are a major source of employment and tax revenue for the city and state.

Deputy Secretary Kimmitt and Director Reed will join Chairman Don Powell, the President's Federal Coordinator for the Gulf Coast Rebuilding, to see how the NMTC Program is helping to repair areas of Ochsner Baptist Medical Center that were damaged by Hurricane Katrina. After the tour, they will make the national announcement of the organizations selected to receive allocations under the 2007 NMTC Program. The following events are open to credentialed media:

Who
Deputy Treasury Secretary Robert M. Kimmitt
CDFI Fund Director Kimberly A. Reed
What
Tour of National World War II Museum
When
Friday, October 5, 1:45 PM (CDT)
Where
945 Magazine Street
New Orleans, La.

Who
Deputy Treasury Secretary Robert M. Kimmitt
CDFI Fund Director Kimberly A. Reed
Chairman Don Powell
What
Tour of Ochsner Hospital, National New Markets Tax Credit Program **Award Announcement**
When
Friday, October 5, 2:15 PM (CDT)
Where
Ochsner Baptist Medical Center
2700 Napoleon Avenue
New Orleans, La.

About the New Markets Tax Credit Program
The NMTC Program, established by Congress in December 2000, provides individual and corporate taxpayers with a credit against federal income taxes for making qualified equity investments in investment vehicles known as Community Development Entities (CDEs). Substantially all of the taxpayer's investment must be used by the CDE to make qualified investments supporting certain business activities in low-income communities. More information on the NMTC program can be found at www.cdfifund.gov.

October 2, 2007
hp-588

Media Advisory:
U.S. Treasurer to Speak at Conference on Reaching the Unbanked

U.S. Treasurer Anna Escobedo Cabral will discuss ways to bring more Americans into the financial mainstream at the Financial Education and Literacy Commission's regional conference in New York City on Thursday.

More than 10 million Americans do not have access to mainstream financial services, such as banks or credit unions, making them more likely to pay extraordinarily high fees for basic services and less likely to save for the future. Deputy Assistant Secretary for Financial Education Dan Iannicola, Jr. will join officials from the National Credit Union Administration and the New York City Department of Consumer Affairs as featured speakers.

The regional conference is the fourth in a series of national discussions that will be held as part of the Financial Literacy and Education Commission's National Strategy for Financial Literacy. For more information about the Commission visit its website at www.mymoney.gov.

Who U.S. Treasurer Anna Escobedo Cabral
Deputy Assistant Secretary for Financial Education Dan Iannicola, Jr.

What Remarks on Reaching Unbanked People

When Thursday, October 4, 9 a.m. (EDT)

Where Northeast Regional Conference on Reaching Unbanked People
CUNY Graduate Center
365 Fifth Avenue
New York, NY

-30-

October 3, 2007
HP-589

**Remarks by Treasury Secretary Henry M. Paulson, Jr.
at the
U.S. Treasury Department's Annual Iftaar Dinner**

Washington, DC –Peace be with you. Dear friends, I enjoyed our discussions earlier this evening and now am honored that you have joined me for this Iftaar during these holiest days of the Muslim faith.

During Ramadan, Muslims reflect and remember dependence on God through fasting and prayer. It is also a time full of special devotion to family, to kindness and acts of charity.

It is an important and treasured time of year, and I think a reminder to all of us that a day spent dedicated to compassion and service is a day well-spent. This country appreciates and honors Muslims throughout America – for your friendship and contributions to our society, our economy and the enrichment of our culture.

A large part of your contributions include helping to create opportunity and prosperity for your fellow citizens. Our gathering tonight includes successful businessmen and women who innovate and create the jobs that fuel our economy, academicians who, through research and teaching, provide roadmaps and promise for the future, and those who spend the year-round in charitable work, helping those in need.

I am certain that today's meetings have been informative for all of us. We discussed U.S. capital market competitiveness, charitable giving, tax and economic policy matters, the need to stop illicit finance and the importance of trade and open investment to economic growth. We continued to build a partnership for working together on economic issues in the future.

Thank you again for coming to the Treasury Department today, and staying with us this evening. Ramadan Mubarak.

-30-

October 3, 2007
HP-590

Prepared Remarks of Office of Foreign Assets Control Director Adam J. Szubin on the Treasury Department's Role in Addressing the Situation in Darfur Before the Senate Committee on Banking, Housing and Urban Affairs

Washington, DC -- Chairman Dodd, Ranking Member Shelby and Members of the Committee, thank you for the opportunity to speak to you today about the Treasury Department's role in addressing the situation in Darfur and the Sudanese Government's support for terrorism, as well as its views regarding the various Sudan-related pieces of legislation that are pending in the Congress. I welcome the Committee's interest in these matters, and want to take this opportunity to thank the Committee for its continued support of Treasury and OFAC and its mission over the years, in particular as we have pursued sanctions against governments like Sudan.

We share an acute concern about the devastating suffering in Darfur, and an understanding that economic pressure can play an important role in bringing about a political resolution to this complex situation. Secretary Paulson has made it clear that we should spare no effort in using all tools at the Treasury Department's disposal to advance this goal. For OFAC, and for myself in particular, imposing smart and effective pressure on Sudan has been a foremost priority.

Treasury Department Actions against Sudan

The Scope of Sanctions

The United States has levied economic sanctions against Sudan since 1997. At that time, the Government of Sudan's support for international terrorism and widespread human rights violations led President Clinton to impose comprehensive trade sanctions against Sudan, and block all property of the Government of Sudan in the United States or within the control of U.S. persons anywhere in the world.

Acting with Congress, President Bush amended these broad sanctions in 2006 to carve out certain areas from our sanctions, notably Southern Sudan and Darfur, provided that the relevant transactions do not involve Sudan's petroleum or petrochemical industries or any property or property interest of the Government of Sudan.

In addition to these comprehensive sanctions, the President recently imposed strict economic sanctions against persons responsible for violence or atrocities in Darfur. Issued in accordance with actions taken by the United Nations Security Council, Executive Order 13400 blocked the property of four individuals connected to the conflict in Darfur. It also authorized the Treasury Department to block the property and interests in property of persons determined to: constitute a threat to the peace process in, and stability of, Darfur; be responsible for conduct related to the conflict in Darfur that violates international law; be responsible for heinous conduct with respect to human life or limb related to the conflict in Darfur; have supplied, sold, or transferred arms or any related materiel related to military activities to the warring parties in Darfur; or be responsible for offensive military overflights in and over the Darfur region. Treasury's authority applies as well to those determined to have materially assisted or supported, or to have acted for or on behalf of, any of the above.

Recent Actions

A primary objective of these sanctions, of course, has been to alter the behavior of those responsible for the terrible suffering in Darfur, first and foremost the Sudanese Government of President Bashir. This past April, on Holocaust Memorial

Day, the President issued a clear warning to the Sudanese Government. Either they would live up to their prior commitments and allow the deployment of a joint United Nations-African Union peacekeeping force, or the United States would impose further economic sanctions on the Sudanese Government and seek a United Nations Security Council Resolution to do likewise.

When President Bashir did not follow through, President Bush did. On May 29, Treasury announced the designation of three additional Sudanese individuals and thirty-one additional Sudanese companies subject to the asset freeze strictures of Executive Orders 13067, 13400, and 13412. We imposed sanctions against three individuals and one company because of their role in the ongoing violence in Darfur. We designated Ahmad Muhammed Harun, Sudan's State Minister for Humanitarian Affairs, and Awad Ibn Auf, Sudan's head of Military Intelligence and Security, who are among Khartoum's senior leadership and have acted as liaisons between the Sudanese government and the Government-supported Janjaweed militias. We also designated Khalil Ibrahim, leader of the Justice and Equality Movement (JEM), a rebel group that has been responsible for a number of violent incidents, and the Azza Air Transport company, which had been conveying artillery, small arms, and ammunition to Sudanese government forces and Janjaweed militia in Darfur for their activities in Darfur.

Simultaneously, we targeted 30 additional companies owned or controlled by the Government of Sudan, thereby subjecting them to the asset freeze imposed on the Government by Executive Orders 13067 and 13412. These targeted companies included five petrochemical companies, Sudan's national telecommunications company, and an entity that has supplied armored vehicles to the Sudanese Government for military operations in Darfur.

In addition to these actions to strengthen our financial measures against Sudan, we have stepped up enforcement of our Sudan sanctions, and have made such enforcement a top priority within OFAC. While I cannot comment on specific open enforcement cases, I can tell you that we are aggressively pursuing a number of violators to expose and penalize those who are violating our sanctions and deter those who might think of doing so.

In this regard, I would like to thank the Chairman and this Committee for its support in passing S. 1612, the International Emergency Economic Powers Enhancement Act, which provides for increased civil penalties for violations of IEEPA – the statute pursuant to which our sanctions against Sudan are imposed. We have sought these increased penalties in no small part because we faced impediments to obtaining meaningful enforcement of our sanctions against Sudan. The passage of this bill will provide a strong tool to make our sanctions effective.

It can be notoriously difficult to measure and attribute the impact of sanctions, when the ultimate objective is a change in regime behavior. It is certainly true that our sanctions were watched very carefully in Khartoum and taken seriously. Immediately after the sanctions were announced, the Sudanese Government took steps to sell off Government assets that we had identified and its Central Bank imposed broad restrictions on the movement of foreign currency. And, most importantly, we believe that the new U.S. sanctions – and the threat of international sanctions along similar lines – played a role in President Bashir's announcement in early June that Sudan would allow the deployment of a joint African Union-United Nations peacekeeping force in Darfur.

In addition to ensuring that our sanctions have the maximum possible effect on the Government of Sudan (GOS), we are also taking steps to protect the Government of Southern Sudan (GOSS) and humanitarian aid efforts in Darfur and elsewhere. We have prepared regulations that will help clarify the scope of sanctions with respect to South Sudan, Darfur and other exempt areas, and hope that those regulations will spur interest in investment and economic development in the South. And to facilitate the vital assistance activities of our State Department and USAID colleagues and those in the NGO community, we are licensing humanitarian work. Since January, 2006, we have issued approximately 87 licenses and registered approximately 48 NGOs to conduct this critical assistance work.

Pending Legislation Concerning Sudan

We appreciate and share the concerns that animate the various pieces of Sudan-

related legislation pending before Congress. Let there be no mistake – these concerns are deeply shared by the Treasury Department and the entire Administration.

A Government-Generated List

In imposing economic sanctions or other measures against Sudan – or any other regime – we must always keep in mind the ultimate goals of those sanctions. While the Department shares the Committee's and the Congress' goal of increasing pressure on the Sudanese government to end the violence in Darfur, we have several concerns with the various legislative proposals that have been introduced and discussed in the Congress.

Of particular concern are the various proposals that would require either the President or the Secretary of the Treasury to prepare a list of all companies engaged in specified business activities in Sudan. The preparation and publication of such a list raise a series of significant concerns for the Department, and may not add much value, given that non-governmental organizations have produced such lists for purposes of divestment.

A primary concern with the creation of such a list is the impact it is likely to have on our ability to maintain multilateral pressure on the regime in Khartoum. Because of the United States' broad sanctions against Sudan, no U.S. companies are likely to be included on such a list, as investment by such companies in Sudan is generally prohibited absent a license from OFAC. Consequently, the list would consist of foreign companies whose activities in Sudan are most likely legal in their home countries. Such a list likely will be viewed by our allies as a U.S. Government "blacklist" – not of Sudanese government entities – but of other companies based in their nations, and, therefore, as an unwelcome effort by the United States to expand the scope of our sanctions. As a result, such a list seriously risks alienating the very countries whose assistance we need to maintain and increase international pressure on the Bashir regime. These third countries hold important leverage that may be needed to threaten and ultimately impose additional measures against the Bashir regime, should it fail to follow through on its commitments. The promulgation of what will likely be perceived as a U.S. Government blacklist targeted at the lawful conduct of non-GOS companies based in these allied nations, however, risks shifting the focus of the debate from the Bashir government's compliance to the propriety of U.S. actions, and thus jeopardizes the international coalition that has helped bring about the recent positive developments in Sudan. Particularly in light of the current track of negotiations, including upcoming peace talks in Libya later this month, we strongly believe that requiring the promulgation of such a list is unwise.

In addition, creation of such a list raises a host of practical concerns. Any such list created by the U.S. Government will necessarily be incomplete. It would not identify those companies whose involvement in Sudan is not sufficiently established or is known only through classified information. The resultant list would be limited to publicly available information. Such a list would attempt to duplicate similar lists already compiled by non-governmental organizations based on public information but it would likely be less inclusive in light of the government's inability to rely on certain sources of information.

Further, the agency tasked with creating such a list would face difficult issues in determining what type and amount of evidence would suffice to include a company on the list. And, the inclusion or exclusion of certain companies from the list could subject the agency to legal challenges under the Administrative Procedure Act.

Creation of a list would also impose an ongoing, burdensome requirement on the agency tasked with its creation, especially a list that would need to be updated continually or on a regular basis as called for by some legislative proposals. These demands will necessarily divert resources from other important government functions. Indeed, those on my staff who have the most familiarity with Sudan are currently working to target companies and individuals for additional sanctions.

With relevant lists already available from non-governmental sources, all of the above costs would seem to greatly outweigh what incremental benefit a new government-generated list might provide.

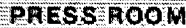
Other Policy Proposals

Many legislative proposals would encourage and affirmatively authorize State and local government action. As noted by my State Department colleague, the Administration opposes proposals to authorize divestment by state and local governments, which impair the ability of the president to act on behalf of the nation as a whole and risk creating a multiplicity of foreign policies.

I understand that the Committee is considering alternative proposals to a government-generated list. We look forward to continuing to work with you and your staffs as you consider the costs and benefits of such proposals, and would look forward answering the Committee's questions regarding these issues.

Conclusion

We all share the same objective when it comes to Darfur: a negotiated settlement that will bring a stable and lasting peace to Darfur. We remain committed to continuing the constructive dialogue we have had with your staffs on these important issues, as we very much want to ensure that the U.S. Government has all appropriate tools at its disposal to address this situation. Thank you again for the opportunity to testify today about this important issue.



October 4, 2007
HP-591

**Treasurer Anna Escobedo Cabral Remarks
Before the Eastern Regional Conference
on Reaching Unbanked People**

New York City - Thank you for that introduction. I'm pleased to be here this morning and to welcome all of you to the Eastern Regional Conference on Reaching Unbanked People. I want to recognize our many partners who have helped organize this conference. I also want to thank all of you for being here and joining us in our efforts to reach some of America's most financially vulnerable citizens – those who have no relationship with mainstream financial institutions, such as banks or credit unions.

Your participation is important today for a few reasons. First, I've spent the majority of my career working for the federal government, and I've learned that the government is most effective when we enlist the help of our many partners – the private sector, state and local governments and community-based organizations.

For example, Treasury is beginning an aggressive outreach campaign to connect with the homeowners who could face foreclosure in the next 18 months to two years. We want to encourage these homeowners to reach out to their lenders before they're hit with the payment shock of a mortgage reset. We know that for many people, products exist to help them. We want these homeowners to begin paying attention to their mortgage statements and talk to their lenders to determine their options early in the process.

There's a common misconception from borrowers that lenders want to take their homes, and as a result, borrowers do not reach out for help. In fact, we've heard that in 50 percent of foreclosures, the borrower never even spoke with their lender or a counselor. It is critical for borrowers to reach out as early as possible. In many cases, there may be a possibility to refinance or reduce the payment so the family can keep their home. If we can help keep more families in their homes, individuals, families, and our communities benefit, and our country and economy are better off as a whole.

The challenge to reaching struggling homeowners is similar to the challenge of reaching the unbanked. Just as we have to find creative ways to break down the barriers that keep borrowers from contacting their lenders, we must be innovative in our approaches to welcoming people into the financial mainstream. Our progress in reaching the unbanked population is only as strong as the partnerships we can create with each other.

This is a theme we've heard echoed in each of the three previous conferences we've held across the United States.

In Chicago we learned of effective partnerships and saw examples of the great work the Chicago Fed, community banks and others are doing to reach unbanked populations and new immigrants. In Texas, we learned about the unique challenges in border communities and saw creative business models community credit unions have adopted to bring in new customers. For example, one credit union offered small loans without a credit check on the condition that the individual receive broader financial education. Earlier this year, at the conference in Seattle, we heard about the efforts of Washington Mutual to reach out to the unbanked. We also heard about the unique challenges faced in serving diverse communities.

Today we're building on these discussions, and it's appropriate that we're here in New York City – the financial capital of the world.

That brings me to the second reason I think it's important that you're here. Each of you has unique perspectives and expertise to bring to the table. We benefit greatly when we can get your thoughts, hear what works and what doesn't. So I invite you to share your ideas with us and with each other.

Finally, I think it's critical that we're all here to talk about the issue of banking the unbanked, because at the end of the day, this is an issue of improving quality of life for individuals and families. This is about strengthening our communities and bringing Americans who are living on the edge of opportunity into the financial mainstream to experience the great promise our country has to offer.

After all, knowing how to manage your finances and take advantage of the wide array of financial products that exist in today's marketplace is critical to economic mobility. But we can't even begin to talk about financial education with the estimated 10 million Americans who remain outside of the financial mainstream. For these individuals, learning how to manage their personal finances is critical but abstract because they're outside of the system.

Now many people aren't familiar with the issues surrounding the unbanked, and they're surprised at the large amount of individuals who do not have a relationship with a bank or credit union. Quite frankly, it is surprising when most of us have several different accounts and a few too many credit cards. I'm sure there are a lot of us who could fall into the category of "overbanked" if it existed.

So why should we care about people who are unbanked? The answer is simple. Getting more Americans involved in the mainstream financial sector is about investing in our communities. If we can help individuals and families climb the ladder of economic success – our communities prosper and our entire country benefits. Becoming a part of the financial mainstream is the first step on that ladder. It's our job – working together everyone in this room – to find creative ways to lay out the welcome mat.

For our part at Treasury, we look for ongoing opportunities to demonstrate the importance of establishing a relationship with a financial institution. For example, the CDFI Fund does great work to support community financial institutions which often provide enhanced access to financial services and build bridges to the unbanked.

The Earned Income Tax Credit provides low income working families with a little extra money, and can be a valuable tool in lifting people out of poverty and opening up an opportunity to create a nest egg for the future. In fact, a recent Census study found that 4.6 million people were lifted out of poverty in 2002 thanks to the tax credit.

From our perspective at Treasury, this is a great opportunity to reach those families who don't have a bank account and raise awareness about the doors that could be opened by entering the financial mainstream. The IRS does a tremendous job working with organizations like the United Way and city mayors to help spread the word about the tax credit and encourage people to build on this wealth by opening a bank account and saving for the future.

Treasury also works hard on an outreach campaign called Go Direct which encourages people to sign up for direct deposit to receive their federal benefit payments. About 80 percent of federal benefits are made by direct deposit. That means more than 12 million Americans still receive their federal benefits in the form of a paper check through the mail. About 4.5 million of these recipients do not have a bank account, and we're working hard to let them know the potential benefits of direct deposit with a bank or credit union. In addition to saving the government money – it costs 80 cents to mail a paper check – direct deposit protects against identity theft and fraud and offers a more reliable and convenient method of receiving payments.

Our work with the Earned Income Tax Credit and Go Direct outreach efforts raises the point that the unbanked are in many cases hard-working Americans who are often good savers. We know there are many reasons why people are unbanked – some face language or cultural barriers, some live in rural areas with no convenient access to financial institutions, and some simply have never had a relationship with

a financial institution.

To be sure, the unbanked population is diverse, and a diversity of financial products and services is required in order to meet their unique needs. This means that in some cases financial institutions might need to change their business models. For example, we've seen successful models of credit unions in immigrant communities who provide multilingual materials and put employees behind the counter who can speak the same language. Others found that simply changing the workplace attire from coat and tie to khakis and a polo shirt helped provide a more welcoming atmosphere for new customers.

We've also heard that many unbanked people prefer face to face interaction. Most of us today do our banking on-line and visit ATM machines, rarely stepping foot inside our financial institutions. This isn't the case with everyone. Some people would like to see their bankers and interact with a trusted representative because for them there's a certain comfort level that can be established.

The idea is that we need to know and understand the consumer – that includes knowing both current customers and potential customers. We need to identify their perspectives and experiences in order to understand how to reach them and what products we can develop to truly serve them. This can be a difficult task but also one that is worthwhile.

Today, I thank you again for being here and for your continued hard work to help more Americans experience the hope, promise and opportunity our country offers. I call on you to listen and learn from each other today and forge new partnerships that will help strengthen our efforts going forward. This is work that has the potential to not only make a positive difference for families and communities here and now, but it can help build a better life for generations that follow.

Thank you.

October 5, 2007
hp-592

Treasury Economic Update 10.5.07

"Today's data demonstrate the resilience of the U.S. economy. Steady job creation, rising wages, and still-low unemployment mean that the U.S. economy is in good shape to weather the difficulties we are seeing in housing and credit markets."

Assistant Secretary Phillip Swagel, October 5, 2007

Job Creation Continues:

Job Growth: 110,000 new jobs were created in September, the 49th straight month of job gains. The United States has added 1.6 million jobs in the past 12 months and over 8.4 million jobs since August 2003. Employment increased in 48 states and the District of Columbia over the year ending in August. *(Last updated: October 5, 2007)*

Low Unemployment: September's 4.7 percent unemployment rate is close to its lowest reading in 6 years. Unemployment rates have declined or held steady in 29 states and the District of Columbia over the year ending in August. *(Last updated: October 5, 2007)*

There are Still Many Signs of Economic Strength:

Economic Growth: Real GDP growth was 3.8 percent in the second quarter of 2007, supported by strong gains in business investment and exports. *(Last updated: September 27, 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: September 27, 2007)*

Exports: Strong global growth is boosting U.S. exports, which grew by 7.1 percent over the past 4 quarters. *(Last updated: September 27, 2007)*

Inflation: Core inflation remains contained. The consumer price index excluding food and energy rose 2.1 percent over the 12 months ending in August. *(Last updated: September 19, 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 2.2 percent Over the Past 12 Months (ending in August). This translates into an additional $720 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 projectedto 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

Subscribe to Economy e-mail updates.

The U.S. economy is strong and getting stronger. Since the President signed the Jobs & Growth Act in May 2003, providing much needed tax relief, the U.S. economy has made a remarkable recovery. This Administration will continue pursuing pro-growth policies that will sustain economic growth for future generations.

LATEST NEWS

Asst Sec Swagel to Participate in Panel on Outlook for the U.S. Economy

FOCUS ON

Treasury Releases Social Security Papers on Common Ground

To build on the discussions that Secretary Paulson has had with members of Congress in both parties, Treasury will release a series of issue briefs that will discuss Social Security reform, focusing on the nature of the problem and those aspects of reform that have broad support.

- Paulson Statement on Treasury Social Security Papers on Common Ground
- **Issue Brief 1**: Social Security Reform: The Nature of the Problem
- **Issue Brief 2** : Social Security Reform: A Framework for Analysis

Job Creation Continues:

- **Job Growth:** 166,000 new jobs were created in October, the 50th straight month of job gains. The United States has added 1.7 million jobs in the past 12 months and about 8 and a half million jobs since August 2003. Employment increased in 49 states and the District of Columbia over the year ending in September. (Last updated: November 2, 2007)
- **Low Unemployment:** October's 4.7 percent unemployment rate is close to its lowest reading in 6 years. Unemployment rates have declined or held steady in 27 states and the District of Columbia over the year ending in September. *(Last updated: November 2, 2007)*

There are Still Many Signs of Economic Strength :

- **Economic Growth:** Real GDP growth was 3.9 percent in the third quarter of 2007, supported by strong gains in business investment and exports. *(Last updated: October 31, 2007)*
- **Business Investment:** Business spending on commercial structures and equipment rose solidly in the third quarter. Strong corporate profits and healthy balance sheets bode

search

"A sound labor market is vital fo Americans to continue to see ris incomes. We are encouraged b today's data showing healthy jo creation and continued low unemployment."

- Assistant Secretary Phillip Swa November 2, 2007

MORE INFORMATION

- Economic Report of the Pres
- The White House Economy Budget
- Bureau of Economic Analysi
- Bureau of Labor Statistics
- The Federal Reserve
- Economic Data Tables

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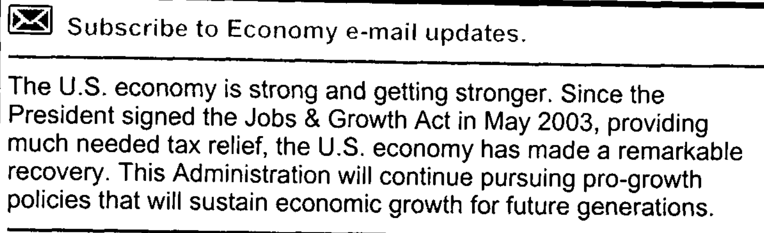

well for continued investment growth. *(Last updated: October 31,2007)*

- **Exports:** Strong global growth is boosting U.S. exports, which grew by 9.6 percent over the past 4 quarters. *(Last updated: October 31, 2007)*
- **Inflation:** Core inflation remains contained. The consumer price index excluding food and energy rose 2.1 percent over the 12 months ending in September. *(Last updated: October 17, 2007)*
- **Tax Revenues:** Tax receipts rose 6.7 percent in fiscal year 2007 (FY07) on top of FY06's 11.8 percent increase. As a share of GDP, FY07 receipts exceeded their 40-year average. *(Last updated: October 12, 2007)*

Americans Are Keeping More of Their Hard-Earned Money:

- **Real Wages Increased 1.3 percent Over the Past 12 Months** (ending in September). This translates into an additional $449 above inflation for the average full-time production worker over the last year. *(Last updated: October 17, 2007)*

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

- **We are on track to make significant further progress on the deficit.** The FY07 budget deficit was down to 1.2 percent of GDP, from 1.9 percent in FY06. 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.

Last Updated: November 2, 2007

October 5, 2007
HP-593

Treasury Awards $3.9 Billion to Encourage Private Sector Investments in Distressed Communities

Awards Announced Under 5th Round of New Markets Tax Credit Program

New Orleans- U.S. Treasury Deputy Secretary Robert Kimmitt and Treasury's Community Development Financial Institutions (CDFI) Fund Director Kimberly Reed announced today in New Orleans, La., the 61 organizations selected to receive $3.9 billion in tax credits for use in low-income communities. Treasury awarded the credits under the 2007 round of the New Markets Tax Credit (NMTC) Program.

Deputy Secretary Kimmitt and Director Reed were in the Gulf for the announcement to highlight the 11 organizations receiving $400 million in NMTC for specific use in the redevelopment of the Hurricane Katrina Gulf Opportunity Zone (GO Zone). The 61 allocatees are headquartered in 24 states and the District of Columbia, but anticipate serving 45 states, D.C. and Puerto Rico. The remaining five states would be served by allocatees with a national service area.

"These tax credits are intended to spur new private sector investment in communities in need across the United States and encourage continued redevelopment and reconstruction in the Hurricane Katrina Gulf Opportunity Zone," said Deputy Secretary Kimmitt. "The vision of the Community Development Financial Institutions Fund is to help give all Americans access to affordable credit, capital, and financial services."

"These tax credits, totaling $3.9 billion, are important to encourage investment in rural and urban low-income communities across the United States," said CDFI Fund Director Reed. "We also are committed to helping those affected by Hurricane Katrina, and I am pleased how the New Markets Tax Credit Program is making a difference in the redevelopment of communities across the Gulf Coast."

The NMTC Program attracts private-sector capital investment into the nation's urban and rural low-income areas to help finance community development projects, stimulate economic growth and create jobs.

The NMTC Program, established by Congress in December 2000, permits individual and corporate taxpayers to receive a credit against federal income taxes for making qualified equity investments in investment vehicles known as Community Development Entities (CDEs). The credit provided to the investor totals 39 percent of the cost of the investment and is claimed over a seven-year period.

Substantially all of the taxpayer's investment must in turn be used by the CDE to make qualified investments in low-income communities. The 61 organizations were selected through a competitive application and rigorous review process.

The NMTC program is administered by Treasury's Community Development Financial Institutions (CDFI) Fund. Throughout the life of the NMTC Program, the CDFI Fund is authorized to allocate to CDEs the authority to issue to their investors up to the aggregate amount of $19.5 billion in equity as to which NMTCs can be claimed, including $1 billion for use in the GO Zone. In the five rounds to date, the CDFI Fund has made 294 awards totaling $16 billion in tax credit authority.

A complete list of the 61 organizations selected and additional information on the NMTC Program can be found on the CDFI Fund's web site at: www.cdfifund.gov

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October 9, 2007
hp-594

Treasury, IRS Issue Pension Protection Act Guidance

Washington, DC--The Treasury Department and the Internal Revenue Service (IRS) today issued a notice providing guidance on the corporate bond yield curve and associated segment rates that will be used under the enhanced pension funding rules enacted by the Pension Protection Act of 2006 (PPA).

Under PPA, Treasury was required to produce a yield curve and simplified segment rates for investment-quality corporate bonds that are in the top three quality levels for use by private pension plans in determining their funding obligations and the amounts of lump-sum payments to retirees. IRS Notice 2007-81 outlines the methodology used by Treasury in producing the yield curve.

The Notice also provides the full yield curve and various segment rates for August 2007 together with the 23 months of historical segment rates extending back to September of 2005. In addition, each month IRS will publish a standard notice containing updated monthly yields along with the additional rates required under the provisions of PPA.

The initial yield curve, as well as monthly updates will also be posted on the IRS's website . Notice 2007-81 is attached.

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REPORTS

- Notice 2007-81

Part III --- Administrative, Procedural and Miscellaneous

Interest Rate Modification

Notice 2007-81

This notice provides guidance on the corporate bond yield curve and the segment rates required to compute the funding target and other items under § 430 of the Internal Revenue Code of 1986 (Code) and § 303 of the Employee Retirement Income Security Act of 1974 (ERISA). In addition, this notice provides guidance on the interest rates for determining minimum present values as required under § 417(e)(3) of the Code and § 205(g)(3) of ERISA. This notice implements changes to the funding rules and minimum present value requirements made by sections 101, 102, 111, 112, and 302 of the Pension Protection Act of 2006, P.L. No. 109-280 (PPA).

BACKGROUND AND PRIOR LAW

Section 412 of the Code provides minimum funding requirements that generally apply for defined benefit plans. Under § 412(b)(5)(A) prior to amendment by PPA, the funding standard account (and items therein) must be charged or credited with interest at the appropriate rate consistent with the rate or rates of interest used under the plan to determine costs.

Section 412(b)(5)(B) prior to amendment by PPA provides rules for specifying the interest rate that is used to determine a plan's current liability for purposes of § 412(l) and for purposes of the minimum full funding limitation under § 412(c)(7)(E). Section 412(b)(5)(B)(ii)(III) prior to amendment provides that, for plan years beginning in 2004, 2005, 2006, and 2007, the interest rate used to determine current liability must not be above and must not be more than 10 percent below the weighted average of the rates of interest on amounts invested conservatively in long-term investment-grade corporate bonds during the 4-year period ending on the last day before the beginning of the plan year. Notice 2004-34, 2004-1 C.B. 848, specified the corporate bond indices and the methodology for determining these corporate bond rates.

Section 417(e)(3) provides assumptions for determining minimum present values for certain purposes. For plan years beginning before 2008, the applicable interest rate for these purposes is the annual rate of interest on 30-year Treasury securities as prescribed by the Commissioner.

PENSION PROTECTION ACT OF 2006

PPA makes extensive changes to the minimum funding requirements that generally apply for plan years beginning on or after January 1, 2008. However, certain plans have delayed effective dates for these amendments provided under sections 104, 105, and 106 of PPA.

Section 430 of the Code, added by section 112 of PPA, specifies the minimum funding requirements that apply to single employer plans pursuant to § 412 of the Code. Section 430(a) defines the minimum required contribution for a single employer plan as

the sum of the plan's target normal cost and the shortfall and waiver amortization charges for the year. Under § 430(b), a plan's target normal cost is generally equal to the present value of all benefits expected to accrue or be earned under the plan during the plan year. Under § 430(d)(1), a plan's funding target for a plan year is generally equal to the present value of all benefits accrued or earned under the plan as of the beginning of the plan year.

Section 430(h)(2) specifies the interest rates that must be used to determine a plan's target normal cost and funding target. Under this provision, present value is generally determined using three interest rates ("segment rates"), each of which applies to cash flows during specified periods.

Each segment rate is, for any month, the single rate of interest determined by the Secretary for such month on the basis of the applicable corporate bond yield curve for that month, taking into account only that portion of such yield curve applicable to that segment. Section 430(h)(2)(D)(i) provides that the Secretary shall prescribe a corporate bond yield curve applicable for each month. The applicable corporate bond yield curve is, with respect to any month, a yield curve which reflects a 24-month average (the average of the yield curve values for the preceding month and the prior 23 months) of the yields on investment grade corporate bonds with varying maturities and that are in the top 3 quality levels available. Under § 430(h)(2)(D)(ii), an election may be made to use the corporate bond yield curve determined without regard to the 24-month averaging in lieu of the segment rates.

A transitional rule under § 430(h)(2)(G) applies for plan years starting in 2008 and 2009 (if the plan had its first plan year before 2008). Under this rule, the 24-month average segment rates as computed above are blended with the corporate bond weighted average rates determined under § 412(b)(5)(B)(ii)(II) (prior to amendment). However, § 430(h)(2)(G)(iv) provides that an election may be made to apply the 24-month average segment rates without applying the blended rates under the transitional rule of § 430(h)(2)(G).

Generally, section 302(b) of PPA amends § 417(e)(3) of the Code to provide that the interest rates used for the determination of minimum present values are segment rates as computed under § 430(h)(2), but determined without regard to yield curve rates from the preceding 23 months. However, for plan years beginning in 2008, 2009, 2010, and 2011 these segment rates are blended with the applicable rate of § 417(e)(3)(A)(ii)(II) as in effect for plan years beginning in 2007. This amendment is effective for plan years beginning after December 31, 2007. PPA provides conforming amendments to ERISA for the amendments to §§ 412, 417, and 430 of the Code.

Section 430(h)(2)(F) provides that the Secretary shall publish each month the corporate bond yield curve and the rates described above. In addition, the Secretary shall publish a description of the methodology used to determine such yield curve and such rates in sufficient detail to enable plans to make reasonable predictions regarding the yield curve and rates for future months.

DETERMINATION OF THE SEGMENT RATES

The following methodology is established to determine the corporate bond yield curve and the segment rates. A yield curve is calculated for each business day of the

month based on investment grade corporate bonds in the top three quality levels. The construction of the yield curve for a given day is explained in Appendix A to this notice. This daily yield curve is expressed as the yield for a zero coupon bond at each maturity point from ½ year to 100 years, in ½ year intervals. The value at any maturity point of the monthly yield curve is set equal to the arithmetic average for all of the business days in a month of the values for that maturity point from the daily yield curves. The monthly yield curve then is the set of values for each of the 200 maturity points. The monthly corporate bond yield curve derived from August 2007 data is shown in Table I of Appendix B. The monthly corporate bond yield curve is the table which would be used if an election is made under § 430(h)(2)(D)(ii).

The first segment rate applicable for a given month is the arithmetic average over the 10 maturity points from ½ year to 5 years of the applicable corporate bond yield curve. This is mathematically the same as the arithmetic average for the preceding 24 months of the "spot" first segment rates that can be developed from each of the monthly yield curves (as the arithmetic average over the 10 maturity points from ½ year to 5 years of those monthly yield curves) and this second approach has been used in order to facilitate presentation of the segment rates. Similarly, the second segment rate applicable for the given month is the arithmetic average for the preceding 24 months of the spot second segment rates for those months (where the spot second segment rate for a month is the arithmetic average over the 30 maturity points from 5½ years to 20 years of the monthly yield curve). The third segment rate applicable for the given month is the arithmetic average for the preceding 24 months of the spot third segment rates for those months (where the spot third segment rate for a month is the arithmetic average over the 80 maturity points from 20½ years to 60 years of the monthly yield curve). These 24-month average segment rates are the rates that would be applicable if an election was made under § 430(h)(2)(G)(iv) not to use the transitional rule of § 430(h)(2)(G), or if a plan's first plan year begins after 2007. The three 24-month average corporate bond segment rates applicable for September 2007 are as follows:

24-Month Average Segment Rates
Applicable For September 2007

First Segment	Second Segment	Third Segment
5.26	5.82	6.38

The funding transitional segment rates determined under § 430(h)(2)(G) applicable for September 2007, taking into account the corporate bond weighted average of 5.86 for September 2007 published in Notice 2007-68, 2007-35 I.R.B. 468, are as follows:

Funding Transitional Segment Rates
Applicable For September 2007

For Plan Years Beginning in	First Segment	Second Segment	Third Segment
2008	5.66	5.85	6.03

INTEREST RATE FOR MINIMUM PRESENT VALUE

Generally for plan years beginning after December 31, 2007, the applicable interest rates under § 417(e)(3) are segment rates computed without regard to a 24-month average. These are the monthly spot segment rates. For plan years beginning in years 2008, 2009, 2010, and 2011, the applicable interest rate is the monthly spot segment rate blended with the applicable rate under § 417(e)(3)(A)(ii)(II) as in effect for plan years beginning in 2007, where the blending ratio depends on the plan year. The minimum present value transitional segment rates determined under § 417(e)(3)(D) for August 2007, taking into account the August 2007 30-year Treasury rate of 4.93 published in Notice 2007-68, are as follows:

Minimum Present Value Transitional Segment Rates
For August 2007

For Plan Years Beginning in	First Segment	Second Segment	Third Segment
2008	5.02	5.18	5.28

SUPPLEMENTAL INFORMATION

The spot first, second, and third segment rates for August 2007 are, respectively, 5.40, 6.20, and 6.66. The spot segment rates for each of the months from September 2005 through August 2007 are shown in Table II of Appendix B. These rates are preliminary values from which the 24-month average segment rates and the minimum present value transitional segment rates provided above can be derived.

MONTHLY PUBLICATION OF RATES

Each month, the Service publishes by notice the corporate bond weighted average applicable for the current month as provided under § 412(b)(5)(B) prior to amendment by PPA and the 30-year Treasury rate as provided under § 417(e)(3). In the same notice, the Service will publish the monthly corporate bond yield curve of § 430(h)(2) derived from the preceding month (and the corresponding spot segment rates), the 24-month average funding segment rates applicable for the current month, and the funding transitional segment rates under the transition rule of § 430(h)(2)(G) applicable for the current month. In the same notice, the Service will also publish the

minimum present value segment rates as required under the transitional rule provided in § 417(e)(3)(D).

DRAFTING INFORMATION

The principal author of this notice is Tony Montanaro of the Employee Plans, Tax Exempt and Government Entities Division. However, other personnel from the Service and the Treasury Department participated in preparing this notice. Mr. Montanaro may be e-mailed at RetirementPlanQuestions@irs.gov.

APPENDIX A

The daily yield curve for a given day is constructed under methods and assumptions as described in this section. The description applies to the methodology in use at the present time. Any significant changes in this methodology will be announced by notice.

Data Set

The following criteria are provided for identifying those bonds to be included in the database used to construct the yield curve. The universe of possible bonds consists of a set of bonds which are designated as corporate, have high quality ratings (AAA, AA, or A) from nationally recognized statistical rating organizations, and have at least $250 million in par amount outstanding on at least one day during the reporting period. The database is extended for maturities below 1 year by using AA financial and AA non-financial commercial paper rates, as reported by the Federal Reserve Board. The bonds chosen for the bond set pay fixed nominal semiannual coupons and the principal amount at maturity. Bonds with different or additional characteristics are generally excluded. The main exclusions are:

(1) bonds not denominated in U.S. dollars;
(2) bonds not issued by U.S. corporations;
(3) bonds which are capital securities (hybrid preferred stock);
(4) bonds having variable coupon rates;
(5) convertible bonds;
(6) "Agency" bonds, such as FNMA bonds;
(7) asset-backed bonds;
(8) callable bonds unless the call feature is make-whole;
(9) putable bonds; and
(10) bonds with sinking funds.

In addition, a bond is excluded from use with respect to a given day if the bond has for that day:

(1) a par amount outstanding below $250 million;
(2) a maturity greater than 30 years; or
(3) a rating below A.

These criteria leave about 1,400 bonds in each daily set of bonds. For each day, the database information for each bond includes the bid price (for commercial paper, it is the ask price), coupon rate, maturity, par amount outstanding, and ratings.

Derivation of the Yield Curve

The daily yield curve is derived from a pricing model that gives the price of a bond as the discounted present value of its cash flows plus adjustment factors for credit quality. The results of the model generate a discount function, and the rates for the daily yield curve are calculated from the discount function. The discount function is derived from the daily determination of the instantaneous forward interest rates for each point in the future.

Derivation of Forward Interest Rates

The forward interest rates are assumed to be described as a series of cubic polynomials that are smoothly joined at specified knot points. The specified knot points are maturities of 0, 1.5, 3, 7, 15, and 30 years, and having a smooth junction at a knot means that the two polynomials that are meeting at the knot have the same value, the same derivative, and the same second derivative at that knot point. Such a series of cubic polynomials is called a cubic spline.

Three constraints are placed on the forward interest rate function. First, the second derivative of the function is set to zero at maturity zero. Second, the value of the forward rate function at and after 30 years is constrained to equal its average value from 15 to 30 years. Third, the derivative of the forward rate function is set to zero at maturity 30 years.

Using these constraints, the assumed cubic spline for the forward interest rate function can be described as a linear combination of B-splines, with five parameters. Thus, the daily forward rate function can be defined by determining the five daily parameters for the B-splines. These parameters, together with two adjustment factors described below, are estimated from the bond data.

Adjustment Factors for Credit Quality

In the pricing model, the adjustment factors for credit quality are added to the present value of the bond's cash flows as given by the forward rate and the discount function. Specifically, the adjustment factors are made up of two linear regression variables added to the present value with two respective regression coefficients that need to be estimated. These variables adjust the bond prices so that the discount function and the spot rates represent market-weighted average credit quality of the top three quality levels (AAA, AA, and A).

Specifically, some of the deviation between the predicted price for the bond (based on the cash flows and the discount function) and the actual price for the bond can be attributed to differences in credit quality and some of the deviation is an error factor. The model determines the portion of the deviation that is attributable to credit quality by determining the two adjustment factors that reflect the relative proportion of A-rated bonds within the data set and the relative proportion of AA-rated bonds within the subset of AA- and AAA-rated bonds. A high proportion of A-rated bonds results in a

larger deviation in price for the higher quality bonds, which means that the discount function used to develop the yield curve is more closely aligned with a discount function for A-rated bonds than for the higher rated bonds. Similarly, a higher proportion of AA-rated bonds within the subset of AA- and AAA-rated bonds means that the discount function is more representative of the AA-rated universe than the AAA-rated bonds.

These adjustment factors allow the yield curve to be based on the proportion of bonds at the three quality levels in the market determined over the entire maturity spectrum (rather than on the proportion at each specific maturity point). This avoids potential distortions which could arise because of different proportions of bonds at the three quality levels at various maturity points.

Estimates for the parameters

These seven parameters, comprising five parameters in the cubic spline and the two adjustment coefficients on the bond-quality adjustment variables, are estimated from the bond price data. The estimation is done by nonlinear least squares, that is, the seven parameter estimates are chosen to minimize the sum of the squared differences between the actual bond prices and the prices given by the bond price model.

Before the estimation is carried out, the bond data are weighted. The weighting consists of two stages. In the first stage, equal weights are assigned to the commercial paper rates at the short end of the curve, and the par amounts outstanding of all the bonds are rescaled so that their sum equals the sum of the weights for commercial paper. Then, the squared price difference for each bond is multiplied by the bond's rescaled par amount outstanding, and the squared difference for each commercial paper rate is multiplied by the commercial paper weight. In the second stage, for bonds with duration greater than 1, the weighted squared price difference for each bond from the first stage is divided by duration.

Additional Information

Additional background information regarding the daily corporate bond yield curve can be found at the following URL:

http://www.ustreas.gov/offices/economic-policy/reports/corporate_yield_curve_2007.pdf

Other developmental papers on the corporate bond yield curve can be found at the following URL:

http://www.ustreas.gov/offices/economic-policy/speeches_testimony_refund.shtml

APPENDIX B

Table I

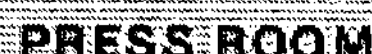
Monthly Yield Curve Derived From August 2007 Data

Maturity	*Yield*	*Maturity*	*Yield*	*Maturity*	*Yield*	*Maturity*	*Yield*	*Maturity*	*Yield*
0.5	5.47	20.5	6.49	40.5	6.68	60.5	6.75	80.5	6.78
1.0	5.37	21.0	6.50	41.0	6.69	61.0	6.75	81.0	6.78
1.5	5.29	21.5	6.51	41.5	6.69	61.5	6.75	81.5	6.78
2.0	5.26	22.0	6.51	42.0	6.69	62.0	6.75	82.0	6.78
2.5	5.28	22.5	6.52	42.5	6.69	62.5	6.75	82.5	6.79
3.0	5.33	23.0	6.53	43.0	6.70	63.0	6.75	83.0	6.79
3.5	5.40	23.5	6.54	43.5	6.70	63.5	6.76	83.5	6.79
4.0	5.47	24.0	6.55	44.0	6.70	64.0	6.76	84.0	6.79
4.5	5.54	24.5	6.55	44.5	6.70	64.5	6.76	84.5	6.79
5.0	5.62	25.0	6.56	45.0	6.70	65.0	6.76	85.0	6.79
5.5	5.69	25.5	6.57	45.5	6.71	65.5	6.76	85.5	6.79
6.0	5.75	26.0	6.57	46.0	6.71	66.0	6.76	86.0	6.79
6.5	5.81	26.5	6.58	46.5	6.71	66.5	6.76	86.5	6.79
7.0	5.86	27.0	6.58	47.0	6.71	67.0	6.76	87.0	6.79
7.5	5.91	27.5	6.59	47.5	6.71	67.5	6.76	87.5	6.79
8.0	5.95	28.0	6.59	48.0	6.71	68.0	6.76	88.0	6.79
8.5	6.00	28.5	6.60	48.5	6.72	68.5	6.77	88.5	6.79
9.0	6.04	29.0	6.60	49.0	6.72	69.0	6.77	89.0	6.79
9.5	6.07	29.5	6.61	49.5	6.72	69.5	6.77	89.5	6.79
10.0	6.11	30.0	6.61	50.0	6.72	70.0	6.77	90.0	6.79
10.5	6.14	30.5	6.62	50.5	6.72	70.5	6.77	90.5	6.79
11.0	6.17	31.0	6.62	51.0	6.72	71.0	6.77	91.0	6.79
11.5	6.19	31.5	6.63	51.5	6.73	71.5	6.77	91.5	6.79
12.0	6.22	32.0	6.63	52.0	6.73	72.0	6.77	92.0	6.80
12.5	6.24	32.5	6.63	52.5	6.73	72.5	6.77	92.5	6.80
13.0	6.27	33.0	6.64	53.0	6.73	73.0	6.77	93.0	6.80
13.5	6.29	33.5	6.64	53.5	6.73	73.5	6.77	93.5	6.80
14.0	6.31	34.0	6.65	54.0	6.73	74.0	6.77	94.0	6.80
14.5	6.33	34.5	6.65	54.5	6.73	74.5	6.77	94.5	6.80
15.0	6.34	35.0	6.65	55.0	6.74	75.0	6.78	95.0	6.80
15.5	6.36	35.5	6.66	55.5	6.74	75.5	6.78	95.5	6.80
16.0	6.38	36.0	6.66	56.0	6.74	76.0	6.78	96.0	6.80
16.5	6.39	36.5	6.66	56.5	6.74	76.5	6.78	96.5	6.80
17.0	6.41	37.0	6.66	57.0	6.74	77.0	6.78	97.0	6.80
17.5	6.42	37.5	6.67	57.5	6.74	77.5	6.78	97.5	6.80
18.0	6.43	38.0	6.67	58.0	6.74	78.0	6.78	98.0	6.80
18.5	6.44	38.5	6.67	58.5	6.75	78.5	6.78	98.5	6.80
19.0	6.46	39.0	6.68	59.0	6.75	79.0	6.78	99.0	6.80
19.5	6.47	39.5	6.68	59.5	6.75	79.5	6.78	99.5	6.80
20.0	6.48	40.0	6.68	60.0	6.75	80.0	6.78	100.0	6.80

Table II

Historical Spot Segment Rates

Month	Year	First Segment	Second Segment	Third Segment
September	2005	4.44	5.23	6.05
October	2005	4.78	5.50	6.27
November	2005	4.95	5.60	6.34
December	2005	4.96	5.54	6.24
January	2006	4.96	5.49	6.14
February	2006	5.19	5.61	6.09
March	2006	5.27	5.77	6.31
April	2006	5.43	6.06	6.67
May	2006	5.52	6.19	6.79
June	2006	5.67	6.21	6.78
July	2006	5.67	6.19	6.75
August	2006	5.46	5.98	6.59
September	2006	5.32	5.81	6.42
October	2006	5.33	5.81	6.36
November	2006	5.25	5.64	6.07
December	2006	5.16	5.60	6.09
January	2007	5.35	5.78	6.22
February	2007	5.31	5.76	6.13
March	2007	5.13	5.68	6.19
April	2007	5.23	5.81	6.34
May	2007	5.32	5.85	6.32
June	2007	5.58	6.21	6.61
July	2007	5.53	6.22	6.60
August	2007	5.40	6.20	6.66



October 9, 2007
hp-595

Assistant Secretary for Financial Institutions
David G. Nason
Remarks before The National Organization of Life & Health Insurance Guaranty Associations

Amelia Island, Fla. - Thank you for that kind introduction. It is a pleasure for me to join you here today. I appreciate the invitation to come back before you to discuss the economy, in which insurance plays an important role, and the credit and mortgage markets. I also plan to talk about how public policy makers are evaluating and thinking about the regulatory structure of the insurance industry. Lastly, I will provide a brief legislative update on terrorism risk insurance and share the Treasury Department's perspective on this important topic.

Financial Market Developments

It has been an especially busy time at Treasury. As you know, there has been an adjustment taking place in the overall credit market and the mortgage market in particular.

Largely because of lax underwriting, the mortgage market, especially the subprime market, has been experiencing a high number and percentage of delinquencies and defaults. As a result, subprime mortgage-backed securities have performed poorly.

This has led investors to reassess the risk of these securities and subsequently to reassess price.

Because of the interrelation of our capital markets, the concerns we have seen in subprime mortgages and related securities have had an impact on investors' confidence and assumptions about the credit quality and value of other assets, especially asset backed securities.

This has lead to a rather widespread reassessment of risk, and a subsequent revaluation across capital markets globally. Certain asset classes were able to reprice 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.

In general, the marketplace reaction to some of these excesses has been severe. Many of the mortgage originators with weak underwriting standards are out of business. Investors in the mortgage markets are experiencing heavy losses, especially those that failed to perform adequate due diligence to understand the risks of their investments. We expect the markets to continue to impose discipline on those lenders and investors who took risks without proper diligence.

We have seen the effects in the financial markets, and it will take some time for these market adjustments to play out. During this time, our country and the Treasury Department are very fortunate to have Secretary Paulson serving in office. At the Treasury Department, we have been actively engaged in the situation as it has continued to develop. Secretary Paulson has been working with financial regulators and with market participants. At a time like this when risk is being reappraised and market discipline is being imposed, confidence is key. Having the Treasury led by a Secretary who has spent his life in the financial markets, through

good times and bad times, is significant and meaningful.

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 and months, it is not a surprise that this event will have an impact on the economy. And at the same time, households were already feelings strains from high energy prices and the ongoing slowdown in the housing market after several years of extraordinary gains. Working in our favor was that the capital markets stress occurred against the backdrop of a strong global economy that has boosted U.S. exports. Moreover, the U.S. economy went into the credit disruption with some notable positive aspects. Most importantly, our labor market has remained healthy, with a still-low unemployment rate, ongoing job creation, and sizeable wage gains. And, business investment has picked up in the middle of 2007 after a slowdown in late 2006 and early 2007.

All told, the recent reappraisal of risk will result in a penalty to economic growth. We will continue to analyze this situation. It will take time for the current reappraisal to work itself out, but in our view the underlying strength of the economy should enable continued growth.

Housing Impact

Regardless of their eventual impact on the economy, these looming problems are incredibly meaningful to the homeowners undergoing strain. Therefore, I thought I would take a few moments to share the Administration's current thinking regarding the proper public policy response to these straining times.

We at Treasury are very focused on the difficulties facing many homeowners. Recently, President Bush, with Secretary Paulson and Housing and Urban Development (HUD) Secretary Jackson, 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. It is important to note at the outset the principles that we use to approach this problem. First, our efforts are targeted at homeowners that have the financial ability to own a home over the long-term. Second, our efforts will not be targeted to speculators that acquired real estate for investment purposes. Third, we want to avoid bailing out lenders. Lenders must recognize the value of these impaired mortgages and should not expect government assistance in their commercial transactions.

This summer, President Bush renewed his call on Congress to pass Federal Housing Administration (FHA) modernization legislation, which would lower down payment requirements, allow FHA to insure bigger loans, and give FHA more pricing flexibility and offer more options to homeowners looking to refinance their existing mortgage.

The Administration has launched a new FHA program to help people who have good credit but who have not made all of their payments on time because of rising mortgage payments. For the first time, FHA will be able to offer many of these homeowners an option to refinance their existing mortgage so they can make their payments and keep their homes. FHA will also charge mortgage insurance premiums based on the individual risk of each loan, using traditional underwriting standards, so it can expand access and help even more families.

President Bush also announced a new foreclosure avoidance initiative to help struggling homeowners find ways to refinance their homes. Treasury and HUD have begun reaching out to a wide variety of groups that offer foreclosure counseling and refinancing for American homeowners. These groups include community organizations like NeighborWorks, mortgage lenders and loan servicers, FHA, and Government-Sponsored Enterprises like Fannie Mae and Freddie Mac. The goal of this initiative is to expand mortgage financing options, identify homeowners before they face hardships, help them understand their financing options, and allow them to find a mortgage product that works for them.

Financial Services Regulatory Review

While Treasury has been focused on these important issues, it has not detracted us from our other important work. One of the most exciting projects underway involves

our examination of the U.S. financial services regulatory system. As some of you know, earlier this year Secretary Paulson asked the Treasury Department to engage in a broad, ongoing initiative to examine and strengthen the competitiveness of our capital markets.

The structure for regulating financial institutions in the United States generally has served us well. Much of this basic regulatory structure has developed over time. And while there have been important changes in the way financial institutions are regulated, the Treasury Department believes it is important to continue to evaluate our regulatory structure and to consider ways to improve efficiency, to reduce overlap, to strengthen consumer and investor protection, and to ensure that financial institutions have the ability to adapt to constantly-changing strategies and tools.

The Treasury Department's review of the financial regulatory structure is focused on all types of financial institutions: commercial banks and other insured depository institutions; securities firms; commodities firms; other financial intermediaries – and, important for this group, insurance firms.

Issues of regulatory structure are not new to you in the insurance industry. Unlike banks and other financial institutions that are regulated primarily at the federal level or on a dual federal/state basis, insurance companies are regulated solely by the states. This regulatory approach developed historically from the chartering of insurance companies by state legislatures and the evolution of state tax and insurance codes. The state-based regulatory approach was reaffirmed in 1945 by the McCarran-Ferguson Act and in 1999 by the Gramm-Leach-Bliley Act, which allowed for greater affiliations across financial firms.

Many believe that the patchwork of a more than 51-state regulatory system has led to market inefficiencies and that the insurance regulatory structure needs to be modernized to reflect the complexities of today's global marketplace. The full spectrum of proposals have included: total federal preemption; dual federal/state systems under an optional federal charter approach; mandating national standards on the state-based system; and harmonizing and making more uniform regulation among the states.

As part of Treasury's ongoing study, the Department is reaching out to experts concerning the regulatory structure of financial institutions in the United States. These are complicated issues that do not lend themselves to easy solutions. We plan to release the results of our review, which will include a discussion on insurance regulation, early next year.

We have not made any decisions regarding the recommendations of our regulatory structure review. However we provided some views on insurance regulatory modernization in testimony before the Senate Banking Committee in July 2006. Treasury testified that the issues surrounding insurance regulation are significant because the U.S. financial services industry is one of our country's most important areas of economic activity, and the insurance industry is a large part of the U.S. financial sector. The testimony reflected our focus on three main issues:

- potential economic inefficiency, resulting both from the substance (such as price controls) and structure of state regulation;
- international impediments, both questions of comity (facilitating international firms' operations in the U.S.) and competitiveness (facilitating U.S. firms' operations abroad); and
- systemic "blind spots" – the inability of the official sector to understand and respond to the insurance sector's evolving contribution to risks affecting the financial system as a whole.

Treasury is continuing to monitor closely the developments of the various approaches to modernizing insurance regulation, including proposals to establish an optional federal charter (OFC), which would establish a federal insurance regulator and would allow both life and property/casualty insurers to obtain federal charters. Many of the largest domestic insurance institutions believe that this approach is better suited to deal with their worldwide operations. Treasury is interested to see how this approach could potentially address these issues. We will also focus on approaches that are best suited to provide appropriate consumer protection

As you know, the 110th Congress is actively looking at insurance regulation. In the Senate, Senators Sununu and Johnson have introduced their updated bipartisan bill, the National Insurance Act of 2007; in the House, Representative Melissa Bean and Representative Ed Royce have introduced a bipartisan companion bill.

Last week the House Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises held a hearing on the need for insurance regulatory reform.

The OFC bills are substantially similar to those introduced in the last Congress, but there are some key differences, including several changes in Title VI applicable to guaranty funds. Clearly guaranty funds play an important role in the insurance industry by providing a level of protection to policyholders, and they have provided this service well for many years. Further understanding and refining how the guaranty funds would operate under an OFC model is important to evaluating the overall model. We look forward to continuing to evaluate this issue in the coming months.

Another issue in the insurance industry that is related to regulatory structure is the NAIC's efforts to modernize its treatment of reinsurance collateral requirements. Given the cross border nature of the reinsurance industry, this issue also is directly related to how the U.S. insurance industry interacts with the rest of the world.

Under the current state-based insurance system, a non-U.S. reinsurer can do business in the U.S. by subjecting itself to state-solvency regulation by becoming licensed or creating and licensing a U.S. affiliate or branch in each state it does business; or, by posting 100 percent collateral on its gross U.S. obligations. For the past several years, non-U.S. reinsurers have pursued changes to the U.S. reinsurance collateral rules on the basis that the rules do not adequately account for the underlying credit quality on non-U.S. reinsurers. It has been a tortuous process thus far, with most U.S. insurers and reinsurers opposed to any change. The NAIC has attempted to resolve the dispute by proposing various alternative regulatory regimes, but none have gained any traction.

The NAIC initiated its latest effort for a solution last month when its Reinsurance Task Force released a new proposal that would revamp the entire state regulatory structure for reinsurance, including but not limited to collateral requirements. The new proposal envisions a regulatory system for U.S.-licensed reinsurers where one state would be solely responsible for their U.S. regulation. As to non-U.S. reinsurers not wishing to become licensed or post 100 percent collateral, the new proposal envisions a third option: certification, which would be broadly based on a mutual recognition framework with individual "port-of-entry" states still allowed to set collateral requirements (minimum 60 percent). The certification requirements are rather complicated and still generating considerable concern among non-U.S. reinsures and foreign regulators.

The NAIC plans to continue its work on the proposal, but as with other recent efforts on reinsurance collateral it remains unclear as to whether it can achieve a solution or if the current state-based regulatory system can be effectively integrated into the global insurance marketplace. While this is a very technical issue, it is helpful to show the impact that regulatory structure has on an industry's ability to remain competitive in a global marketplace.

Terrorism Risk Insurance

I would like to use the rest of my time here today to talk about terrorism risk insurance. This issue is being heavily debated in Washington because the current program is scheduled to expire at year-end.

Following the significant economic dislocation that occurred in the wake of the September 11 attacks, President Bush and Congress responded by passing the Terrorism Risk Insurance Act of 2002, known as TRIA. TRIA ensured the continued widespread availability and affordability of commercial property and casualty terrorism coverage by basically placing the government in the reinsurance business.

Temporary by design, TRIA provided time for insurers and others to adjust to the

risks made clear by the September 11 terrorist attacks. Subsequently, there were positive market responses by insurers and reinsurers to the reductions in the federal role over the five years that TRIA was in place. The most notable one was the increasing role of the private sector in each year of the program. Insurers increased their terrorism risk exposure as TRIA scaled back, and prices for terrorism risk coverage declined or remained stable. In some sense, we conducted a market experiment under TRIA that illustrated that the private sector is capable of taking on increasing amounts of terrorism risk as the Federal Government's role recedes. TRIA generally was effective in encouraging the greater provision of terrorism risk insurance, while at the same time encouraging and supporting private market development.

Given the success achieved under TRIA to date, the obvious question is whether or not the Federal Government should maintain a limited role in the provision of terrorism risk insurance going-forward. Based on where the market for terrorism risk insurance is today, it is Treasury's view is that TRIA should continue to be phased out in order to increase private sector participation. Earlier this year Treasury laid out three critical elements needed if TRIA is to be reauthorized for a second time:

- that the program remains temporary and short-term;
- that private sector retentions are increased; and
- that there is no expansion of the program.

Unfortunately, the bill the House passed, H.R. 2761, does not meet these critical elements. There are some particularly objectionable provisions in the House bill such as:

- an extension of the program for 15 more years – a *de facto* permanent extension;
- the failure to continue to increase private sector retentions;
- the expansion of the program to add group life insurance; and
- for the first time, the mandate for insurers to offer coverage for nuclear, biological, chemical and radiological (NBCR) attacks.

I realize that the addition of group life insurance, as well as insurers taking on more NBCR risk may be of particular interest to some in this room. Let me briefly address those two issues.

As a basic principle, the Federal Government's role in any market, including the market for terrorism risk insurance, should be limited to those areas where private markets cannot function and hence broader costs are imposed on our nation's overall economy. As found by government studies in 2003 and 2006, group life insurance is still widely available in the private market even though it is not part of the TRIA program. Group life insurers acknowledge that competitive pressures have caused them to make coverage available, even in the absence of TRIA protection. Thus, the private market is functioning in this area.

With regard to NBCR risk, even prior to September 11, insurance typically does not cover these losses, regardless of the cause, except when mandated by state law, such as with workers' compensation. Still, TRIA covers insured losses from NBCR losses resulting from a certified act of terrorism *if* the coverage is provided in the insurance policy. But it seems clear to us that TRIA has been largely ineffective in spurring the development of a private NBCR market because even with TRIA, there is limited availability.

While the facts are less than clear that TRIA can help, there are indications that amending TRIA in this way can be harmful. If insurers must offer NBCR-terrorism coverage, insurer capacity might draw from conventional attack capacity. Moreover, some insurers are concerned about taking on such exposure and the effect on credit ratings and more importantly their solvency in the event of an actual attack.

Most recognize that the Federal Government is already involved in the sharing of NBCR-terrorism risk given the expectation that uninsured losses will be likely compensated through federal disaster aid programs. We agree that this is an important and complex issue and acknowledge the absence of a functioning private

market for NBCR risks. However, based on the last five years of experience with the TRIA program, we at Treasury are not convinced that the House's approach will lead to the development of a NBCR market.

These are very significant changes to a program that was designed to be temporary. For this reason, the Administration noted that senior advisors to President Bush would recommend that he veto the bill. Despite this, the House bill passed by a wide margin and all eyes are on the Senate. I am hopeful that the Senate will work toward legislation that addresses the critical elements the Administration laid out so that a scaled-back TRIA program can be reauthorized.

As you can see, we have a number of issues on our plate right now. These are incredibly interesting times to be serving in the public sector at the Treasury Department. Thank you for listening and I would be happy to take a few questions.

- 30 -

October 9, 2007
hp-596

Secretaries Paulson and Jackson to Join Mortgage Servicers, Housing Counselors and Investors to Announce Efforts to Help Struggling Homeowners

Treasury Secretary Henry M. Paulson, Jr. and HUD Secretary Alphonso Jackson will be joined by mortgage market participants tomorrow to announce the formation of a new alliance that will develop strengthened efforts to help struggling homeowners keep their homes.

In the wake of housing market weakness and credit market turmoil, many Americans face mortgage resets that pose significant challenges. On August 31, President Bush announced an initiative to help as many Americans as possible keep their homes. Foreclosures are painful not only for families, but also for neighborhoods and for the economy. He asked Secretaries Paulson and Jackson to spearhead an effort to identify and help struggling homeowners. Treasury and HUD have been meeting with the nation's leading mortgage counselors, mortgage servicers, lenders, investors and other industry experts to explore ideas on how to reach and help as many homeowners as possible.

Who
Treasury Secretary Henry M. Paulson, Jr.
HUD Secretary Alphonso Jackson
NeighborWorks America CEO Ken Wade
Wells Fargo Home Mortgage Co-President Michael J. Heid
American Securitization Forum Executive Director George Miller

What
Announcement of New Effort to Help Struggling Homeowners

When
Wednesday, October 10, 10:30 a.m. (EDT)

Where
Treasury Department
Media Room – 4121
1500 Pennsylvania Avenue, NW
Washington, D.C.

Note: Media without Treasury press credentials should contact Anita Hunt at (202) 622-2920, or anita.hunt@do.treas.gov with the following information: full name, Social Security number and date of birth.

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PRESS ROOM

October 9, 2007
2007-10-9-15-27-9-3174

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 $68,589 million as of the end of that week, compared to $68,977 million as of the end of the prior week.

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

	October 5, 2007		
A. Official reserve assets (in US millions unless otherwise specified)	Euro	Yen	Total
(1) Foreign currency reserves (in convertible foreign currencies)			68,589
(a) Securities	13,781	10,900	24,681
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	13,764	5,369	19,133
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	4,454		
(3) SDRs	9,281		
(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)	68,589
--currencies in SDR basket	68,589
--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

October 9, 2007
HP-597

Treasury Secretary Henry M. Paulson, Jr. to Travel to Austin to Participate in the National Park Foundation Summit Next Week

Secretary Henry M. Paulson, Jr. will participate in The National Park Foundation Leadership Summit on Partnership and Philanthropy on Monday, Oct. 15. Paulson will speak about the importance of supporting our national parks.

The following event is open to media:

Who
Treasury Secretary Henry M. Paulson, Jr.

What
The National Park Foundation Leadership Summit on Partnership and Philanthropy
The Business Case: A Conversation with Secretary Paulson

When
Monday, October 15, 9:55 a.m. CDT

Where
The University of Texas at Austin
Etter-Harbin Alumni Center
2110 San Jacinto Blvd.
Austin, Texas

Note: Press must register with Mollie Fullington at mfullington@lakpr.com or 917-414-1639.

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PRESS ROOM

October 10, 2007
2007-10-10-10-45-44-17660

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 $68,589 million as of the end of that week, compared to $68,977 million as of the end of the prior week.

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

	October 5, 2007		
A. Official reserve assets (in US millions unless otherwise specified)	Euro	Yen	Total
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(a) Securities	13,781	10,900	24,681
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	13,764	5,369	19,133
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	4,454		
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(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		
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--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)

		Total	Maturity breakdown (residual maturity) 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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--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)

	Total	Maturity breakdown (residual maturity, where applicable) 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				
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(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)	
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--short positions	
--long positions	
--other instruments	
(c) pledged assets	
--included in reserve assets	
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--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	
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--currencies in SDR basket	68,589
--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.

October 10, 2007
HP-598

Treasury Designates Three Key Terrorist Financiers

The U.S. Department of the Treasury today designated as Specially Designated Global Terrorists (SDGTs) three individuals based in Saudi Arabia who have served as significant sources of financial and other support to individuals and entities in Southeast Asia previously named as SDGTs and listed pursuant to United Nations Security Council Resolution (UNSCR) 1267.

"These three terrorist financiers were instrumental in raising money to fund terrorism outside of Saudi Arabia," said Stuart Levey, Under Secretary for Terrorism and Financial Intelligence. "In order to deter other would-be donors, it is important to hold these terrorists publicly accountable."

Abdul Rahim Al-Talhi, Muhammad `Abdallah Salih Sughayr, and Fahd Muhammad `Abd Al-`Aziz Al-Khashiban were designated for providing support to the Abu Sayyaf Group (ASG), an al Qaida-affiliated terrorist group responsible for multiple bombings, kidnappings and other terrorist attacks in Southeast Asia.

Today's action was taken pursuant to Executive Order 13224. E.O. 13224 is aimed at financially isolating terrorists and their support networks. Designations made under this authority freeze any assets the designees may have under U.S. jurisdiction and prohibit transactions by U.S. persons with the designees. This action under E.O. 13224 also implements yesterday's decision by the UN 1267 Committee to include these three persons on its Consolidated List of persons and entities associated with al Qaida, the Taliban, or Usama bin Laden. This UN decision obligates UN member countries around the world to freeze the assets of the designees.

Identifying Information

The three individuals who have been designated have been known by a variety of name spellings and aliases. Those can be found on the website of the Office of Foreign Assets Control (OFAC), http://www.treasury.gov/ofac.

Abdul Rahim Al-Talhi

ADDRESS: *Buraydah, Saudi Arabia*
DOB: *December 8, 1961*
POB: *Al-Taif, Saudi Arabia*
NATIONALITY: *Saudi Arabian*
PASSPORT: *F275043, issued 05/29/04, expires 04/05/09*

Abdul Rahim al-Talhi (al-Talhi) was designated under E.O. 13224 for providing support to the ASG. Al-Talhi is an al Qaida-affiliated financier, a loyal colleague of Usama bin Laden, and a member of a Saudi Arabia-based donor network funding terrorists and supporting extremist activity.

Al-Talhi provided financial and other assistance to the ASG in the Philippines for many years. In the early 1990s, al-Talhi visited the Philippines with the goal of financing the ASG in its fight against the Philippine government. By the mid-1990s, al-Talhi was providing the ASG with financial assistance derived from donors in Saudi Arabia and other Gulf states. In addition, al-Talhi regularly supplied al Qaida ideological and training materials, including the al Qaida operations manual, to Philippine contacts.

In the late 1990s, Muhammad `Abdallah Salih Sughayr, who was also designated

today, was selected to succeed al-Talhi as the principal backer of the ASG and its affiliates in the Philippines. Al-Talhi remained active, however. As of early 2003, al-Talhi was assisting Sughayr in obtaining financial support from Saudi Arabia-based extremist donors. As of December 2006, al-Talhi had helped groom ASG leaders.

Muhammad `Abdallah Salih Sughayr

DOB: *August 20, 1972*
Alternate *DOB: August 10, 1972*
POB: *Al-Karawiya, Saudi Arabia*
NATIONALITY: *Saudi Arabian*

Muhammad `Abdallah Salih Sughayr (Sughayr) was designated today under E.O. 13224 for supporting the ASG. Sughayr has a history of providing support to terrorist groups in Southeast Asia and has been identified as one of the major financial supporters of the ASG. Recent information indicates that he continues to be active in transferring funds to the Philippines.

In the late 1990s, unidentified Saudi extremist donors wishing to provide financial and ideological support to the ASG network in the Philippines selected Sughayr to be their principal conduit. Sughayr was to succeed Al-Talhi, a Saudi national and al Qaida-affiliated financier who had recently left the Philippines. Sughayr, however, continued to receive support from Al-Talhi. From 1998 to 2003, Sughayr ensured continued financial and ideological support to the ASG and its affiliates in the Philippines. He also facilitated unspecified weapons and ammunition shipments to the ASG and provided advice and assistance to the group. In addition, he recruited foreign fighters to fill out ASG ranks and gave specialized training in guerilla operations to the ASG.

In one instance in June 2004, Sughayr was made aware of certain ASG financial needs and deposited an unspecified sum of money into an account and alerted a possible ASG associate the deposit had been made. Also in 2004, Sughayr planned to send money for weapons to an ASG member. Sughayr was arrested by Philippine authorities in 2005 and subsequently deported to Saudi Arabia.

Fahd Muhammad `Abd Al-`Aziz Al-Khashiban

DOB: *October 16, 1966*
POB: *`Aniza, Saudi Arabia*
NATIONALITY: *Saudi Arabian*

Fahd Muhammad Abd Al-`Aziz Al-Khashiban (Khashiban) was designated today under E.O. 13224 for supporting the ASG, including ASG's leadership. In the early 2000s, Khashiban gave then-ASG leader Khadaffy Janjalani approximately US $18,000 to finance a planned ASG bombing operation targeting either the U.S. or the Australian embassy in Manila. Philippine authorities disrupted this plot before its completion, but Khashiban continued to routinely provide money to the ASG.

October 10, 2007
HP-599

Statement by Secretary Henry M. Paulson, Jr.
on Announcement of New Private Sector Alliance – HOPE NOW

Washington, DC--Thank you, Secretary Jackson, for being here today. And thank you to everyone here today with one common objective – helping homeowners stay in their homes. We all know well the turmoil in today's mortgage markets. A combination of stagnant or falling house prices, low down payment mortgages and resetting adjustable-rate mortgage rates are creating real challenges for many American homeowners. More and more homeowners are having trouble meeting their monthly mortgage payments, and foreclosure rates have risen in recent quarters. Foreclosures are painful not only for families, but also for neighborhoods, for mortgage servicers, for mortgage investors, and for the economy as a whole. This morning, I welcome you all here to applaud a new alliance of mortgage market participants who recognize that cost, and are stepping up efforts to prevent it for as many families as possible.

On August 31, President Bush announced a foreclosure prevention initiative. He asked Secretary Jackson and me to spearhead an effort to identify struggling homeowners and help as many as possible to keep their primary residences. We have been meeting with the nation's leading mortgage counselors, mortgage servicers, lenders, investors and other industry experts to explore their ideas on how to reach and help homeowners.

We learned that many individual participants are already actively engaged. Leading mortgage servicers have increased their outreach to borrowers who may need help. Mortgage counselors have been working hard to support the large numbers of homeowners who are calling them and asking for help. State and local governments across the country have started innovative programs targeted at people and neighborhoods hit worst by the market downturn.

Each of these steps is critical, and each has an impact. But we also know that we will not be nearly as effective as we need to be unless everyone is working together. Only through better integration of their efforts can mortgage counselors and mortgage servicers reach the greatest number of borrowers facing payments they can't meet and only with increased coordination can they be more effective in finding solutions for those homeowners.

Today, for the first time, 11 of the largest mortgage servicers representing 60 percent of the mortgages in America, several of the leading mortgage counselors, investors, and large trade organizations have come together and formed a partnership to help more Americans keep their homes. These leaders recognize that by working together, coordinating and scaling up their activities, they will be able to work toward the goal to help more homeowners.

Their partnership, called HOPE NOW, has put together an aggressive plan to reach more homeowners and help them find a way to stay in their homes. And I'm glad to see the American Securitization Forum, representing investors as well as servicers, is joining this alliance, recognizing that mortgage investors also have an interest in expanding the reach of mortgage counselors to prevent foreclosures whenever possible.

This coalition has a lot of work to do – I applaud you for running toward this challenge. I'm pleased that in my discussions with members of Congress on this initiative I've heard bipartisan support for this effort. I also hope to see this alliance grow. Although, the servicers here represent 60 percent of mortgages outstanding, we need greater participation if we are going to get to all those that need help as quickly as possible. Others have good reason to join this alliance, because

minimizing foreclosures benefits lenders and investors as well as homeowners.

Thank you all for what you are doing, and keep up the effort. I know you are working to develop standardized metrics to track your progress and effectiveness in reaching and helping borrowers. I am also convinced that only by working together do we have any chance of being as successful as we need to be. A unified strategy and better integration will mean homeowners get better help with their mortgages, servicers get better responses when they reach out to people, and our communities will see fewer foreclosures.

Let me be clear. I'm not announcing we have solved this problem. What we're announcing is a necessary step toward a very important objective. We all have a lot more work to do. And we at Treasury look forward to working with this group and with Congress as we continue to confront this challenge.

The alliance members standing here with us today will give you more detail on their plans. But first, let me turn the microphone to Secretary Jackson, and let me put in a plug for his agency. As we all know, the sooner a troubled borrower reaches out to explore financial options, the more likely he or she will be able to find an affordable mortgage solution. Anyone worried today – please call your lender or go on the HUD website to find a mortgage counselor and ask for help. I'm sure Secretary Jackson will say that too – but it bears repeating.

PRESS ROOM

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October 10, 2007
hp-600

Treasury Targets Financial Empire of Colombian Trafficker

The U.S. Department of the Treasury's Office of Foreign Assets Control (OFAC) today added to its list of Specially Designated Narcotics Traffickers seven individuals and 14 companies tied to Colombian narcotics trafficker Juan Carlos Ramirez Abadia (a.k.a. Chupeta). Among those designated today are key financial associates of Ramirez Abadia, including Diego and Tulio Alzate Jimenez, and a Colombian currency exchange and money remittance company (*casa de cambio*).

"Today's designations are the latest in a series aimed at Chupeta's illicit business empire," said OFAC Director Adam J. Szubin. "This action targets *Cambios y Capitales S.A.*, a major money service business, along with several of Chupeta's most important financial associates."

Juan Carlos Ramirez Abadia, who was identified as a Specially Designated Narcotics Trafficker by OFAC in August 2000, was arrested in Brazil on August 7, 2007. He was previously indicted on federal drug trafficking charges in Colorado in 1994 and the Eastern District of New York in 1995 and 2004. In 2004, Colombia's North Valle drug cartel was indicted in the District of Columbia under the federal Racketeer Influenced and Corrupt Organizations Act. Juan Carlos Ramirez Abadia was identified in this U.S. indictment as one of the cartel's leaders.

OFAC has worked closely with the Drug Enforcement Administration and the U.S. Attorney's Office for the Eastern District of New York on this sanctions investigation.

Diego Uriel Alzate Jimenez, Luis Holmes Alzate Jimenez, and Tulio Hernando Alzate Jimenez are among the primary shareholders of *Cambios y Capitales S.A.*, which is headquartered in Bogota, Colombia. One of the brothers, Tulio Hernando Alzate Jimenez, was indicted on federal narcotics-trafficking and money- laundering charges in the Southern District of Florida in 1994. The Alzate Jimenez brothers are also owners of *Andinaenvios AN EN S.A.*, a courier and money remittance business located in Quito, Ecuador, which was also designated today by OFAC.

Another key group of financial associates for Juan Carlos Ramirez Abadia identified by OFAC today are the Lopera Barbosa siblings. Adriana Lopera Barbosa, Jairo Humberto Lopera Barbosa, and Juan Carlos Lopera Barbosa own and manage four Colombian companies, including *Coinemp S.A.* and *J.A.J. Barbosa y Cia. S.C.S.*, that act as real estate holding firms to hide the assets of Ramirez Abadia. Another Ramirez Abadia front person, Nelson Salazar Lugo, helps manage the Colombian tourism company *Turismo Hansa S.A.* The Alzate Jimenez brothers and the Lopera Barbosa siblings also play ownership and management roles in *Turismo Hansa S.A.* on behalf of Juan Carlos Ramirez Abadia.

Today's announcement marks OFAC's third action targeting the assets of Ramirez Abadia since 2006. In August 2006, OFAC designated the Colombian pharmaceutical distribution company *Disdrogas Ltda.* along with Ramirez Abadia's parents, who were managing the company on his behalf. On August 15, 2007, OFAC designated several of Ramirez Abadia's key lieutenants as well as a theme park (*Parque Yaku*) and a *paso fino* horse breeding farm (*Criadero Santa Gertrudis S.A.*) located near Cali, 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. (see link below)*

LINKS

- Chart
- Impact Report on Economic Sanctions Against Colombian Drug Cartels (March 2007)

North Valle Cartel Financial Network

October 2007

SDNT Principal since 2000

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

Specially Designated Narcotics Traffickers

Indicted on Narcotics Trafficking & Money Laundering Charges Southern District of Florida (1994)

Juan Carlos RAMIREZ ABADIA
(a.k.a. "Chupeta")
CC 16684736 (Colombia)

Arrested in Brazil on August 7, 2007

Front Persons for "Chupeta"

- Diego Uriel ALZATE JIMINEZ, CC 16658014 (Colombia)
- Tulio Hernando ALZATE JIMINEZ, CC 16659731 (Colombia)
- Luis Holmes ALZATE JIMINEZ, CC 16597861 (Colombia)
- Nelson SALAZAR LUGO, CC 16594719 (Colombia)
- Adriana LOPERA BARBOSA, CC 31930002 (Colombia)
- Jairo Humberto LOPERA BARBOSA, CC 16792756 (Colombia)
- Juan Carlos LOPERA BARBOSA, CC 16746731 (Colombia)

Associated Companies

- ANDINAENVIOS AN EN S.A., Quito, Ecuador, RUC # 1791769155001 (Ecuador)
- ASESORIA Y SOLUCIONES GRUPO CONSULTOR S.A., Cali, Colombia, NIT # 805018000-1 (Colombia)
- CAMBIOS Y CAPITALES S.A., Bogota, Colombia, NIT # 805001015-5 (Colombia)
- CONSTRUCTORA E INMOBILIARIA ANDINA S.A., Cali, Colombia, NIT # 800155233-7 (Colombia)
- COINEMP S.A. (f.k.a. ASECOM S.A.), Cali, Colombia, NIT # 890326149-8 (Colombia)
- FINANCIACION Y EMPRESA S.A, Cali, Colombia, NIT # 800153965-0 (Colombia)
- FUNDASOCIAL, Cali, Colombia, NIT # 800142875-9 (Colombia)
- INVERSIONES CORPORATIVAS LTDA., Cali, Colombia, NIT # 800203027-2 (Colombia)
- INVERSIONES EPOCA S.A., Cali, Colombia, NIT # 805012582-7 (Colombia)
- INVERSIONES SARDI ALZATE S.C.S., Cali, Colombia, NIT # 805009126-0 (Colombia)
- J.A.J. BARBOSA Y CIA. S.C.S., Cali, Colombia, NIT # 800214437-6 (Colombia)
- OUTSOURCING DE OPERACIONES S.A., Bogota, Colombia, NIT # 805021157-8 (Colombia)
- T.H. ALZATE Y CIA. S.C.S., Cali, Colombia, NIT # 805008972-0 (Colombia)
- TURISMO HANSA S.A., San Andres, Colombia, NIT # 860027780-4 (Colombia)

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October 10, 2007
HP-601

Testimony of Treasury Assistant Secretary for Tax Policy Eric Solomon before the House Oversight Subcommittee on Domestic Policy on Tax Exempt Bond Financing

Washington, DC -- Chairman Kucinich, Ranking Member Issa, and distinguished Members of the Subcommittee:

I appreciate the opportunity to appear before you today to discuss certain Federal tax issues regarding the use of tax-exempt bond financing. The Administration recognizes that tax-exempt bond financing plays an important role as a source of lower-cost financing for State and local governments. As a nation, we are focusing on the critical need to support capital investment in public infrastructure. The Federal government provides an important Federal subsidy for tax-exempt bond financing through the Federal income tax exemption for interest paid on State or local bonds under Section 103 of the Internal Revenue Code (the "Code"), which enables State and local governments to finance public infrastructure projects and other public-purpose activities at lower costs.

The cost to the Federal government of tax-exempt bonds is significant and growing. Unlike direct appropriations, however, the cost of this Federal subsidy receives less attention because it is not tracked annually through the appropriations process. In addition, it also is important to recognize that the Federal subsidy for tax-exempt bonds is less efficient than that for direct appropriations because of the inefficiency of pricing in the tax-exempt bond market. In this regard, since some bond purchasers have higher marginal tax rates than those of the bond purchasers needed to clear the market, tax-exempt bonds cost the Federal government more in foregone revenue than they deliver to State and local governments in reduced interest expenses. The steady growth in the volume of tax-exempt bonds reflects the importance of this incentive in addressing public infrastructure and other needs. At the same time, it is appropriate to review the tax-exempt bond program to ensure that it is properly targeted and that the Federal subsidy is justified in light of the lost Federal revenue and other costs imposed.

My testimony covers four main issues. First, my testimony provides an overview of the legal framework for tax-exempt bonds. Second, it discusses the use of tax-exempt bonds to finance public infrastructure projects and stadium projects under the existing legal framework. Third, my testimony comments on certain tax policy and regulatory authority considerations. Finally, it provides certain statistical data on tax-exempt bonds for background.

Overview of Legal Framework for Tax-Exempt Bonds

A. Introduction

In general, there are two basic types of tax-exempt bonds: Governmental Bonds and Private Activity Bonds. Bonds generally are classified as Governmental Bonds if the proceeds are used for State or local governmental use or the bonds are repaid from State or local governmental sources of funds. Bonds generally are classified as Private Activity Bonds if they meet the definition of a Private Activity Bond under the Code, based on specified levels of private business involvement. In general, the interest on Private Activity Bonds is taxable unless the bonds meet qualification requirements for financing certain projects and programs specifically identified in the Code.

B. Governmental Bonds

State and local governments issue Governmental Bonds to finance a wide range of public infrastructure projects. The Code does not provide a specific definition of "Governmental Bonds." Instead, bonds are generally treated as Governmental Bonds if they avoid classification as Private Activity Bonds, as defined in the Code, by limiting private business use or private business sources of payment or security, and also by limiting private loans. Here, it is important to appreciate that bonds can qualify as Governmental Bonds if they are either used predominantly for State or local governmental use or payable predominantly from State or local governmental sources of funds, such as generally applicable taxes. Stated differently, under the current legal framework, Governmental Bonds can be used to finance a project that has significant private business use or that are payable from significant private business sources of payment, but not both.

In order for the interest on Governmental Bonds to be excluded from the bond holder's gross income for Federal tax purposes, a number of general eligibility requirements must be met. Requirements generally applicable to all tax-exempt bonds include arbitrage restrictions, bond registration and information reporting requirements, a general prohibition on Federal guarantees, advance refunding limitations, restrictions on unduly long spending periods, and pooled financing bond limitations.

C. Private Activity Bonds

1. In General

Under section 141 of the Code, bonds are classified as Private Activity Bonds if more than 10 percent of the bond proceeds are both:

(1) used for private business use (the "private business use limitation"); and

(2) payable or secured from payments derived from property used for private business use (the "private payments limitation").

Bonds also are treated as Private Activity Bonds if more than the lesser of $5 million or 5 percent of the bond proceeds are used to finance private loans, including business and consumer loans. The permitted private business thresholds are reduced from 10 percent to 5 percent for certain private business use that is "unrelated" to governmental use or that is "disproportionate" to governmental use financed in a bond issue. These tests are intended to identify arrangements that have the potential to transfer the benefits of tax-exempt financing to nongovernmental persons.

2. Projects and Programs Eligible for Tax-Exempt Private Activity Bond Financing

Private Activity Bonds may be issued on a tax-exempt basis only if they meet the requirements for qualified Private Activity Bonds, including targeting requirements that limit such financing to specifically defined facilities and programs. Under present law, qualified Private Activity Bonds may be used to finance eligible projects and activities, including the following: (1) airports, (2) docks and wharves, (3) mass commuting facilities, (4) facilities for the furnishing of water, (5) sewage facilities, (6) solid waste disposal facilities, (7) qualified low-income residential rental multifamily housing projects, (8) facilities for the local furnishing of electric energy or gas, (9) local district heating or cooling facilities, (10) qualified hazardous waste facilities, (11) high-speed intercity rail facilities, (12) environmental enhancements of hydroelectric generating facilities, (13) qualified public educational facilities, (14) qualified green buildings and sustainable design projects, (15) qualified highway or surface freight transfer facilities, (16) qualified mortgage bonds or qualified veterans mortgage bonds for certain single-family housing facilities, (17) qualified small issue bonds for certain manufacturing facilities, (18) qualified student loan bonds, (19) qualified redevelopment bonds, (20) qualified 501(c)(3) bonds for the exempt charitable and educational activities of Section 501(c)(3) nonprofit organizations, (21) certain projects in the New York Liberty Zone, and (22) certain projects in the Gulf Opportunity Zone.

Qualified Private Activity Bonds are subject to the same general rules applicable to

Governmental Bonds, including the arbitrage investment limitations, registration and information reporting requirements, the Federal guarantee prohibition, restrictions on unduly long spending periods, and pooled financing bond limitations. In addition, most qualified Private Activity Bonds are also subject to a number of additional rules and limitations. One notable additional rule limits the annual amount of these bonds that can be issued in each state (the "bond volume cap" limitation) under section 146 of the Code. Another notable additional rule prohibits advance refundings for most Private Activity Bonds under section 149(d)(2) (other than for qualified 501(c)(3) bonds). Further, unlike the tax exemption for interest on Governmental Bonds, the tax exemption for interest on most qualified Private Activity Bonds is generally treated as a preference item under the alternative minimum tax ("AMT"), meaning that the benefit of an exclusion from income for interest paid on these bonds can be taken away by the AMT.

The current legal framework for Private Activity Bonds was enacted as part of the Tax Reform Act of 1986. The basic purpose of the Private Activity Bond limitations was to limit the ability of State and local governments to act as conduit issuers in financing projects for the use and benefit of private businesses and other private borrowers except in prescribed circumstances. Prior to the Tax Reform Act of 1986, the predecessor legal framework had more liberal rules regarding the use of tax-exempt bonds for the benefit of private businesses (then called "industrial development bonds"), including a more liberal 25-percent limitation on permitted private business use and private payments (as compared to the present 10-percent private business and private payment limitations), and it did not include bond volume cap limitations on private activity bonds.

Prior to the Tax Reform Act of 1986, stadiums were on the list of eligible facilities that could be financed with tax-exempt industrial development bonds. Stadiums were removed from the list of facilities eligible for tax-exempt Private Activity Bond financing in 1986, but stadiums remain eligible for Governmental Bond financing notwithstanding the substantial private business use of these facilities if they meet the requirements for Governmental Bonds. Under current law, these requirements can generally be met when State and local governments subsidize the projects with governmental revenues or generally applicable taxes.

3. The Private Business Use Limitation

In general, private business use of more than 10 percent of the proceeds of a bond issue violates the private business use limitation. Private business use generally arises when a private business has legal rights to use bond-financed property. Thus, private business use arises from ownership, leasing, certain management arrangements, certain research arrangements, certain utility output contract arrangements (e.g., certain electricity purchase contracts under which private utilities receive benefits and burdens of ownership of governmental electric generation facilities), and certain other arrangements that convey special legal entitlements to bond-financed property.

Various exceptions and safe harbors apply with respect to the private business use limitation, which allow limited private business use of property financed by Private Activity Bonds in prescribed circumstances. Exceptions to the private business use limitation include exceptions for use in the capacity as the general public, such as use by private businesses of public roads ("general public use"), certain very short-term use arrangements, certain de minimis incidental uses, certain uses as agents of State and local governments, and certain uses incidental to financing arrangements (e.g., certain bondholder trustee arrangements). In addition, safe harbors against private business use apply to certain private management and research arrangements. Thus, for management contracts, in Rev. Proc. 97-13, 1997-1 C.B. 632, the IRS provided safe harbors that allow private businesses to enter into certain qualified management contracts with prescribed terms and compensation arrangements without giving rise to private business use to accommodate public-private partnerships for private management of public facilities. For research contracts, in Rev. Proc. 2007-47, 2007-29 I.R.B. 108 (July 16, 2007), the IRS provided updated safe harbors that allow certain research contract arrangements with private businesses at tax-exempt bond financed research facilities without giving rise to private business use (e.g., certain Federally sponsored research).

4. The Private Payments Limitation

In general, private payments aggregating more than 10 percent of the debt service on a bond issue (on a present value basis) violates the private payments limitation. The private payments limitation considers direct and indirect payments with respect to property used by private businesses that represent sources of payment or security for the debt service on a bond issue. For example, if a private business pays rent for its use of the bond-financed property, the rent payments give rise to private payments. Various limited exceptions apply for purposes of the private payments limitation.

5. The Generally Applicable Taxes Exception to the Private Payments Limitation

A notable exception to the private payments limitation applies to payments from generally applicable taxes. In the legislative history to the Tax Reform Act of 1986, Congress indicated its intent to exclude revenues from generally applicable taxes from treatment as private payments for purposes of the private payments limitation. The Conference Report to the Tax Reform Act of 1986 included the following statement:

> *Revenues from generally applicable taxes are not treated as payments for purposes of the security interest test*; however, special charges imposed on persons satisfying the use test (but not on members of the public generally) are so treated if the charges are in substance fees paid for the use of bond proceeds.

Consistent with this legislative history, Treasury Regulations define a generally applicable tax as an enforced contribution imposed under the taxing power that is imposed and collected for the purpose of raising revenue to be used for a governmental purpose. A generally applicable tax must have a uniform tax rate that is applied equally to everyone in the same class subject to the tax and that has a generally applicable manner of determination and collection. By contrast, a payment for a special privilege granted or service rendered is not considered a generally applicable tax. Special assessments imposed on property owners who benefit from financed improvements are also not considered generally applicable taxes. For example, a tax that is limited to the property or persons benefiting from an improvement is not considered a generally applicable tax. Although taxes must be determined and collected in a generally applicable manner, the Treasury Regulations permit certain agreements to be made with respect to those taxes. An agreement to reduce or limit the amount of taxes collected to further a bona fide governmental purpose is such a permissible agreement. Thus, an agreement to abate taxes to encourage a property owner to rehabilitate property in a distressed area is a permissible agreement.

In addition, the Treasury Regulations treat certain "payments in lieu of taxes" and other tax equivalency payments ("PILOTs") as generally applicable taxes. Under the current Treasury Regulations, a PILOT is treated as a generally applicable tax if the payment is "commensurate with and not greater than the amounts imposed by a statute for a tax of general application." For instance, if the payment is in lieu of property tax on the bond-financed facility, it may not be greater in any given year than what the actual property tax would be on the property. In addition, to avoid being a private payment, a PILOT must be designated for a public purpose and not be a special charge. Under this rule, a PILOT paid for the use of bond-financed property is treated as a special charge.

In 2006, the Treasury Department and the Internal Revenue Service (IRS) published Proposed Regulations to modify the standards for the treatment of PILOTs to ensure a close relationship between eligible PILOT payments and generally applicable taxes. Under the Proposed Regulations, a payment is commensurate with general taxes only if the amount of the payment represents a fixed percentage of, or a fixed adjustment to, the amount of generally applicable taxes that otherwise would apply to the property in each year if the property were subject to tax. For example, a payment is commensurate with generally applicable taxes if it is equal to the amount of generally applicable taxes in each year, less a fixed dollar amount or a fixed adjustment determined by reference to characteristics of the property, such as size or employment. The Proposed Regulations permit the level of fixed percentage or adjustment to change one time following completion of development of the property. The Proposed Regulations also provide that eligible PILOT payments must be based on the current assessed value of the property for property taxes for each year in which the PILOTs are paid, and the assessed value must be determined in the same manner and with the same frequency as property subject to generally applicable taxes. A payment is not commensurate if it is based

in any way on debt service with respect to an issue or is otherwise set at a fixed dollar amount that cannot vary with the assessed value of the property. The Treasury Department and the IRS are in the process of reviewing the public comments on the Proposed Regulations regarding the treatment of PILOTs.

Governmental Bonds for Public Infrastructure Projects and Private Stadiums Under the Existing Legal Framework

A. Public Infrastructure Projects

For public infrastructure projects, qualification for Governmental Bond financing focuses on limiting private business use to not more than 10-percent private business use under the first prong of the Private Activity Bond definition. In general, Governmental Bonds are an important tool that State and local governments use to finance public infrastructure projects to carry out traditional governmental functions, such as providing public roads, bridges, courthouses, and schools. Typically, State and local governments finance public infrastructure projects with Governmental Bonds based on predominant State or local governmental use of the projects and limited private business use within the permitted 10-percent private business use limitation for Governmental Bonds. Often, State and local governments finance public infrastructure projects with Governmental Bonds based in part on reliance on the general public use exception to private business use. Thus, for example, public roads may be financed with Governmental Bonds even if private businesses use them in the same way as individual members of the general public.

The tax policy justification for a Federal subsidy for tax-exempt bonds is strongest in circumstances where State or local governments use Governmental Bonds to finance public infrastructure projects and other traditional governmental functions to carry out clear public purposes.

B. Private Stadiums

For stadium projects that are acknowledged to exceed the 10-percent private business use limitation, qualification for Governmental Bond financing depends on limiting private payments to comply with the 10-percent private payments under the second prong of the Private Activity Bond definition. Here, it is important to recognize that, under the existing legal framework, bonds are classified as Private Activity Bonds only if they exceed both the 10-percent private business use limitation and the 10-percent private payments limitation. Thus, a State or local government may issue tax-exempt Governmental Bonds to finance a project that is 100-percent used for private business use, such as a stadium that a private professional sports team uses 100-percent for private business use, provided that the issuer does not receive private payments from the team or elsewhere that in the aggregate exceed the 10-percent private payments limitation. Alternatively, a State or local government may issue tax-exempt Governmental Bonds to finance a stadium to be used for private business use if it subsidizes the repayment of the bonds with State or local governmental funds, such as generally applicable taxes. For example, a city could pledge revenues from a city-wide sales tax, hotel tax, car tax, property tax, or other broadly based generally applicable tax to pay the debt service on Governmental Bonds to finance a stadium.

The tax policy justification for a Federal subsidy for tax-exempt bonds is weaker when State or local governments use Governmental Bonds to finance activities beyond traditional governmental functions, such as the provision of stadiums, in which the public purpose is more attenuated and private businesses receive the benefits of the subsidy.

Certain Tax Policy and Regulatory Authority Considerations Regarding Tax-Exempt Bond Financing

A. Targeting the Federal Subsidy for Tax-Exempt Bonds in General

In general, it is important to ensure that the Federal subsidy for tax-exempt bonds is properly targeted and justified. A rationale for a Federal subsidy for tax-exempt bonds for State and local governmental projects and activities exists when they serve some broader public purpose. The tax policy justification for a Federal subsidy for State or local governmental projects and activities is clearest in the case

of traditional public infrastructure projects to carry out traditional governmental functions where the public purpose is clear, particularly when the Federal subsidy is necessary to induce the projects to be undertaken.

The tax policy justification for this Federal subsidy becomes weaker, however, in circumstances that are more attenuated from traditional State or local governmental activities, such as circumstances that lack a clear public purpose justification, provide significant benefits to private businesses, or involve projects that might have been undertaken in any event without the benefit of the Federal subsidy.

In addition, it also is important to recognize that, in general, the Federal subsidy for tax-exempt bonds is less efficient than that for direct appropriations because of the inefficiency of pricing in the tax-exempt bond market. In this regard, since some bond purchasers have higher marginal tax rates than those of the bond purchasers needed to clear the market, tax-exempt bonds cost the Federal government more in foregone revenue than they deliver to State and local governments in reduced interest expenses. Thus, for example, if taxable bonds yield 10 percent and equivalent tax-exempt bonds yield 7.5 percent, then investors whose marginal income tax rates exceed 25 percent will derive part of the Federal tax benefits, resulting in a subsidy to the State and local governmental issuer that is less than the reduction in Federal revenue.

At the same time, it is important to point out that tax-exempt bond financing has advantages over the use of appropriated funds by government agencies. The involvement of private investors in the decision-making process for infrastructure investment can bring with it greater sensitivity to actual project costs and returns than in public sector investment decision-making. In some cases, this enhanced sensitivity to project costs and returns may compensate for the somewhat lower tax efficiency of tax-exempt bonds and lead to a more efficient investment outcome overall. In 2005, the Administration supported legislation that extended Private Activity Bond authority to qualified highway and surface freight transfer facilities in the highway and transit reauthorization based in part on these considerations.

B. Certain Tax Policy Considerations regarding Tax-Exempt Bond Financing of Stadiums

From a tax policy perspective, the ability to use Governmental Bonds to finance stadiums with significant private business use when the bonds are subsidized with State or local governmental payments, such as generally applicable taxes, arguably represents a structural weakness in the targeting of the Federal subsidy for tax-exempt bonds under the existing legal framework.

At the same time, the tax policy justification in favor of the existing two-pronged Private Activity Bond definition is that it gives State and local governments appropriate flexibility and discretion to finance with Governmental Bonds a range of projects in public-private partnerships with significant private business use when the projects are sufficiently important to warrant subsidizing them with State and local governmental funds, such as generally applicable taxes. Here, political constraints against commitment of such governmental funds ordinarily serve as a sufficient check against excess financing of such projects. An argument can be made, however, that this justification may be debatable in certain cases, such as in the case of certain stadium financings.

Several options could be considered to address the possible structural weakness in the targeting of the tax-exempt bond subsidy relative to tax-exempt Governmental Bonds for stadium financings.

First, Congress could consider repealing the private payments prong of the Private Activity Bond definition for stadiums only. This possible change would prevent use of tax-exempt Governmental Bonds to finance a stadium whenever the stadium has more than 10 percent private business use, as would typically be the case with any professional sports stadium. This option would preserve the ability of State and local governments to use Governmental Bonds to finance stadiums used primarily for governmental use (e.g., stadiums for state universities or city-sponsored amateur sports). This option would ensure targeting of the Federal subsidy for tax-exempt Governmental Bonds to circumstances involving predominant State or local governmental use of stadiums. In its Options to Improve Tax Compliance and Reform Tax Expenditures (JCS-02-05, January 27, 2005), the Congressional Joint

Committee on Taxation included this option to repeal the private payments limitation for stadium financings.

Second, Congress could consider combining the first option described above with an amendment to Section 142 of the Code to allow the use of tax-exempt Private Activity Bonds to finance stadiums used primarily for private business use within the constraint of the annual State tax-exempt Private Activity Bond volume caps. This measured option would constrain stadiums to compete with other eligible projects for allocations of this bond volume cap.

Third, Congress could consider banning tax-exempt bond financing for stadiums altogether. In 1996, Senator Patrick Moynihan sponsored a widely-publicized legislative proposal to this effect, which was never enacted into law.

Fourth, Congress could consider a broader option to repeal the private payments prong of the Private Activity Bond definition altogether. This possible change would treat bonds as Private Activity Bonds whenever private business use exceeded the 10 percent private business use limitation. This broader option would have an effect well beyond stadiums. This broader option would affect all types of projects with significant private business use that otherwise could be financed currently with Governmental Bonds based on payments from governmental funds. In its 2005 tax compliance options mentioned above, the Joint Committee on Taxation also discussed this broader option to repeal the private payments limitation altogether.

At this time, the Administration does not take a position on any specific policy option with respect to possible legislative changes to the tax-exempt bond provisions relative to stadium financings. This topic raises difficult questions which require balancing the interests of State and local governments in flexibility to finance projects they deem sufficiently important to subsidize with governmental funds and the Federal interest in ensuring effective targeting of the Federal subsidy for tax-exempt bonds. The Administration recognizes that review of this important Federal subsidy may be appropriate in considering ways more generally to simplify this area and to ensure effective targeting of this subsidy for public infrastructure in order to justify its cost.

C. Certain Regulatory Authority Considerations

The question has been raised whether the Treasury Department has the regulatory authority to restrict the use of tax-exempt bond financing for professional sports stadiums. The existing legal framework allows the use of Governmental Bonds to finance professional sports stadiums when the bonds are payable from governmental sources of funds, such as generally applicable taxes. In the legislative history to the present tax-exempt bond provisions of the Code, Congress clearly stated its intent to allow Governmental Bonds when secured by generally applicable taxes. The Treasury Department's and the IRS's roles in providing regulatory guidance are to interpret the Code in a manner consistent with Congressional intent.

Therefore, while the Treasury Department and the IRS have broad regulatory authority to interpret the Code, neither the Treasury Department nor the IRS has regulatory authority so broad as to read the private payments limitation out of the Private Activity Bond definition under Section 141 of the Code or to disregard Congress' expressed intent to exclude generally applicable taxes from private payments for this purpose. Thus, we do not believe the Treasury Department has the regulatory authority to prohibit use of Governmental Bonds to finance stadiums under the existing statutory structure.

Certain Statistical Data on Tax-Exempt Bonds

The Treasury Department estimates that Federal tax expenditures for the Federal subsidy for tax-exempt bonds grew from about $26 billion in 1998 to about $30.9 billion in 2006. This tax expenditure is estimated to grow to about $41.1 billion in 2012. Attached to my testimony is certain statistical data on tax-exempt bonds. One chart provides information on long-term new money (versus refinancing) tax-exempt bond issuance from 1991-2005, derived from IRS Statistics of Income data, and shows that annual total tax-exempt bond issuance grew from about $100 billion in 1991 to over $200 billion in 2005. Two additional charts provide breakdowns of the

types of projects financed with Governmental Bonds and Private Activity Bonds from 1991-2005.

Although the Treasury Department has no specific data on tax-exempt bond usage for stadiums, in a U.S. Government Accounting Office ("GAO") Report entitled "Federal Tax Policy: Information on Selected Capital Facilities Related to the Essential Governmental Function Test" (GAO-06-1082, dated September 2006), the GAO estimated that, during the period from 2000 through 2004, approximately $5.3 billion in tax-exempt bonds were issued in about 119 bond issues to finance stadiums and arenas.

Conclusion

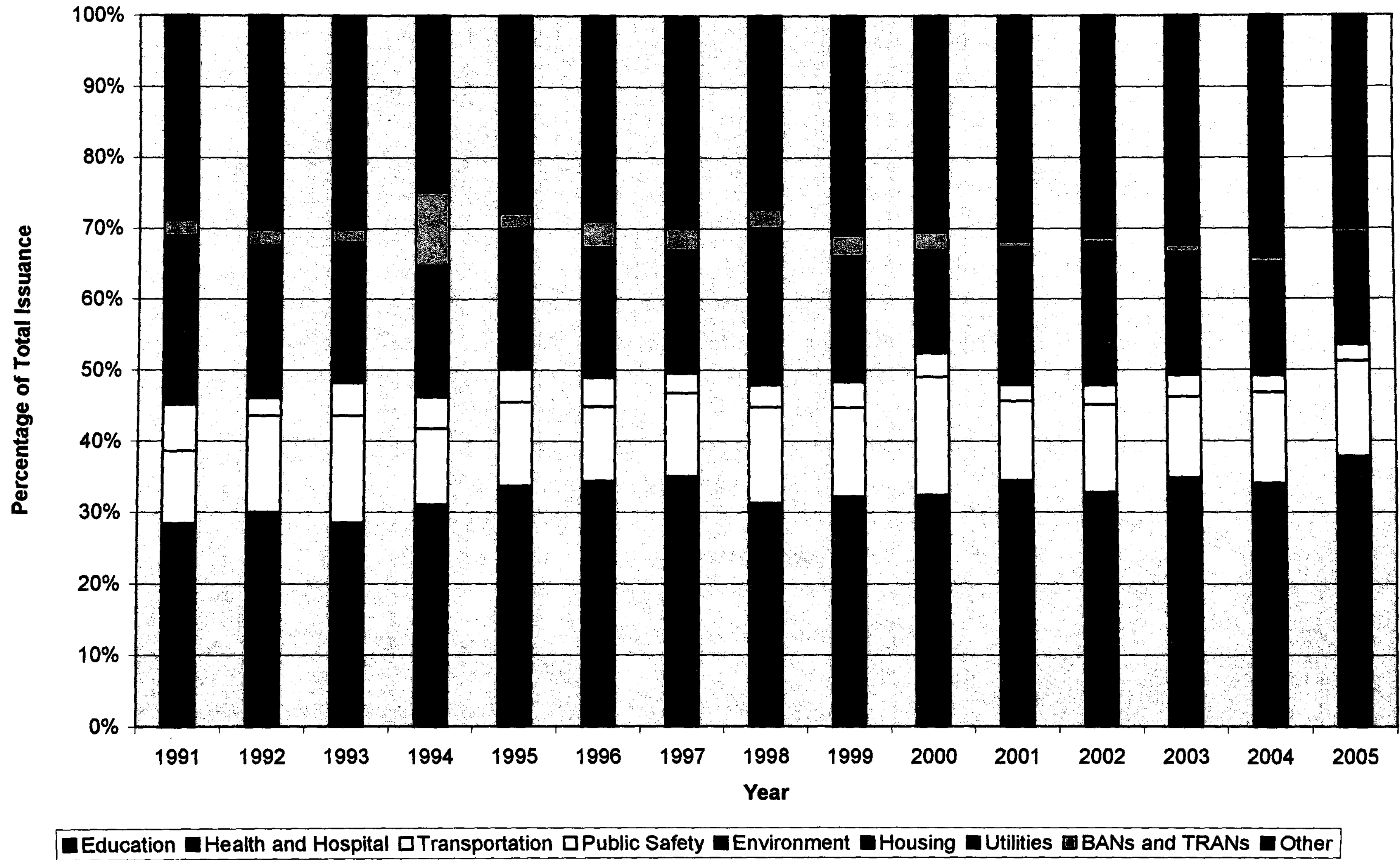
The Administration recognizes the important role that tax-exempt bond financing plays in providing a source of lower-cost financing for critical public infrastructure projects and other significant public purpose activities. It is important to ensure that the tax-exempt bond program is properly targeted so that it works most effectively and that the Federal subsidy for tax-exempt bonds is justified in light of the revenue costs and other costs imposed. The Administration would be pleased to work with the Congress in reviewing possible options to try to improve the effectiveness of this important Federal subsidy.

Thank you again, Mr. Chairman, Ranking Member Issa, and other Members of the Subcommittee for the opportunity to appear before you today. I would be pleased to answer any questions.

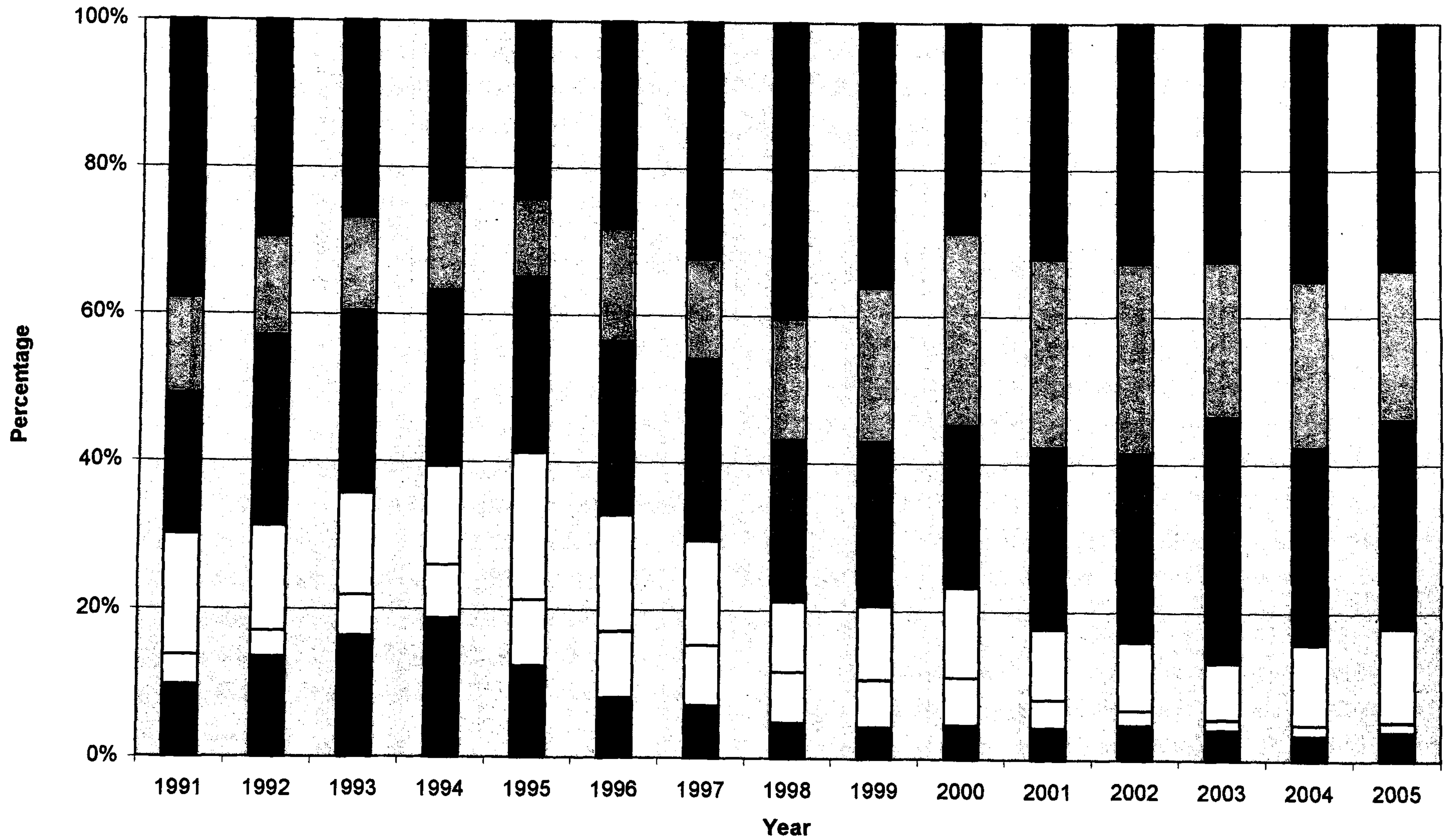
- 30 -

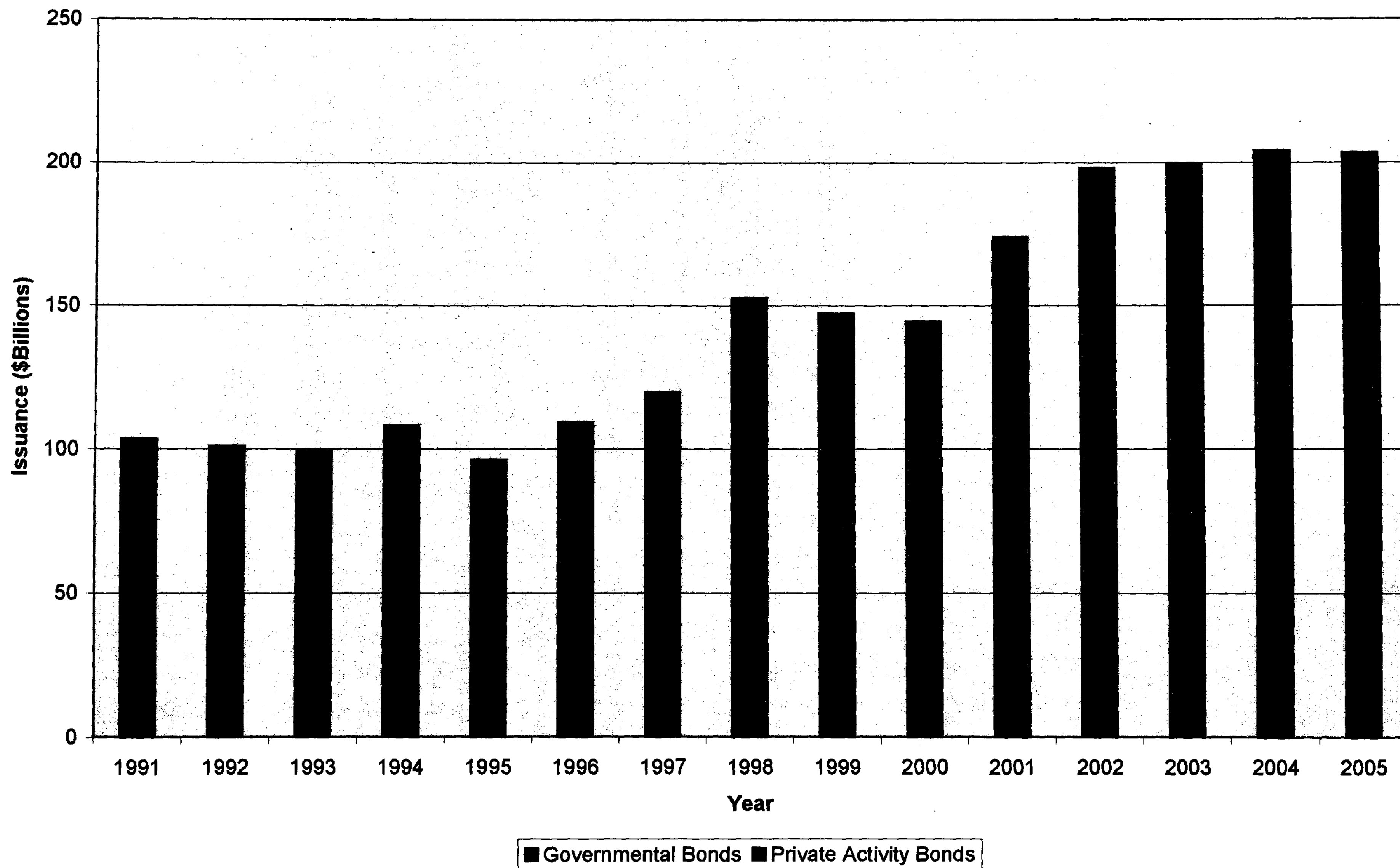
REPORTS

- Chart 1
- Chart 2
- Chart 3



Governmental Tax-Exempt Bonds by Purpose, 1991-2005
100%
90%
80%
70%
60%
50%
40%
30%
20%
10%
0%
Percentage of Total Issuance
1991
1992
1993
1994
1995
1996
1997
1998
1999
2000
2001
2002
2003
2004
2005
Year
Education
Health and Hospital
Transportation
Public Safety
Environment
Housing
Utilities
BANs and TRANs
Other


Private Activity Bond Issuance by Purpose, 1991-2005
100%
80%
60%
40%
20%
0%
Percentage
1991
1992
1993
1994
1995
1996
1997
1998
1999
2000
2001
2002
2003
2004
2005
Year
Energy
Pollution/Sewage
Small Issue IDBs
Mortgage subsidy
Rental
Airports & Docks
Student Loans
Private Education
Hospital


Long-Term, New Money Tax-Exempt Debt Issuance, 1991-2005
Issuance ($Billions)
250
200
150
100
50
0
1991
1992
1993
1994
1995
1996
1997
1998
1999
2000
2001
2002
2003
2004
2005
Year
Governmental Bonds
Private Activity Bonds

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October 11, 2007
HP-602

Treasury Requests Public Input on Review to Improve Regulatory Structure

Washington- The Department of the Treasury today released a request for public input as it prepares a blueprint for an improved U.S. financial regulatory structure. Secretary Paulson first announced his plans to review and recommend improvements to the regulatory structure in June as part of his initiative to strengthen U.S. financial markets' ability to compete in the global economy.

The blueprint, set for release early next year, will seek a more effective regulatory structure that can adapt to the dynamic U.S. marketplace while improving oversight. Treasury believes it is important to continue to evaluate our regulatory structure to consider ways to improve efficiency, reduce overlap, strengthen consumer and investor protection and ensure that financial institutions have the ability to keep pace with evolving markets.

The Department's review of the financial regulatory structure will focus on all types of financial institutions: commercial banks and other insured depository institutions; insurance companies; securities firms; futures firms; and other types of financial intermediaries.

Treasury asks for public comments on topics including overlapping state and federal regulation, ways to improve market discipline and consumer protection, the strengths and weaknesses of having multiple regulators and multiple federal charters for financial institutions, as well as other issues.

Comments are due by Wednesday, November 21 and may be submitted at www.regulations.gov.

REPORTS

- Federal Register Notice

BILLING CODE 4811-42

DEPARTMENT OF THE TREASURY

Review by the Treasury Department of the Regulatory Structure Associated with Financial Institutions.

AGENCY: Department of the Treasury, Departmental Offices.

ACTION: Notice; request for comments.

SUMMARY: The Treasury Department is undertaking a broad review of the regulatory structure associated with financial institutions. To assist in this review and obtain a broad view of all perspectives, the Treasury Department is issuing this notice seeking public comment.

DATES: Comments should be submitted electronically and received by Wednesday, November 21, 2007.

ADDRESSES: Please submit comments electronically through the Federal eRulemaking Portal – "Regulations.gov." Go to http://www.regulations.gov, select "Department of the Treasury – All" from the agency drop-down menu, then click "Submit." In the "Docket ID" column, select "TREAS-DO-2007-0018" to submit or view public comments and to view supporting and related materials for this notice. The "User Tips" link at the top of the Regulations.gov home page provides information on using Regulations.gov, including

instructions for submitting or viewing public comments, viewing other supporting and related materials, and viewing the docket after the close of the comment period.

Please include your name, affiliation, address, e-mail address and telephone number(s) in your comment. Where appropriate, comments should include a short Executive Summary (no more than five single-spaced pages). All statements, including attachments and other supporting materials, received are part of the public record and subject to public disclosure. You should submit only information that you wish to make available publicly.

FOR FURTHER INFORMATION CONTACT: Jeffrey Stoltzfoos, Senior Advisor, Office of the Assistant Secretary for Financial Institutions, (202) 622-2610 or Mario Ugoletti, Director, Office of Financial Institutions Policy, (202) 622-2730 (not toll free numbers).

SUPPLEMENTARY INFORMATION: The Treasury Department is currently engaged in a number of initiatives associated with maintaining the competitiveness of United States capital markets. One of those initiatives is evaluating the regulatory structure associated with financial institutions.

The regulatory structure for financial institutions in the United States has served us well over the course of our history. Much of the basic regulatory structure associated with financial institutions was established decades ago. While there have been important

changes over time in the way financial institutions have been regulated, the Treasury Department believes that it is important to continue to evaluate our regulatory structure and consider ways to improve efficiency, reduce overlap, strengthen consumer and investor protection, and ensure that financial institutions have the ability to adapt to evolving market dynamics, including the increasingly global nature of financial markets.

The Treasury Department's review of regulatory structure will focus on all types of financial institutions: commercial banks and other insured depository institutions; insurance companies; securities firms; futures firms; and other types of financial intermediaries.

The Treasury Department is soliciting comments to assist in this review. The Treasury Department would be particularly interested in comments on the specific questions set forth below, or on other issues related to the regulatory structure associated with financial institutions. We are also interested in specific ideas or recommendations as to how we can improve our current regulatory structure.

I. General Issues

1.1 What are the key problems or issues that need to be addressed by our review of the current regulatory structure for financial institutions?

1.2 Over time, there has been an increasing convergence of products across the traditional "functional" regulatory lines of banking, insurance, securities, and futures. What do you view as the significant market developments over the past two decades (e.g.

securitization, institutionalization, financial product innovation and globalization) and please describe what opportunities and/or pressures, if any, these developments have created in the regulation of financial institutions?

1.2.1 Does the "functional" regulatory framework under which banking, securities, insurance, and futures are primarily regulated by respective functional regulators lead to inefficiencies in the provision of financial services?

1.2.2 Does the "functional" regulatory framework pose difficulties for considering overall risk to the financial system? If so, to what extent have these difficulties been resolved through regulatory oversight at the holding company level?

1.2.3 Many countries have moved towards creating a single financial market regulator (e.g., United Kingdom's Financial Services Authority; Japan's Financial Services Agency; and Germany's Federal Financial Supervisory Authority (BaFin)). Some countries (e.g., Australia and the Netherlands) have adopted a twin peaks model of regulation, separating prudential safety and soundness regulation and conduct-of-business regulation. What are the strengths and weaknesses of these structural approaches and their applicability in the United States? What ideas can be gleaned from these structures that would improve U.S. capital market competitiveness?

1.3 What should be the key objectives of financial institution regulation? How could the framework for the regulation of financial institutions be more closely aligned with the objectives of regulation? Can our current regulatory framework be improved, especially in terms of imparting greater market discipline and providing a more cohesive look at

overall financial system risk? If so, how can it be improved to achieve these goals? In regards to this set of questions, more specifically:

1.3.1 How should the regulation of financial institutions with explicit government guarantees differ from financial institutions without explicit guarantees? Is the current system adequate in this regard?

1.3.2 Is there a need for some type of market stability regulation for financial institutions without explicit Federal Government guarantees? If so, what would such regulation entail?

1.3.3 Does the current system of regulating certain financial institutions at the holding company level allow for sufficient amounts of market discipline? Are there ways to improve holding company regulation to allow for enhanced market discipline?

1.3.4 In recent years, debate has emerged about "more efficient" regulation and the possibility of adopting a "principles-based" approach to regulation, rather than a "rules-based" approach. Others suggest that a proper balance between the two is essential. What are the strengths, weaknesses and feasibility of such approaches, and could a more "principles-based" approach improve U.S. competitiveness?

1.3.5 Would the U.S. financial regulatory structure benefit if there was a uniform set of basic principles of regulation that were agreed upon and adopted by each financial services regulator?

1.4 Does the current regulatory structure adequately address consumer or investor protection issues? If not, how could we improve our current regulatory structure to address these issues?

1.5 What role should the States have in the regulation of financial institutions? Is there a difference in the appropriate role of the States depending on financial system protection or consumer and investor protection aspects of regulation?

1.6 Europe is putting in place a more integrated single financial market under its Financial Services Action Plan. Many Asian countries as well are developing their financial markets. Often, these countries or regions are doing so on the basis of widely adopted international regulatory standards. Global businesses often cite concerns about the costs associated with meeting diverse regulatory standards in the numerous countries in which they operate. To address these issues, some call for greater global regulatory convergence and others call for mutual recognition. To what extent should the design of regulatory initiatives in the United States be informed by the competitiveness of U.S. institutions and markets in the global marketplace? Would the U.S. economy and capital market competitiveness be better served by pursuing greater global regulatory convergence?

II. Specific Issues

2.1 Depository Institutions

2.1.1 Are multiple charters for insured depository institutions the optimal way to achieve regulatory objectives? What are the strengths and weaknesses of having charters tied to specific activities or organizational structures? Are these distinctions as valid and important today as when these charters were granted?

2.1.2 What are the strengths and weaknesses of the dual banking system?

2.1.3 What is the optimal role for a deposit insurer in depository institution regulation and supervision? For example, should the insurer be the primary regulator for all insured depository institutions, should it have back-up regulatory authority, or should its functions be limited to the pricing of deposit insurance, or other functions?

2.1.4 What role should the central bank have in bank regulation and supervision? Is central bank regulatory authority necessary for the development of monetary policy?

2.1.5 Is the current framework for regulating bank or financial holding companies with depository institution subsidiaries appropriate? Are there other regulatory frameworks that could or should be considered to limit the transfer of the safety net associated with insured depository institutions?

2.1.6 What are the key consumer protection elements associated with products offered by depository institutions? What is the best regulatory enforcement mechanism for these elements?

2.2 Insurance

2.2.1 What are the costs and benefits of State-based regulation of the insurance industry?

2.2.2 What are the key Federal interests for establishing a presence or greater involvement in insurance regulation? What regulatory structure would best achieve these goals/interests?

2.2.3 Should the States continue to have a role (or the sole role) in insurance regulation? Insurance regulation is already somewhat bifurcated between retail and

wholesale companies (e.g., surplus lines carriers). Does the current structure work? How could that structure be improved?

2.2.4 States have taken an active role in some aspects of the insurance marketplace (e.g., workers' compensation and residual markets for hard to place risks) for various policy reasons. Are these policy reasons still valid? Are these necessarily met through State (as opposed to federal) regulation?

2.3 Securities and Futures

2.3.1 Is there a continued rationale for distinguishing between securities and futures products and their respective intermediaries?

2.3.2 Is there a continued rationale for having separate regulators for these types of financial products and institutions?

2.3.3 What type of regulation would be optimal for firms that provide financial services related to securities and futures products? Should this regulation be driven by the need to protect customers or by the broader issues of market integrity and financial system stability?

2.3.4 What is the optimal role for the states in securities and futures regulation?

2.3.5 What are the key consumer/investor protection elements associated with products offered by securities and futures firms? Should there be a regulatory distinction among retail, institutional, wholesale, commercial, and hedging customers?

2.3.6 Would it be useful to apply some of the principles of the Commodity Futures Modernization Act of 2000 to the securities regulatory regime? Is a tiered

system of regulation appropriate? Is it appropriate to make distinctions based on the relative sophistication of the market participants and/or the integrity of the market?

Dated:

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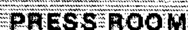
Taiya Smith
Executive Secretary of the Treasury



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October 11, 2007
HP-603

Joint Statement of
Henry M. Paulson, Jr., Secretary of the Treasury,
And Jim Nussle, Director of the Office of Management and Budget,
on Budget Results for Fiscal Year 2007

SUMMARY

The Administration today released the September 2007 Monthly Treasury Statement of Receipts and Outlays of the United States Government. The statement shows the actual budget totals for the fiscal year that ended September 30, 2007, as follows:

- A deficit of $163 billion;
- total receipts of $2,568 billion; and
- total outlays of $2,731 billion.

"This year's budget results demonstrate the remarkable strength of the U.S. economy. This strength has translated into record-breaking revenues flowing into the U.S. Treasury and a continued decline in the federal budget deficit. President Bush's fiscal policies have helped promote economic growth and steady job creation. We must keep taxes low and restrain federal spending to continue the economic expansion in the wake of credit market disruptions and the housing market downturn. Shrinking the budget deficit and keeping the economy strong are critical elements to help us address the coming wave of entitlement spending. We must work together to find a solution to this problem, or we will cripple future generations with obligations they cannot afford."

- Treasury Secretary Henry M. Paulson, Jr.

"This year's budget results further demonstrate how the President's tax relief, combined with spending discipline, has helped promote a sustained economic expansion, which led to revenue growth, and resulted in a declining deficit. Our short-term budget outlook is improving, but beyond the horizon is a huge budgetary challenge – the unsustainable growth in Social Security, Medicare and Medicaid. The President has proposed reasonable changes that begin to fix this serious problem. For the sake of our children and grandchildren, Congress should begin to take action to prevent this fiscal train wreck."

- OMB Director Jim Nussle

Table 1. TOTAL RECEIPTS, OUTLAYS AND SURPLUS/DEFICIT (-)

(in billions of dollars)

	Receipts	Outlays	Surplus/Deficit (-)
2006 Actual....................................	2,407	2,655	-248
FY 2007 Estimates:			
FY 2008 Budget........................	2,540	2,784	-244

FY 2008 Mid-Session Review...	2,574	2,779	-205
Actual..	2,568	2,731	-163

The FY 2007 unified deficit was $163 billion, or an estimated 1.2 percent of the Gross Domestic Product (GDP). At this level, the deficit is half of the 40-year average of 2.4 percent of GDP. The deficit for FY 2007 was $42 billion lower than projected in July in the Mid-Session Review (MSR) because outlays were $48 billion lower than expected and receipts were $6 billion lower than expected. The deficit was also $81 billion lower than projected last February in the FY 2008 Budget, with receipts coming in $28 billion higher and outlays $54 billion lower than projected.

Overall, receipts in FY 2007 were 6.7 percent higher than in FY 2006, marking the third consecutive year in which receipt growth outpaced growth in GDP. Receipts rose from 18.5 percent of GDP in FY 2006 to 18.8 percent of GDP in FY 2007. This level of receipts is above the 40-year historical average of 18.3 percent.

Outlays for FY 2007 grew by $76 billion, or 2.8 percent, from last year, representing the smallest percentage growth in outlays in 10 years. The increase was driven by growth in the Departments of Defense and Health and Human Services and the Social Security Administration. Overall, outlays decreased as a percent of GDP, from 20.4 percent in FY 2006 to 20.0 percent in FY 2007. This spending level is below the 40-year historical average of 20.6 percent.

RECEIPTS

Total receipts for FY 2007 were $2,568 billion, $6 billion lower than the MSR estimate of $2,574 billion. Table 2 displays actual receipts and estimates from the Budget and MSR by source.

- Individual income taxes were $1,163 billion, $5 billion lower than the MSR estimate. An accounting adjustment based on more recent data reallocated $3 billion less than had been expected in withheld tax payments from the Social Security and Medicare Trust Funds to individual income taxes, reducing withheld individual income taxes $3 billion below the MSR estimate. Lower-than-estimated non-withheld payments reduced individual income taxes an additional $3 billion below the MSR estimate. These shortfalls in payments of withheld and non-withheld taxes were partially offset by lower-than-expected refunds.
- Corporation income taxes were $370 billion, $1 billion lower than the MSR estimate. Lower-than-estimated corporate tax payments of $2 billion, which were partially offset by lower-than-estimated refunds, were responsible for the difference in collections relative to the MSR.
- Social insurance and retirement receipts were $870 billion, the same as the MSR estimate, despite the lower-than-expected reallocation of withheld tax payments from the Social Security and Medicare Trust Funds to individual income taxes, as described above.
- Other sources of receipts (excise taxes, customs duties, estate and gift taxes, and miscellaneous receipts) were $164 billion, the same as the MSR estimate, due to small offsetting changes among these sources of receipts.

OUTLAYS

Total outlays were $2,731 billion, $48 billion below the MSR estimate. Outlays for nearly all agencies were lower than MSR estimates, with the largest differences in the Departments of Defense, Health and Human Services, and Homeland Security. Table 3 displays actual outlays by agency and major program as well as estimates from the Budget and the MSR. The largest changes in outlays from the MSR were in the following areas:

- Department of Agriculture – Department of Agriculture outlays were $84 billion, $4.5 billion below the MSR estimate. The Farm Service Agency's (FSA) FY 2007 outlays were $2.7 billion below the MSR estimate. FSA did not outlay $1.4 billion in planned disaster assistance in FY 2007; these payments will now be made in FY 2008. Also, commodity prices were slightly stronger than anticipated, which contributed to lower-than-

anticipated commodity payments and also resulted in fewer producers taking FSA loans on the 2007 crop than anticipated in the MSR. Additionally, outlays for the Risk Management Agency were lower than the MSR estimate because the weather for areas where the bulk of crops is insured was better than expected, reducing crop insurance payments.

- Department of Defense – Military outlays were $530 billion in FY 2007, $9 billion (1.7 percent) below the MSR estimate. Outlays for military personnel, operations and maintenance, and procurement were all lower than expected. The late passage of the FY 2007 emergency supplemental caused the military services to restrain spending and delay planned activities. At the time of the MSR, many of these programs projected rapid recovery from these disruptions. However, while outlays have picked up gradually since June, spending has not been as high as projected.
- Department of Education – Outlays for the Department of Education were $66 billion in FY 2007, $1.5 billion below the MSR estimate. This stemmed from lower-than-estimated outlays for several programs in the Office of Elementary and Secondary Education, other offices with formula grant programs, and appropriations provided for hurricane relief.
- Department of Energy – Outlays for the Department of Energy were $20 billion, $1 billion lower than the MSR estimate. Program outlays for the National Nuclear Security Administration were $0.7 billion lower than expected. In addition, net outlays for the Bonneville Power Administration were $0.5 billion less than estimated in the MSR due to higher-than-expected secondary market revenues. Secondary market revenues, which result from Bonneville selling surplus power in the wholesale market, are difficult to predict in advance because they are primarily driven by weather events, such as heavy rain or snow pack.
- Department of Health and Human Services – Outlays for the Department of Health and Human Services were $672 billion, $7.1 billion lower than the MSR estimate. Outlays for Medicaid were $6.2 billion lower than projected in the MSR, due to lower-than-expected claims for Federal share reimbursement of State Medicaid spending. Additionally, Medicare gross outlays increased by $3.2 billion (0.7 percent) compared to MSR estimates. Key factors explaining the difference include higher-than-expected skilled nursing facility and home health spending, partially offset by lower-than-expected inpatient hospital spending.
- Department of Homeland Security – Outlays for the Department of Homeland Security were $39 billion in FY 2007, $7.1 billion below the MSR estimate. Nearly $3 billion of this difference is attributable to delayed obligations by Customs and Border Protection and Immigration and Customs Enforcement from supplemental funding and capital investments in the Secure Border Initiative. In the Federal Emergency Management Agency, outlays were $2.6 billion less than estimated in the MSR, due primarily to reduced estimates for flood insurance claims related to hurricane Katrina. In addition, spending for the Bioshield program was $1.0 billion less than anticipated because private sector demand for next generation vaccine development dollars has not materialized as expected at the time of the MSR.
- Department of State – Outlays for the Department of State were $13.7 billion in FY 2007, $2.9 billion below the MSR estimate. Outlays for Administration of Foreign Affairs were $2.1 billion below the MSR estimate due to slower-than-expected spending on capital construction projects, lower-than-expected outlays for Iraq operations and other supplemental funding received late in the fiscal year, and higher-than-expected proceeds for sale of real property overseas. In addition, outlays were $0.6 billion lower for International Organizations due to the timing of payments to the United Nations and $0.5 billion lower than the MSR estimate for International Narcotics Control and Law Enforcement programs.
- Department of Transportation – Department of Transportation outlays were $61.7 billion in FY 2007, $2.4 billion below the MSR estimate. The decrease was due to slower-than-anticipated obligation and spending of funds for many Federal-Aid Highway grants, surface transportation safety bureaus, Federal Aviation Administration grants and capital investments.
- Department of the Treasury – The Department of the Treasury had actual outlays of $491 billion, $2.0 billion higher than the MSR estimate. Interest on the public debt was $430 billion, $0.7 billion higher than the MSR estimate. The remainder of the difference is in offsetting receipt amounts, primarily due to lower-than-anticipated interest received from credit financing accounts.
- Department of Veterans Affairs – Outlays for the Department of Veterans Affairs were $73 billion, $2.0 billion lower than estimated in the MSR. The

difference was largely due to lower-than-anticipated spending in veterans' medical care. Outlays for benefit programs were $0.7 billion lower than expected, primarily for the compensation and pension programs.

- Army Corps of Engineers – FY 2007 outlays for the Corps of Engineers were $3.9 billion, $2.8 billion below MSR projections. The majority of the difference is attributable to higher-than-expected reimbursements from FEMA for Corps activities in response to the 2005 hurricanes. Other differences are due in large part to weather, legal and other natural-disaster delays or adjustments.
- International Assistance Programs – Outlays for International Assistance Programs were $12.8 billion in FY 2007, $4.0 billion below the MSR estimate. Outlays for the Economic Support Fund were $1.2 billion lower than the MSR estimate, and outlays for the Agency for International Development were $0.8 billion lower due in part to slower-than-expected obligations of FY 2007 supplemental funds for Iraq and Afghanistan. Foreign Military Financing program outlays were $0.4 billion lower than estimated in the MSR due to slower-than-expected release of full-year funding for grant programs.

REPORTS

- Additional Table 2
- Additional Table 3

Table 2.--2007 BUDGET RECEIPTS BY SOURCE
(fiscal years; in millions of dollars)

Receipts by Source	2006 Actual	2007 Estimate Budget	2007 Estimate Mid-Session	2007 Actual	Change, 2007 Actual from: Budget	Change, 2007 Actual from: Mid-Session
Individual income taxes	1,043,908	1,168,846	1,168,298	1,163,472	-5,374	-4,826
Corporation income taxes	353,915	342,057	371,655	370,243	28,186	-1,412
Social insurance and retirement receipts:						
Employment and general retirement:						
On-budget	181,660	189,520	188,521	189,170	-350	649
Off-budget	608,382	634,130	632,845	635,088	958	2,243
Subtotal, Employment and general retirement	790,042	823,650	821,366	824,257	607	2,891
Unemployment insurance	43,420	44,985	43,562	41,091	-3,894	-2,471
Other retirement contributions	4,358	4,742	4,742	4,258	-484	-484
Subtotal, Social insurance and retirement receipts	837,820	873,377	869,670	869,607	-3,770	-63
Excise taxes	73,962	57,062	65,218	65,069	8,007	-149
Estate and gift taxes	27,877	25,277	25,800	26,044	767	244
Customs duties	24,810	26,766	26,466	26,010	-756	-456
Miscellaneous receipts	44,384	46,711	46,800	47,227	516	427
Total, Receipts	2,406,675	2,540,096	2,573,907	2,567,671	27,575	-6,236
On-budget	1,798,293	1,905,966	1,941,062	1,932,583	26,617	-8,479
Off-budget	608,382	634,130	632,845	635,088	958	2,243

NOTE: Detail may not add to totals or changes due to rounding.

Table 3.--2007 BUDGET OUTLAYS BY AGENCY
(fiscal years; in millions of dollars)

Outlays by Major Agency	2006 Actual	2007 Estimate Budget	2007 Estimate Mid-Session	2007 Actual	Change, 2007 Actual from: Budget	Change, 2007 Actual from: Mid-Session
Legislative Branch	4,129	4,306	4,428	4,306	*	-122
The Judiciary	5,820	5,845	6,082	6,008	163	-74
Agriculture:						
Farm Service Agency	21,395	14,577	15,071	12,336	-2,241	-2,735
Food and Nutrition Service:						
Food stamps	34,620	35,564	35,090	34,885	-679	-205
Other	17,832	19,172	18,825	18,683	-489	-142
Agriculture Marketing Service	1,584	1,272	1,279	967	-305	-312
Natural Resources Conservation Service	2,769	2,821	3,048	2,730	-91	-318
Rural Housing Service	896	717	711	685	-32	-26
Risk Management Agency	3,445	3,992	4,382	3,550	-442	-832
Rural Utilities Service	712	-995	-1,953	-2,076	-1,081	-123
Forest Service	5,528	5,369	5,814	5,833	464	19
Offsetting receipts	-2,683	-1,223	-1,223	-1,759	-536	-536
Other	7,428	7,501	7,869	8,602	1,101	733
Subtotal, Agriculture	93,533	88,767	88,913	84,437	-4,330	-4,476
Commerce	6,374	6,179	6,612	6,479	300	-133
Defense-Military:						
Military Personnel	127,542	128,780	130,283	128,827	47	-1,456
Operations and Maintenance	203,787	224,799	221,320	217,421	-7,378	-3,899
Procurement	89,758	104,302	101,541	98,857	-5,445	-2,684
Research, Development, Test, and Evaluation	68,628	71,075	70,995	73,136	2,061	2,141
Military Construction	6,245	8,758	8,151	7,898	-860	-253
Revolving and Management Funds	2,230	3,223	3,142	1,370	-1,853	-1,772
Allowance for the proposed final Continuing Resolution (distributed across accounts in Mid-Session Review and actuals)	---	4,115	---	---	-4,115	---
Other	1,161	3,863	3,393	2,362	-1,501	-1,031
Subtotal, Defense-Military	499,350	548,915	538,825	529,871	-19,044	-8,954
Education:						
Office of Elementary and Secondary Education	21,773	22,071	21,851	21,252	-819	-599
Office of Special Education and Rehabilitative Services	15,135	15,265	15,271	15,136	-129	-135
Office of Postsecondary Education	2,265	2,501	2,561	2,480	-21	-81
Office of Federal Student Aid	48,024	25,886	26,637	26,676	790	39
Hurricane education recovery	1,140	743	553	415	-328	-138
Other	5,091	1,574	1,046	412	-1,162	-634
Subtotal, Education	93,427	68,040	67,919	66,372	-1,668	-1,547

Table 3.--2007 BUDGET OUTLAYS BY AGENCY
(fiscal years; in millions of dollars)

Outlays by Major Agency	2006 Actual	2007 Estimate Budget	2007 Estimate Mid-Session	2007 Actual	Change, 2007 Actual from: Budget	Change, 2007 Actual from: Mid-Session
Energy:						
Atomic energy defense activities	16,290	16,620	16,423	15,763	-857	-660
Other	3,362	5,368	5,082	4,353	-1,015	-729
Subtotal, Energy	19,653	21,988	21,505	20,117	-1,871	-1,388
Health and Human Services:						
Medicare (gross outlays)	381,817	436,380	437,520	440,756	4,376	3,236
Medicaid	180,625	191,876	196,844	190,624	-1,252	-6,220
State children's health insurance fund	5,451	5,647	6,294	6,000	353	-294
Other Centers for Medicare and Medicaid Services programs	1,244	1,680	1,548	1,280	-400	-268
Public Health Service	47,107	48,075	48,458	48,467	392	9
Temporary assistance for needy families and payments to States for child support enforcement and family support programs	20,898	21,837	21,642	21,114	-723	-528
Other Administration for Children and Families	26,018	26,185	26,253	26,114	-71	-139
Proprietary receipts	-53,493	-65,433	-64,427	-66,715	-1,282	-2,288
Other	4,646	5,007	5,051	4,397	-610	-654
Subtotal, Health and Human Services	614,313	671,254	679,183	672,036	782	-7,147
Homeland Security:						
Security, Enforcement, and Investigations	14,309	18,468	18,213	15,383	-3,085	-2,830
Coast Guard	7,897	8,218	8,219	8,181	-37	-38
Federal Emergency Management Administration	45,799	21,087	17,066	14,483	-6,604	-2,583
Science and Technology	1,051	1,226	1,231	1,118	-108	-113
Other	42	1,419	1,550	6	-1,413	-1,544
Subtotal, Homeland Security	69,100	50,418	46,279	39,172	-11,246	-7,107
Housing and Urban Development:						
Public and Indian Housing Programs	31,400	31,838	32,217	32,253	415	36
Federal Housing Administration	2,382	708	533	-4	-712	-537
Other housing programs	312	498	252	480	-18	228
Community Planning and Development	8,570	11,503	14,900	14,485	2,982	-415
Government National Mortgage Association	-422	-324	-324	-360	-36	-36
Other	193	-1,389	-1,945	-1,295	94	650
Subtotal, Housing and Urban Development	42,434	42,834	45,633	45,559	2,725	-74

Table 3.--2007 BUDGET OUTLAYS BY AGENCY
(fiscal years; in millions of dollars)

Outlays by Major Agency	2006 Actual	2007 Estimate Budget	2007 Estimate Mid-Session	2007 Actual	Change, 2007 Actual from: Budget	Change, 2007 Actual from: Mid-Session
Interior	9,063	10,877	10,495	10,488	-389	-7
Justice:						
Office of Justice Programs	4,300	3,639	3,723	3,818	179	95
Federal Bureau of Investigation	5,681	5,814	6,023	5,724	-90	-299
Federal Prison System	5,051	4,770	4,909	5,173	403	264
Drug Enforcement Administration	1,933	1,773	1,822	1,826	53	4
Other	6,356	7,043	7,745	6,810	-233	-935
Subtotal, Justice	23,320	23,039	24,222	23,351	312	-871
Labor:						
Training and employment services	5,255	5,314	5,238	5,158	-156	-80
Unemployment trust fund	35,104	35,747	35,646	36,147	400	501
Pension Benefit Guaranty Corporation	-2,618	316	508	457	141	-51
Employment Standards Administration	3,022	3,270	3,229	3,165	-105	-64
Other	2,377	2,793	2,902	2,616	-177	-286
Subtotal, Labor	43,139	47,440	47,523	47,543	103	20
State:						
Administration of Foreign Affairs	7,701	9,934	9,730	7,616	-2,318	-2,114
International organizations and conferences	2,023	2,417	2,690	2,119	-298	-571
International narcotics control and law enforcement	424	953	696	238	-715	-458
Andean counterdrug initiative	678	680	733	698	18	-35
Other	2,130	2,338	2,819	3,078	740	259
Subtotal, State	12,957	16,322	16,668	13,749	-2,573	-2,919
Transportation:						
Federal Highway Administration	34,192	35,375	35,929	34,970	-405	-959
Federal Transit Administration	8,637	10,235	9,737	9,199	-1,036	-538
Federal Aviation Administration	14,189	14,545	14,596	14,154	-391	-442
Other	3,122	3,620	3,811	3,370	-250	-441
Subtotal, Transportation	60,141	63,775	64,073	61,693	-2,082	-2,380
Treasury:						
Exchange stabilization fund	-917	-937	-1,405	-1,367	-430	38
Interest on the public debt	405,872	433,004	429,266	429,978	-3,026	712
Internal Revenue Service:						
Earned income tax credit	36,166	36,461	38,309	38,274	1,813	-35
Child tax credit	15,473	14,931	15,981	16,159	1,228	178

Table 3.--2007 BUDGET OUTLAYS BY AGENCY
(fiscal years; in millions of dollars)

Outlays by Major Agency	2006 Actual	2007 Estimate Budget	2007 Estimate Mid-Session	2007 Actual	Change, 2007 Actual from: Budget	Change, 2007 Actual from: Mid-Session
Refunding collections, interest	4,172	4,580	3,524	3,282	-1,298	-242
Other	10,601	10,980	10,759	10,810	-170	51
Financial Management Service:						
Payment to Resolution Funding Corporation	1,979	2,140	2,140	1,987	-153	-153
Interest paid to credit financing accounts	5,200	5,067	5,090	4,604	-463	-486
Other	1,987	2,245	2,548	2,574	329	26
Federal Financing Bank	-417	-433	-433	-496	-63	-63
Offsetting receipts	-16,756	-18,818	-18,810	-16,663	2,155	2,147
Other	1,385	1,287	1,670	1,474	187	-196
Subtotal, Treasury	464,745	490,507	488,639	490,615	108	1,976
Veterans Affairs:						
Veterans Health Administration	31,338	31,805	34,955	33,734	1,929	-1,221
Benefits Programs	38,996	40,570	39,704	38,999	-1,571	-705
Other	-527	-50	123	86	136	-37
Subtotal, Veterans	69,808	72,325	74,782	72,820	495	-1,962
Corps of Engineers	6,946	7,557	6,715	3,918	-3,639	-2,797
Other Defense Civil Programs:						
Military retirement fund	41,145	43,673	43,673	43,510	-163	-163
Medicare eligible retiree health care	7,067	7,680	7,680	7,604	-76	-76
Intrabudgetary transactions	-4,550	-4,400	-4,386	-4,586	-186	-200
Other	773	683	684	584	-99	-100
Subtotal, Other Defense Civil Programs	44,435	47,636	47,651	47,112	-524	-539
Environmental Protection Agency	8,322	8,038	7,864	8,258	220	394
Executive Office of the President:						
Iraqi relief and reconstruction fund	5,062	2,300	2,550	2,581	281	31
Other	316	377	381	376	-1	-5
Subtotal, Executive Office of the President	5,378	2,677	2,931	2,957	280	26
General Services Administration	22	498	279	32	-466	-247
International Assistance Programs:						
International Security Assistance:						
Foreign military financing program	4,594	4,715	4,738	4,326	-389	-412
Foreign military loan program	-472	-222	-222	-274	-52	-52
Economic support fund	2,842	3,807	4,442	3,285	-522	-1,157
Other	824	987	1,008	647	-340	-361
Agency for International Development	4,623	4,658	4,916	4,126	-532	-790
Overseas Private Investment Corporation	-310	-261	-261	-416	-155	-155

Table 3.--2007 BUDGET OUTLAYS BY AGENCY
(fiscal years; in millions of dollars)

Outlays by Major Agency	2006 Actual	2007 Estimate Budget	2007 Estimate Mid-Session	2007 Actual	Change, 2007 Actual from: Budget	Change, 2007 Actual from: Mid-Session
Multilateral assistance	2,533	2,353	2,830	2,189	-164	-641
Military sales programs	-1,199	---	-1,693	-1,646	-1,646	47
International monetary programs	-77	---	---	-258	-258	-258
Other	587	1,024	996	784	-240	-212
Subtotal, International Assistance Programs	13,945	17,061	16,754	12,764	-4,297	-3,990
National Aeronautics and Space Administration	15,125	16,143	16,182	15,861	-282	-321
National Science Foundation	5,541	5,860	5,944	5,529	-331	-415
Office of Personnel Management:						
Civil Service Retirement and Disability Fund	57,983	84,538	78,650	78,146	-6,392	-504
Employees and Retired Employees Health Benefits Funds	-2,265	-1,597	-964	-1,031	566	-67
Other	6,682	-24,139	-18,238	-18,665	5,474	-427
Subtotal, Office of Personnel Management	62,400	58,802	59,448	58,450	-352	-998
Small Business Administration	905	675	1,263	1,175	500	-88
Social Security Administration:						
Old age and survivors insurance (off-budget)	461,025	485,204	485,931	486,392	1,188	461
Disability insurance (off-budget)	93,572	101,396	99,729	99,850	-1,546	121
Supplemental security income program	40,203	39,457	38,999	38,461	-996	-538
Other:						
On-budget	13,049	16,283	16,514	16,455	172	-59
Off-budget	-22,106	-19,421	-19,402	-19,397	24	5
Subtotal, Social Security Administration	585,742	622,919	621,771	621,761	-1,158	-10
Other independent agencies:						
Corporation for National and Community Service	842	901	894	899	-2	5
District of Columbia	671	708	738	673	-35	-65
Export-Import Bank	-2,191	-1,337	-1,334	-1,365	-28	-31
Federal Communications Commission:						
Universal service fund	7,562	8,601	7,803	7,478	-1,123	-325
Spectrum auction subsidies	142	50	50	32	-18	-18
Universal service fund income and other	-782	-287	-280	-287	-*	-7
Subtotal, Federal Communications Commission	6,922	8,364	7,573	7,222	-1,142	-351
Federal Deposit Insurance Corporation:						
Deposit insurance fund	-1,181	-1,594	-1,019	-1,235	359	-216
FSLIC resolution fund (including RTC)	481	-241	85	211	452	126
Other FDIC	23	26	31	26	-*	-5
Subtotal, Federal Deposit Insurance Corporation	-677	-1,809	-903	-999	810	-96
Federal Drug Control Programs	401	384	384	377	-7	-7
National Credit Union Administration	-279	-357	-357	-363	-6	-6

Table 3.--2007 BUDGET OUTLAYS BY AGENCY
(fiscal years; in millions of dollars)

Outlays by Major Agency	2006 Actual	2007 Estimate Budget	2007 Estimate Mid-Session	2007 Actual	Change, 2007 Actual from: Budget	Change, 2007 Actual from: Mid-Session
Postal Service:						
On-budget	104	103	103	104	1	1
Off-budget	-1,075	2,642	5,723	5,093	2,451	-630
Subtotal, Postal Service	-971	2,745	5,826	5,197	2,452	-629
Railroad Retirement Board	3,368	3,996	1,708	2,267	-1,729	559
Securities and Exchange Commission	-1,033	-542	-539	-710	-168	-171
Tennessee Valley Authority	-380	-548	-263	-559	-11	-296
Other (net)	5,677	6,203	6,354	5,631	-572	-723
Subtotal, other independent agencies	12,351	18,708	20,081	18,271	-437	-1,810
Allowances	---	8,002	---	---	-8,002	---
Undistributed offsetting receipts:						
Employer share, employee retirement (on-budget):						
Military retirement and health	-27,378	-27,665	-28,317	-28,364	-699	-47
Other	-21,853	-21,180	-21,185	-21,111	69	74
Employer share, employee retirement (off-budget)	-11,625	-12,289	-12,299	-12,299	-10	---
Interest received by on-budget trust funds	-71,574	-75,067	-71,363	-71,961	3,106	-598
Interest received by off-budget trust funds	-97,722	-106,249	-106,697	-106,003	246	694
Rents and royalties on the Outer Continental Shelf lands	-7,282	-6,810	-6,391	-6,762	48	-371
Spectrum auction proceeds	-111	-6,850	-6,850	-6,850	*	*
Spectrum relocation activities	---	-7,030	-6,930	-6,850	180	80
Other	-2	---	---	-1	-1	-1
Subtotal, undistributed offsetting receipts	-237,546	-263,140	-260,032	-260,201	2,939	-169
Total, Outlays	2,654,873	2,784,267	2,778,632	2,730,505	-53,762	-48,127
On-budget	2,232,803	2,332,984	2,325,647	2,276,868	-56,116	-48,779
Off-budget	422,069	451,283	452,985	453,637	2,354	652
Deficit(-)/Surplus(+)	-248,197	-244,171	-204,725	-162,833	81,338	41,892
On-budget	-434,510	-427,018	-384,585	-344,284	82,734	40,301
Off-budget	186,313	182,847	179,860	181,451	-1,396	1,591

* indicates $500 thousand or less.

NOTE: Detail may not add to totals or changes due to rounding.

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Issue Brief No. 2: Social Security Reform: A Framework for Analysis

Washington, DC-- Treasury today released the second in a series of papers on Social Security. Issue Brief No. 2 is entitled Social Security Reform: A Framework for Analysis.

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REPORTS

- Issue Brief No. 2: Social Security Reform: A Framework for Analysis

ISSUE BRIEF NO. 2

SOCIAL SECURITY REFORM: A FRAMEWORK FOR ANALYSIS

INTRODUCTION

This is the second in a series of Treasury issue briefs on Social Security reform. The first brief explained that the birth cohorts who will bear the financial consequences of reform must receive benefits whose present value is lower than the present value of the Social Security taxes they pay by more than $13.6 trillion. This is necessary because Social Security has paid or promised earlier birth cohorts a net benefit of equal magnitude.[1] By looking at reform in terms of how it affects the well-being of different birth cohorts, the first brief demonstrated that reform can be fairer to future generations the sooner that it is initiated.

This brief seeks to advance the debate over Social Security reform by offering a top-down framework for designing and evaluating Social Security reform plans. This framework centers on the following four key questions that any plan must address.

1. **Fairness across generations.** How should the burden of the changes that are required to make Social Security solvent be distributed across generations? That is, how should current and future generations share the necessary adjustments to Social Security benefits and/or taxes?

2. **Fairness within generations.** How should Social Security's benefits and taxes be distributed across people *within* each generation? Put differently, how progressive should Social Security's tax and benefit structure be?

3. **Size of the safety net.** How large should Social Security's benefits be? Likewise, how large should the taxes needed to support these benefits be?

4. **Pre-funding future benefits.** Are Social Security surpluses set aside to help pay future Social Security benefits? More generally, do contributions in excess of benefits paid constitute true pre-funding of future Social Security benefits? If not, how are the answers to the first three questions affected?

Once agreement is reached on the answers to these questions, it should be possible to identify specific reforms that are consistent with them. Hence, these questions help to define a top-down framework for designing, debating, and evaluating Social Security reform plans.

The principal purpose of this brief is to introduce this approach to Social Security reform. The brief elucidates the four key questions identified above and develops objective metrics that can be used to assess how reform affects the well-being of entire birth cohorts, the well-being of groups within cohorts, and the adequacy of benefits.

1 As in the first issue brief, all present values discussed here are computed as of the start of 2007.

The brief stops short, however, of *answering* these questions. Later issue briefs will propose benchmarks for assessing fairness and benefit adequacy with an eye toward providing concrete demonstrations of how the framework can be used to design and evaluate particular Social Security reform plans. Another issue brief will explore alternative mechanisms for ensuring that attempts to pre-fund Social Security result in the accumulation of additional resources that can be used to finance future benefits.

A key message of this brief is that whether it is possible to truly pre-fund future benefits profoundly influences the choices that are available for ensuring fairness across generations and benefit adequacy. If it is not possible to safeguard Social Security surpluses, then there is little prospect for a Social Security reform that is fair to future generations. The discussion of the first three questions is therefore divided into two parts. First, each question is discussed under the assumption that attempted pre-funding is or can be made real. Next, how the absence of true pre-funding would affect the answers to these questions is considered when the fourth question is discussed. Organizing the brief in this way underscores its central point: that the ability to safeguard Social Security surpluses is an essential element in making Social Security fair to future generations.

FIRST KEY QUESTION: HOW SHOULD THE SOCIAL SECURITY REFORM BURDEN BE DISTRIBUTED ACROSS GENERATIONS?

Treasury's first issue brief explained that the current and future generations who will bear the financial burden of making Social Security permanently solvent will face some combination of benefit and/or tax adjustments amounting to $13.6 trillion in present-value terms.[2] These "reform cohorts" must in effect pay for the excess of benefits over contributions that Social Security conveyed or has promised to the generations who preceded them and who are not themselves subject to reform.

A natural measure of how Social Security affects the well-being of individuals and birth cohorts is the *lifetime net benefit rate*. For an individual, the lifetime net benefit rate is defined as the present value of net lifetime Social Security benefits (benefits less taxes) as a percentage of the present value of the individual's lifetime wages. This summarizes the difference between the benefits a person eventually receives in retirement and the taxes he or she pays into the system while working. The lifetime net benefit rate for a birth cohort is the same as that for an individual except that the numerator (net Social Security benefits) and the denominator (lifetime wages) are sums computed over all members of the birth cohort. Box 1 compares the lifetime net benefit rate with two other commonly used measures of Social Security's value to individuals.

2 To put this number in perspective, permanent solvency could be achieved, for instance, with roughly a 20 percent reduction in scheduled (but not payable) benefits or an immediate and permanent 3.5 percentage point increase in the payroll tax rate on the share of earnings that is subject to tax under current law. These figures are used purely to illustrate the magnitude of the problem; in practice, a revenue adjustment could involve changes in the tax base—the taxable earnings share—as well as changes to the tax rate.

BOX 1

SOCIAL SECURITY'S LIFETIME NET BENEFIT RATE COMPARED TO TWO COMMON ALTERNATIVE MEASURES OF SOCIAL SECURITY'S NET VALUE TO INDIVIDUALS

Measures of the financial value of the Social Security program to an individual are useful in considering how to allocate the burden of Social Security reform across different groups. This issue brief focuses on the lifetime net benefit rate as an indicator of the relationship between lifetime benefits received and taxes paid. Two common alternative measures of Social Security's value to individuals are Social Security's "rate of return" and Social Security's "money's worth ratio." It is argued below that these measures are not as useful as the lifetime net benefit rate for assessing the fairness of Social Security reform.

Because Social Security must levy a net tax on cohorts who are subject to reform, the discussion is most naturally couched in terms of the lifetime net *tax* rate, which is simply the negative of the lifetime net benefit rate (the net tax rate is the excess of taxes over benefits divided by lifetime wages rather than the excess of benefits over taxes, with all values measured in present-value terms). The present values that are used to construct the net tax rate or net benefit rate are computed with a risk-free rate like that on long-term government bonds.

SOCIAL SECURITY'S RATE OF RETURN

Social Security's rate of return to an individual is the answer to the following question: If all of a worker's Social Security taxes were invested, what average annual rate of return must be earned in order for the investment proceeds to be just sufficient to finance that worker's Social Security benefits? If Social Security's rate of return is equal to the return on a long-term government bond, then individuals receive a return on their taxes that implies that their lifetime net tax rate is zero. In this case, Social Security is providing a return that is no better or worse than what workers could receive from directly investing their contributions in government bonds. If the Social Security rate of return is less than the government bond rate, however, then the lifetime net tax rate is positive, as workers earn a lower rate of return on Social Security taxes than what they could earn on an actual investment in government bonds and thus implicitly pay a "tax" that reflects the foregone return on the government bond. By contrast, a Social Security rate of return greater than the rate on government bonds implies that lifetime net taxes are negative and that workers are doing better by paying into the system and receiving benefits than what they could earn by directly investing in government bonds.

Social Security's rate of return provides incomplete information, however, in terms of how Social Security reform plans affect the well-being of a particular individual or group. This can be seen with an example. Suppose that Social Security reform plan A assesses $10,000 in taxes in year 1 and pays $10,300 in benefits in year 2, while reform plan B assesses $1,000 in taxes in the first year and pays $1,010 in benefits in the second. In this example, then, Social Security's rate of return is 3 percent for plan A, and 1 percent for plan B. Then judged on the basis of rates of return, it would be concluded that reform plan A is better.

Why this conclusion is not necessarily correct can be seen from a comparison of lifetime net taxes under the two plans. If the government bond rate is 5 percent, for example, then the lifetime net taxes under reform plan A equal the cost of receiving 2 percentage points below the market return on $10,000, which is $200. Likewise, for reform plan B the lifetime net tax is the cost of receiving 4 percentage points below the market return on $1,000, or $40. Hence, reform plan B is more beneficial to the individual—that is, it is less costly. (In this example taxes are collected at a single point in time. Note that the cost of receiving a below-market return depends not only on the magnitude of the taxes paid, but also on the length of time over which the below-market return is earned.)

Social Security's rate of return also may not fully capture the differential effect a particular Social Security reform has on different individuals or groups. This can be seen in the context of an example comparing two members of a particular birth cohort—a low-income individual and a high-income individual. Suppose a particular reform plan results in the Social Security rate of return being 1 percent for the high-income person and 3 percent for the low-income person, and that the government bond rate is again 5 percent. As with the previous example, it would not be possible to infer the lifetime net taxes that each person pays without knowing how much gross tax each person contributes to the system.

BOX 1 (CONTINUED)

SOCIAL SECURITY'S MONEY'S WORTH RATIO

Social Security's money's worth ratio is the present value of lifetime Social Security benefits divided by the present value of lifetime Social Security taxes. As in the computation of Social Security's net lifetime taxes, the present values are computed with a risk-free rate like that on government bonds. Hence, a money's worth ratio greater than one implies that lifetime net taxes are negative, and a money's worth ratio less than one implies that lifetime net taxes are positive.

Like Social Security's rate of return, the money's worth ratio may not fully capture the effect of a particular Social Security reform. For example, if a person is offered the choice between two Social Security reforms, one in which benefits are 10 percent lower than taxes (yielding a money's worth ratio of 0.9), and the other in which benefits are 20 percent lower than taxes (a money's worth ratio of 0.8), it is not possible to infer which is better without having additional information. If, for example, the present value of gross taxes is $100,000 when the money's worth ratio is 0.9 and $10,000 when the money's worth ratio is 0.8, then the latter case results in smaller lifetime net taxes ($2,000, computed as 20 percent of $10,000) than the former case ($10,000, computed as 10 percent of $100,000) despite the latter plan's lower money's worth ratio.

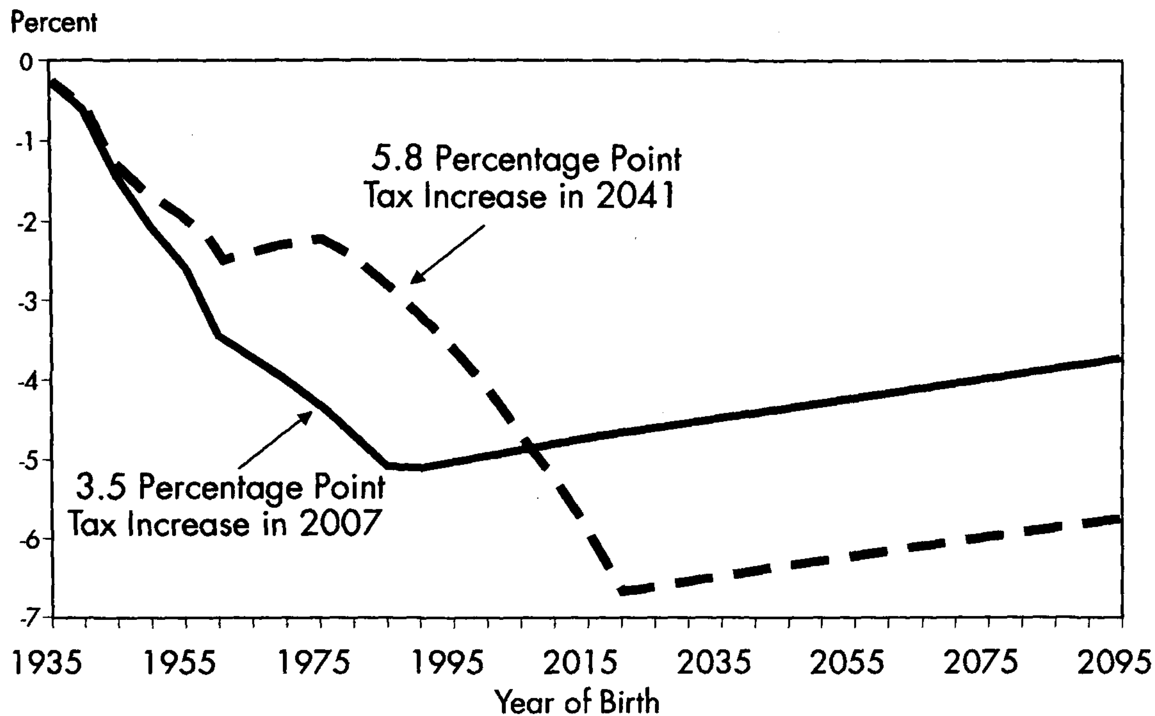
This example makes clear that money's worth ratios are not sufficient to assess the fairness of Social Security's treatment of individuals at different points in the income distribution.

On average, people who share in the burden of reform must have a negative lifetime net benefit rate—that is, reform cohorts must on average receive benefits whose present value is less than the present value of the taxes they pay into the system. A negative lifetime net benefit rate essentially acts as a net tax rate. For example, if the lifetime net benefit rate for the 1980 birth cohort is negative 3 percent, then Social Security affects the cohort's well-being as if it were a 3 percent tax on the cohort's lifetime wages—for every $100 in wages, $3 are taken by Social Security to finance the excess of benefits over taxes that have been paid or promised to early birth cohorts (roughly, people born prior to 1930). In this framework, policymakers must choose lifetime net benefit rates for the various reform cohorts such that the total burden adds up to an amount exceeding $13.6 trillion in present value.[3] Again, this can be achieved by adjusting benefits, taxes, or some combination of the two.

Figure 1 uses lifetime net benefit rates to help assess the intergenerational fairness of two illustrative policies that would make Social Security permanently solvent. The first policy immediately increases the payroll tax rate by 3.5 percentage points starting in 2007, while the second policy raises the payroll tax rate by 5.8 percentage points starting in 2041, which is the projected trust fund exhaustion date. (Again, these policies are used purely for illustration, and are not actual recommendations.) As can be seen from the figure, waiting to reform Social Security puts a lighter burden on cohorts born prior to 2005 and a heavier burden on cohorts born after this date.

3 As noted in Treasury's first issue brief, current law already imposes a small net tax on the reform cohorts; relative to current law, it is necessary to raise the present value of contributions made by the reform cohorts and/or reduce the present value of their scheduled benefits by $13.6 trillion. For ease of exposition, the current issue brief assumes that the net tax that the reform cohorts must pay is exactly equal to $13.6 trillion.

Figure 1: Lifetime Net Benefit Rates by Birth Cohort



Source: Department of the Treasury

Under both policies, lifetime net benefit rates are reduced in accordance with how long a birth cohort faces higher taxes. In the case of the immediate tax increase, the lifetime net benefit rate bottoms out at negative 5.1 percent for people born in 1985 (the 1985 birth cohort), who are assumed to begin work at age 22 in 2007. The lifetime net benefit rate increases (becomes less negative) for later birth cohorts because increasing longevity implies that they will receive benefits over a longer period of time. Under the delayed tax increase, the lifetime net benefit rate bottoms out for the 2019 birth cohort.[4]

The estimates shown in Figure 1 are very approximate. Disability benefits and taxes as well as the taxes on Social Security benefits are not included in the calculations, and it is assumed that the tax increases necessary to make the overall program solvent fall entirely on the retirement portion of the program. (In general, Treasury's issue briefs are focused on potential reforms to the retirement income portion of Social Security, not the disability insurance portion.) Nevertheless, the basic lesson of the chart is robust: The smaller is the reform burden imposed on early birth cohorts, the larger must be the burden that is placed on later birth cohorts.

Finally, it should be noted that how the Social Security reform burden is allocated across generations has implications for economic efficiency as well as fairness. This topic is discussed in a future issue brief.

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4 Figure 1 assumes that the additional tax revenues under the two policies result in lower issuance of publicly held debt—that is, the additional revenues are truly saved. As is discussed below with respect to the fourth key question (regarding pre-funding), if trust fund accumulations are not truly saved then the effect that Social Security policy has on the well-being of future generations is undone by changes in spending and taxes in other parts of the federal budget. In that case, the usefulness of accounting measures such as those shown in the figure will be greatly reduced.

SECOND KEY QUESTION: HOW SHOULD THE SOCIAL SECURITY REFORM BURDEN BE DISTRIBUTED *WITHIN* GENERATIONS?

Once a decision is made as to how the Social Security reform burden should be distributed *across* reform cohorts, the natural next question is how the burden should be distributed *within* birth cohorts. This brief (together with future briefs) focuses on how the burden is distributed across income groups within generations—that is, how "progressive" Social Security should be.[5]

For example, imagine that policymakers decide on fairness grounds that the lifetime net benefit rate should be the same for all reform cohorts—that is, they decide that all generations affected by the reform should face an equal net tax rate in the form of higher contributions and/or lower benefits. (This example is purely illustrative; it may or may not be a desirable outcome in practice.) Suppose further that the present value of wages earned by reform cohorts were projected to equal $340 trillion and that the burden that must be imposed on the reform cohorts is precisely $13.6 trillion (as explained in footnote 3, the true burden is somewhat larger). Then the lifetime net benefit rate that should be imposed across all reform cohorts in order to make Social Security solvent is negative 4 percent (computed as negative $13.6 trillion divided by $340 trillion, which is –0.04). This means that each reform cohort would be asked to contribute 4 percent of their lifetime wages to make Social Security permanently solvent through benefits that have a lower present value than the present value of taxes paid.

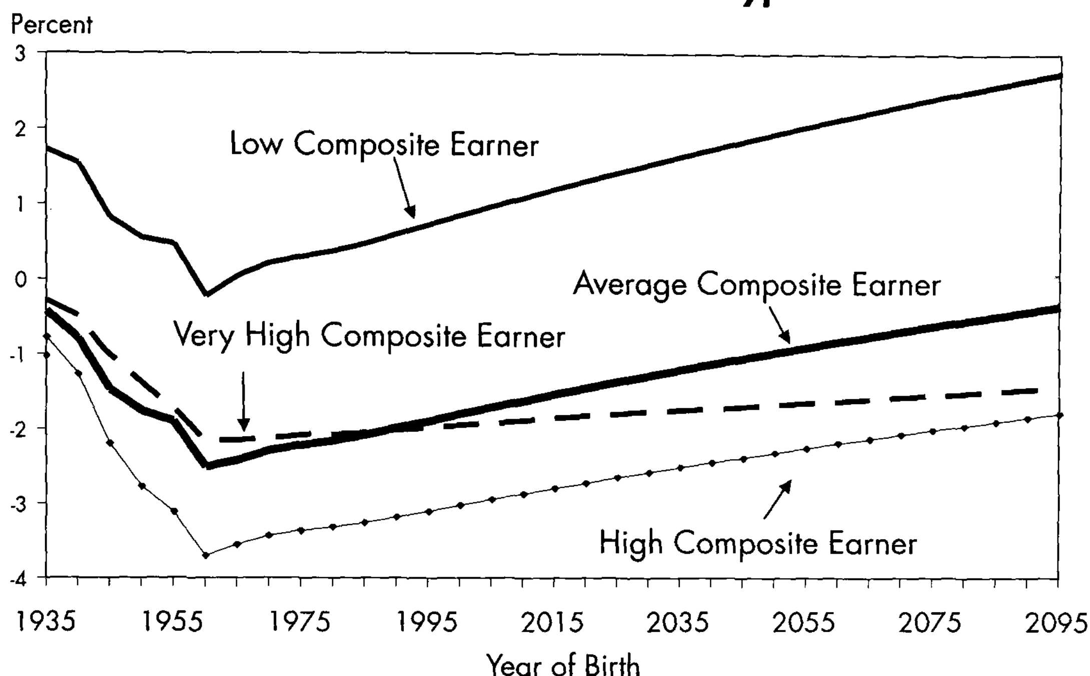
Once the decision is made that a cohort should contribute 4 percent of its wages to making Social Security solvent, it must be decided how to distribute that burden *within* the birth cohort. It is reasonable to expect that this burden will be apportioned in a progressive fashion, with lower-income workers relatively more shielded from the effects of the reform. Retirees who had lower lifetime earnings would get a net lifetime benefit that is larger relative to their lifetime wages than people with higher lifetime earnings; that is, the lifetime net benefit rate would be more negative as individuals' lifetime income increases (and might even be positive for the lowest income groups). Progressivity can be achieved in any number of ways. For example, under current law it is primarily implemented with a progressive benefit formula, but in principle it could be achieved by varying payroll tax rates as well.

To illustrate how progressivity can be assessed, Figure 2 gives Treasury estimates of lifetime net benefit rates by income level for the birth cohorts included in Figure 1.[6] A lifetime net benefit rate profile is computed for each of four income levels, denoted as low, average, high, and very high. Each profile is calculated as a weighted average of several representative (but not exhaustive) family types. For example, the high-wage composite earner is a weighted average of the lifetime net benefit rate for five family types: a single high-wage female; a single high-wage male; a one-earner couple headed by a high-wage male; a dual-earner couple with both earning high wages; and a dual-earner couple made up of a female with average earnings and a male with high earnings.

5 Although the focus here is on redistribution across income groups within a generation, one could also consider the distributional impact of Social Security along many other dimensions (sex, race, family structure, career length, and so on).

6 The measures shown in Figure 2 use current-law scheduled benefits and taxes. Social Security will certainly not evolve in accordance with current-law benefits and taxes given that the system is insolvent; nevertheless, the figure is useful because we are concerned with the *relative* differences in lifetime net benefits across income groups, not the absolute levels of lifetime net benefits that are relevant for solvency.

Figure 2: Lifetime Net Benefit Rates by Birth Cohort and Earner Type



Source: Department of the Treasury

The progressive nature of Social Security under current law is verified by the results given in Figure 2, which show that the lifetime net benefit rate profile for the low-earner composite is above the profile for the average-earner composite, which in turn is above the profile for the high-earner composite. (The very-high-earner composite has earnings far above the maximum level subject to tax and is discussed below.) That is, lower-income workers receive net benefits under Social Security that are larger as a share of lifetime income than those received by higher-income workers. Lifetime net benefit rates rise for successive birth cohorts because of increasing longevity. People living longer receive benefits over additional years, and the effect on the value of benefits is most pronounced for people with lower earnings, as longevity increases the present value of benefits proportionately but has little effect on the contributions they make to the system because the retirement age is not changed in this calculation. Since low earners have a relatively high ratio of benefits to lifetime wages, a proportionate increase in the present value of benefits has a relatively large effect on their lifetime net benefit rate.[7]

While the current-law Social Security program is progressive overall, it is regressive (as measured by the net benefit rate) for income levels that exceed the maximum taxable earning threshold. This reflects Social Security's original historical design: The program was intended to provide a basic level of social insurance, not to have its contributions and benefits be based on total earnings (though rising wage inequality in recent years has left a smaller share of earnings subject to tax than in the past). In the figure, the lifetime net benefit rate profile for very high earners lies above the corresponding profile for high earners and average earners born prior to about 1990. Intuitively, since net benefits "bottom out" once

7 The lifetime net benefit rate profiles shown in Figure 2 assume that mortality probabilities do not depend on income. There is some evidence that mortality rates are lower for higher-income groups, but not by enough to change the general implications of the figure. See Congressional Budget Office, "Is Social Security Progressive?" December 15, 2006.

the taxable maximum is reached—neither benefits nor contributions increase further after this point—they represent a smaller fraction of lifetime earnings the higher these earnings become. The very-high-earner composite shown in Figure 2 has earnings far above the taxable maximum. Its lifetime net benefit rate profile lies above the profile for the average composite up to the 1990 birth cohort, and above the profile for the high-earner composite for all cohorts shown. This pattern reflects two independent factors.

- First, very high earners do not pay tax or accrue benefits on the portion of their earnings that is above the taxable maximum ($97,500 in 2007). To see how this is relevant, compare a person earning an amount that is exactly equal to maximum taxable earnings in every year of his or her life with someone whose earnings are many multiples higher in every year and who retires at the same time. Both individuals pay the same tax and receive the same benefits. For incomes above the maximum taxable earnings level, therefore, net taxes paid to Social Security become smaller as a share of lifetime wages—that is, the lifetime net benefit rate becomes less negative—the higher are earnings above the maximum taxable earnings threshold. This explains how it is possible under current law for the lifetime net benefit rate profile for the very-high-earner composite to be higher than the lifetime net benefit rate profiles for some of the lower-income composites.

- Second, increasing longevity has relatively less effect on the lifetime net benefit rate of the very-high-income composite because they have a relatively low ratio of benefits to lifetime wages. Hence, future increases in longevity cause the lifetime net benefit rate for the very high earners to rise more slowly than the rate for the other earners, which is why the lifetime net benefit rate profiles for these two groups cross in the figure.

A future issue brief will consider the implications of progressivity for economic efficiency.

THIRD KEY QUESTION: HOW LARGE SHOULD SOCIAL SECURITY'S BENEFITS BE?

Once it is decided how to allocate the burden of reform across generations and across different people within generations (by choosing lifetime net benefit rates for reform cohorts and by income level within each cohort), the next question to consider relates to the size of retirement benefits and the corresponding taxes needed to fund them. The choice of lifetime net benefit rates for birth cohorts and income groups within birth cohorts is consistent with any level of benefits. For example, suppose policymakers decide that the lifetime net benefit rate for a particular income group within the 2000 birth cohort should be negative 4 percent. Then one possibility is that this group could face a 12.4 percent payroll tax rate and receive benefits with an expected present value equal to 8.4 percent of lifetime wages. (For simplicity, this assumes that taxable wages equal total wages.) Alternatively, one could envision having a system with higher benefits and taxes—for example, a system with a payroll tax rate of 15 percent and benefits whose present value equaled 11 percent of wages; still another possibility is for a low-benefit system where the tax rate is 8 percent and benefits are 4 percent of wages. There are innumerable alternatives, each resulting in a different level of benefits and all with the same implications for the long-term solvency of Social Security and the allocation of the Social Security reform burden across cohorts.

Put another way, once it is decided how to allocate the burden of paying for the existing financing gap of $13.6 trillion, the Social Security system can be made large or small depending on society's evaluation of the pros and cons of mandating that workers put a particular share of their earnings into the Social Security system to fund retirement benefits. Specifically, one's judgment as to what role Social Security should play in providing retirement security and social insurance and how much choice individuals

should have in making their saving and spending decisions will determine whether one prefers a system in which high taxes finance a high level of benefits, or an alternative (but still solvent) system in which low taxes finance a more modest level of benefits. If one believes that individuals should be allowed to choose to save or spend their earnings as they wish, one might prefer lower taxes and benefits. If one instead believes that workers generally do not save enough for retirement, then one might prefer higher benefits (and thus higher taxes) since this protects workers from the consequences of their failing to save.

The fact that benefit levels can be decided entirely independently of how Social Security's reform burden is allocated reflects the fact that contributions to Social Security made while working can in general be thought of as comprising a "net tax" component that goes to make the system permanently solvent and a "forced saving" component that funds retirement benefits. In the case of a payroll tax rate of 12.4 percent and benefits that have a present value equal to 8.4 percent of wages, the net tax amounts to 4 percent of wages while forced saving is 8.4 percent of wages. For the forced-saving component, Social Security is acting like a savings account receiving 8.4 percent of wages in every working year (albeit one that the worker is required to pay in to) that then finances benefits in retirement. By contrast, the remaining 4 percent is a pure tax from the worker's perspective, since he or she never sees it returned in the form of benefits. Importantly, it is the forced-saving component of Social Security contributions made while working that determines the level of benefits in retirement.

For individuals who would not save enough on their own for retirement, Social Security's forced saving element has two important consequences. First, Social Security increases these individuals' total retirement income (albeit at the cost of their having less disposable income before retirement). Hence, to the extent that the interests of society are served by ensuring that all persons have income in retirement that is at least partly related to their earnings while working, the forced saving component of Social Security represents a useful and important feature of the program. Second, forced saving affords access to Social Security's relatively advantageous annuity terms. The retirement benefit paid by Social Security is a real annuity; that is, it is paid out as long as the retiree is alive and is indexed to inflation once benefits commence with retirement. Because of the program's relatively low administrative costs and inflation-indexation provisions—and because forcing nearly all workers to participate eliminates the adverse selection problems that affect private annuities—it is likely that Social Security can transform a given amount of forced savings into a more generous real annuity than could a private company.

For individuals who would have saved on their own, Social Security mainly acts to displace private saving rather than to increase retirement income—someone forced to save through Social Security will simply save less on their own. If a hypothetical change to Social Security increases taxes and benefits by an equivalent amount, people are in essence being forced to do a larger portion of their retirement saving through the Social Security system. People who were already happy with the amount of retirement saving that they were doing would therefore be expected to simply unwind a modest increase in forced saving by reducing the amount of savings that they hold elsewhere in comparable investments.[8] Making such adjustments to one's asset holdings might involve some costs; for example, young people wishing to invest their full portfolio in equities would have to borrow to neutralize their safe Social Security assets and buy equities with the proceeds. That said, Social Security's forced saving might still be beneficial to this group to the extent that the system's annuity terms are better than what can be obtained in the private sector and to the extent that they would want to fully annuitize this portion of their retirement savings.

8 If Social Security surpluses do not cause larger non-Social Security deficits, then such an increase in forced saving would mean higher government saving that is offset by lower private saving (for individuals who would have saved on their own). In this case, there would be no change in national saving.

MEASURING BENEFIT ADEQUACY

One measure of benefit adequacy is the ratio of benefits to the amount of retirement income that would be needed to sustain a person's living standard while working—what will be referred to as the "benefit replacement rate." As a proxy for the standard of living attained while working, the measure uses the constant level of real consumption that would be possible between the ages of 21 and 65 if all pre-tax wages earned during those years were consumed; this then forms the denominator of the benefit replacement rate while the numerator is the level of benefits.[9] Note that this measure understates the size of benefits relative to a retiree's actual standard of living while working, because it assumes all wage income is available for consumption when in reality some income goes to pay taxes.

Figure 3 plots the benefit replacement rate under current-law scheduled benefits for the low-, average-, high-, and very-high-earning composite earners shown in Figure 2 under the assumption that all workers retire at age 65.[10] As can be seen from the figure, the benefit replacement rate falls as lifetime income within each cohort rises: Social Security's progressive benefit formula implies that an increase in lifetime earnings results in a less-than-proportionate increase in benefits. For each composite earner, the replacement rate varies a small amount for cohorts born between 1935 and 1965 before leveling out for later birth cohorts.[11] For individuals turning 62 in 2007, the estimated benefit replacement rates for the low, average, high, and very high composite earners are 67 percent, 51 percent, 44 percent, and 19 percent, respectively.

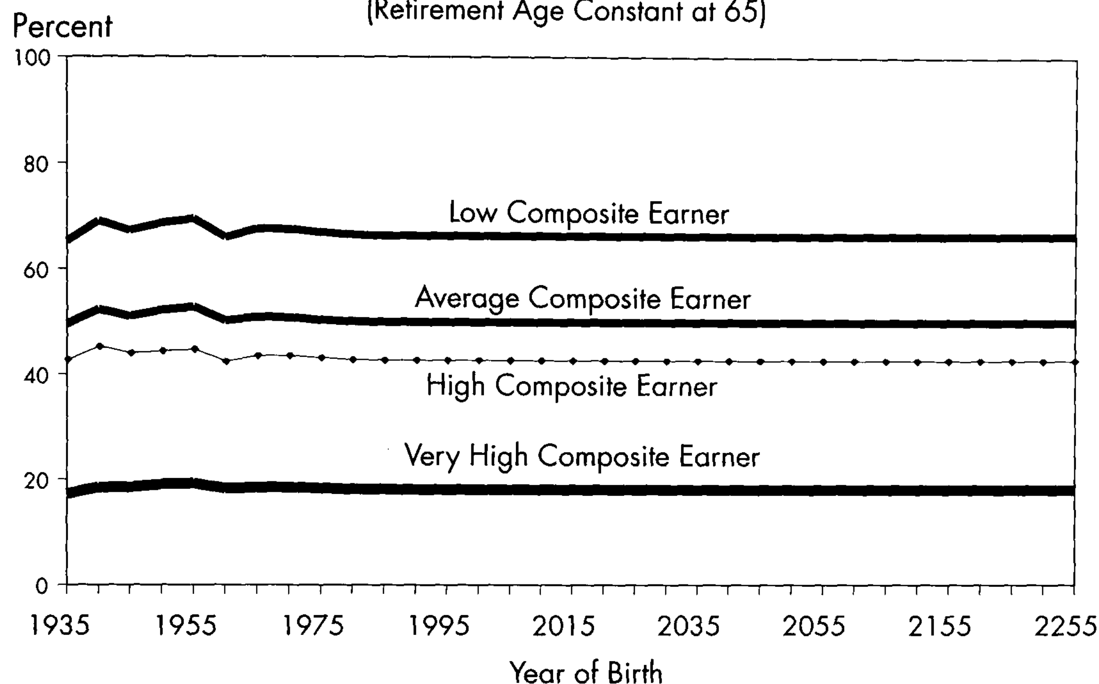
Benefit replacement rates tend not to change much for successive birth cohorts—the profiles shown in Figure 3 are basically flat—because the measure of wages that enters into the benefit calculation (average indexed monthly earnings, or the AIME) tends to grow for successive birth cohorts at the same rate as do actual real wages for successive birth cohorts.[12] In addition, the benefit formula is adjusted each year to ensure that its progressivity remains unchanged for successive birth cohorts.

9 This concept of the replacement rate is not the same as the replacement rates reported in various editions of the Trustees Report. The Trustees Report estimates are made for hypothetical single workers rather than the composite workers used here. In addition, there are other important technical differences between the two measures.

10 This measure of the replacement rate is developed here to illustrate how to evaluate the impact of various changes to the system. Because scheduled benefits are not payable (the system is insolvent), actually maintaining the constant replacement rates shown in the figure would require higher revenues than what are provided for under current law.

11 The variation in replacement rates for the 1935-1965 birth cohorts reflects variation in real wage growth that causes variations in the denominator in the replacement rate calculation, together with changes in the normal retirement age and price inflation that cause variation in the numerator. By contrast, for individuals born in 1965 and later the normal retirement age is constant at 67 and real wage growth and price inflation for most or all of peoples' lives accord with current Social Security Administration projections, which show little variation.

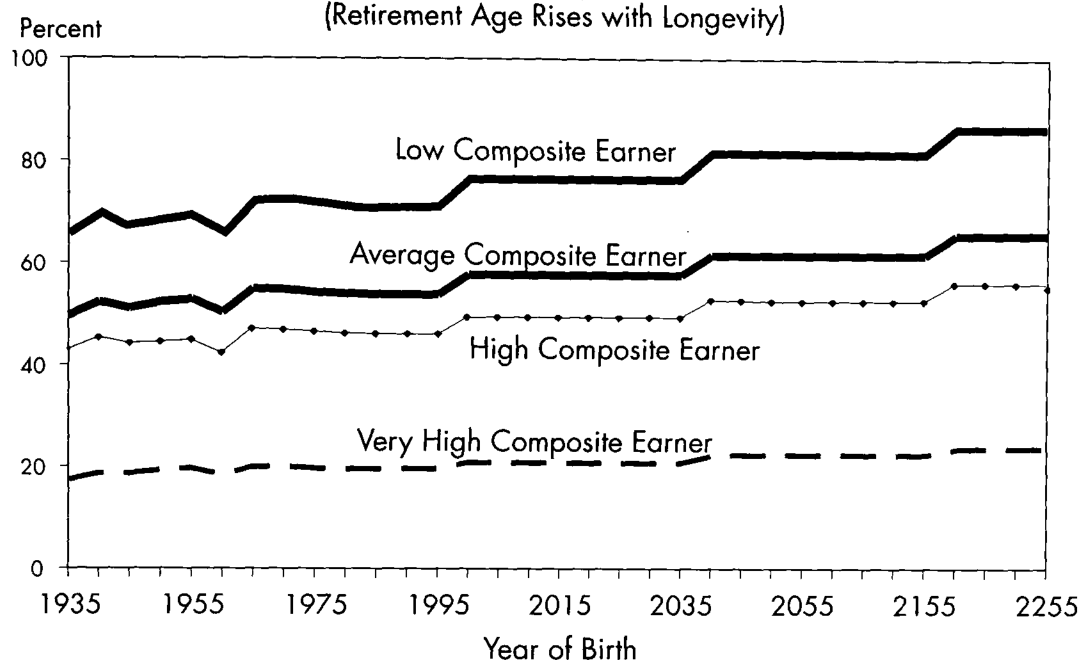
12 To calculate the AIME, taxable wages at each age prior to age 60 are indexed to the level of economy-wide average wages in the year the person is age 60 before they are averaged together. While this indexation causes the AIME to be larger than more straightforward measures of average actual taxable real wages while working, this overstatement occurs for all birth cohorts and does not have any systematic effect on the rate at which benefits rise for successive birth cohorts.



Source: Department of the Treasury

By assuming that all workers retire at age 65, the calculations in Figure 3 do not allow for the possibility that people will work longer as expected lifespans increase. Figure 4 therefore shows benefit replacement rates for the same set of composite earners under the alternative assumption that workers work longer as their life expectancies increase beginning with the 1946 birth cohort (who become eligible for benefits in 2008). Specifically, Figure 4 assumes that workers born prior to 1946 work until age 65, and that later cohorts work an additional year for every two-year increase in their projected life expectancy at age 62 relative to the 1945 birth cohort. As can be seen from the figure, replacement rates slowly rise as individuals work longer.[13] Because the calculations assume retirement on a birthday, the assumed retirement age jumps in discrete one-year intervals, which makes the calculated benefit replacement rates trend upward in steps.

13 To keep the yardstick against which benefit adequacy is measured constant across cohorts, the denominator in the benefit replacement rate calculation is the same in Figure 4 as was used in Figure 3. That is, the denominator in both cases is the level of real consumption possible between the ages of 21 and 65 if all wages during those years were consumed. The increase in benefit replacement rates as people live and work longer thus reflects both a somewhat higher level of lifetime wages being used in the benefit computation, as well as—and more importantly—actuarial adjustments that are made to initial benefits and that depend on the age that benefits commence.



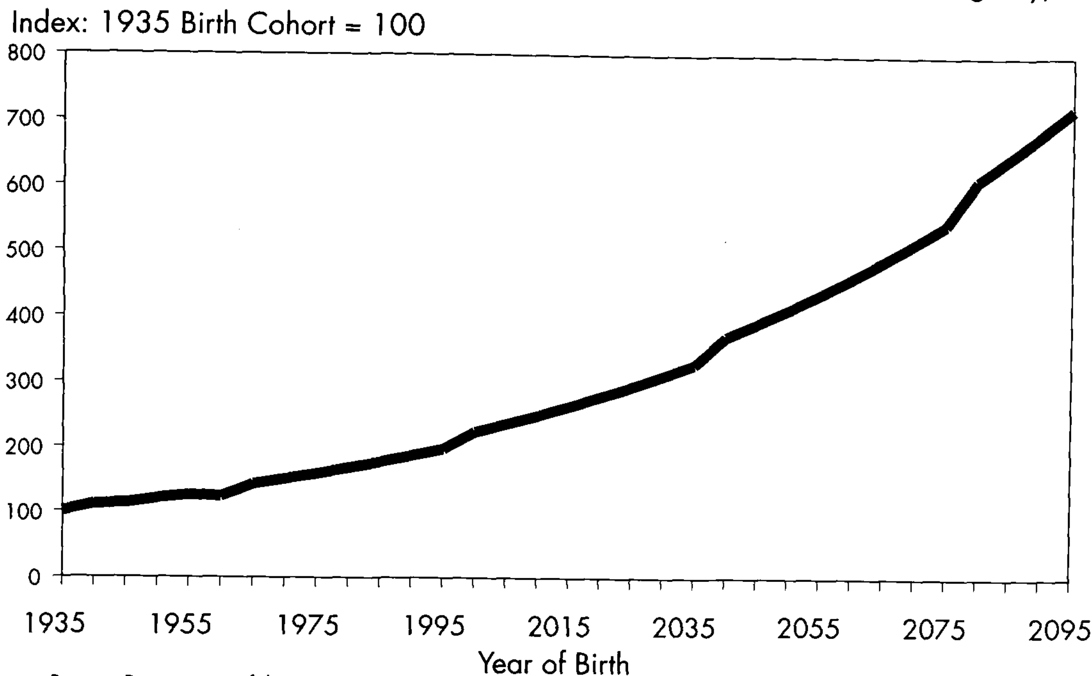
Source: Department of the Treasury

Because wages tend to rise faster than inflation over time (reflecting increased labor productivity), lifetime earnings—and thus benefits—will rise more rapidly than inflation for each cohort. As a result, the absolute *level* of real benefits for successive birth cohorts will rise more rapidly than the replacement rate. That is, Social Security is set up to provide each new generation of retirees with higher real benefits than what previous generations received. This can be seen in Figure 5, which plots real benefit levels for the average composite worker in the case where the age at which individuals retire is assumed to rise with longevity. Because absolute real benefit levels are difficult to interpret by themselves, benefits for the 1935 birth cohort are scaled to equal 100 and the benefits of all other cohorts are expressed relative to this one; in addition, only the average composite earner is shown because profiles for the other three composites are essentially the same.

A future issue brief will use the concept of the benefit replacement rate to assess the effect of specific reform provisions on benefit adequacy and compare the impact of various reform plans on both the replacement rate and the level of real benefits.

Figure 5: Real Benefit Level

(Average Wage Composite Worker, Retirement Age Rises With Longevity)



Source: Department of the Treasury

FORCED SAVING AND ECONOMIC EFFICIENCY

The size of benefits (or equivalently, the amount of forced saving) has a direct relationship with the size of the trust fund, because an increase in the amount of forced saving implies a corresponding increase in the amount of attempted pre-funding of Social Security benefits. (Whether this attempted pre-funding constitutes true pre-funding is discussed with reference to question four, below.) In the current system, any increase in forced saving accumulates in the trust fund; under some reform proposals, some or all of the increased forced saving would go into an alternative saving vehicle, such as personal retirement accounts.

A simplified example is useful to illustrate the relationship between benefit levels and the size of the trust fund. Suppose that for people born in 1980 one-third of the payroll taxes that workers pay under a reformed Social Security system are net taxes to make the system permanently solvent and two-thirds constitute forced saving to provide retirement benefits (using the example from above, this could involve 4 percentage points of earnings going to solvency and 8 percentage points that eventually come back as retirement benefits). Then it would be possible to eliminate two-thirds of this cohort's payroll taxes and all of its benefits without affecting the long-term solvency of Social Security (whether this would be a good idea is a different matter). In this case, the trust fund would have less revenue up front and a correspondingly lower benefit obligation in the future; the result is a lower trust fund balance at all dates between when the 1980 birth cohort first contributes taxes and when its last member dies. The same conclusion applies to other birth cohorts and for less drastic reductions in forced saving. This illustrates that the magnitude of retirement benefits has a direct impact on the size of the trust fund.

The Social Security system must impose a net tax exceeding $13.6 trillion on reform cohorts (through benefits that have a lower present value than taxes paid), and the net tax will be related to wages if it is to be fair. Taxing work discourages work, with the magnitude of this economic impact depending on the precise way that the burden of reform is allocated across and within generations. These incentive effects of reform will be discussed in a future issue brief.

Social Security reform involves work disincentives because the net tax burden associated with reform must ultimately be imposed. The size of retirement benefits, on the other hand, derives from forced saving that is not related to the net taxes that affect work incentives. Provided that forced savings add to true pre-funding and that individuals understand that the part of their payroll taxes that constitutes forced saving will be returned to them as benefits in retirement, having higher or lower benefit levels does not have an additional impact on work incentives.[14] If either of these conditions does not hold, however, increasing benefits while keeping net taxes unchanged (that is, increasing forced saving) will result in additional economic distortions.

To illustrate this point, imagine a reform plan—call it "Plan A"—that levies a $13.6 trillion-plus net tax on reform cohorts in a progressive manner and that involves a small amount of forced saving and thus modest retirement benefits. This could be a plan with a 6 percent payroll tax, where 4 percentage points go to make the system solvent and 2 percentage points fund future retirement benefits. Then Plan A can be modified by introducing a second tier of benefits that is crafted so as to have potentially no additional effect on work incentives. Specifically, the second tier of benefits would be funded with an additional payroll tax that accumulates in the trust fund (or in another saving vehicle, such as a personal retirement account), and each person's additional benefits would equal the annuity value of a hypothetical account balance computed under the assumption that their own additional payroll taxes earn the same return as do trust fund securities (when done through the trust fund, such an arrangement is often referred to as a "notional account" or a "cash balance account"). So long as people understand the direct relationship between taxes and future benefits, these taxes should have no effect on work incentives.

It is worth emphasizing once again that increasing taxes beyond the amount needed to achieve permanent solvency in order to fund benefits does not discourage work effort only if two key assumptions are satisfied. First, individuals must understand that additional forced saving will be returned to them in the form of additional benefits—put differently, they must recognize that this truly represents forced saving, not a pure tax. Second, the additional forced saving must add to true pre-funding dollar for dollar. That is, the additional revenues must be kept secure so that they are available to fund future benefits. (In the context of the current system, this is the same task as ensuring that Social Security surpluses are saved.) The possibility that this latter assumption does not hold true will now be considered.

14 In addition to these key conditions, this conclusion requires that individuals put the same value on the benefits Social Security provides them in retirement as they do on income received while working.

FOURTH KEY QUESTION: IS ATTEMPTED PRE-FUNDING REAL? IF NOT, HOW DOES THAT AFFECT THE ANSWERS TO THE QUESTIONS ABOUT FAIRNESS AND BENEFIT SIZE?

How one answers the questions about intergenerational fairness and benefit size will be profoundly influenced by whether attempts to pre-fund future benefits by collecting current contributions in excess of current benefits are in fact successful. The imminent retirement of the relatively large baby-boomer cohorts and sustained improvements in longevity are expected to cause the ratio of retirees to workers to rise rapidly over the next 30 years. In these circumstances, maintaining Social Security contributions and benefits that are stable relative to peoples' wages while working implies that the system will collect more revenues than it pays out as benefits in the near term when the ratio of retirees to workers (the old-age dependency rate) is relatively low. It also implies that the system will pay more benefits than it collects in taxes later when the old-age dependency rate is relatively high. This financing strategy is reasonable *provided that the near-term surplus revenues are safeguarded in a way that allows them to be used in the future to pay for benefits.*

If Social Security surpluses accumulate in the trust fund, these surpluses will increase the government's capacity to pay benefits in the future *only* to the extent that they result in smaller amounts of public debt issuance than would occur if there were no surpluses. This is because reducing near-term public debt issuance would increase the government's capacity to issue debt in the future to help pay benefits (see Box 2 for additional discussion of this point). The result would be an accumulation of real resources now (through higher government saving) that can then be drawn upon in the future to finance benefits.

BOX 2

TRUST FUND ACCOUNTING: HOW IT WORKS AND WHAT IT MEANS

As required by law, excess revenues from Social Security taxes are used to purchase special-issue federal securities that are held in the Social Security trust fund and redeemed as needed to pay future benefits. The trust fund is credited with interest at a rate comparable to that paid on federal debt issued to the public. Social Security benefit payments are automatically authorized provided there are sufficient assets in the pertinent trust fund.

Because trust fund securities are themselves federal securities, they are often dismissed as IOUs that the government has made out to itself that do not increase its ability to pay benefits. This is true in the following sense: If information about trust fund holdings were somehow lost, there would be no impact on the government's ability to finance its overall operations going forward because government assets and liabilities would be reduced by identical amounts. But it does not necessarily follow that Social Security surpluses cannot increase the government's ability to pay future Social Security benefits. Social Security surpluses increase the government's capacity to pay future benefits to the extent that they reduce publicly held federal debt. If they reduce the issuance of publicly held federal debt now when the old-age dependency ratio is relatively low, it would be possible to issue more publicly held debt in the future to help finance benefits when the old-age dependency ratio is relatively high. (These effects arise from the surpluses, not from the trust fund accounting or the issuance of trust fund securities.)

The degree to which today's Social Security surpluses result in additional resources in the future depends on the effect that they have on spending and taxes in the rest of the federal budget. This is an empirical question that involves the political economy of government finance. If Social Security's finances do not influence the non-Social Security portion of the federal budget, then Social Security surpluses pay down publicly held debt dollar-for-dollar, and the trust fund balance at each point in time is a precise measure of how much the program has reduced publicly held federal debt up to that point. The trust fund balance at the end of 2006 was $2 trillion. Hence, if Social Security does not influence non-Social Security fiscal decisions, then Social Security has increased the government's capacity to issue publicly held debt for the sake of paying Social Security benefits by $2 trillion as of the end of 2006. To the extent, however, that Social Security surpluses result in higher deficits in the non-Social Security portion of the budget, then government saving is not increased by higher Social Security surpluses. In that case, future Social Security benefits that would have been financed with higher issuance of publicly held debt will instead have to be financed with reductions in non-Social Security spending or increases in non-Social Security taxes.

Many analysts believe Social Security surpluses do not increase the government's capacity to pay future Social Security benefits. Under this view, Social Security surpluses are offset in the rest of the federal budget by some combination of higher non-Social Security spending and/or lower non-Social Security taxes. To the extent that this is true, Social Security's surpluses do not increase the government's capacity to pay future Social Security benefits. The future benefit payments that would have been financed with public debt issuance had Social Security surpluses truly been saved must instead be financed with lower non-Social Security spending and/or higher non-Social Security taxes. In this case, the existence of the present Social Security surplus causes the non-Social Security budget to be more profligate, and the future Social Security cash deficit would be expected to cause the non-Social Security budget to become more austere. Under this scenario, an attempt to make Social Security fair to future generations by accumulating near-term surpluses in the trust fund would be undone by a non-Social Security policy that is less fair to future generations. Rather than resulting in resources that provide future benefits, running a Social Security surplus today would instead lead to more debt outside the trust fund that must be paid off by future generations, leaving them with no net gain.

THE IMPLICATIONS FOR REFORM OF NOT BEING ABLE TO EFFECTIVELY PRE-FUND BENEFITS

If Social Security surpluses are not truly saved in the trust fund and if it is not possible to put in place some other mechanism to ensure that future Social Security benefits are pre-funded (such as personal retirement accounts or some other "lockbox" provisions), then it would be reasonable to compromise other reform objectives so as to limit trust fund accumulations. This can be accomplished in two ways: by reducing benefit levels while holding reform burdens constant, and/or by reducing the share of the Social Security reform burden that is imposed on early birth cohorts while keeping benefit levels constant. However, as will be discussed, only the first method of reducing trust fund accumulations would benefit future generations.

Reducing Benefit Levels Holding Reform Burdens Constant

An inability to pre-fund Social Security benefits has an important effect on the decision of how large to make benefits. Compared with a reform that would be best overall if pre-funding were real, lowering each person's taxes paid while working and benefits received in retirement in an actuarially equivalent manner (that is, reducing forced saving) would greatly reduce trust fund accumulations without affecting Social Security's solvency or changing the distribution of Social Security's net taxes across birth cohorts or income groups within birth cohorts. This policy change would have little effect on the well-being or retirement incomes of individuals who increase their private saving by the amount of their tax reductions—such people would do less forced saving through Social Security but make it up by saving more on their own. Individuals who do not save their tax reductions, however, might have inadequate income in retirement. That downside must be weighed against the increased fairness of overall fiscal policy toward future generations.

Changing the Distribution of the Reform Burden Holding Benefit Levels Constant

Suppose the level of benefits (that is, forced saving) is held constant. Then trust fund accumulations could be reduced by shifting reform burdens only if payroll taxes were reduced for early birth cohorts and increased for later birth cohorts. Clearly, this policy change would not benefit future generations.

However, it is worth noting that shifting the payroll tax burden from early to later generations would also not harm later generations if trust fund accumulations are not truly saved. To see this, suppose payroll taxes are reduced in the near term and increased in the longer term so that the present value of payroll tax revenues is unchanged, and that the near-term payroll tax increases are exactly offset by higher non-Social Security revenues in every year. Then the amount of publicly held debt that future generations inherit would not be changed, and nor would their benefit payment obligations. It follows that those generations are made no better or worse off by the policy change.[15]

HOW CAN EFFECTIVE PRE-FUNDING BE ACHIEVED?

If true pre-funding is not possible, the prospects for Social Security reform that is fair to future generations and that ensures adequate retirement incomes are greatly hindered. Rather than compromise on these

15 While total publicly held debt would be unchanged, the amount that would be attributable to past Social Security cash flows would be larger, and the amount that would be attributable to past non-Social Security cash flows would be smaller. So while future generations would pay higher payroll taxes to make up for the higher amounts of public debt attributable to Social Security policy, they would pay lower non-Social Security taxes to service public debt attributable to non-Social Security policy.

goals, a better option would be to find a mechanism that provides more confidence that surplus revenues are truly saved. A future Treasury brief will explore this topic in detail.

CONCLUSION

This issue brief has posed four key questions that policymakers should consider as a first step to deciding on the particular details of Social Security reform, and has offered an analytical framework to help answer them. Answers to these four questions will help define achievable goals for Social Security reform and help guide the process of crafting a reform package.

October 12, 2007
HP-605

Auditing Committee to Host First Public Meeting

The Department of the Treasury's Advisory Committee on the Auditing Profession will convene its first meeting at the Treasury Department on Monday, October 15, at 10 a.m. Committee Chairmen Arthur Levitt, Jr. and Donald T. Nicholaisen will host the meeting. Treasury Under Secretary for Domestic Finance Robert K. Steel also will give remarks.

The public is invited to attend and submit written statements with the Advisory Committee at its website: http://www.treas.gov/offices/domestic-finance/acap/index.shtml. The following event is open to the press:

Who
Under Secretary for Domestic Finance Robert K. Steel
Department of the Treasury's Advisory Committee on the Auditing Profession
What
Public Meeting
When
Monday, October 15, 10 a.m. (EDT)
Where
U.S. Treasury Department
Cash Room
1500 Pennsylvania Ave.
Washington, D.C.
Note
Media without Treasury press credentials planning to attend must contact Frances Anderson in Treasury's Office of Public Affairs at (202) 622-2960 or (202) 528-9086 with the following information: name, Social Security number and date of birth. This information may also be emailed to frances.anderson@do.treas.gov. Those wishing to attend who are not members of the press should contact Serita Winborne at (202) 622-4944 with the following information: name, Social Security number and date of birth. This information may also be emailed to serita.winborne@do.treas.gov.

PRESS ROOM

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October 12, 2007
HP-606

**Statement by Secretary Henry M. Paulson, Jr.
on the FATF's Public Statements on Iran**

"The Financial Action Task Force has taken a dramatic step in highlighting the significant threat Iran poses to the international financial system. As the premier standard-setting body for countering terrorist financing and money laundering, the FATF's expression of concern toward Iran speaks volumes.

"Over the past year, financial institutions across the globe have been re-examining and adjusting their relationships with Iran in light of its ongoing pursuit of nuclear weapons in defiance of the international community, support for lethal terrorist groups, and deceptive financial practices. FATF members advised those financial institutions still dealing with Iran to seriously weigh the risks posed by Iran's failure to comply with international standards.

"I commend the FATF for undertaking these actions and for calling upon Iran to urgently address its systemic failures to combat terrorist financing and money laundering.

"FATF separately identified customers and transactions associated with Iran as representing a significant risk factor for financing the proliferation of weapons of mass destruction.

"In the wake of two unanimous UN Security Council Resolutions addressing Iran's nuclear and ballistic missile programs, Iran's extensive deceptive financial conduct, and the statements issued by the FATF, financial institutions should be mindful of the extraordinary risks that accompany doing business with Iran."

FATF Statement on Iran – Paris Plenary, October 11, 2007

http://www.fatf-gafi.org/dataoecd/1/2/39481684.pdf

FATF Chairman's Summary – Paris Plenary, October 10 – 12, 2007

http://www.fatf-gafi.org/dataoecd/0/23/39485130.pdf

The Financial Action Task Force is an inter-governmental body whose purpose is the development and promotion of policies, both at the national and international levels, to combat money laundering and terrorist financing. The thirty-four members of the FATF are: Argentina; Australia; Austria; Belgium; Brazil; Canada; China; Denmark; the European Commission; Finland; France; Germany; Greece; the Gulf Cooperation Council; Hong Kong, China; Iceland; Ireland; Italy; Japan; Luxembourg; Mexico; the Kingdom of the Netherlands; New Zealand; Norway; Portugal; the Russian Federation; Singapore; South Africa; Spain; Sweden; Switzerland; Turkey; the United Kingdom; and the United States.

FATF STATEMENT ON IRAN

Paris, 11 October 2007

The Financial Action Task Force (FATF) is concerned that the Islamic Republic of Iran's lack of a comprehensive anti-money laundering / combating the financing of terrorism (AML/CFT) regime represents a significant vulnerability within the international financial system. FATF calls upon Iran to address on an urgent basis its AML/CFT deficiencies, including those identified in the 2006 International Monetary Fund Article IV Consultation Report for Iran.

FATF members are advising their financial institutions to take the risk arising from the deficiencies in Iran's AML/CFT regime into account for enhanced due diligence.

FATF looks forward to engaging with Iran to address these deficiencies.

Notes:

1. For further information, journalists are invited to contact Mr. Rick McDonell, Executive Secretary, FATF (email: contact@fatf-gafi.org).

2. The FATF is an inter-governmental body whose purpose is the development and promotion of policies, both at national and international levels, to combat money laundering and terrorist financing. The FATF Secretariat is housed at the OECD.

3. The thirty-four members of the FATF are: Argentina; Australia; Austria; Belgium; Brazil; Canada; China; Denmark; the European Commission; Finland; France; Germany; Greece; the Gulf Co-operation Council; Hong Kong, China; Iceland; Ireland; Italy; Japan; Luxembourg; Mexico; the Kingdom of the Netherlands; New Zealand; Norway; Portugal; the Russian Federation; Singapore; South Africa; Spain; Sweden; Switzerland; Turkey; the United Kingdom; and the United States.

4. India and the Republic of Korea are observer countries. The Asia Pacific Group on money laundering (APG)[1], the Grupo de Acción Financiera de Sudamérica (GAFISUD)[2], the Middle East and North Africa Financial Action Task Force (MENAFATF)[3] and the Council of Europe Committee of Experts on the Evaluation of Anti-Money Laundering Measures (MONEYVAL)[4] are Associate Members.

5. The global network that is committed to combating money laundering and terrorist financing also includes four other regional bodies: the Caribbean Financial Action Task Force (CFATF)[5], the Eastern and South African Anti Money Laundering Group (ESAAMLG)[6], the Eurasian Group on combating money laundering and financing of terrorism (EAG)[7] and the Groupe Inter-gouvernemental d'Action contre le Blanchiment en Afrique (GIABA)[8]. The Offshore Group of Banking Supervisors (OGBS)[9] is a part of this network as well.

[1] www.apgml.org
[2] www.gafisud.org
[3] www.menafatf.org
[4] www.coe.int/moneyval
[5] www.cfatf.org
[6] www.esaamlg.org
[7] www.eurasiangroup.org
[8] www.giaba-westafrica.org
[9] www.ogbs.net

Chairman's Summary
Paris Plenary, 10-12 October 2007

12 October 2007

New steps to protect the international financial system from abuse were agreed by the FATF at its meeting in Paris on 10-12 October 2007. Attended by over 400 delegates from 34 countries and 20 international organisations, this was the first plenary meeting under the UK Presidency of the FATF. The FATF:

- called upon **Iran** to strengthen, as a matter of urgency, its anti-money laundering and counter-terrorist financing (AML/CFT) controls. FATF members are advising their financial institutions to take account of the risks in enhanced due diligence;
- agreed new steps to strengthen **private sector engagement** in the global fight against money laundering and terrorist financing;
- committed to produce a regular **global threat assessment** setting out key issues of criminal and terrorist financing concern;
- published new guidance to address the threat of **weapons of mass destruction (WMD) proliferation** emanating from Iran, in accordance with the financial provisions of United Nations Security Council Resolution 1737; and
- discussed and adopted an **evaluation of the AML/CFT system in Finland**.

Iran

On 11 October 2007, the FATF Plenary released the following statement on Iran:

> The Financial Action Task Force (FATF) is concerned that the Islamic Republic of Iran's lack of a comprehensive anti-money laundering / combating the financing of terrorism (AML/CFT) regime represents a significant vulnerability within the international financial system. The FATF calls upon Iran to address on an urgent basis its AML/CFT deficiencies, including those identified in the 2006 International Monetary Fund Article IV Consultation Report for Iran.
>
> FATF members are advising their financial institutions to take the risk arising from the deficiencies in Iran's AML/CFT regime into account for enhanced due diligence.
>
> The FATF looks forward to engaging with Iran to address these deficiencies.

Strengthening dialogue with the private sector

A new forum bringing together the FATF and key private sector bodies is to be launched by the FATF. The forum builds on existing outreach activities and will formalise and enhance dialogue and a partnership approach between the FATF and key private sector organisations from a wide range of sectors across the globe.

The FATF will also meet with key private sector organisations in London in December 2007. This first joint meeting to exchange information on money laundering and terrorist financing techniques reflects an enhanced commitment by the FATF to engage with the private sector.

Work will also commence between the FATF and representatives of key non-financial businesses and professions to develop shared guidance on the risk-based approach to tackling money laundering and terrorist financing. This activity builds on joint guidance on the risk-based approach published in July 2007 by the FATF and representatives of the international banking and securities sectors.

Global threat assessment of money laundering and terrorist financing threats

The FATF plans to produce a regular global threat assessment, setting out key issues of criminal and terrorist financing concern.

This new threat assessment will be developed following a process of enhanced surveillance of international money laundering and terrorist financing risks and will help national governments and the private sector take actions to manage key international threats. This initiative builds upon and complements the FATF's existing typologies work. The FATF has also agreed to support countries in the development of national-level threat assessments.

Combating the financing of WMD proliferation

The FATF will continue to work on the combating of proliferation financing in response to UN Security Council Resolutions. It is developing a new study on the trends and techniques involved in WMD proliferation financing activity.

Other action taken this week builds on previous work published by the FATF in June and September 2007 to assist jurisdictions in the implementation of the targeted financial sanctions contained within UN Security Council Resolution 1737.

Specifically, the FATF agreed new guidance on the implementation of financial prohibitions to combat the threat of WMD proliferation by Iran. This represents a major step forward in the implementation of financial measures contained within UN Security Council Resolution 1737. The guidance, to be released on the FATF website, will facilitate further cooperation between national governments and financial institutions in the fight against WMD proliferation financing.

Finland: Evaluation of anti-money laundering and counter-terrorist financing action

The FATF discussed and adopted a mutual evaluation report assessing Finland's compliance with the FATF standards: the 40+9 Recommendations. A summary of the assessment will shortly be released on the FATF website. The full report will be released publicly in the coming weeks.

Mr James Sassoon
President, Financial Action Task Force

Paris, 12 October 2007

Notes:

1. For further information, journalists are invited to contact Helen Fisher, OECD Media Relations, (Tel: +33 1 45 24 80 97 or helen.fisher@oecd.org) or the FATF Secretariat, 2, rue André-Pascal, 75775 Paris Cedex 16 (tel: +33 1 45 24 79 45, fax: +33 1 44 30 61 37, email: contact@fatf-gafi.org).

2. The FATF is an inter-governmental body whose purpose is the development and promotion of policies, both at national and international levels, to combat money laundering and terrorist financing. The FATF Secretariat is housed at the OECD.

3. The thirty-four members of the FATF are: Argentina; Australia; Austria; Belgium; Brazil; Canada; China; Denmark; the European Commission; Finland; France; Germany; Greece; the Gulf Co-operation Council; Hong Kong, China; Iceland; Ireland; Italy; Japan; Luxembourg; Mexico; the Kingdom of the Netherlands; New Zealand; Norway; Portugal; the Russian Federation; Singapore; South Africa; Spain; Sweden; Switzerland; Turkey; the United Kingdom; and the United States.

4. India and the Republic of Korea are observer countries. The Asia Pacific Group on money laundering (APG)[1], the Grupo de Acción Financiera de Sudamérica (GAFISUD)[2], the Middle East and North Africa Financial Action Task Force (MENAFATF)[3] and the Council of Europe Committee of Experts on the Evaluation of Anti-Money Laundering Measures (MONEYVAL)[4] are Associate Members.

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[1] www.apgml.org
[2] www.gafisud.org
[3] www.menafatf.org
[4] www.coe.int/moneyval
[5] www.cfatf.org
[6] www.esaamlg.org
[7] www.eurasiangroup.org
[8] www.giaba-westafrica.org
[9] www.ogbs.net

October 12, 2007
HP-607

Treasury Releases Schedule for Fall G7 Meeting

U.S. Treasury Secretary Henry M. Paulson, Jr. will host a meeting of the G7 finance ministers and central bank governors on Friday, October 19, in Washington, D.C. Following is a schedule of events:

Who
Under Secretary for International Affairs David McCormick
What
Pre-G7 Press Conference
When
Wednesday, October 17, 2:30 p.m. (EDT)
Where
Treasury Department Media Room (4121)
1500 Pennsylvania Avenue, 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.

***

Who
G7 Finance Ministers and Central Bank Governors
What
Ministerial Meeting – Photos at the Top
When
Friday, October 19, 1:15 p.m.
(EDT)
Where
Treasury Department Cash Room
1500 Pennsylvania Avenue, NW
Washington, D.C.
Note
This is a pooled photo event – photographers wishing to participate should contact Courtney Forsell at (202) 622-2591, or [illegible] for more information.

***

Who
G7 Finance Ministers and Central Bank Governors
What
Family Photo
When
Friday, October 19, 4:00 p.m. (EDT)
Where
Treasury Department – Bell Entrance Steps (West Side of Building)
1500 Pennsylvania Avenue, NW
Washington, D.C.
Note
Photographers wishing to participate must contact Frances Anderson at (202) 622-2439 or frances.anderson@do.treas.gov. Photographers may begin setting up at 2:45 p.m. (EDT). Photographers must be in place no later than 3:30 p.m. (EDT).

Who
U.S. Treasury Secretary Henry M. Paulson, Jr.
What
Press Conference
When
Friday, October 19, 7:00 p.m. (EDT)

Where
Office of Thrift Supervision Auditorium
1700 G Street, NW
Washington, D.C.
Note
Media may begin setting up at 5:30 p.m. (EDT). Treasury, White House, and IMF/World Bank Fall Meeting press credentials will be accepted – no additional clearance is needed.

October 12, 2007
HP-608

Secretary Paulson to Deliver Speech on Homeownership, Mortgage Markets, and the U.S. Economy

Treasury Secretary Henry M. Paulson, Jr. will deliver remarks next week on homeownership, mortgage markets, and the U.S. economy.

Who
Treasury Secretary Henry M. Paulson, Jr.

What
Remarks on Homeownership, Mortgage Markets, and the U.S. Economy

When
11 a.m. EDT on Tuesday, October 16

Where
Georgetown University Law Center
Gewirz Student Center, 12th Floor
120 F Street, NW
Washington, D.C.

Note
Media interested in attending should contact Kara Tershel at

October 15, 2007
HP-609

Treasury Statement on Private-Sector Announcement Of Liquidity Facility for Asset Backed Commercial Paper

Washington- The U.S. Department of the Treasury issued the following statement today regarding the intention of major global banks to create a liquidity facility to bolster the asset backed commercial paper market:

"Treasury is pleased with the response by the private sector to enhance liquidity in the short term credit markets. The joint efforts of domestic and international financial institutions, broker dealers, and investors have resulted in a potential structure to improve liquidity in the asset backed commercial paper markets. This proposal will complement other solutions investors and asset managers may utilize in committing and deploying capital to support more efficient markets.

"The Department appreciates this global consortium's cooperation during the last several weeks and their leadership in developing a market-based response to this situation. Such efforts help to foster orderly capital markets."

October 15, 2007
hp-610

Under Secretary for Domestic Finance
Robert K. Steel
Welcome and Introductory Remarks Before the
Initial Meeting of the Department of the Treasury's
Advisory Committee on the Auditing Profession

Washington - Good morning. Welcome to the Department of the Treasury. Thank you for being here today at the initial meeting of the Advisory Committee on the Auditing Profession. I want to extend my gratitude as well as that of Secretary Paulson and the Department to the members of the Committee. We appreciate the generosity of your service.

I want to thank, in particular, the Co-Chairs of the Committee, former Securities and Exchange Commission Chairman Arthur Levitt, Jr. and former SEC Chief Accountant Donald T. Nicolaisen. The high regard in which these two gentlemen are held is reflected in the willingness of the distinguished individuals gathered around this table to serve as members of this Committee.

As many of you know, this Committee stems from the capital markets competitiveness initiatives that Secretary Paulson has spearheaded. Nearly a year ago, the Secretary delivered a speech on the need to maintain and enhance U.S. capital markets competitiveness. He specifically pointed out the sustainability of the auditing profession as a vital component to this competitiveness.[1]

The link between the auditing profession and capital markets competitiveness was established during the adoption of the federal securities laws almost 75 years ago. To assist in restoring investor confidence and encouraging capital development after the 1929 crash, the auditing profession, itself, lobbied for independent audits of financial statements as part of the legislative reforms Congress was considering. [2]

Agreeing with the profession, Congress mandated in the federal securities laws independently audited financial statements for all public companies. Certifying financial statements, the independent auditor would help accomplish the aims of the Securities Act of 1933 "to restore the confidence of the prospective investor in his ability to select sound securities; ...and to bring into productive channels of industry and development capital which has grown timid."[3]

Congress had decided then to bestow on the public company auditor a critical role of trust, integral to investor confidence, integral to the flow of capital. This trust clearly broke down at the beginning of this century when public company accounting scandals challenged the credibility of the auditing profession. Congress, considering what would eventually become the Sarbanes-Oxley Act of 2002, harshly reminded the profession: "[T]he franchise given to public accountants by the securities laws is *conditional*; it comes in return for the CPA's faithful assumption of a public trust."[4]

To restore credibility in the profession, the Sarbanes-Oxley Act mandated several major changes, the most prominent being the move from self-regulation and peer review to a system of federal oversight: The Public Company Accounting Oversight Board, whose creation has been termed the "centerpiece" [5] of the Act, now registers and inspects all public company auditing firms and sets and enforces auditing standards. The Sarbanes-Oxley Act also enhanced auditor independence standards, required mandatory auditing firm partner rotation, and strengthened the audit committee's role in monitoring the auditor and the audit process.

Five years have passed since the passage of this landmark legislation. The

profession continues to adapt to these changes as it reasserts its role in enhancing investor confidence and the competitiveness of our capital markets. At the same time, the profession faces considerable challenges.

Secretary Paulson outlined these challenges in his competitiveness speech last year. I repeat his precise words:

- "Given the importance of accounting to our financial system, is there enough competition?"
- "Will our reformed accounting system produce the high-quality audits and attract the talented auditors we need?"
- "Do auditors seek detailed rules in order to focus on technical compliance rather than using professional judgment that could be second-guessed by the PCAOB or private litigants?"[6]

The Department has charged the Committee with developing recommendations taking into consideration the issues impacting the sustainability of the auditing profession, including those raised by these questions. Neither the difficulty nor the importance of this task should be underestimated.

Again, we are grateful for your service. Secretary Paulson and the Department await your recommendations. I now yield the floor to the Co-Chairs for their meeting. Thank you.

[1] Henry M. Paulson, Jr., Secretary of the U.S. Department of the Treasury, *Remarks on the Competitiveness of the U.S. Capital Markets Before the Economic Club of New York* (Nov. 20, 2006).

[2] Gary John Previts & Barbara Dubis Merino, *A History of Accountancy in the United States: The Cultural Significance of Accounting* 723 (1998).

[3] S. Rep. No. 47, 73rd Cong., 1st Sess. 1 (Apr. 17, 1933).

[4] S. Rep. No. 205, 107th Cong., 2nd Sess. 6 (July 3, 2002).

[5] Douglas R. Carmichael, *The PCAOB and the Social Responsibility of the Independent Auditor*, Accounting Horizons Vol. 18, No. 2, 127-33 (June 2004).

[6] Henry M. Paulson, Jr., Secretary of the U.S. Department of the Treasury, *Remarks on the Competitiveness of the U.S. Capital Markets Before the Economic Club of New York* (Nov. 20, 2006).

October 15, 2007
2007-10-15-14-13-12-20204

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 $68,589 million as of the end of the prior week.

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

	October 12, 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	13,777	10,840	24,617
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	13,788	5,339	19,127
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	4,453		
(3) SDRs	9,280		
(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)

		Total	Maturity breakdown (residual maturity) 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)

	Total	Maturity breakdown (residual maturity, where applicable) 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				
(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	

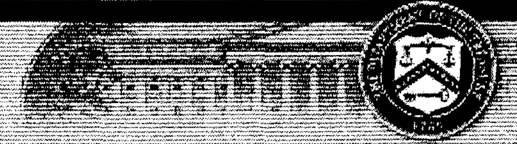
(d) securities lent and on repo	
--lent or repoed and included in Section I	
--lent or repoed but not included in Section I	
--borrowed or acquired and included in Section I	
--borrowed or acquired but not included in Section I	
(e) financial derivative assets (net, marked to market)	
--forwards	
--futures	
--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.



FROM THE C .IC AFFAIRS

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October 16, 2007
HP-611

Treasury Internati :) Data for August

Treasury International Capital (TIC) data for August are released today e U.S. Treasury web site (www.treas.gov/tic). The next release, which will report on data for September, is scheduled for November 16, 2007.

Net foreign purchases of long-term securities were minus $69.3 billion.

- Net foreign purchases of long-term U.S. securities were minus : nis, net purchases by foreign official institutions were minus $24.2 billion, and net purchases by private foreign investors were min
- U.S. residents purchased a net $34.5 billion of long-term foreig

Net foreign acquisition of long-term securities, taking into account adju: ted to have been minus $85.5 billion.

Foreign holdings of dollar-denominated short-term U.S. securities, incl ls, and other custody liabilities increased $33.9 billion. Foreign holdings of Treasury bills increased $21.0 billion.

Banks' own net dollar-denominated liabilities to foreign residents decre n.

Monthly net TIC flows were minus $163.0 billion. Of this, net foreign p ninus $141.9 billion, and net foreign official flows were minus $21.1 billion.

TIC Monthly Reports on Cross-Border Financial Flows

(Billions of dollars, not seasonally adjusted)

		2005	2006	Aug-06	Aug-07	May-07	Jun-07	Jul-07	Aug-07
	Foreigners' Acquisitions of Long-term Securities								
1	Gross Purchases of Domestic U.S. Securities	17157.5	21186.9	19531.8	26957.4	2429.8	2609.4	2474.0	3323.7
2	Gross Sales of Domestic U.S. Securities	16145.9	20021.0	18385.7	25852.8	2259.8	2487.7	2449.0	3358.6
3	**Domestic Securities Purchased, net** (line 1 less line 2) /1	**1011.5**	**1165.9**	**1146.1**	**1104.6**	**170.1**	**121.7**	**25.0**	**-34.9**
4	**Private, net /2**	**891.1**	**967.0**	**985.5**	**940.2**	**158.6**	**93.9**	**20.6**	**-10.6**
5	Treasury Bonds & Notes, net	269.4	135.4	193.2	175.3	27.2	18.2	-2.4	27.1
6	Gov't Agency Bonds, net	187.6	201.4	207.1	145.7	14.3	23.6	1.2	5.5
7	Corporate Bonds, net	353.1	485.5	435.4	457.2	74.3	24.8	3.4	-4.2
8	Equities, net	81.0	144.6	149.7	162.0	42.7	27.2	18.4	-39.0
9	**Official, net /3**	**120.4**	**199.0**	**160.6**	**164.5**	**11.5**	**27.8**	**4.4**	**-24.2**
10	Treasury Bonds & Notes, net	68.7	71.8	52.1	8.6	-4.6	6.4	-6.9	-29.7
11	Gov't Agency Bonds, net	31.6	92.6	70.9	122.3	12.8	16.0	7.5	4.1
12	Corporate Bonds, net	19.1	28.5	26.8	35.2	4.0	3.7	1.0	3.0
13	Equities, net	1.0	6.0	10.8	-1.7	-0.7	1.7	2.8	-1.6
14	Gross Purchases of Foreign Securities from U.S. Residents	3700.0	5527.1	4959.1	7510.7	742.3	730.5	759.3	824.0
15	Gross Sales of Foreign Securities to U.S. Residents	3872.4	5778.9	5153.1	7829.7	780.0	752.2	764.9	858.5
16	**Foreign Securities Purchased, net** (line 14 less line 15) /4	**-172.4**	**-251.8**	**-194.0**	**-319.0**	**-37.6**	**-21.8**	**-5.5**	**-34.5**
17	Foreign Bonds Purchased, net	-45.1	-144.1	-99.1	-166.1	-21.2	-8.2	0.9	-21.7
18	Foreign Equities Purchased, net	-127.3	-107.7	-94.9	-152.9	-16.5	-13.5	-6.4	-12.8
19	**Net Long-Term Securities Transactions** (line 3 plus line	**839.1**	**914.2**	**952.1**	**785.6**	**132.4**	**99.9**	**19.5**	**-69.3**
20	**Other Acquisitions of Long-term Securities, net /5**	**-143.0**	**-169.9**	**-159.0**	**-191.5**	**-15.2**	**-15.4**	**-22.2**	**-16.1**
21	**Net Foreign Acquisition of Long-Term Securities** (lines 19 and 20):	**696.2**	**744.2**	**793.1**	**594.1**	**117.2**	**84.4**	**-2.7**	**-85.5**
22	**Increase in Foreign Holdings of Dollar-denominated Short-U.S. Securities and Other Custody Liabilities: /6**	**-47.6**	**135.2**	**123.8**	**133.4**	**2.5**	**-16.0**	**56.2**	**33.9**
23	**U.S. Treasury Bills**	**-58.9**	**-9.0**	**-16.0**	**9.4**	**-4.4**	**-18.0**	**18.6**	**21.0**

24	Private, net	-15.6	16.0	-0.5	19.5	1.0	-6.2	3.3	17.2
25	Official, net	-43.3	-25.0	-15.4	-10.1	-5.5	-11.8	15.3	3.8
26	**Other Negotiable Instruments and Selected Other Liabilities: /7**	**11.4**	**144.2**	**139.7**	**124.0**	**6.9**	**2.0**	**37.5**	**12.8**
27	Private, net	10.6	164.0	139.6	103.4	6.5	-2.6	36.6	-14.5
28	Official, net	0.8	-19.8	0.2	20.6	0.4	4.6	1.0	27.4
29	**Change in Banks' Own Net Dollar-Denominated Liabilities**	**16.4**	**184.3**	**258.9**	**-56.2**	**-3.6**	**-15.4**	**40.9**	**-111.4**
30	**Monthly Net TIC Flows** (lines 21,22,29) /8	**665.0**	**1063.7**	**1175.8**	**671.3**	**116.0**	**53.1**	**94.3**	**-163.0**
	of which								
31	Private, net	578.0	921.0	1040.8	480.7	118.0	21.1	56.0	-141.9
32	Official, net	87.0	142.8	135.0	190.6	-2.0	32.0	38.4	-21.1

/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)

October 16, 2007
HP-612

**Remarks by Secretary Henry M. Paulson, Jr.
on Current Housing and Mortgage Market Developments
Georgetown University Law Center**

Washington, DC--Good morning. As students of law, business and public policy, you have an interest in real life case studies that combine financial markets and policy issues. Current developments in the housing and mortgage markets provide such an example. I will spend my time this morning reviewing the current state of the housing and mortgage markets, the implications for our capital markets and economy, and the role government and the private sector should play as we go forward.

The ongoing housing correction is not ending as quickly as it might have appeared late last year.

And it now looks like it will continue to adversely impact our economy, our capital markets, and many homeowners for some time yet. Even so, I believe we have a healthy, diversified economy that will continue to grow.

The housing correction has its roots in an eight-year period of exceptional home price appreciation which was fueled by an increased demand for, and an abundant supply of easy credit. Speculation also played a significant role, as the share of buying activity by investors or individuals buying second homes more than doubled from 2000 to 2005. Homebuilders responded to the extraordinary demand for more and larger homes as if it would last forever.

As mortgage lenders and investors reached for higher returns this "demand" pressure, coupled with our fragmented mortgage origination process, led to a decline in underwriting standards and a sharp increase in the issuance of riskier mortgage products. As demand for housing began to slow in 2004, originators, eager to maintain high mortgage origination volumes, further lowered their underwriting standards.

While adjustable-rate mortgages (ARMs) are not new, recent years saw an increase in hybrid-ARMs with low teaser rates, interest-only features, low- or no-down payments, and even negative amortization. In fact, about one-quarter of mortgage originations were non-traditional ARMs in 2005 and 2006, exposing mortgage holders to much greater risk than the traditional 30-year fixed rate mortgage with a 20 percent down payment.

This decline in lending standards was not limited to, but was most pronounced, in the case of subprime lending, which grew from only about 2 percent of mortgages in 1998 to nearly 14 percent in mid-2007. A significant percentage of the non-traditional ARMs were marketed and sold to subprime borrowers. Predictably, the result has been progressively higher rates of default on subprime mortgages.

The inevitable correction began in early 2006. Today, average nationwide home prices are barely up in the year through June, sales of existing single-family homes are down by nearly 25 percent from the peak in 2005, and the inventory of unsold homes has increased to levels last seen in the early 1990s. Housing should be analyzed by local or regional markets; averages can be misleading. Areas with the greatest price appreciation prior to the correction, such as Las Vegas, San Diego, central California and a number of cities in Florida, have seen declines. And prices are falling in other parts of the country where economic growth is slower, such as Michigan and parts of Ohio. Working through the housing correction will continue to take time.

As I mentioned earlier, mortgage defaults and foreclosures are rising. While the delinquency rate today is near the 2001 rate, there are over seven times more subprime mortgages today than there were in 2001. At the end of the second quarter of this year, more than 900,000 subprime loans were at least 30 days delinquent. Foreclosures are also up significantly – increasing about 50 percent from 2000 to 2006. Foreclosures on subprime loans are up over 200 percent in that same period. Current trends suggest there will be just over 1 million foreclosure starts this year - of which 620,000 are subprime.

Of the approximately 50 million outstanding mortgages in the U.S. today, approximately 10 million are subprime loans. Many have cited the statistic that 2 million of those subprime mortgages will reset to higher rates in the next 18 months That statistic is true, relevant, and troubling, but it is not the complete picture of the risk going forward. Many of those borrowers will be able to afford their new mortgage payment or they will be able to refinance into another more affordable mortgage. Yet, the problem today is not limited to subprime mortgages as the number of homeowners having trouble making payments on prime mortgages is also increasing. And finally, the wide geographic variation in home price trends adds to the complexity of sizing this problem with any certainty.

While innovation in the mortgage sector has brought benefits to our economy, the industry and homeowners, it has also introduced some challenges. Gone are the days when a homebuyer only went to the corner bank to take out a mortgage. Today, the mortgage process is disaggregated and less personal. A mortgage loan is likely to be originated, serviced, and owned by three different entities. Originators often sell mortgages to securitizers who package them into mortgage-backed securities, which are then divided and sold again to a global network of investors.

In today's decentralized system, a homeowner having trouble making payments often does not know where to turn for assistance.

In addition to affecting individual homeowners, the housing correction is also having a real impact on our economy. Annual housing starts peaked at an annual rate of almost 2.3 million units in early 2006 before falling off more than 40 percent through August of this year. Employment in residential building, including specialty trade contractors, has dropped by almost 200,000 since early 2006, offsetting about one-quarter of the jobs gained in the housing boom. It looked like housing construction had reached a bottom in the first half of this year, but starts have declined again since June and data on permit applications and inventories of unsold homes suggest further declines lie ahead.

We confront these current challenges against the backdrop of a strong economy – not just in the U.S., but globally. Indeed, this is the first housing downturn in the past three decades in which U.S. GDP growth has not turned negative. Business investment has expanded in recent months, our exports are being boosted by the strong economic growth of our trading partners and the healthy job market has helped consumer spending continue to grow.

But let me be clear, despite strong economic fundamentals, the housing decline is still unfolding and I view it as the most significant current risk to our economy. The longer housing prices remain stagnant or fall, the greater the penalty to our future economic growth.

So where do we go from here and what is the proper role for government?

First, our immediate concern must be for struggling borrowers whose primary residence is at risk. We must help as many able homeowners as possible stay in their homes. Foreclosures are costly and painful for homeowners. They are also costly for mortgage servicers and investors. They can have spillover effects into property values throughout a neighborhood, creating a downward cycle we must work to avoid.

Second, we must minimize the impact of the current downturn on our economy, recognizing the tension between such actions and the possibility of moral hazard.

When investors are relieved of the costs of bad decisions, they are more likely to repeat their mistakes. I have no interest in bailing out lenders or property

speculators. Still, we must recognize the very real harms to families affected by the housing downturn. We must take steps to minimize the neighborhood effects and the macroeconomic effects of this housing market correction.

Third, we need to identify public policy changes that will reduce the likelihood of repeating some of the excesses of recent years while maintaining access to credit for able homeowners.

Helping Struggling Homeowners

Today's mortgage market is different than in the past and it requires policymakers to think and act creatively.

A first and important step is to bring mortgage servicers and the mortgage investors together in a coordinated effort to identify struggling borrowers early, connect them to a mortgage counselor and find a sustainable mortgage solution. In August, the President charged Secretary Alphonso Jackson and me to lead this effort. HUD and Treasury have been working closely with mortgage market participants to address the complexities of the modification process, especially in a mortgage market primarily based on a securitization model. The breadth of disaggregation in the mortgage market today is unprecedented, presenting a fundamental, practical problem that does not lend itself to an easy solution.

Recent surveys have shown that as many as 50 percent of the borrowers who have gone into foreclosure never had a prior discussion with a mortgage counselor or their servicer. That must change. Early intervention is critical – the earlier borrowers explore alternative options, the more likely they will find a workable solution and keep their home. We cannot expect to avert every foreclosure and, indeed, some are warranted. Even in years of strong housing performance, we witness several hundred thousand foreclosures. But today many homeowners out there can be helped, and we are committed to efforts designed to do just that.

Last week, I joined a group of mortgage servicers, counselors and investors as they launched a bipartisan alliance, called Hope Now, to coordinate efforts to reach more homeowners and find affordable solutions. I applaud this effort. This challenge is significant and only by working together will we reach more homeowners in need.

We have an immediate need to see more loan modifications and refinancing and other flexibility. For many families, this will be the only viable solution. The current process is not working well. This is not about finger pointing; it is about putting an aggressive plan together and moving forward. This alliance is dedicated to seeing that happen, and I expect to see results. I also call on those servicers who are not yet a part of this alliance to join. You have an obligation to help meet this challenge, and you can do so more effectively as part of an integrated effort.

Not all servicers are staffed for aggressive loss-mitigation. Preventing foreclosures is in investors' interest and investors must take an active role in demanding that all servicers, large or small, are pursuing all available loss-mitigation strategies. Today the industry doesn't have a thorough, standardized set of loss-mitigation metrics with which to evaluate servicers' performance. I expect the Hope Now alliance to quickly develop and begin reporting those metrics so investors, policy makers, and homeowners can measure results.

The efforts of this private sector alliance alone will not solve the problem. But it is a critical piece of the solution. As we work with them, we will all learn and improve the means of reaching and helping homeowners to prevent foreclosures.

We must also take steps to make more affordable mortgage products available for struggling homeowners. In August, the President renewed his call on Congress to pass FHA modernization to make affordable FHA loans more widely available. To facilitate mortgage workouts, the President has also called on Congress to temporarily eliminate taxes on mortgage debt forgiven on a primary residence.

FHA reform is moving through Congress, and I am hopeful that it will reach the President's desk soon. The tax relief proposal has cleared the House and is awaiting further action in the Senate. GSE reform has cleared the House, and also

awaits action in the Senate. Congress should enact these bills as quickly as possible.

The GSEs also have a role to play in making affordable mortgage products more widely available. It is their mission. The secondary market in GSE mortgage-backed securities is functioning well. The GSEs could increase the flow of mortgage capital to refinance subprime borrowers if they securitized a greater number of these mortgages. To accomplish this, the GSEs must work closely with their private mortgage insurance company partners in the development of new products. The GSEs have additional capacity to help more blemished-credit struggling homeowners and we are hopeful that they will step up to this challenge.

In addition to these current initiatives, we welcome further input and will openly consider other ideas to assist struggling homeowners.

Public Policy Questions

We also need to make some changes in our laws and rules in order to prevent some of the excesses and abuses of the last few years from happening again. We must do so in a balanced, thoughtful way so as to avoid overreacting and introducing unintended consequences such as those that might shut off credit to able borrowers.

Homeownership brings substantial benefits to our society. For millions of Americans, their home is their largest financial asset, the key to their future financial security. And homeownership gives people a stake in their community that often leads to more civic involvement, better schools and safer neighborhoods.

While financial innovation has helped increase the homeownership rate in recent years, it has also introduced new complexities. Homebuyers today have more choices than ever before in finding a mortgage that best suits their circumstances. Yet, comparing the attractiveness of one mortgage product to another can be difficult. Homebuyer education and effective disclosure are critical to helping borrowers understand the risks of innovative mortgage products.

Furthermore, our complex and fragmented regulatory system complicates an already difficult situation. Existing federal laws address mortgage fraud, disclosures, fair lending, unfair and deceptive practices, and other aspects of the mortgage process. But the regulatory and enforcement authority varies across different federal agencies. States have also enacted an additional layer of regulation, typically applied only to certain institutions that operate within that state and enforced by the state agencies.

This patchwork structure should be streamlined and modernized.

Treasury is already spending considerable energy in developing ideas on how to improve the financial regulatory structure more broadly and, early next year, we will release a blueprint for comprehensive overhaul. Our goal is to improve oversight and allow our financial services industry to better adapt and compete in the global marketplace. However, fundamental changes to our regulatory system will take years to consider and implement. Homeowners should not wait years - we need to move now to make interim improvements to our current mortgage regulatory system.

We can do so by focusing on four key issues: disclosure, origination, predatory lending and liability.

We need simple, clear, and understandable mortgage disclosure. We must identify what information is most critical for borrowers to have so that they can make informed decisions. At closing, homebuyers get writer's cramp from initialing pages and pages of unintelligible and mostly unread boilerplate that appears to be designed to insulate the originator or lender from liability rather than to provide useful information to the borrower. We can and must do better.

The most critical facts, including potential future monthly payments, should be on a single page in clear, easy-to-understand language, to be signed by the borrower

and the lender. In my judgment, this may have prevented many of the problems that we are seeing today.

The Federal Reserve is leading on this issue through a comprehensive review of the disclosure regime underlying the Truth in Lending Act. As part of this review, the Federal Reserve is engaged in extensive consumer testing to determine what types of disclosures provide the best information to consumers. I support the Federal Reserve's consumer-oriented approach -- this testing is critical to determining what improved disclosures are going to be most useful. This is hard and necessary work, but it is very important.

Borrowers have responsibility as well. Mortgage providers must offer clear, transparent and understandable information on the mortgage products they sell. And homebuyers have a responsibility to use that information. Buying a home today is a complex process, but that in no way excuses homebuyers from their obligation for due diligence. Just as investors in the stock market have a responsibility to understand the risks associated with their investment, homebuyers have a responsibility to understand their mortgages.

Secondly, we need to bring a higher level of integrity to the mortgage origination process. The development of a uniform national licensing, education, and monitoring system for all mortgage brokers is worth considering.

Some of the conduct and practices that I have learned about are shameful. It is no secret that, while not the norm, some fraudulent activity on behalf of mortgage brokers occurred.

Today, mortgage brokers are regulated at the state level, and the rigor of that regulation varies from state to state. State regulators have begun an effort geared toward uniform licensing and education requirements for mortgage brokers. We support this effort, but since other brokers are employed by federally-regulated entities, this effort will not cover the full universe of mortgage originators. We need to consider a national approach that builds upon the state efforts that are currently underway.

Licensing requirements should take into account prior fraudulent or criminal activity, and should require initial and ongoing education. At a minimum mortgage originators should be able to demonstrate a sound understanding of the products that they will be selling.

Common sense licensing requirements that are uniformly enforced could greatly help in weeding out the bad actors. A nationwide monitoring system that covers all mortgage originators could help prevent unscrupulous mortgage originators from moving across state lines or switching employers to evade detection. This is worth considering.

The third area that also warrants our focus is predatory lending.

Homebuyers must not be subject to unfair and deceptive lending practices. Here too, the Federal Reserve is engaged in a comprehensive review of its authority under the Home Ownership and Equity Protection Act, including its authority to broadly define unfair and deceptive practices. These rules would apply to the entire mortgage industry.

The Federal Reserve can inject greater uniformity and objective standards into the mortgage origination process, and I encourage them to do so.

In addition, there have been calls for legislation to address certain practices that are often associated with predatory lending, such as prepayment penalties or stated-income loans. There are clearly circumstances in which these product features are marketed inappropriately. There are also clearly circumstances in which any one of these features can make sense for the borrower and significantly improve credit availability.

We need to strike a careful balance of providing adequate consumer protection without limiting overall credit availability or consumer choice, especially for those

who most need that flexibility.

This is a difficult balance to achieve because each lending determination is relatively unique based on the different facts and circumstances associated with each borrower. Yet, I am hopeful that we can do it.

In my view, it makes a great deal of sense to recognize that certain products are right for some borrowers and not for others. The Federal Reserve has already stated that it will examine some of these specific issues including prepayment penalties, stated-income loans, escrow accounts and ability-to-repay considerations.

The fourth issue that has garnered attention is whether greater liability should be imposed on securitizers and investors. In my view, this is not the answer to the problem. Imposing broad liability provisions on investors and securitizers would very likely generate significant unintended consequences. It would potentially paralyze securitization, a process that has been extremely valuable in extending the availability of credit to millions of homeowners nationwide and lowering the cost of financing. Again, balance is critically important. Congress should proceed with extreme caution so as to avoid cutting off investment inflows to the housing market.

Before concluding I will briefly summarize two other broad-based capital markets related initiatives under way that will also address some of the problems which have arisen in the mortgage market.

Broader Capital Markets Issues

The President's Working Group (PWG) – chaired by Treasury and consisting of the Federal Reserve, the SEC, and the CFTC -- is leading a comprehensive review into the policy implications resulting from current challenges in the credit markets. A number of these issues are directly tied to the mortgage markets; others affect the capital markets more broadly. Given the global nature of our financial markets, I will also work with the G7 and through the Financial Stability Forum to address several of these issues.

One area the PWG has already addressed is hedge funds. Back in February, the PWG produced forward-leaning guidance for the industry and its participants including regulated financial institutions which serve as prime brokers and counterparties to hedge funds. Our principles and guidelines serve as a foundation to enhance vigilance and market discipline, strengthen investor protection and guard against systemic risk. While a small number of hedge funds were forced to wind down in recent months, there were no systemic events associated with their closure, and hedge funds have not proven to be a significant problem.

The real irony is that the material problems arising in recent months were in regulated institutions in certain markets. Many regulated institutions, both in the U.S. and elsewhere, appear not to have fully appreciated all of the risks associated with the securitized assets on their balance sheets or the many risks associated with commitments to provide liquidity to off-balance sheet vehicles, such as conduits and structured investment vehicles.

Deteriorating subprime mortgage performance over the last several months led investors to question their assumptions about the credit quality and value of many assets. In July, as default rates surpassed their models' projections, ratings agencies downgraded billions of dollars worth of subprime mortgage backed securities.

The statement by ratings agencies that they were unable to accurately characterize the default probabilities of subprime mortgages created broader uncertainties in financial markets. Not surprisingly, investors reacted by reassessing and repricing risk across all market segments that relied heavily on the use of ratings, particularly in complex, structured credit products. Predictably, given the interconnectedness of our capital markets, the influence of this development was global.

The reassessment of risk has played out more rapidly in some markets than in others. In certain asset classes, risk has been reassessed and repriced fairly quickly as investors gained confidence in their fundamental assessments. In such

markets, liquidity has returned and markets are operating normally. Good examples would include world equity markets, sovereign debt markets, and investment grade corporate debt.

On the other hand, some sectors that are characterized by more complex securities or that rely more heavily on securitization and ratings -- such as the jumbo mortgage market, the leveraged loan market, and the asset backed commercial paper market -- are still operating under some stress with impaired liquidity. Conditions are better than they were a few weeks ago, and we continue to see improvements, but it will take longer for these sectors to fully recover.

Market-based efforts and initiatives are emerging to address some of the current challenges in the capital markets. I am pleased that yesterday a group of commercial banks announced their intent to establish a master conduit to help improve liquidity in the asset-backed commercial paper marketplace. The market participants and investors who may voluntarily participate in this enhanced facility recognize the benefit of such a structure. The leading financial institutions as well as investors realize the importance of improved liquidity in the high quality, asset backed commercial paper sector – a sector of the market with great importance for securitized assets such as mortgages, as well as for the broader capital markets.

This is promising. Just as in the mortgage market, we need to work on parallel tracks, addressing current concerns as well as addressing policy issues to avoid repeating the recent market turmoil.

Treasury and the President's Working Group are conducting a comprehensive review of such issues, including two areas that have a direct relationship to the events in the mortgage markets.

First, it is clear that we must examine the role of credit rating agencies including transparency and potential conflicts of interest. We must also assess if regulations and supervisory policies are encouraging an over-reliance on ratings by financial institutions and investors.

Second, we must continue to address financial institution risk management and related regulatory issues. In particular, we must ensure that they adequately take into account the risks posed by protracted periods of market illiquidity or the risks posed by a reduced ability to securitize and sell loans, including leveraged syndicated loans and mortgages.

Our bank regulators must evaluate regulatory capital requirements applicable to bank exposures to off-balance sheet vehicles. Transparency is important here, so we will also review the accounting rules that are applicable to off-balance sheet vehicles.

We will examine other areas that are indirectly related to the mortgage market which nevertheless impact our capital markets, ranging from enhancing the management of counterparty credit risks, to market infrastructure issues, to issues surrounding reporting and risk disclosure, to evaluating the important role of investors and, finally, how our long-standing regulatory structure and tools respond to today's continuously evolving financial system.

Conclusion

Innovation is the hallmark of our capital markets and it brings with it significant benefits to individual investors and our overall economy. However, innovation often outpaces regulation. That is not surprising, and we would not want it the other way around. If it were, we would have less competitive and efficient markets, which would ultimately stifle economic growth. It would mean fewer jobs and lower wages.

However, when problems arise, we need to shine a light on them and move to address them in a balanced way. Today it is clear that we need to do just that. We have a lot of work to do. We need to ensure yesterday's excesses are not repeated tomorrow.

As the mortgage and credit markets continue to adjust, all of us – policymakers and

market participants -- will no doubt learn new lessons. Through a dedicated effort by all parties, we will work to strike the right balance, protect consumers and make mortgage capital widely available to Americans ready to be homeowners.

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October 16, 2007
HP-614

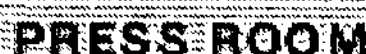
Secretaries Paulson and Gutierrez Call for Permanent Extension of Internet Tax Moratorium

Washington, DC--U.S. Treasury Secretary Henry M. Paulson and Commerce Secretary Carlos M. Gutierrez issued a statement today calling on Congress to make permanent the moratorium on Internet access taxes and on multiple or discriminatory taxes on electronic commerce. The House is scheduled to take up an extension of the Internet Tax Moratorium today.

"Although we recognize that a temporary extension is better than letting the moratorium expire, we are extremely disappointed that the legislation does not extend permanently the moratorium on Internet access taxes and on multiple or discriminatory taxes on electronic commerce. 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 and keeping the Internet free of multiple or discriminatory taxes will help sustain an environment for innovation, help ensure that consumers continue to have affordable access to the Internet, and strengthen the foundations of electronic commerce as a vital and growing part of our economy.

"We look forward to working with Congress as the process moves forward to take advantage of this bipartisan opportunity to extend the moratorium permanently."



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October 16, 2007
HP-615

Testimony of Deputy Assistant Secretary McDonald on Technical Assistance

Washington, DC-- Mr. Chairman and Members of the Committee, thank you for the opportunity to testify today about Treasury Department personnel serving in Iraq and Afghanistan.

Treasury personnel serving in these two countries represent an important part of Treasury's overall international presence. In comparison to other agencies testifying today, my Department's international presence is relatively small, but the significance of the economic and financial issues that Treasury covers is large. In Iraq, Afghanistan and elsewhere, Treasury personnel pursue objectives that are central to the Department's mission "to promote the conditions for prosperity and stability in the United States and encourage prosperity and stability in the rest of the world."

Treasury's overseas personnel fall broadly into three categories. Treasury attachés advocate the adoption and implementation of sound policies – policies to spur economic growth and to make the international financial system more efficient, stable and resistant to abuse by criminals and terrorists. Currently, Treasury has eight overseas attachés. The second category, Treasury technical assistance providers, help developing, transition and post-conflict countries build the human and institutional capacity they need in order to implement sound policies. Currently, Treasury has 55 technical assistance advisors posted in 37 countries and another 70 advisors working on intermittent tasks in 47 countries. Finally, a number of specialized offices and Treasury bureaus have officials posted overseas -- for example the Office of Foreign Assets Control and the Internal Revenue Service. I oversee the second category, Treasury's international assistance program, but work very closely with those who manage the attachés and other overseas personnel. In a previous job, I was the head of a special task force set up to provide "back office" support to Treasury officials serving in Iraq and Afghanistan.

Let me turn to the focus of today's hearing: the recruitment, retention and care of overseas personnel in Iraq and Afghanistan. Above all, I would like to emphasize that Treasury places great importance on the careful recruitment, preparation, deployment and reintegration of all of our overseas personnel -- in particular for those serving in Iraq and Afghanistan. Over the past 5 years or so, we have learned a great deal about the challenges of stabilization and reconstruction work. Treasury is collaborating with interagency partners and the Coordinator for Reconstruction and Stabilization at the Department of State to strengthen the U.S. Government's ability to respond quickly and effectively to future stabilization and reconstruction challenges.

Treasury personnel in Iraq and Afghanistan include both USG officials and Personal Service Contractors (PSCs). I note this distinction because it explains the occasional differences that apply in some areas, such as recruitment and compensation. Regardless of their employment status, however, we prepare and support with care all Treasury employees in their overseas assignments. Indeed, when it comes to service in Iraq and Afghanistan we salute them for their willingness to put their lives on the line in support of the U.S. mission.

Recruitment

Recruitment varies somewhat according to the type of Treasury representation in question. While the recruitment for attaché positions starts with current USG Treasury officials who respond to Treasury-wide internal postings, we have also

recruited excellent talent from outside the Department – including for Iraq. Recruitment for technical assistance, in particular the medium to long-term assistance emphasized by Treasury's program, usually begins outside of the Department. Nonetheless, we do at times utilize talent from current Treasury and Federal Reserve employees, and many of our advisors are retired officials from the Treasury, the Federal Reserve and other government agencies.

Indeed, the bulk of Treasury personnel in Iraq and Afghanistan at present are either current or former USG employees who have returned to career positions. We have a few officials who are from other agencies (for example a budget specialist from Peace Corps headquarters) loaned to us through reimbursable agreements. And we have hired a number of PSCs with special skills in areas like systems development, banking, debt management, and energy sector financing. In general, we have been able to attract a high level of interest in our programs to date and have not encountered insurmountable difficulties in filling our vacancies. Our compensation packages have become more generous over time as we keep pace with State Department changes.

Benefits

In general, Treasury benefit packages are line with State Department practices, and are identical with respect to allowances, danger pay, and in-country medical coverage. Our benefit packages have become more generous over time as we try to stay aligned with State Department practices. As noted earlier, there are occasional differences depending on employment status. For example, the compensation for a regular USG hire versus a PSC may differ slightly, in part because PSCs have no guarantee of further employment. Despite the flexibility afforded, there are only minor differences between offices -- notably on the mix of leave opportunities -- and our pay rates are fairly standard and as generous as permissible. There are a few options, again notably in leave policies, that volunteers can choose from that will allow the individual to craft a package tailored to their needs and desires. For example, Treasury technical advisors who are on one-year assignments can choose a mix of regional and home leave rest breaks. USG hires on the other hand can have home leave after 24 months of continuous service.

I would now like to summarize information that is particular to Iraq and Afghanistan.

Iraq

Treasury personnel have been present in Iraq since the first arrival of U.S. civilians in Baghdad in April 2003. Since then, over 75 Treasury personnel have served in Iraq. While relatively small in number, Treasury officials have been highly productive. Their early efforts contributed to the stabilization of Iraq's macro-economy following the fall of Saddam Hussein, the reconstitution of the Finance Ministry and Central Bank, the negotiation of a major international debt relief package, and the introduction of a new and stable Iraqi currency which is now used throughout the country. More recently, Treasury personnel have contributed to the successful negotiation of the International Compact with Iraq, strengthening Iraqi budget execution, establishment of an electronic payments system, and the interdiction of terrorist financing. Currently, Treasury has 13 full-time placements in Iraq, including an attaché, a deputy attaché, 6 technical assistance providers, and 5 terrorist financing/financial crimes experts. In addition to the full-time placements, Treasury sends a number of intermittent personnel to support the mission. Treasury has recently increased its overall effort in support of the President's "New Way Forward."

At this time, all Treasury staff are based in Baghdad. We do not have staff based in the Provincial Reconstruction Teams (PRT's), but Treasury officials travel within Iraq in support of PRT missions and we are exploring ways to strengthen our support. Treasury's Office of Intelligence and Analysis (OIA) and Internal Revenue Service Office of Criminal Investigations are represented at the Iraq Threat Finance Cell (ITFC) where OIA staff serve as the ITFC co-lead with the Department of Defense.

Afghanistan

Currently Treasury has three full-time placements based in the embassy in Kabul

including a Treasury attaché focused on fiscal sustainability and financial sector development and two technical assistance advisors working on debt issues and financial crimes enforcement capacity building. Treasury and USAID are equally sharing the costs of the technical advisors, and the attaché is funded out of regular appropriations.

As in Iraq, Treasury personnel arrived in Kabul very soon after the cessation of hostilities, and have contributed to some significant successes. For example, the first Afghan budget since the fall of the Taliban was crafted on a lap-top computer by Finance Ministry officials working side-by-side with a Treasury budget advisor. Treasury's debt management experts have helped Afghanistan secure over $10 billion international debt relief and build capacity to avoid falling back into unsustainable debt. Treasury support to Afghanistan's Financial Intelligence Unit has expanded the reach of Central Bank regulation to include previously unregistered hawalas and elements of the cash courier market, in addition to improving the reporting relationship with the country's formal banking institutions. Finally, Treasury's attachés have helped the Afghan government meet its IMF program benchmarks and facilitated its interactions with donor agencies, including the World Bank and the Asian Development Bank.

In Country Casualties and Medical Care

Treasury personnel are subject to the same risks as other civilian US personnel in Iraq and Afghanistan. To do our job effectively, we must interact with Iraqi and Afghani government officials and venture outside of the International Zone or confines of the embassies. Treasury has been fortunate that we have suffered no casualties to date. As for medical care, Treasury employees in both countries are respectively under Chief of Mission authority and are eligible to use Department of State and Defense medical system and other health resources available in country. We are grateful for access to those services. In addition, Treasury reimburses PSCs for 50% of their medical insurance and pays for 100% of personal accident/war risk insurance. Employees are covered under the Office of Workers' Compensation (OWC) Programs for compensable illnesses, diseases, or injuries identified during and after deployment. Under the OWC Program, employees are eligible for medical care at private sector medical facilities for occupational illnesses and diseases at no cost to them.

In closing, I would like to emphasize that the Department of the Treasury is committed to recruiting and caring for expert personnel who will continue to serve our country's interests in Iraq, Afghanistan and elsewhere. I appreciate the opportunity to present information on our program to the Committee, and I look forward to any questions you may have.

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REPORTS

- Appendix

SUMMARY
Treasury Employees Deployed to a Combat Zone

EMPLOYEES		
Office of Technical Assistance (OTA)	6	2
Terrorism and Financial Intelligence (TFI)	3	0
International Affairs (IA)	2	1
Internal Revenue Service (IRS)	2	0
TOTAL	13	3
LOCATION	International "Green" Zone, Other Baghdad locations	Embassy Compound
PERSONNEL WOUNDED OR KILLED	0	0
MEDICAL CARE	All staff deployed under Chief of Mission (COM) authority and are therefore eligible for all life support services offered by Mission Medical Clinic and Army Medical Corps. Under the OWC Program, employees are eligible for medical care, at no cost, for occupational illnesses, injuries, and diseases, identified during or after deployment.	All staff deployed under Chief of Mission (COM) authority and are therefore eligible for all life support services offered by Mission Medical Clinic. Under the OWC Program, employees are eligible for medical care, at no cost, for occupational illnesses, injuries, and diseases, identified during or after deployment.
DEPLOYMENT INCENTIVES	o 35% Hardship Differential (USG/PSC) o 35% danger pay (USG/PSC) o 3 or more rest/regional breaks, add'l admin leave (Employee choice) o Increased annual leave ceiling (USG/PSC) o Rollover of compensation when capped (USG/PSC) o $200,000 personal accident/war risk insurance (USG/PSC) o 1 home leave after 24 months of continuous svc (USG) o Relocation allowances (USG/PSC) o Retain all rights (USG) and worker's comp benefits (USG/PSC)	o 35% Hardship Differential (USG/PSC) o 35% danger pay (USG/PSC) o 2 or more rest/regional breaks (Employee choice) o 1 home leave after 24 months of continuous svc (USG/PSC) o Increased annual leave ceiling (USG/PSC) o Rollover of compensation when capped (USG/PSC) o $200,000 personal accident/war risk insurance (USG/PSC) o Relocation allowances (USG/PSC) o Retain all rights (USG) and worker's comp benefits (USG/PSC)
POSITIONS REIMBURSABLE BY STATE/USAID	None of the positions are reimbursed.	USAID funded two OTA Resident Advisor positions for one year each. The remainder of activities, including funding the resident advisors beyond the one year USAID commitment funded from Treasury appropriation within the 150 Account.
CONTRACTORS UNDER TREASURY SUPERVISION	In Iraq, Treasury is implementing the procurement of an automated bank modernization system. The contractor utilized for that activity is supervised by a contracting officer and a contracting officer's technical representative in Washington.	
TYPES OF ASSIGNMENTS	Resident and Temporary Duty: Financial and Economic Attachés, Technical Assistance: Banking, Budget Analysis and Budget Execution.	Resident and Temporary Duty: Financial and Economic Attachés, TFI/AML Policy, Technical Assistance: Debt Management; TFI/AML Institutional and Capacity Building.
EMPLOYEES SERVING ON PRTs	0	0

October 17, 2007
HP-616

Treasury Announces Debt for Nature Agreement to Conserve Costa Rica's Forests

Washington, DC-- The Governments of the United States of America and Costa Rica, the Central Bank of Costa Rica, Conservation International and The Nature Conservancy, have concluded agreements to reduce Costa Rica's debt payments to the United States by $26 million over the next 16 years. In return, the Central Bank of Costa Rica has committed to pay these funds to support grants to non-governmental organizations and other groups to protect and restore the country's important tropical forest resources.

The debt for nature program was made possible through contributions of over $12.6 million by the U.S. Government under the Tropical Forest Conservation Act of 1998 and a combined donation of over $2.5 million from Conservation International and The Nature Conservancy.

The funds will help conserve several important forest areas in Costa Rica. The Osa Peninsula is home to the scarlet macaw and many other bird species, as well as to the squirrel monkey and jaguar. The La Amistad region contains the most extensive tract of untouched forest in the country and is the source of much of Costa Rica's fresh water. The Maquenque Wildlife Refuge area is home to the great green macaw, while the Tortuguero region contains a rich variety of forest ecosystems. The area north of Rincon de la Vieja contains dry forest, cloud forest, and rain forest. Nicoya Peninsula's dry forests and mangroves are important to the preservation of water resources in the region.

The Tropical Forest Conservation Act provides opportunities for eligible developing countries to reduce concessional debt owed the United States while generating funds to conserve their forests. The program with Costa Rica, the largest of the funds created to date, marks the 12th established under the Bush Administration, following agreements with Belize, Botswana, Colombia, El Salvador, Guatemala, Jamaica, Panama (2), Paraguay, Peru and the Philippines. These programs, together with one established with Bangladesh in 2000, will generate more than $163 million over 10-25 years to protect tropical forests.

PRESS ROOM

October 17, 2007
HP-617

Secretary Paulson to Deliver Speech on India

Treasury Secretary Henry M. Paulson, Jr. will speak next week on his upcoming trip to India focusing on India's rise as an important player on the global economic stage.

Who
Treasury Secretary Henry M. Paulson, Jr.

What
Remarks on India

When
12:30 p.m. EDT, Wednesday, Oct. 24

Where
Council on Foreign Relations
1779 Massachusetts Avenue, NW
Washington, D.C.

Note
Media interested in attending must RSVP by 5 p.m. Oct. 23 to: **DCpressRSVP@cfr.org.** Space is limited.

October 17, 2007
HP-618

David G. Nason, Assistant Secretary for Financial Institutions
Remarks on Financial Regulation
Before the Exchequer Club

Washington- Thank you for inviting me to join you today at this luncheon. I am honored to have the opportunity to speak to this distinguished group of financial services industry professionals and policy leaders. In its 47th year, this group is well regarded as a place where important policy issues are contemplated and solutions are advanced.

I am especially pleased to follow in the footsteps of other Treasury Department officials who have offered remarks here at the Exchequer Club, three of with whom I am fortunate to have worked with -- my previous Under Secretary for Domestic Finance Randal Quarles, my predecessor Emil Henry, and my current Under Secretary for Domestic Finance Robert Steel who spoke here in April. I would also note that my Treasury colleague John Dugan, the current Comptroller of the Currency, served as Chancellor of this distinguished club.

General Economic and Market Conditions

It has been an especially busy time at the Treasury Department. As you know, there has been an adjustment taking place in the overall credit market and the mortgage market in particular.

Largely because of lax underwriting, the mortgage market, especially the subprime market, has been experiencing a high number and percentage of delinquencies and defaults. As a result, subprime mortgage-backed securities have performed poorly. This has led investors to reassess the risk of these securities and as a corollary to reassess their pricing.

Because of the interrelation of our capital markets, the concerns we first saw in subprime mortgages and related securities have had an impact on investors' confidence and on their assumptions about the credit quality and value of other assets, especially asset-backed securities.

This has led to a rather widespread reassessment of risk and a subsequent revaluation across capital markets globally. In general, the marketplace reaction to some of these excesses has been severe. Many of the mortgage originators with weak underwriting standards are out of business. Investors in the subprime mortgage market are experiencing heavy losses, especially those that failed to perform adequate due diligence to understand the risks of their investments. We expect the markets to continue to impose discipline on those lenders and investors who took risks without proper diligence.

We have seen the effects in the financial markets, and it will take time for these market adjustments to play out. At the Treasury Department, we have been actively engaged in the situation as it has continued to develop. Secretary Paulson has been working with all financial regulators and with market participants. At a time like this when risk is being reappraised and market discipline is being imposed, confidence is key. Having the Treasury Department led by a Secretary who has spent his life in the financial markets, through good times and bad times, has been fortunate for our country and the Treasury Department.

Given the importance of credit markets to the functioning of our economy, when we experience a fundamental reappraisal like we have witnessed over the last several weeks and months, it is essential that policymakers evaluate the potential impact on the economy. Fortunately, the capital markets stress is occurring against the

backdrop of a strong global economy. However, as Secretary Paulson noted yesterday, the ongoing housing correction, rooted in an eight year period of exceptional housing price appreciation, will continue to impact the economy adversely. We continually analyze this situation, knowing that it will take time to work itself out. In our view, the underlying strength of the economy should enable further continued growth. However, despite these strong fundamentals, it is the Treasury Department's view that the housing decline is the most significant current risk to our economy.

Regulatory Blueprint

When Secretary Paulson arrived at the Treasury Department, he immediately and appropriately focused his attention on financial preparedness and the competitiveness of our capital markets. Today, I am here to talk about capital markets competitiveness. Capital markets are the lifeblood of the United States economy. They enable capital investments to finance companies, which leads to job creation and economic prosperity. American consumers and investors benefit from a vibrant and healthy financial services sector that provides opportunities to access credit, save and invest for the future, and insure against risks. It is important, therefore, that our capital markets remain the best in the world.

The regulatory policies in place for financial institutions must effectively protect consumers and investors, while at the same time promote entrepreneurialism and capitalism that are the foundation of our national economic success. These qualities are not at all mutually exclusive. At the Treasury Department's Capital Markets Competitiveness Conference earlier this year, regulatory effectiveness, including that of our regulatory structure, was cited repeatedly as a key ingredient to maintaining our competitiveness. Secretary Paulson highlighted regulatory structure as a potential primary driver of trends cited as being troubling. He noted that over the course of our nation's history, we have added multiple regulators to respond to the issues of the day. Our regulatory system has adapted to the changing market by expanding, but perhaps not always by focusing on the broader objective of regulatory effectiveness and protecting consumers and investors.

Accomplishing the right regulatory balance is not a task to be undertaken just once and never again considered. Markets are constantly evolving, in recent years particularly global markets, so it is very much an ongoing process. We should analyze and understand the rationale or justification for our current regulatory structure as well as the inefficiencies it can breed along with the benefit and burden of our regulations.

Policymakers have an obligation to assess continually whether our current regulatory structure is serving America as well as it could. Our current regulatory structure has been largely knit together over the last 75 years. Much of this framework was put into place for particular reasons in a different time.

Therefore, under Secretary Paulson's leadership, the Treasury Department is engaged in a comprehensive review of our regulatory structure to evaluate this issue and propose solutions that achieve the right balance. Over the next several months, we will produce a regulatory reform blueprint that will outline recommendations on how to modernize our regulatory regime. The Treasury Department is undertaking this report on its own initiative, unlike previous reports that were mandated by Congress. Examination and reexamination of financial services regulation are essential to fulfilling the Treasury Department's mission to promote the conditions for prosperity and stability in the United States and to encourage prosperity and stability in the rest of the world. This report will be framed by the goal of ensuring America's competitiveness and anticipating potential systemic issues that may arise.

It has been ten years since the Treasury Department released a financial services industry study – a time during which the financial services industry has undergone significant change. Markets and capital flows ignore national boundaries and tremors in one market can lead to impacts across other markets. The Treasury Department will take a holistic approach to reviewing the current financial services regulatory structure, taking into account all financial services industry players including insurance, securities, and futures firms, in addition to depository institutions, upon which most past Treasury Department studies have focused.

There is a rich tradition of this work coming from the Executive Branch. In 1984, President Reagan's Administration produced the Blue Print for Reform under the leadership of Vice President Bush's Task Group on Regulation of Financial Services. In 1991, President Bush's Treasury Department authored a study known as the Green Book. These reports shaped the debate for reform of regulation in the 1980s and 1990s. For instance, the 1984 and 1991 reports laid the foundation for the ideas (such as functional regulation) carried through in the Gramm-Leach-Bliley Act of 1999.

In preparing a regulatory reform plan, we will assess the current financial services regulatory structure in the United States and make recommendations to modernize oversight to fit demands of the marketplace. We believe that a 21st Century regulatory regime should:

- safeguard the safety and stability of the financial system;
- maintain high standards of both consumer and investor protection; and
- promote efficient and competitive capital markets.

As part of this effort and in order to inform our work, the Treasury Department published a Federal Register notice seeking public comment. We are asking for thoughts on topics including: overlapping state and federal regulation, ways to improve market discipline and consumer protection, and the strengths and weaknesses of having multiple regulators and multiple Federal charters for financial institutions.

We will focus our attention on depository institutions and securities, futures, and insurance firms. Our examination will include consideration of issues that are specific to each of these three financial services functions. The Federal Register notice raises what we believe are the important questions for each of these areas. But, we do not believe that we should necessarily separate our work product or recommendations among the three general areas under consideration. The Federal Register notice also includes a section of general questions to enable consideration from a broad and integrated perspective of certain issues, including functional regulation, overall risk, principles for and of regulation, rules-based regulation and macro-level regulatory structure models.

While this project was contemplated well before we entered this period of mortgage market stress, the complexity of the mortgage market regulatory structure provides an interesting backdrop. More people are now willing to consider and discuss regulatory structure and these events highlight the importance of the questions posed in the Federal Register notice. In particular, at the federal level, there are laws addressing mortgage fraud; disclosure; fair lending; unfair and deceptive practices; and other aspects of the mortgage process. The regulatory authority to implement these laws varies across different Federal agencies as does the enforcement authority. States have also enacted numerous laws addressing various aspects of the mortgage process. These state laws typically only apply to certain institutions that operate within a particular state and are enforced by state agencies. While there are various efforts underway within the current structure to improve the process, we should evaluate fully how many of the problems were related to the structure itself.

These are significant issues that many policymakers have considered over the years. Success of this initiative will not and should not be tied to short-term accomplishments. Today, I have identified the issues and segments that we are going to focus on during this project. We will recommend specific changes to our financial services industry regulatory structure. Some of the recommendations will be immediately relevant to legislative and regulatory policy issues. On these matters, our hope is that the Treasury Department's report will spur near-term tangible results. Implementation of other, longer-term recommendations will be subject to outside factors, but will be ready should support for these reforms develop. Finally, our hope is that some of the recommendations will shape debates in the future when regulatory structure issues are considered.

Government Sponsored Enterprise (GSE) Regulatory Reform

The last issue that I would like to discuss with you today is GSE regulatory reform. This is an area where the current regulatory structure is clearly deficient. In a period where the capital markets, especially the mortgage market, are undergoing

stress, it inevitably leads to a question of the proper role of the GSEs. The regulatory structure of GSEs has had a long and tortured history. Looking back on history, and given the current debate on GSE regulatory reform, the regulatory framework established for Fannie Mae and Freddie Mac in 1992 that created Office of Federal Housing Enterprise Oversight (OFHEO) appears to have been flawed from the outset. However, it was the best that could be achieved at the time, and it was largely and appropriately viewed as an improvement over what had existed previously. Now is the time to build on the improvements made in 1992.

As many of you know, the Treasury Department has been and continues to be a strong proponent of meaningful GSE regulatory reform. As has been well documented, the current GSE safety and soundness regulator is hindered by a number of shortcomings:

- there is limited flexibility to set capital standards;
- no receivership authority;
- a bifurcation of regulatory authority with the Department of Housing and Urban Development (HUD);
- less authority to take enforcement actions; and
- a requirement to go through the appropriations process to obtain funding.

Put another way, these trillion dollar organizations are regulated by an entity with less tools and authorities than a small community bank's regulator possesses. As Secretary Paulson recently noted in Congressional testimony, "[m]any 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."

The idea that the GSEs have unique characteristics that could create tensions or potential problems is not an ideological or partisan view. Policymakers have been struggling with the inherent tension and the potential problems posed by the GSEs for decades. In fact, a Treasury Department official stated in testimony a few years ago that: "As the GSEs continue to grow and to play an increasingly central role in the capital markets, issues of potential systemic risk and market competition become more relevant." That statement was not from a member of the Bush Administration Treasury Department, but rather from testimony delivered in March of 2000 by former Under Secretary Gensler of the Clinton Administration Treasury Department.

As we all know, 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 most important benefit is the market's misperception that the GSEs are somehow backed by the Federal Government. It is this misperception that has provided the GSEs with the ability to grow rapidly with little market discipline, and creates the potential for the GSEs to pose systemic risks.

We have an opportunity to strengthen regulation of the GSEs. The House of Representatives has passed a meaningful GSE regulatory reform bill that, while not perfect, goes a long way toward addressing the issues that must be considered. Unfortunately, there has not been any action in the Senate on comprehensive GSE regulatory reform. We will continue to press for this, especially at a time when increased attention on the mortgage markets is warranted.

Unfortunately, the legislative focus now seems to be on lifting the retained portfolio caps put in place by OFHEO. This is an unfortunate development. The reason these caps were put in place are well documented and not worth rehashing. The GSEs have made improvements and are working to remediate those problems, and OFHEO has acknowledged their progress. However, decisions impacting safety and soundness should continue to be left to OFHEO, as Congress intended.

The housing market is undoubtedly going through a transition. The Administration has put forth a comprehensive plan to address these issues, which include: passing Federal Housing Administration (FHA) modernization legislation; targeted tax reform; and working with all mortgage market participants to avoid as many foreclosures as possible. The GSEs can and should play a role in addressing

current mortgage problems, and they can play that role with the current portfolio caps in place. The GSEs have ample opportunity to provide assistance through additional securitization activity, which can assist multiple borrowers in comparison to increasing the size of their retained mortgage portfolios. In addition to the recent portfolio cap flexibility granted by OFHEO, the GSEs also have additional flexibility under the portfolio caps as mortgages in their existing portfolios are paid down.

There are no easy fixes to the current problems in the housing market. But if we are serious about promoting a sound and resilient housing finance system, Congress must take action to pass a meaningful GSE regulatory reform bill.

Thank you for listening and, again, thank you for inviting me to join you here today. I hope my remarks were informative. I would be happy to take a few of your questions.

October 17, 2007
HP-619

Prepared Statement by Treasury Under Secretary David McCormick in Advance of Meetings of the G-7 Finance Ministers and Central Bank Governors, the International Monetary Fund, and the World Bank

Washington, DC-- Good afternoon. I am looking forward to a very busy set of meetings over the next several days.

Secretary Paulson will host G-7 Finance Ministers and Central Bank Governors here at the Treasury on Friday. They will discuss current economic conditions and financial market developments, trade, reform of the international financial institutions, development issues, and energy and the environment among other things. Clearly recent financial market turmoil will be a focal point and a good part of the G-7 meeting will be devoted to this issue.

The fundamentals of the U.S. economy remain strong even while overall growth is moderating. Consumer spending is good, unemployment remains low, export growth is strong, the current account deficit has narrowed, and our budget situation has improved considerably. We recognize the need to continue our efforts to raise national savings and reduce the deficit. I am pleased to report that for the just-complete fiscal year, our deficit fell to 1.2 percent of GDP, and we remain on track to balance the budget in 2012.

The global economy remains quite strong with a robust outlook for the remainder of 2007 and 2008. Importantly, there has been some rebalancing of domestic demand growth and this is being reflected in somewhat smaller global imbalances, with the notable exception of China, which still has a rising external surplus. As in the past, Ministers will discuss the near-term outlook and prospects for growth enhancing reforms in Europe and Japan.

The strong global economy and well-capitalized financial institutions provide a strong platform for addressing recent market turbulence. Financial authorities throughout the world have acted to promote systemic stability. There are signs that financial market conditions have begun to stabilize in some areas, although we recognize that it will take some time to work through the recent difficulties.

The issues raised by the recent turmoil are complex and require careful analysis. We must undertake this work quickly, but we cannot rush to judgment. In this light, Secretary Paulson – working with the G7 has asked the Financial Stability Forum – under the leadership of Bank of Italy Governor Mario Draghi – to form a working group to look at the underlying causes of the turbulence and offer proposals in the areas of risk management, the accounting and valuation of financial derivatives, the role and methodologies of credit rating agencies in structured finance, and basic supervisory principles of prudential oversight of regulated financial entities. This weekend, Mario Draghi is expected to brief the G7 on the working group's work plan going forward with an expected final report to be delivered next April. Finally on this front and notwithstanding the recent turmoil, we should remember that the globalization of capital markets has brought enormous benefits to the world – broader choices in financial products, greater prosperity, and expanded opportunity.

The Secretary will raise the issue of a clean technology fund, which President Bush mentioned two weeks ago as part of the Major Economies Meeting. The Fund would help finance clean energy projects in the developing world by focusing on financing the gap between traditional and more expensive clean technology. We envision that the fund will leverage bilateral donor resources, multilateral development institution resources, and private resources. We look forward to working with other countries to explore this concept and ensure the fund's success.

The G-7 meeting will also include an outreach dinner on sovereign wealth funds. In particular, we seek to discuss the implications of these funds for an international financial system fundamentally based on the principle of private sector allocation of resources to their most efficient uses, and to emphasize our joint commitment to maintain openness to investment and to promote financial stability. The Secretary has invited Finance Ministry and sovereign wealth fund representatives from China, Korea, Kuwait, Norway, Russia, Saudi Arabia, Singapore and the United Arab Emirates to join us. We look forward to a constructive discussion.

Over the weekend, at the International Monetary and Financial Committee and Development Committee meetings, we will discuss reform of the international financial institutions. On the IMF, we are going to emphasize the importance of the IMF implementing the new surveillance procedures on exchange rate regimes as well as the need for fundamental reform of the governance structure to reflect the rising weight of dynamic emerging markets. Our discussions on quota reforms are ongoing and we will continue to work towards a comprehensive agreement. We will also emphasize that in tackling the Fund's medium-term financing picture, serious consolidation of expenditures must be on the table in tandem with a review of the income situation. On World Bank reform, we will have an opportunity to discuss President Zoellick's recently announced priorities and strategy and focus on how the Bank can best enhance its development impact in a changing global environment.

October 17, 2007
hp620

Treasury Officials Span the Country Teaching Financial Literacy

Washington - U.S. Treasury Department officials and bankers across the country will team up Thursday to promote wise credit habits for U.S. teens as part of the American Bankers Association Education Foundation's annual Get Smart About Credit Day. Students will participate in lessons on the responsible use of credit and the importance of a positive credit history, as Treasury officials and staff travel to schools nationwide to teach classes with local bankers.

Media interested in attending classes with Treasury officials should contact Jennifer Zuccarelli. The following events are open to the press:

Syracuse, N.Y. 8:21 a.m. EDT
Anthony W. Ryan, Assistant Secretary for Financial Markets
Christian Brothers Academy
6545 Randall Road

Salt Lake City, Utah 9:00 a.m. MDT
David Miller, District Community Affairs Officer, Office of the Comptroller of the Currency
West High School
241 N 300 W.

Providence, R.I. 9:00 a.m. EDT
David Nason, Assistant Secretary for Financial Institutions
Chariho Regional High School
453 Switch Road.

Boise, Idaho 9:30 a.m. MDT
Mary Kertz, Special Advisor, U.S.-China Strategic Economic Dialogue
Life's Kitchen
1025 S. Capitol Boulevard

Columbia, S.C. 10:00 a.m. EDT
Roger Kodat, Deputy Assistant Secretary for Government Financial Policy
AC Flora High School
1 Falcon Drive

Wilmington, Del. 10:00 a.m. EDT
Dan Iannicola, Jr., Deputy Assistant Secretary for Financial Education
McKean High School
301 McKennan's Church Road

East Syracuse, N.Y. 10:30 a.m. EDT
Anthony W. Ryan, Assistant Secretary for Financial Markets
East Syracuse Minoa High School
6400 Fremont Road

Catonsville, Md. 10:50 a.m. EDT
Justin Grove, Office of Financial Education
Catonsville High School
421 Bloomsbury Avenue

Catonsville, Md. 10:50 a.m. EDT.
Thomas Kurek, Program Coordinator
Catonsville High School
421 Bloomsbury Avenue

El Paso, Texas 11:30 a.m. MDT
Anna Escobedo Cabral, U.S. Treasurer
Radford School
2001 Radford Street

Omaha, Neb. 12:00 p.m. CDT
Alex Kaplan, Deputy to the Assistant Secretary Office for Legislative Affairs
College of St.Mary's
7000 Mercy Road

Manlius, N.Y. 12:15 p.m. EDT
Anthony W. Ryan, Assistant Secretary for Financial Markets
Fayetteville-Manlius High School
8021 E. Seneca Turnpike

Alexandria, Va. 12:30 p.m. EDT
Alise DeLeon, Financial Education Analyst
T.C. Williams High School
3330 King Street

Omaha, Neb. 2:30 p.m. CDT
Alex Kaplan, Deputy to the Assistant Secretary Office for Legislative Affairs
College of St. Mary's
7000 Mercy Road

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October 19, 2007
HP-621

U.S. Treasurer to Visit Cleveland to Offer Mortgage Financing Advice

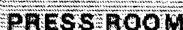
The United States Treasurer Anna Escobedo Cabral will visit South Elyria in Cleveland, Ohio Thursday to deliver advice to homeowners who may be experiencing difficulty paying their mortgage and may face foreclosure.

More than half of borrowers who go into foreclosure never reach out for help. Treasurer Cabral will deliver remarks at the South Elyria Neighborhood Development Corp Annual Education Luncheon to discuss the mortgage financing services and options offered by counseling agencies, which may help homeowners find a more affordable mortgage.

The Treasurer's efforts are part of Treasury's initiative to help subprime homeowners stay in their homes. Secretary Paulson and U.S. Housing and Urban Development Secretary Alfonso Jackson last week encouraged the creation of HOPE NOW, a new national alliance of leading counselors, servicers, investors who will work together to educate more homeowners about their mortgage options. The announcement follows on President Bush's broad plan to help homeowners, announced in August.

The Treasurer is available for media interviews and the following event is open to media:

Who
U. S. Treasurer Anna Escobedo Cabral
What
South Elyria Neighborhood Development Corp Annual Education Luncheon
When
Thursday, October 25, 11:30 a.m. (EDT)
Where
Elyria Holiday Inn
1825 Lorain Blvd.
Elyria, Ohio



October 19, 2007
hp622

Treasury Continues to Pressure Burma's Regime

Action Targets Additional Senior Burmese Officials

The U.S. Department of the Treasury today is designating 11 additional senior Burmese Government officials, cutting them off from the U.S. financial system. Treasury's action follows President George W. Bush's announcement today of additional measures increasing U.S. sanctions against the military regime in Burma.

"The President has made clear that Burmese officials will be held to account for the violent oppression of their people," said Adam Szubin, Director of the Office of Foreign Assets Control (OFAC). "Today's action targets eleven senior Burmese officials, and we will continue to designate and expose those responsible."

Treasury's action follows President George W. Bush's September 25, 2007, speech before the United Nations General Assembly in which he announced plans for tightened U.S. sanctions against the military regime in Burma. The Treasury Department subsequently designated 14 senior Burmese leaders on

Today's 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, persons 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 are Brigadier General Tin Naing Thein, Minister of Commerce; Brigadier-General Thein Zaw, Minister of Telecommunications, Post, & Telegraph; Major-General Saw Tun, Minister of Construction; Dr. Chan Nyein, Minister of Education; Colonel Zaw Min, Minister of Electric Power 1; Major-General Hla Tun, Minister of Finance and Revenue; Major-General Saw Lwin, Minister of Industry 2; Soe Tha, Minister of National Planning and Economic Development; Thaung, Minister of Science and Technology and Minister of Labor; Dr. Kyaw Myint, Minister of Health; and Brigadier-General Aung Thein Lin, Mayor and Chairman of Rangoon City Development Committee.

Treasury has previously designated 14 senior officials of the Government of Burma. 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.

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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.

October 19, 2007
HP-623

Treasury Selects Professor for Competitiveness Study on Financial Restatements

Washington- The Treasury Department announced today the selection of University of Kansas Professor Susan Scholz to conduct its examination of the impact of and the reasons behind public company financial restatements. Secretary Henry M. Paulson, Jr. discussed the need for a better understanding of this issue when he unveiled the auditing and accounting stage of his capital markets competitiveness initiative in May.

Numerous studies have pointed to a significant increase in the number of financial restatements during the past few years. Many reports attribute the growing number of restatements to increased management and auditor focus on accurate financial reporting due to the mandates in the Sarbanes-Oxley Act and greater financial reporting review and enforcement by financial regulators.

However some studies suggest that while some financial restatements are clearly material, immaterial financial restatements might pose significant and unwarranted challenges to the capital markets. Immaterial restatements might unnecessarily harm investor confidence by calling into question the credibility of company management, auditors, and the financial reporting system as a whole.

Professor Scholz will examine the factors triggering public company financial restatements, describe public company financial restatements, analyze the impact of public company financial restatements upon investors and the capital markets, and evaluate the significance of public company financial restatements. The study will focus on restatements from 1997-2006. Treasury intends to make the study's results public by early 2008.

Treasury selected Professor Scholz through the government procurement process. She is an associate professor and Harper Faculty Fellow at the University of Kansas School of Business. She received her doctorate degree in business administration from the University of Southern California.

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May 17, 2007
HP-408

Paulson Announce: :apital Markets .

Washington, DC- U.S. Treasury Secret: son, Jr. announced initiatives today to enhance U.S. capital veness, focused on strengthened financial reporting and a m nd transparent auditing profession.

"Strengthening the competitiveness of A arkets has been a priority issue for me since taking office," said Se 'I have listened carefully to many diverging views on this issue, a non theme throughout: A transparent financial reporting system a profession form the backbone of a marketplace investors ca o strengthen our capital markets must be based upon this princip

Today's initiatives are one piece of the f Capital Markets Competitiveness conference Secretary I rities and Exchange Commission Chairman Christopher Cox rch. At that conference, financial reporting was one of the main t n among leading experts representing investors, auditors, public ancial regulators. The conference raised other issues importar /eness of our capital markets, and Treasury will be unveiling in those areas in the near future.

Today's initiatives are part of an ongoin the issues affecting U.S. capital markets competitiveness. Initiati clude:

Provide Investors with A Transparen e Auditing System The Treasury Department intends to charter ommittee to develop recommendations to consider options a then the industry's financial soundness and its ability to attract and rsonnel. Treasury has asked former SEC Chairman Arthur Le SEC Chief Accountant Donald T. Nicolaisen to serve as co-chairs for this public forum.

Gain Better Understanding of Reasons for Increasing Financial Restatements
Restatements have soared during the past decade from 116 in 1997 to 1,876 in

2006. Treasury intends to commission a rigorous analysis of the factors driving financial restatements and their impact on investors and the capital markets. Results of the analysis will be made public upon completion.

Additionally, the Treasury Department believes the following initiatives are important to maintaining the competitiveness of our capital markets:

Enhance Financial Reporting U.S. Generally Accepted Accounting Principles are comprised of more than 2000 individual pronouncements issued by various regulatory bodies. Investors often seek information not provided under financial reporting requirements. The Treasury Department is supportive of the SEC and the Financial Accounting Standards Board's efforts to enhance financial reporting transparency and accessibility for investors.

Streamline Accounting Requirements to Encourage International Companies to List on U.S. Exchanges and Increase Investor Opportunities U.S. public markets should not be closed off to companies that adhere to high quality internationally accepted accounting standards. The Treasury Department is supportive of the SEC's action to eliminate the U.S. GAAP reconciliation requirement by 2009 of International Financial Reporting Standards reporting companies and the continued convergence of U.S. GAAP and IFRS.

Secretary Paulson will continue to provide follow up steps to other ideas discussed at the March conference.

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Subscribe to U.S. Capital Markets Competitiveness e-mail updates.

"As the Treasury Secretary, my goal is to promote the conditions for American prosperity and economic growth – and maintaining the competitiveness of our capital markets is central to that goal. Capital markets are the lifeblood of our economy." - Secretary Henry M. Paulson, Jr.

Strengthening Our Capital Markets
The United States has the strongest capital markets in the world, and this position is achieved through hard work and smart strategies that keep up with a dynamic, global marketplace. Secretary Paulson hosted a conference in March with some of the best and brightest financial minds to examine ways to maintain U.S. capital markets competitiveness and has embarked on multiple initiatives to strengthen our markets.

07/20/2007	Under Sec Steel Statement on Basel II Resolution
06/27/2007	Next Steps of Capital Markets Competitiveness Plan
06/19/2007	Treasury Seeks Nominations on Accounting Committee
05/24/2007	Under Sec Steel Statement on 404 Action
05/17/2007	First Stage of Treasury Capital Markets Competitiveness Action Plan
05/17/2007	Secretary Paulson OpEd Financial Reporting
05/17/2007	Under Sec Steel Remarks on Capital Markets Action Plan
03/09/2007	Treasury Capital Markets Conference Schedule
03/13/2007	Paulson Opening Remarks at Treasury Conference
11/20/2006	Paulson November 2006 Speech on Capital Markets Competitiveness

- Treasury Advisory Committee on the Auditing Profession

Private Pools of Capital
The President's Working Group on Financial Markets recently released guidance for private pools of capital, which include hedge funds, private equity and venture capital funds, to address systemic risk and investor protection issues. The guidance represents a uniform view from Treasury and a broad group of key independent regulators that heightened vigilance is necessary and desired to address market developments.

09/25/2007	PWG Announces Private Sector Groups for Private Pools of Capital
09/17/2007	Asst Sec Ryan Remarks before SIFMA Asset Managers
07/11/2007	Under Sec Steel Testimony on Hedge Fund Oversight
06/11/2007	Asst Sec Ryan Remarks in Chicago on Hedge Funds, Systemic Risk
03/06/2007	Asst Sec Ryan Speech in Greenwich, CT
02/27/2007	Under Sec Steel Remarks on Principles and

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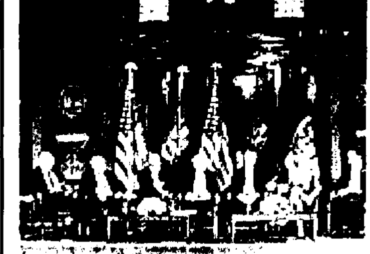
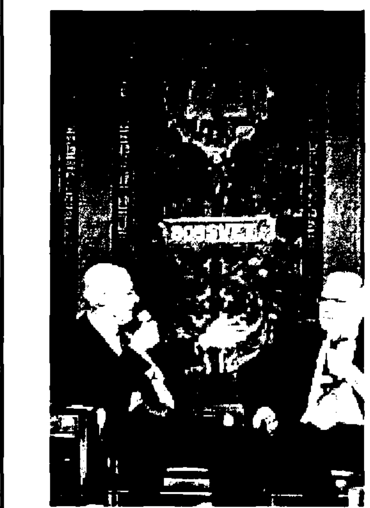

Secretary Paulson hosted a conf in March to discuss the competiti of America's capital markets with financial experts representing pu companies, regulators, policy ma and investor advocates.


Secretary Paulson spoke to Warı Buffet about corporate governanı transparent financial reporting, in protection and many other issues affecting U.S. markets at Treasuı Capital Markets Competitiveness Conference in March.

KEY INITIATIVES

- Capital Markets Competitivene
- U.S. - China Strategic Econom Dialogue
- Keeping The U.S. Economy Gr Open Markets, Investment & Tı
- Secretary's Corner

	Guidelines for Private Pools of Capital
02/22/2007	President's Working Group Agreement on Principles and Guidelines for Private Pools of Capital

Principles-Based Regulation

Secretary Paulson believes the U.S. financial regulatory system should seek better managed, more competitive companies that earn investor confidence through sound leadership, thoughtful governance, and outstanding performance. While our existing regulatory system was created to achieve this goal, we must seek a system that is also flexible enough to adapt to an ever-changing marketplace and that takes into consideration a more rigorous cost-benefit analysis of new regulation.

05/17/2007	Under Sec Steel Remarks on Capital Markets Action Plan
03/13/2007	Paulson Opening Remarks at Treasury Conference
02/27/2007	Under Sec Steel Remarks on Principles and Guidelines for Private Pools of Capital
02/22/2007	President's Working Group Agreement on Principles and Guidelines for Private Pools of Capital
11/20/2006	Paulson November 2006 Speech on Capital Markets Competitiveness

Last Updated: October 1, 2007

October 19, 2007
hp-624

Statement by Treasury Secretary Henry M. Paulson, Jr.
Following Meeting of G-7 Finance Ministers and Central Bank Governors

Washington, D.C.– The G-7 Finance Ministers and Central Bank Governors just concluded their meeting. Recent global economic developments and financial market turmoil dominated the discussion, though there was also a good discussion on a number of issues.

Regarding the global economy and financial markets, the main focus was on the implications of the turmoil for our economies, the extent to which the functioning of various credit markets has improved and what lessons we could draw from the experience.

I reported to my colleagues that we confront these current challenges against the backdrop of a strong economy – not just in the U.S., but globally. Indeed, this is the first housing downturn in the past three decades in which U.S. GDP growth has not turned negative. Business investment has expanded in recent months, our exports are being boosted by the strong economic growth of our trading partners and the healthy job market has helped consumer spending continue to grow.

The outlook for the remainder of 2007 and 2008 remains quite healthy, influenced heavily by the strong performance of emerging market economies – particularly China – as well as some rebalancing of domestic demand growth in the industrial countries. In this regard, our European colleagues were able to point to the stronger performance of their economies over the past year. The capitalization of our financial institutions is remarkably strong, which is also a major help in addressing the current environment. Our macroeconomic policy stances on the whole are sound and there was complete agreement around the table that monetary policy must continue to remain vigilant in maintaining price stability.

In the US I believe we have a healthy, diversified economy that will continue to grow. But, despite strong economic fundamentals, the housing decline is still unfolding and I view it as the most significant current risk to our economy. The longer housing prices remain stagnant or fall, the greater the penalty to our future economic growth.

Chairman Bernanke and I also reported on the steps the U.S. has taken to protect the systemic stability of global financial markets and address the problems in the mortgage financing sector. The U.S. current account deficit, which was 6.75 percent of GDP at the end of 2005, is now 5.5 percent of GDP. I recognized the need to increase our national savings and continue reducing the fiscal deficit. I was able to report that for the just-completed fiscal year, our deficit fell to 1.2 percent of GDP, and we remain on track to balance the budget in 2012. However, growing social insurance outlays pose a medium-term challenge to the fiscal outlook, which we must address.

The general feeling around the table was that there are some markets are returning to normalcy as risk has been reassessed and repriced. In other markets, that reassessment will take longer, in part due to the complexity of underlying securities. Competitive and innovative global markets bring many benefits – expanded job opportunities, broader prosperity, and widespread access to a diverse array of financial products. Yet there are risks as well, and the issues arising from the recent turmoil are complex and require careful analysis. I welcomed the update from Mario Draghi, Chairman of the Financial Stability Forum, on the Forum's review of the underlying causes of recent financial market turbulence, and look forward to the full report early next year. I also briefed my colleagues on the actions that were being taken in the President's Working Group on Financial Markets to address the

recent turbulence, and our comprehensive review of the relevant policy issues including the role of credit rating agencies and securitization.

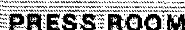
We had a good discussion on appropriate reforms for the international financial institutions. We heard from Ambassador Zoellick on the need to strategically deploy the World Bank's assets and improve its development effectiveness. I am encouraged by -- and strongly support -- Ambassador Zoellick's priorities and plan for the World Bank. Regarding the IMF, I emphasized the critical imperative of firmly implementing the recent decision on exchange rate surveillance. I also continue to urge a significant reform to the IMF's governance structure, improving the shares of dynamic emerging markets, and I stressed that as part of the Fund's consideration of its medium term financing picture, serious consolidation of expenditures must be considered in tandem with a review of income.

We discussed the creation of an international clean technology fund to help developing nations harness the power of clean energy technologies, and solicited feedback on this proposal. This fund could be part of the broader major economies initiative, in which the world's largest producers of greenhouse gas emissions will work together to establish a new international approach on energy security and climate change in 2008 that will contribute to a global agreement by 2009 under the UN Framework Convention on Climate Change. We look forward to working with other countries to develop this concept.

I urged my counterparts to step up efforts to restart the Doha talks, and emphasized the equal importance of results in agriculture, non-agriculture market access, and services - including financial services. A Doha agreement is within reach and we should not lose the opportunity before us. Success on Doha is the single most effective thing we can do to raise living standards around the world. Reducing trade and investment barriers and maintaining open markets is critical to ensuring that the benefits of trade are shared broadly. I also emphasized that the United States is committed to working with our global trading partners to ensure a successful Doha Round.

We reaffirmed our commitment to vigorously counter money laundering, terrorist and proliferation financing in order to promote economic development and safeguard the integrity of the global financial system. We discussed ways to deal with Iran's pursuit of a nuclear capability and ballistic missiles, the regime's vast financial support to lethal terrorist groups, and the deceptive financial tactics employed by Iran to evade sanctions and mask illicit transactions. We welcomed the recent statement by the Financial Action Task Force highlighting the significant threat Iran's illicit conduct poses to the international financial system.

The Financial Action Task Force's statement has put the international financial system on notice about the threat that Iran poses to the security and stability of the international financial system. I urge financial institutions everywhere to take FATF's action into account as they evaluate whether handling Iran-related business is worth the risk.



October 19, 2007
HP-625

Statement of G-7 Finance Ministers and Central Bank Governors
October 19, 2007

The global economy is in its fifth year of robust growth. Recent financial market turbulence, high oil prices, and weakness in the US housing sector will likely moderate this growth. Nevertheless, our overall economic fundamentals continue to be strong and emerging markets are providing critical impetus to the strength of the world economy.

We remain committed to doing our part in sustaining strong global growth. We have acted resolutely to protect the systemic stability of global financial markets, and monetary policy must remain vigilant in maintaining price stability. We will continue to pursue medium term structural reforms and fiscal discipline. Technological change and openness to trade and investment are essential for our prosperity in a globalized world. We are committed to resisting protectionist pressures and to a successful conclusion of the Doha Development round that results in significant new trade flows in the key areas of agriculture, non-agriculture market access and services, especially financial services. Trade liberalization and Aid for Trade are critical for global poverty reduction.

We reaffirm that exchange rates should reflect economic fundamentals. Excess volatility and disorderly movements in exchange rates are undesirable for economic growth. We continue to monitor exchange markets closely, and cooperate as appropriate. We welcome China's decision to increase the flexibility of its currency, but in view of its rising current account surplus and domestic inflation, we stress its need to allow an accelerated appreciation of its effective exchange rate.

Following recent global market turbulence, the functioning of financial markets is improving. Strong global fundamentals and well-capitalized financial institutions provide a sound and resilient basis but uneven conditions are likely to persist for some time and will require close monitoring.

Our response to recent financial turbulence must be based on full analysis of its causes. Securitization and financial innovation have contributed significantly to the growth of our economies. We expect market participants to address many of the shortcomings that were exposed by recent events. To ensure a sound, transparent, and comprehensive framework, we have asked the Financial Stability Forum (FSF) to analyze the underlying causes of the turbulence and offer proposals in the areas of liquidity and risk management; accounting and valuation of financial derivatives; role, methodologies and use of credit rating agencies in structured finance; and basic supervisory principles of prudential oversight, including the treatment of off-balance sheet vehicles. We received an outline of the work plan from FSF Chair, Mario Draghi, and look forward to his further reports at our upcoming meetings in Japan and Washington.

We discussed progress made in implementing the FSF recommendations on Highly Leveraged Institutions. In this context, we welcome the work undertaken by private sector representatives in the United Kingdom and the United States to develop strengthened best practices.

We discussed World Bank and IMF reform. We received a report from World Bank President Zoellick on his ideas for the institution's work going forward and we look forward to further discussing with him and other shareholders his plan for ensuring the Bank successfully meets its evolving challenges in promoting economic growth and poverty reduction. We thanked Rodrigo De Rato for his contribution to the work of the IMF and look forward to working with the incoming Managing Director, Dominique Strauss-Kahn. We remain committed to achieving an ambitious

package of fundamental reforms. Quota shares and voice should better reflect the realities of the world economy including the growing weight and role of dynamic members, many of which are emerging markets. We also agreed that the voice of low income countries should be enhanced. We welcome the decision to modernize the Fund's framework for surveillance, including for exchange rates, and we look forward to its firm and even-handed implementation. IMF finances need to be put on a sustainable footing, but concurrently, the IMF must undertake a serious review of its activities and consolidation of its spending.

We discussed the importance of unified action to address energy security and global climate change while supporting growth and economic development. We are committed to working with major economies and through the UN climate process to that end. We agree that market based policy measures should be effectively designed to meet specific conditions in each country. We noted the need for scaling up investments in cleaner and lower carbon technologies through existing mechanisms such as the Clean Energy and Investment Framework and agreed to explore the creation of a clean technology fund to support the deployment of clean energy technologies to developing countries.

Cross-border, market-based investment is a major contributor to robust global growth. In this context, we agreed that sovereign wealth funds (SWFs) are increasingly important participants in the international financial system and that our economies can benefit from openness to SWF investment flows. We see merit in identifying best practices for SWFs in such areas as institutional structure, risk management, transparency and accountability. For recipients of government-controlled investments, we think it is important to build on principles such as nondiscrimination, transparency, and predictability. We are committed to strengthening our dialogue with countries involved and look forward to discussing these issues at our Outreach Dinner later this evening. We ask the IMF, World Bank, and OECD to examine these issues. We will explore opportunities to enhance investment flows between our economies and continue our discussions on mutual recognition of comparable securities regimes.

We asked the Fund, the World Bank, and the African Development Bank to actively support the implementation of the "G-8 Action Plan for Good Financial Governance in Africa" and to better align their strategies in this area. We remain concerned about the problem of aggressive litigation against HIPC countries. We welcome the steps already taken by the Paris Club to address this problem, urge all sovereign creditors not to on-sell claims on HIPCs, and are examining additional steps that might be taken. We discussed the Implementation Report on the G-8 Action Plan for Developing Local Bond Markets in Emerging Market Economies and Developing Countries and welcomed the work underway. We call on all IMF members to respond to the current situation in Liberia and follow us in financing full debt relief at the IMF.

We remain committed to fighting money laundering, terrorist financing and other illicit financing involving similar risks to financial markets, and we commend the Financial Action Task Force (FATF) for its ongoing work examining the risks of weapons of mass destruction proliferation finance, enhancing its surveillance of global threats, and deepening its dialogue with the private sector. We call upon the IMF and World Bank to continue their close cooperation with the FATF, and we urge the FATF to collaborate intensively with jurisdictions that have failed to recognize international standards. We look forward to meeting with other FATF Ministers next Spring to refresh the mandate of the FATF.

We particularly commend FATF for taking steps to protect the international financial system from the various money laundering and terrorist financing risks related to Iran. In the wake of two unanimous UN Security Council Resolutions addressing Iran's nuclear and ballistic missile programs, and the FATF's actions identifying the risks of illicit finance associated with Iran, financial institutions are advised to take into account these risks.

October 20, 2007
hp-626

Statement by U.S. Treasury Secretary Henry M. Paulson, Jr.
at the International Monetary and Financial Committee Meeting

Washington, D.C.– I welcome the opportunity to discuss global economic and financial developments and IMF reform this morning. Let me take this opportunity to thank Rodrigo de Rato for his able leadership of the IMF, for the reform accomplished during his tenure and the groundwork laid for additional reform. I look forward to working with Dominique Strauss-Kahn, as he takes on this role. Let me also welcome my highly talented and experienced colleague, Tommaso Padoa-Schioppa, as our new IMFC Chair.

The World Economy

Today's meeting takes place against the backdrop of continued strength in the global economy, though downside risks have increased following recent financial turbulence. Real global GDP growth is expected once again to be near 5% this year and next, with emerging markets providing well over half of that growth. In addition, there has been some progress toward strengthening domestic demand abroad on a sustainable basis, which should help maintain forward growth momentum. Nonetheless, recent stress in financial markets is a reminder to all of us that continued vigilance is required.

Recent credit market events will impose some penalty on US economic growth, but I expect continued growth. Our financial institutions are in a strong financial position, and our economic fundamentals are healthy: low *unemployment, rising real wages, and strong global growth is boosting U.S. exports*. We have made considerable progress in reducing the federal deficit in the past few years. Our fiscal year just ended with a budget deficit of 1.2% of GDP. This is half the U.S. 40-year average, with growth of expenditures being at a 10-year low. The FY2007 deficit was down to 1.2% of GDP compared to 1.9% last year and 3.6% in FY2004. Key to the strength of the U.S. economy is our commitment to open trade and investment, as President Bush underscored in his public statement on open economies this past May.

Our financial markets are working through a reassessment and repricing of risk. In some sectors, this reassessment has played out more quickly, liquidity has returned and markets are operating more normally. In other sectors that are characterized by more complex securities or that rely more heavily on securitization and ratings, conditions are improving, but adjustment will take longer to play out. Fortunately, the global economy's underlying strengths should limit the negative effects that the turmoil might have on global real economic activity. We need to learn from these events, and take steps to address the policy issues that arise. We welcome the work of the Financial Stability Forum on these issues, and the participation of the IMF in this work.

In recent years, we have witnessed a remarkable rise in cross-border official assets, coupled with projections of continued rapid accumulation. This appears to represent a significant structural shift in the international financial system, where free market economies are fundamentally based on private sector allocation of resources to their most efficient uses. The increase in size and number of sovereign wealth funds (SWFs), in particular, has received increasing attention due to their potential implications for financial markets and investment. Our fundamental premise is that open financial markets and investment policies are beneficial to our well-being and SWFs, first and foremost, should be seen in this light. That said, the growing importance of SWFs merits cautious, well-considered public policy responses. The United States believes a multilateral approach to SWFs that maintains open investment policies is in the best interest of countries that have these funds, and countries in which they invest. The IMF is uniquely

positioned to identify best practices for SWFs, building on the existing Guidelines for Foreign Exchange Reserve Management. Best practices would provide multilateral guidance to new funds on how to make sound decisions on how to structure themselves, mitigate any potential systemic risk, and help demonstrate to critics that SWFs can be constructive, responsible participants in the international financial system. Recipient countries of SWF investment also have a responsibility to maintain openness to investment and should work through the OECD to develop best practices for inward government-controlled investment. Last night's G7 outreach dinner with countries that have sovereign wealth funds was an important initial step in the process of developing consensus and collaboration around this important issue.

The successful conclusion of the Doha Round of trade talks is both more difficult and more important, as global growth slows and protectionist sentiments resurface. At this critical juncture, major trading nations, both developed and developing, need to step up and lower barriers to trade to ensure a successful Doha Round in order to sustain the future growth of global incomes. As finance ministers, we have a special responsibility to ensure that the benefits of greater openness in financial services are fully appreciated.

IMF Reform Agenda

The IMF is an essential institution for global monetary cooperation, and we place a high priority on supporting meaningful IMF reform in order to maintain its credibility and relevance in the rapidly changing global economy.

Firm surveillance over exchange rates is at the very core of the IMF's responsibilities in the international monetary system. The June 2007 revision of the 1977 Decision on Surveillance over Exchange Rate Policies was an extremely important achievement, but rigorous implementation is essential. The IMF's ability to carry out this priority function will define its relevance in the global economy in the years to come. Discussion of exchange regimes and rates, and the spillover effects of members' economic policies on other members, is the one area over which the Fund can claim a unique purview, which it should not sacrifice by failing to meet its own responsibility for surveillance.

The IMF's governance structure needs **fundamental** reform to reflect the realities of the evolving global economy. Quotas must be adjusted significantly to give greater weight to dynamic emerging market economies, while protecting the voice of the poorest countries. We repeat our commitment to forgo the additional quota we would receive in the second stage increase beyond what we need to maintain our pre-Singapore voting share. I call on all members to reenergize their work to forge a consensus on a strong quota reform package in order to bolster the legitimacy and relevance of the Fund and to keep members from drifting away from this critical global institution.

With a structural decline in IMF lending, the IMF's finances have become unsustainable. There has been much attention to possible new income sources and the Crockett Committee has made a constructive contribution. However, an equally important part of the solution must be to seriously reduce spending by re-aligning staff and expenditures to focus on the IMF's core mission. It is time to roll up our sleeves on the expenditure side. A plan for the swift reform of the Fund's expenditure and staffing must be an early priority for the incoming Managing Director. Alongside a concrete work plan for consolidation, we will work on longer-term sources of income for the IMF.

The IMF has an important role to play in low-income countries, providing policy advice and technical assistance in its core areas of expertise, and balance of payments financing, when needed. We welcome the IMF's efforts to re-focus its engagement with low-income countries on addressing the macroeconomic impacts of scaled up aid, but caution against the IMF's over-reaching on longer-term development issues better suited to the multilateral development banks. The IMF's main role with respect to the millennium development goals must be to help countries maintain macroeconomic stability and debt sustainability, and accelerate growth through appropriate macroeconomic frameworks. To this end, vigilant application of the Debt Sustainability Framework and renewed emphasis on the importance of responsible borrowing and lending decisions must be a cornerstone of the IMF's work in low-income countries.

We believe a clear division of labor between the IMF and World Bank, in terms of areas of policy focus and respective financing roles, will serve to strengthen the work of both institutions. We therefore welcome continued follow-up on the recommendations of the Malan Report on Bank-Fund Collaboration.

Other Key Issues

We must continue to apply robust efforts to combat illicit money flows to safeguard the financial system from abuse, support development and economic growth, and protect citizens worldwide. By implementing the Financial Action Task Force's (FATF's) international standards on money laundering and terrorist financing, countries worldwide can help make the global financial system an inhospitable venue for terrorists, proliferators, narcotics traffickers, and other rogue actors. FATF's close cooperation with the IMF and World Bank has been vital to these continued efforts, and we applaud their sustained commitment.

Moving forward, we urge FATF to continue its ongoing work to examine the risks of WMD proliferation finance, and its efforts to identify and engage intensely with jurisdictions that have failed to implement international standards. Further, we call on all countries to fulfill their UN obligations by implementing UN Security Council Resolutions 1540, 1718, 1737, and 1747 against WMD proliferation, particularly the economic and financial provisions of those resolutions. Continued vigilance by both the public sector and the private sector is vital to combating abuse of the international financial system by those who are pursuing weapons of mass destruction and their delivery systems in defiance of the international community.

-30-

October 21, 2007
HP-627

**Statement by Secretary Henry M. Paulson, Jr.
at the Development Committee Meeting**

The global economic environment has evolved substantially in recent decades with the increase in the size and sophistication of private capital markets, the growing level of official and private development assistance, and the continuing rapid expansion of international trade. Despite these positive developments, the World Bank has a large unfinished agenda in promoting economic growth and poverty reduction in the developing world. At the same time it is also being asked to devote resources toward addressing a growing list of global problems that require collective actions. Recognizing that the resources of the World Bank Group are limited while demands on them are rising, we fully support and encourage President Zoellick's efforts to develop a long-term strategic approach to optimal deployment and leveraging of the World Bank Group's resources in this changing environment.

Changing Development Environment

In undertaking this task we must recognize that the needs and challenges of developing countries have evolved and have become more complex. For the poorest countries there continues to be broad agreement that IDA, the World Bank's concessional window, will remain an essential tool, and we applaud President Zoellick's efforts that have resulted in the IBRD and IFC Boards' recent endorsement that these institutions seek to contribute a combined $3.5 billion for IDA15. Notwithstanding this positive development, the share of IDA resources relative to other forms of development assistance is likely to continue to decline due to the rapid growth in development assistance from other sources. While this aid is welcomed, the administrative challenges for developing country governments arising from the growing number of donors and the increasing level of earmarking can diminish overall aid effectiveness. We therefore strongly support IDA as an organization that, because of its convening power, strong analytical work, and country-based approach, can play an important role in helping recipient governments align funding from multiple sources.

At the other end of the development spectrum we see that a growing number of middle-income countries are benefiting from improved access to private financial flows. For these countries, the traditional World Bank product, composed of loans combined with a package of technical and advisory services, is no longer as appropriate as in the past. We believe the World Bank can continue to help these countries but it will require that the World Bank become more focused, efficient and selective in seeking ways to provide its expertise where financing may no longer be required.

We also are increasingly aware that weak private sector activity in the poorest countries as well as in large portions of middle-income countries is due to a combination of factors including a lack of credit, investment resources and good business practices on the one hand, and institutional barriers and governance problems on the other. These impediments not only constrain domestic growth and employment, as the private sector is ultimately the main driver of both, but prevent developing countries from fully exploiting the opportunities offered by the rapidly expanding volume of global trade. We believe a more integrated approach focused on private sector-led growth is needed and applaud the Board of Directors' recent decision to deepen the connection between IFC and IDA as part of a larger growth strategy for IFC to expand its private sector investments in developing countries.

Long-Term Strategy

In developing a long-term strategy to address our challenges we believe that it must

first be grounded in a few guiding principles. World Bank engagement should be limited to programs that clearly meet its core mission of promoting economic growth and poverty reduction, and that the manner in which the World Bank engages in programs should reflect its comparative advantages.

Some areas where we believe the Bank enjoys clear comparative advantage include infrastructure, private sector development, the benefits of trade liberalization, donor coordination, and the development of public financial management and accountability systems for management of public resources.

The economic challenges posed by environmental threats and climate change clearly present the Bank with opportunities to exercise its comparative advantage. The global public goods nature of these challenges points to the usefulness of international approaches that can leverage the Bank's convening power as well as its financing capabilities. We look forward to working with the Bank and all the multilateral development institutions through President Bush's major economies initiative that focuses on collaborating with the world's largest producers of greenhouse gas emissions, both developed and developing nations, to establish a new international approach on energy security and climate change in 2008 that will contribute to a global agreement by 2009 under the UN Framework Convention on Climate Change. As part of that initiative President Bush has proposed the creation of a new international clean technology fund to help developing nations harness the power of clean energy technologies. This fund will help finance clean energy projects in the developing world. The President has asked me to coordinate this effort – and I will continue to reach out to the international community, including the development institution, in the coming months to discuss how best to design, finance and implement such a fund.

Exploiting the Bank's comparative advantages implies that it should seek to complement the activities of other donors including the regional development banks. In this regard, we encourage the World Bank and the regional banks to undertake more rigorous efforts to coordinate their country development strategies along the lines of their respective comparative advantages.

As the World Bank attempts to maintain its engagement with emerging economies through the provision of new innovative and customized products, it should avoid duplication of services and financing that can be provided by the private sector. Where consistent with the country-based model, the Bank should also seek to unbundle its policy advisory and technical assistance products from its lending services. In its efforts to reduce the non-financial costs of doing business with these countries it must ensure that its environmental, social and fiduciary safeguard policies are not diluted. At all times the Bank needs to weigh the costs and benefits of these new programs against expected development results.

We believe a long-term strategy must also address the issue of how to make the World Bank's public sector arms, the IBRD and IDA, and its private sector arms, the IFC and MIGA, work in a more integrated fashion to address the multiple barriers to private sector development in IDA countries and in poorer or frontier development areas of middle-income countries. Too often these institutions operate in isolation and address separate impediments to private sector development when a more integrated approach is required. We encourage President Zoellick to develop additional incentives to encourage the staff of these institutions to work in a more integrated way to promote private sector development. Likewise, it is important to deepen relationships with other institutions, such as regional development banks and export credit agencies, which also provide financing to companies in developing countries.

As Paul Volcker has most recently reminded us in his commission's invaluable work on the Bank's anti-corruption activities, good governance is vital to successful economic development and the Bank must continue its vigorous efforts to investigate and combat corruption in the institution and its countries of operation. We look forward to working with President Zoellick and other shareholders as we carry this essential work forward.

It is essential that a long-term strategy focus on the need to improve the efficiency of administrative expenditures within the Bank Group, including the quality and flexibility of its human resources. Too often the Bank Group has been slow in redeploying its resources and has deployed the wrong mix of resources at the

expense of poor execution on new high priority programs. Implementing more budget discipline including comparisons of the costs and benefits of existing programs compared to new initiatives, combined with the incorporation of proper staff incentives to ensure that the required human resources can be deploy quickly to where they are most needed will free up resources to support new strategic priorities as the global development environment evolves.

Lastly and most importantly, it is imperative that we continue to focus on the need to improve the achievement and reporting of concrete results from the Bank's projects and programs. It remains the central organizing principle for everything the Bank does.

October 20, 2007
HP-628

Treasury Under Secretary for Domestic Finance
Robert K. Steel
Remarks before the Institute of International Finance

Washington- Thank you. I appreciate the invitation to be here today. And to those of you who have traveled from abroad to be here, it is my privilege to welcome you to the United States. For 25 years, the Institute of International Finance has been committed to being an influential global association of financial institutions. Your research, analysis, and best practices are always taken seriously, and it is an honor to be here today. I feel especially honored to be included among such a distinguished group of panelists.

Introduction – Regulation in a Global Economy

As a former business person, I understand that the nature of business today is global and without boundaries. None of us view our business models as beginning or ending within the context of territoriality.

Regulation, on the other hand, has not historically taken that borderless perspective. Today's topic, regulation in a globalized economy, is something upon which Treasury is spending considerable energy analyzing. We are doing our best to examine ways of modernizing our regulatory approach to more accurately reflect business models in today's global financial system.

For example, recent action we have taken with regard to private pools of capital reflect a more global regulatory approach. In February, the President's Working Group on Financial Markets (PWG) released a comprehensive set of principles and guidelines to address the two main challenges that private pools of capital, which include hedge funds, private equity and venture capital, pose to our financial markets: systemic risk and investor protection.

This principles-based framework lays a strong foundation for how market participants- investors, asset managers, creditors, counterparties, and policymakers- should enhance their practices and fulfill their responsibilities.

More recently, on September 25, we created two private-sector committees to develop best practices for the hedge fund industry. Using our principles and guidelines as a framework, these two committees – one comprised of asset managers and the other comprised of investors - will develop best practices. In these efforts, we are collaborating with our British counterparts, to build upon their work underway.

Capital Markets Competitiveness

Making our regulatory structure more effective is one area we have been focusing on at Treasury under a broader rubric of maintaining and enhancing U.S. capital markets competitiveness. Last November, Secretary Paulson gave a major speech on capital markets competitiveness and identified three areas of priority: (1) our regulatory structure and philosophy, (2) our auditing and accounting profession, and (3) legal and corporate governance issues.

Secretary Paulson hosted a conference in March on capital markets competitiveness at Georgetown University. We heard from key policymakers, consumer advocates, business representatives and academics, each with different perspectives on ways to keep U.S. capital markets the strongest and most innovative in the world. Several initiatives have been launched as a result of what

we heard at that conference:

- Advisory Committee on the Auditing Profession: The Treasury Department has chartered a non-partisan, public committee to develop recommendations to address the challenges facing the auditing profession, including industry concentration and competition, and employee recruitment and retention.
- Study on Financial Restatements: Treasury has commissioned an academic study to understand the reasons for the growing number of public company financial restatements over the past decade. The study will explore potential policy implications.
- Regulatory Blueprint: The Treasury Department is working on a comprehensive report that will examine the regulatory structure and philosophy of our financial services industry and the protections they offer to investors. We will produce a blueprint that will outline recommendations on how to modernize our regulatory regime to keep pace with a global market place and uphold the highest investor protection standards.

Regulatory Blueprint

Our review of the U.S. financial regulatory system is particularly relevant today, so I would like to discuss this more in-depth.

While our efforts to modernize regulation were contemplated well before we entered the current period of mortgage market stress, issues of regulation are particularly relevant today, as recent challenges in the credit and housing markets have highlighted the need to modernize and streamline the U.S. regulatory structure.

Our fragmented regulatory system has complicated an already difficult situation in the housing and credit markets. Existing federal laws address mortgage fraud, disclosure, fair lending, unfair and deceptive practices, and other aspects of the mortgage process. But regulatory enforcement authority varies across federal regulatory agencies.

Moreover, many states have enacted additional layers of regulation. These laws often apply exclusively to institutions that operate within a particular state, creating confusion and complexity. This creates a difficult environment for both regulators and those being regulated. Our patchwork regulatory structure needs to be streamlined and modernized.

We believe this issue is so important to our global competitiveness that Treasury Department undertook this report on our own initiative, unlike previous reports mandated by Congress. It has been 10 years since the Treasury Department undertook this type of review and the financial services industry has evolved considerably.

We will take a comprehensive approach as we examine our regulatory structure, taking into consideration the entire financial services industry, including insurance, securities and futures firms, and a topic that was the focus of most past Treasury Department studies- the depository institutions.

Our hope is that this regulatory paper would also have a long-lasting effect, helping to shape the debate about longer-term regulatory reform, as have previous Executive Branch works on financial services regulation. For example, Administration reports in 1984 and 1991 laid the foundation for the ideas that carried through in the Gramm-Leach-Bliley Act of 1999, such as functional regulation.

Such a project gives us the benefit of thinking about what the ideal regulatory structure should look like. If we were starting fresh and had a blank page, no one would choose to draw a regulatory structure that resembles our current picture. For this reason, we are seeking broad public comment on a series of ideas that affect our financial regulatory structure.

Too often discussions about ideal regulatory philosophy and structure have been reduced to a black and white debate of rules vs. principles. This oversimplification undermines the complexity of these issues, and is not constructive. The optimal

construct should balance both rules and principles. A modernized approach recognizes that we should be guided by principles at an overarching level.

But regulation at the retail level will require some focus on rules, particularly to protect less sophisticated market participants, where investor protection must be a paramount focus.

A key element of a modernized approach is a benefit-burden analysis. Policymakers should reject calling for regulation just for regulation's sake. Instead, we should engage in rigorous cost-benefit analysis of proposed and current regulation.

Additionally, there must be engagement between regulators and the regulated. Policymakers must to facilitate a move for constructive dialogue between regulators and the entities they regulate. There should be a clear process for businesses to engage with their regulators when they have questions or need clarification.

Current Market Conditions

Let me conclude by spending just a minute discussing an announcement made earlier this week by private sector banks to create a potential market-based solution to improve liquidity in the asset-backed commercial paper (ABCP) markets.

As Secretary Paulson and I have said many times, the markets needed to reassess and reprice risk. In early August, uncertainty regarding the future prospects of mortgage-backed securities, particularly those with subprime exposure, caused investors to reassess the risk of these securities and subsequently readjust and reassess prices.

This uncertainty and subsequent illiquidity began to spread to the ABCP market, typically a very liquid and important market. After the initial repricing of risk, markets begin to adjust and in most cases began a steady but gradual process of improvement. The ABCP market, however, while showing some signs of improvement, seemed to be improving slower than other segments of the market. The particular risk of a disorderly unwinding of structured investment vehicles (SIVs) became a matter of focus for market participants and the Treasury Department.

As part of our effort to vigilantly monitor markets, we brought together market participants to speak about market conditions, particularly conditions in the credit markets. Throughout these discussions Treasury was in regular dialogue with appropriate US and international regulators. It became clear in discussions with investors across markets, that while there has been some improvement in the ABCP market, this improvement could be enhanced and complemented by market participants working together.

The structure they are developing is expected to be temporary and serve as a bridge, which will provide some time for participating SIVs to restructure in a more orderly fashion. The technical organization of this solution is complex. Initial progress is being made by the lead banks and participation is expected to broaden in the weeks ahead.

We believe that the effect of these complementary efforts should be to enhance the current rate of improvement, and give further investor confidence to the important ABCP market. This effort is focused on improving market conditions so as to benefit all market participants, and not a particular subset of the market.

As regularly indicated, it will take a while for markets to regain full confidence – even with this structure. But we are fortunate to have a backdrop of strong U.S. fundamentals and a growing global economy.

Thank you and I look forward to our discussion.

October 22, 2007
HP-629

Secretary Paulson's Plenary Remarks at the Annual International Monetary Fund and World Bank Meetings

Welcome to Washington. I'm pleased with the new leadership we have at the World Bank and the IMF. I have great confidence in Bob Zoellick and he has clearly hit the ground running. I am really looking forward to working with Dominique Strauss Kahn--a proven leader. And a big thank you to Rodrigo de Rato for his leadership over the last few years. I wish him the best in his future endeavors.

The Changing Global Economic and Financial Landscape

The context to these annual meetings is continued strong global economic conditions and the recent financial turbulence. This context reminds us of the changing and challenging financial landscape and how imperative it is that we adapt ourselves and our institutions to meet these challenges. Let me hit on a few of the key changes we see. First, deeper, more sophisticated, more globally-interconnected capital markets have helped underpin growth in both developed and developing countries, but have also created new complexities. Second, global growth and financial soundness depend increasingly on dynamic emerging market economies, rather than overwhelmingly on industrial countries. Finally, accelerating globalization has heightened our awareness of the links between energy and environmental policies and longer-term global economic prospects.

International capital markets have become more efficient and offer a growing array of innovative financial instruments. The volume of cross-border financial flows has expanded substantially in just the last five years, as has the daily volume of foreign exchange transactions. Innovation brings important economic benefits, promoting growth through the efficient allocation of capital, increasing access to credit and helping spread risks more broadly. But innovation has also brought increased complexity, new risks, new challenges and some new problems, which are now being examined by policymakers and regulators. We need to continue to be vigilant, because all of our capital markets are not yet functioning normally. As we move to address current problems, we must also address policy issues to prevent a repeat of recent excesses. Cooperative bodies like the Financial Stability Forum, the Basel Committee on Banking Supervision and the International Organization of Securities Commissions have a key role to play internationally, complementing domestic regulatory responses.

Global economic trends are increasingly impacted by developments in emerging markets. China, India and Russia presently account for half of global growth. Emerging markets as a whole are growing more than twice as fast as industrial economies, and account for a rising share of global trade and investment. Such realities need to be reflected in international financial and economic institutions, both in the focus of their work, and in their governance structures.

Any long-term view of global economic prospects must take into account energy security, deal with the global challenge of climate change and address environmental impacts for future generations. The cross-border nature of this challenge points to the need for international approaches. President Bush's major economies initiative, to work with the world's largest producers of greenhouse gas emissions to reach agreement by 2009, and his proposal for an international clean technology fund are important steps in this direction.

Modernizing the International Financial Institutions

To remain relevant in this changing landscape, the international financial institutions

must better define their core missions, and align staff and other resources accordingly. Future credibility of the institutions also requires that governance structures evolve to reflect new global realities.

International Monetary Fund
A defining issue for the IMF is how to exercise effective surveillance over member country exchange rate policies in a world of fixed and flexible exchange rate regimes. The recent updating of the IMF's exchange rate surveillance mandate was an essential step, and implementation is equally critical. IMF staff needs to roll up their sleeves, undertake thorough analysis, and put forward their judgments. Without meaningful exchange rate surveillance, governance and management reform will ring hollow.

Fundamental changes to the IMF's governance structure to reflect the growing role of dynamic emerging markets in the global economy must remain a priority. While such changes are not easy to achieve, a strong, credible IMF is in all of our interests. On behalf of the U.S., it is time that we ask emerging markets to take on greater responsibility in the international financial system. But it is fair for them to ask for a greater share in representation in return.

Changes are also needed to put IMF finances on a sustainable footing. One part of the solution must be to reduce expenditures by re-evaluating the IMF's core mission and making difficult decisions on priorities. Hand-in-hand with this, we recognize that we need to consider longer term sources of income for the IMF over the next year.

Multilateral Development Banks
Multilateral development banks also must adapt while continuing to focus on their core missions of economic growth and poverty reduction. On the one hand, there is the challenge of their continuing relevance in countries whose economic success means they no longer need MDB finance. On the other, the poorest countries – especially in Africa – continue to need concessional assistance that is results-oriented, performance-based and focused on each bank's comparative advantage. We look forward to a successful replenishment of IDA to help meet those needs.

Fighting corruption, a fundamental challenge to growth and development, must continue to be central to World Bank operations and policies, as the Volcker committee has recently reminded us. In addition, access to energy and the consequences of climate change have clear implications for growth in the developing world, and the World Bank can and must respond.

The World Bank must also enhance coordination among the World Bank Group itself to serve as one institution on behalf of its clients. At the same time, it must maintain a rigorous focus on defining, managing for, and achieving the desired results. Addressing these multifaceted challenges is no small task, but one that shareholders are demanding and deserve.

I look forward to working together to advance this important agenda.

October 22, 2007
HP-630

U.S., Iceland to Sign New Income Tax Treaty

Treasury Deputy Secretary Robert M. Kimmitt will join Icelandic Finance Minister Árni M. Mathiesen tomorrow, Tuesday, October 23, in signing a new income tax treaty between the two countries.

Who
Deputy Secretary Robert M. Kimmitt
Icelandic Finance Minister Árni M. Mathiesen

What
U.S.-Iceland Tax Treaty Signing

When
2 p.m., EDT

Where
Diplomatic Reception Room (3311)
U.S. Department of the Treasury

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.

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October 22, 2007
HP-631

Treasury, IRS Extends Transition Relief for Deferred Compensation Plans

Washington, DC--The Treasury Department and the Internal Revenue Service (IRS) announced today in Notice 2007-86 that the transition relief for compliance with the final regulations under section 409A of the Internal Revenue Code (409A) has been extended generally for one year.

Section 409A was effective on January 1, 2005 and all affected nonqualified deferred compensation plans have been required to comply with the statute since that date. Under prior guidance, these plans were required to comply in operation with the final regulations beginning in 2008. Notice 2007-86, issued today, generally extends the transitional period for compliance with the final regulations to December 31, 2008. The notice also confirms that the Treasury Department and the IRS expect to issue guidance regarding a correction program as soon as possible.

The regulations provide guidance regarding the requirements for deferral elections and payment timing under section 409A. The regulations were in response to legislation enacted by Congress in 2004 to address concerns involving reported abuses of nonqualified deferred compensation plans.

REPORTS

- Notice 2007-86

Part III – Administrative, Procedural, and Miscellaneous

Notice of Additional 2008 Transition Relief under Section 409A

Notice 2007-86

SECTION 1. PURPOSE

This notice provides additional transition relief regarding the application of section 409A of the Internal Revenue Code to nonqualified deferred compensation plans. Generally, this notice extends to December 31, 2008, the transition relief that was scheduled to expire on December 31, 2007, as provided in Notice 2006-79, 2006-43 IRB 307, and the preamble to the final regulations under section 409A (72 Fed. Reg. 19234 (April 17, 2007)) (the final regulations preamble). This transition relief revokes and supersedes the transition relief provided in § III of Notice 2007-78, 2007-41 IRB 780, and modifies the relief provided in § IV of Notice 2007-78 related to employment agreements, as described below. This transition relief does not affect the guidance provided in § IV of Notice 2007-78 related to predetermined cashout features, or the guidance provided in § VI of Notice 2007-78, related to the application of section 409A(b) (restrictions on certain trusts and other arrangements).

SECTION 2. 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. Beginning with Notice 2005-1, 2005-1 CB 274 , the Treasury Department and the IRS have issued several notices and other guidance providing transition relief intended to permit and promote compliance with the requirements of section 409A. The Treasury Department and the IRS also issued proposed regulations under section 409A (70 Fed. Reg. 57930 (Oct. 4, 2005)) (the proposed regulations), and final regulations under section 409A in April 2007 (the final regulations).

On September 10, 2007, the Treasury Department and the IRS issued Notice 2007-78, granting certain transition relief intended to facilitate compliance with the written plan requirements set forth in the final regulations. See §1.409A-1(c). Commentators stated that although the Notice 2007-78 transition relief was helpful, the transition relief in that notice did not adequately address the need for additional time for service recipients and service providers to analyze all of their plans and make informed and reasoned decisions regarding the changes that would be necessary to bring existing arrangements into compliance with the final regulations. This notice addresses these concerns by generally extending the transition relief currently scheduled to expire on December 31, 2007 through December 31, 2008. Section III of Notice 2007-78 is revoked and superseded by this notice.

SECTION 3. EXTENSION OF TRANSITION RELIEF

.01 Extension of Transition Relief Provided in Notice 2006-79

Section 3 of Notice 2006-79 is modified and superseded in accordance with paragraphs (A) and (B) of this § 3.01.

(A) General rule. During 2008, taxpayers are not required to comply with the requirements of the final regulations. Instead, they are required to operate a nonqualified deferred compensation plan in compliance with the plan's terms, to the extent consistent with section 409A and the applicable guidance (including Notice 2005-1). Where a provision of Notice 2005-1 is inconsistent with the final regulations, taxpayers may rely upon either Notice 2005-1 or the final regulations. To the extent an issue is not addressed in Notice 2005-1 or other applicable guidance, taxpayers must apply a reasonable, good faith interpretation of the statute. Reliance upon the final regulations is treated as applying a reasonable, good faith interpretation of the statute.

Taxpayers may not rely upon the provisions of the proposed regulations for periods after December 31, 2007, except that taxpayers may continue to rely on sections II.E and VI.E of the preamble to the proposed regulations (relating to the application of section 409A to partners and partnerships) until further guidance is issued and sections XI.C (relating to changes in payment elections or conditions) and XI.H (relating to substitutions of non-discounted stock options and stock appreciation rights for discounted stock options and stock appreciation rights) of the preamble to the proposed regulations continue to apply to the extent provided in § 3 of Notice 2006-79, as modified and superseded by paragraph (B) of this § 3.01.

(B) Section 3 of Notice 2006-79 modified and superseded.

(1) Paragraphs .01, .02, .03 and .04 of § 3 of Notice 2006-79 are modified and superseded to reflect the general rule provided in paragraph (A) and to read as follows:

.01. Amendment and operation of plans adopted on or before December 31, 2008

A plan adopted on or before December 31, 2008 will not be treated as violating section 409A(a)(2), (3) or (4) on or before December 31, 2008 if the plan is operated through December 31, 2008 in compliance with the provisions of section 409A and applicable provisions of Notice 2005-1 and any other generally applicable guidance published with an effective date prior to January 1, 2008, and the plan is amended on or before December 31, 2008 to conform to the provisions of section 409A and the final regulations under section 409A (70 Fed. Reg. 19234 (April 17, 2007)) with respect to amounts subject to section 409A. For such periods, to the extent an issue is not addressed in an applicable provision of Notice 2005-1 or other generally applicable guidance published with an effective date prior to January 1, 2008, the plan must be operated consistent with a good faith, reasonable interpretation of section 409A, and, to the extent not inconsistent therewith, the plan's terms. For purposes of this notice, "generally applicable guidance published with an effective date prior to January 1, 2008" does not include the final regulations.

Compliance with the proposed regulations is not required and compliance with the final regulations before January 1, 2009 is not required. However, for periods before January 1, 2008, compliance with the proposed regulations or the final regulations will constitute reasonable, good faith compliance with the statute. For periods after December 31, 2007 and before January 1, 2009, compliance with the final

regulations (but not the proposed regulations) will constitute reasonable, good faith compliance with the statute. To the extent that a provision of either the proposed regulations or the final regulations is inconsistent with a provision of Notice 2005-1, or a provision of the proposed regulations is inconsistent with a provision of the final regulations, for periods before January 1, 2008, the plan may comply with the provision of the proposed regulations, the final regulations or Notice 2005-1. To the extent that a provision of the final regulations is inconsistent with a provision of Notice 2005-1, after December 31, 2007 and before January 1, 2009, the plan may comply with the provision of the final regulations or Notice 2005-1.

A plan will not be operating in good faith compliance if discretion provided under the terms of the plan is exercised in a manner that causes the plan to fail to meet the requirements of section 409A. For example, if an employer retains the discretion under the terms of the plan to delay or extend payments under the plan in a manner that violates section 409A and exercises such discretion, the plan will not be considered to be operated in good faith compliance with section 409A with regard to any plan participant. However, an exercise of a right under the terms of the plan by a participant solely with respect to that participant's benefits under the plan, in a manner that causes the plan to fail to meet the requirements of section 409A, will not be considered to result in the plan failing to be operated in good faith compliance with respect to other participants. For example, the request for and receipt of an immediate payment permitted under the terms of the plan if the participant forfeits 20 percent of the participant's benefits (a haircut) will be considered a failure of the plan to meet the

requirements of section 409A with respect to that participant, but not with respect to all other participants under the plan.

.02. Change in payment elections or conditions on or before December 31, 2008

The transition relief provided in section XI.C of the preamble to the proposed regulations generally continues to apply through December 31, 2008, with certain clarifications described below, and subject to limitations for certain discounted stock rights also described below. Accordingly, with respect to amounts subject to section 409A, a plan may provide, or be amended to provide, for new payment elections on or before December 31, 2008, 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 section 409A(a)(4) or an acceleration of a payment under section 409A(a)(3), provided that the plan is so amended and elections are made on or before December 31, 2008. With respect to an election or amendment to change a time and form of payment made on or after January 1, 2006 and on or before December 31, 2006, the election or amendment may apply only to amounts that would not otherwise be payable in 2006 and may not cause an amount to be paid in 2006 that would not otherwise be payable in 2006. 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. With respect to an election or amendment to change a time and form of payment made on or after January 1, 2008 and on or before December 31, 2008, the election or amendment may apply only to amounts that would

not otherwise be payable in 2008 and may not cause an amount to be paid in 2008 that would not otherwise be payable in 2008. So, for example, where an amount would otherwise be payable upon an event, such as a separation from service, an election in 2008 cannot change the amount that would be payable in 2008 if the service provider separated from service in 2008. In addition, a deferral election may be made with respect to an amount that is a short-term deferral within the meaning of proposed §1.409A-1(b)(4), provided that the election is made before January 1, 2008 and before the year in which the amount would otherwise have been paid. Also, a deferral election may be made with respect to an amount that is a short-term deferral within the meaning of final §1.409A-1(b)(4), provided that the election is made before January 1, 2009 and before the year in which the amount would otherwise have been paid.

This provision applies to elections or amendments by a service provider, a service recipient, or both a service provider and a service recipient. A service provider or service recipient may make more than one change or amendment under this relief, provided that each such change or amendment is made in accordance with the deadlines and conditions set forth in the applicable transition relief. For example, a service provider that in 2005 elected to change the time and form of payment of deferred compensation to a lump sum payment in 2010, may elect again in 2006, 2007 or 2008 to change the time and form of payment in accordance with this paragraph. However, a service provider that in 2005 elected to be paid an amount in 2008 (and that did not change such election in 2006 or 2007) may not in 2008 change the time and form of payment to be paid in a later year.

Similarly, except as provided below with respect to certain discounted stock rights, an outstanding stock right that provides for a deferral of compensation subject to section 409A may be amended to provide for fixed payment terms consistent with section 409A, or to permit holders of such rights to elect fixed payment terms consistent with section 409A, and such amendment or election will not be treated as a change in the time and form of payment under section 409A(a)(4) or an acceleration of a payment under section 409A(a)(3), provided that the option or right is so amended, and any elections are made, on or before December 31, 2008. For this purpose, a stock right will not be treated as payable in a year solely because the stock right is exercisable during that year, if the stock right is also reasonably expected to be exercisable in a subsequent year.

.03 Payments linked to qualified plans and certain other plans

The ability to link a payment election under a nonqualified deferred compensation plan to an election under a qualified plan is extended through 2008. In addition, this relief is extended to payment elections under nonqualified deferred compensation plans that are linked to certain additional employer plans, including section 403(b) annuities, section 457(b) eligible plans, and certain foreign broad-based plans. Accordingly, (i) for periods ending on or before December 31, 2007, an election as to the time and form of a payment under a nonqualified deferred compensation plan that is controlled by a payment election made by the service provider or beneficiary of the service provider under a qualified employer plan described in proposed or final §1.409A-1(a)(2), a plan that includes a trust described in section 402(d), a plan described in section 1022(i)(1) or (2) of the Employee Retirement Income Security Act, or a foreign broad-based plan

described in proposed or final §1.409A-1(a)(3)(v), will not violate the requirements of section 409A, provided that the determination of the time and form of the payment is made in accordance with the terms of the nonqualified deferred compensation plan that govern payment elections, as in effect on October 3, 2004 and (ii) for periods ending after December 31, 2007 and before January 1, 2009, the rules discussed in (i) will be applied by reference to the provisions of the final regulations only. For example, where a nonqualified deferred compensation plan provides as of October 3, 2004, that the time and form of payment to a service provider or beneficiary will be the same time and form of payment elected by the service provider or beneficiary under a qualified plan, it will not be a violation of section 409A for the plan administrator to make or commence payments under the nonqualified deferred compensation plan on or after January 1, 2005, and on or before December 31, 2008, pursuant to the payment election under the qualified plan. Notwithstanding the foregoing, other provisions of the Internal Revenue Code and common law tax doctrines continue to apply to any election as to the time and form of a payment under a nonqualified deferred compensation plan.

.04 Substitutions of non-discounted stock options and stock appreciation rights for discounted stock options and stock appreciation rights

Notice 2005-1, Q&A-18(d) provides that it will not be a material modification to replace a stock option or stock appreciation right otherwise providing for a deferral of compensation under section 409A with a stock option or stock appreciation right that would not have constituted a deferral of compensation under section 409A if it had been granted upon the original date of grant of the replaced stock option or stock appreciation right, provided that the cancellation and reissuance occurs on or before December 31,

2005. Section XI.H of the preamble to the proposed regulations extended the period during which the cancellation and reissuance may occur until December 31, 2006, but only to the extent a cancellation and reissuance in 2006 does not result in the cancellation of a deferral in exchange for cash or vested property in 2006. Except with respect to certain discounted stock rights described in § 3.07 of Notice 2006-79, the period during which the cancellation and reissuance may occur is extended until December 31, 2008, but only to the extent such cancellation and reissuance in 2007 does not result in the cancellation of a deferral in exchange for cash or vested property in 2007 and only to the extent such cancellation and reissuance in 2008 does not result in the cancellation of a deferral in exchange for cash or vested property in 2008. For example, a discounted option generally may be replaced through December 31, 2008 with an option that would not have provided for a deferral of compensation, although the exercise of such a discounted option after 2005 and before the cancellation and replacement generally would result in a violation of section 409A unless such exercise complied in operation with the requirements of section 409A and the applicable guidance.

Where replacement stock options or stock appreciation rights that would not constitute deferred compensation subject to section 409A are issued in accordance with the conditions set forth in Notice 2005-1, Q&A-18(d), the preamble to the proposed regulations and this notice, such replacement stock options or stock appreciation rights will be treated for purposes of section 409A as if granted on the grant date of the original stock option or stock appreciation right. For a discussion of certain methods

that commentators proposed to use to compensate option holders for the value of a lost discount, see section XI.H of the preamble to the proposed regulations.

(2) Paragraph .06 of § 3 of Notice 2006-79 is modified and superseded to read as follows:

.06 Other transition issues

Notice 2005-1, Q&A-21 provided relief with respect to certain initial deferral elections, generally providing that certain requirements would not be applicable to elections made on or before March 15, 2005. One of the conditions of the relief was that the plan be amended to comply with the requirements of section 409A in accordance with Notice 2005-1, Q&A-19. Notice 2005-1, Q&A-19 generally required that plans be amended by December 31, 2005. The March 15, 2005 deadline for initial deferral elections was not extended in the preamble to the proposed regulations; however, the plan amendment requirement generally was extended to December 31, 2006. Although the initial deferral election relief contained in Notice 2005-1, Q&A-21 only referred to the requirements of Notice 2005-1, Q&A-19, the Treasury Department and the IRS have become aware that many taxpayers interpreted the extension of the plan amendment deadlines as flowing through to the requirements of Notice 2005-1, Q&A-21. To avoid unintentional noncompliance in this area, the deadline for a plan to be amended to reflect use of the relief provided in Notice 2005-1, Q&A-21 is extended to December 31, 2008. However, taxpayers retain the burden of demonstrating satisfaction of the requirement by showing that the deferral election was made by the March 15, 2005 deadline, in accordance with the plan terms in effect on or before

December 31, 2005 (other than a requirement to make a deferral election on or before March 15, 2005). See Notice 2005-1, Q&A-21.

(3) Paragraphs .05 and .07 of § 3 of Notice 2006-79 are not affected by this notice.

.02 Modification of Transition Relief Provided in the Final Regulations Preamble

The relief provided in sections XII and XIII of the final regulations preamble is modified to reflect the extension of the Notice 2006-79 transition relief through December 31, 2008, and the guidance provided in section XIV of the final regulations preamble is modified with respect to periods after December 31, 2007, as follows:

(A) General rule. Sections XII and XIII of the final regulations preamble are applied by substituting references to December 31, 2008 for references to December 31, 2007, and substituting references to January 1, 2009 for references to January 1, 2008. However, references to April 10, 2007 (the date of issuance of the final regulations) and October 3, 2004 (the enactment date of the statute) are not modified.

(B) Section XII.C. With respect to the determination of the fair market value of stock, the last sentence of the second paragraph of section XII.C of the final regulations preamble is modified to delete the words "proposed or" so as to eliminate reliance on the provisions of the proposed regulations.

(C) Section XII.D. With respect to programs established before April 10, 2007 where initial deferral elections have not been made by January 1, 2008, the transition relief provided in the second paragraph of section XII.D of the final regulations preamble remains unchanged (that is, no further transition relief is provided by this notice).

(D) Section XIV. The guidance provided in section XIV of the final regulations preamble (Calculation and Timing of Income Inclusion Amounts, Reporting and

Withholding) on the application of section 409A before January 1, 2008 is extended to apply before January 1, 2009 except that paragraph A of such section is not changed.

SECTION 4. EFFECT ON OTHER DOCUMENTS

Nothing in this notice is intended to limit the scope or applicability of the transition relief provided in Notice 2005-1, the proposed regulations or Notice 2006-79 for periods before January 1, 2008. This notice does not affect the guidance provided in Notice 2006-33, 2006-15 IRB 754 (relating to the application of section 409A(b)), Notice 2005-94, 2005-2 CB 1208 (relating to reporting and wage withholding for 2005) and Notice 2006-100, 2006-51 IRB 1109 (relating to reporting and wage withholding for 2006). Notwithstanding the section of the final regulations preamble entitled "Effect on Other Documents", Notice 2005-1 is obsoleted only for taxable years beginning on or after January 1, 2009, except for the following sections of Notice 2005-1, which remain effective after that date as modified by any other applicable guidance: Q&A-6 (application to arrangements covered by section 457); Q&A-7 (application to arrangements between a partnership and a partner of the partnership); and Q&A-24 through Q&A-38 (information reporting and withholding guidance).

Pursuant to this notice, Notice 2006-4, 2006-3 IRB 307 (relating to the application of section 409A to certain outstanding stock rights), is superseded by the final regulations with respect to stock rights issued in taxable years of the service provider beginning after December 31, 2008. Notice 2006-64, 2006-29 IRB 88 (relating to the acceleration of payments to comply with certain conflict of interest rules), is superseded by the final regulations effective for taxable years of the service provider beginning after December 31, 2008.

Section III of Notice 2007-78 is revoked and superseded by this notice. Pursuant to this notice, the penultimate paragraph and the first sentence of the final paragraph of § IV.A of Notice 2007-78 are modified by substituting references to December 31, 2008 for references to December 31, 2007. The guidance otherwise provided in § IV of Notice 2007-78 is not affected by this notice. Section 3 of Notice 2006-79 is modified and superseded as provided in this notice. The guidance and relief provided in the final regulations preamble is modified as provided in this notice.

The Treasury Department and the IRS anticipate issuing guidance as soon as possible with respect to the correction program and other matters discussed in § V of Notice 2007-78 and this notice does not affect that section. In addition, this notice does not affect the guidance provided in § VI of Notice 2007-78.

SECTION 5. DRAFTING INFORMATION

The principal authors of this notice are Stephen Tackney and Bill Schmidt of the Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities), although other Treasury Department and IRS officials participated in its development. For further information on the provisions of this notice, contact Stephen Tackney or Bill Schmidt at (202) 927-9639 (not a toll-free number).

October 22, 2007
2007-10-22-16-9-58-26584

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 $69,181 million as of the end of that week, compared to $68,519 million as of the end of the prior week.

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

	October 19, 2007		
A. Official reserve assets (in US millions unless otherwise specified)	Euro	Yen	Total
(1) Foreign currency reserves (in convertible foreign currencies)			69,181
(a) Securities	13,917	11,073	24,990
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	13,892	5,448	19,340
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	4,478		
(3) SDRs	9,332		
(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				
(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)	69,181
--currencies in SDR basket	69,181
--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.

October 22, 2007
hp-632

Treasury Department Names Brian O'Neill as Deputy Assistant Secretary for Western Hemisphere

Washington, D.C. – Treasury announced that Brian O'Neill joined the Office of International Affairs as the Deputy Assistant Secretary for the Western Hemisphere. O'Neill replaces Nancy Lee, who is taking an 11-month sabbatical at the Center for Global Development to work on models for regional integration. Most recently, O'Neill has served as Managing Director and Vice-Chairman, Investment Banking at JPMorgan. He joined The Chase Manhattan Bank in 1977, and has spent his career working with governments, financial institutions, and corporate clients throughout the countries of Latin America as well as Canada.

O'Neill worked in corporate and investment banking in Chile from 1978 until 1982, in Argentina from 1983 until 1988, and in Brazil from 1989 until 1991. He returned from Sao Paulo, Brazil to New York to serve as Corporate Finance Executive for Latin America in 1991. O'Neill became Latin America Executive in 1994 and added the newly created title of Chairman in 1999. In 2001, he became Chairman of Canada and Latin America for JPMorgan. He served in the role of Managing Director and Vice-Chairman, Investment Banking beginning in 2005.

O'Neill is a Director of the Council of the Americas and of the Americas Society. He is a life member of The Council on Foreign Relations; Member of the Pacific Council on International Policy; Fellow of the Foreign Policy Association; and a member of the Advisory Committee for the David Rockefeller Center for Latin American Studies at Harvard University.

He holds a B.A. degree from the University of San Diego and a Master's degree from the American Graduate School of International Management. In 1991, he completed the Executive Program at the Amos Tuck School at Dartmouth College.

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October 23, 2007
hp-633

Remarks by Secretary Paulson on Managing Complexity and Establishing New Habits of Cooperation in U.S.-China Economic Relations at the 2007 George Bush China-U.S. Relations Conference

Washington, DC--Good morning, General Scowcroft, Vice President Li, President Davis and Ambassador Popadiuk. I appreciate the opportunity to be here at the Third George Bush China-U.S. Relations Conference.

This room is filled with the very best of China expertise and experience from both sides of the Pacific. I applaud your commitment to this bilateral relationship. And of course, there is no better example of this than former President Bush – who has long been a stalwart advocate of advancing U.S.-China ties.

I have devoted much of my professional life – and far too many hours on planes – to learning about and increasing U.S. commercial ties with the People's Republic of China. Now, as Treasury Secretary, I would like to share my thoughts with you on the future of the U.S.-China economic relationship.

New Global Realities and Emerging Bilateral Challenges

China's re-emergence on the global stage is one of the most consequential geopolitical events of recent times. China's global influence is expanding. A cooperative, constructive and candid U.S.-China relationship is central to understanding and responding to China's re-emergence, in all its possible manifestations. The United States must manage our disagreements with China, foster greater bilateral cooperation and improve our ability to work constructively with China across all dimensions of national power.

There is hardly an issue – from trade, to national security, to climate change – or a place – from North Korea to Iran to Sudan – where American and Chinese interests do not increasingly overlap. Because China is now integrated into the global economy, what happens in China's economy affects the entire international community. The U.S.-China relationship has become central not only to each nation's interests, but also to the maintenance of a stable, secure and prosperous global system – which benefits the world.

My focus at Treasury is on the U.S.-China economic relationship, which is a core element of our overall bilateral ties. Yet, the tectonic plates of the U.S.-China economic relationship are shifting. This demands new visions from our leaders and new mechanisms from our governments.

First, U.S.-China economic interdependence is deepening. We need each other more and on a broader number of economic and economically consequential issues. Over the past five years, U.S. exports to China have grown at five times the pace of U.S. exports to the rest of the world, and China has become our fourth largest export market.

Exports to China benefit American businesses by providing new market opportunities for American products and services. Imports from China continue to benefit the American economy and the American consumer by providing an increased diversity of products at lower prices. Imports from China also raise challenges, as I will discuss in a moment. Just as competition from trade with China pushes our industries to stay on the cutting edge, competition will also speed China's development as a more market-oriented and balanced economy.

Moreover, the United States and China are shaping, and being shaped by, global

energy and environmental trends, which have strong economic consequences. Our countries are the world's largest energy consumers and the largest emitters of greenhouse gases. What happens with China's environment impacts all nations; air and water know no boundaries.

These trends create challenges that can not be resolved by the United States or China alone. They certainly can not be solved without China at the table.

Second, whereas trade and investment were once largely a source of stability in bilateral relations, they are now increasingly also a source of tension. Such tensions are straining our domestic consensus on the benefits of economic engagement.

America's large corporations – the longtime proponents of bilateral engagement – as well as America's smaller businesses – who are finding new markets in China – increasingly are concerned about the openness of China's economy, and Chinese counterfeiting of trademarks and pirating of intellectual property. Some American workers believe the field of competition is uneven and unfair. Also, American consumers have very real concerns about the safety of food and product imports from China.

These anxieties manifest themselves in several ways, which leads me to the third dynamic confronting us: the rise of economic nationalism and protectionism in both our nations. These sentiments may constrain leaders from adopting policies that are in the long-term interests of the citizens and economies of the United States and China. Such views also obscure each nation's ability to assess the others' long-term intentions.

In responding to globalization, policymakers in both countries must resist the impulse to discard the hard-fought and long-term gains of open economies by pursuing short-term and misguided policy responses. I am committed to working to maintain an open trade and investment climate in America and to working to open markets in China to greater competition from American goods and services.

These three emerging dynamics to our economic relationship – deepening interdependence, a strained policy consensus, and the rise of economic protectionism – are mutual and require cooperative solutions.

Managing Complexity and Establishing New Habits of Cooperation

These dynamics informed the creation of the Strategic Economic Dialogue (SED) by President Bush and President Hu Jintao in 2006. They envisioned a forum to allow both governments to communicate at the highest levels and with one voice on issues of long-term and strategic importance to ensure bilateral economic stability and prosperity.

By definition, this is a complex relationship and managing complexity is daunting. It begins with speaking to the right people – at the right time – on the right issues – and in the right way.

The Strategic Economic Dialogue – as a new and leading institution in U.S.-China relations – has created these useful channels among policymakers in Washington and Beijing. Through this framework we have advanced the U.S.-China economic relationship by establishing new habits of bilateral cooperation and re-setting the foundation for stable and prosperous economic interactions.

We have embraced a broad agenda that covers cross-cutting economic and economically consequential issues, including regulatory transparency, energy conservation, environmental protection, food and product safety, as well as the important economic issues of exchange rate policy, market access, financial sector liberalization, and macroeconomic policy.

Our approach engages multiple and diverse government officials in both countries to facilitate more inclusive interactions. It breaks down classic bureaucratic stove-pipes that hinder effective communication and impede results. At the same time, we have continual, high-level interactions to set priorities and ensure their full implementation. I talk regularly on the phone with my counterpart Vice Premier Wu

Yi, and our staffs are in constant contact.

That said – process is not result.

Dialogue among senior Chinese and American officials, while useful, needs to be more than talking for the sake of talking and can not give leaders "a pass" on issues of disagreement. It is about setting priorities, specifying consequences and fashioning practical solutions.

And that's what direct engagement does: it keeps the relationship on an even keel by lessening miscommunication and dispelling misperceptions so common in the history of the U.S.-China relationship.

Moreover, solidifying these habits of cooperation is critical to sustaining America's broader China policy, both at home and abroad. It further signals to China that we welcome the rise of a confident, peaceful and prosperous China, while also helping America to hedge against an uncertain Chinese future. A weak and insecure China is not in America's economic or security interests.

In addition to establishing new ways of working together, it is vitally important that our policies accelerate and deepen China's ongoing economic transition.

We applaud China's efforts to transition to an economy that is more market-oriented, less reliant on low-cost manufacturing exports, one that depends more on the skills and resourcefulness of the Chinese people and less on material inputs and natural resource consumption.

The pace of China's growth has clearly been remarkable, but it carries both opportunity and risk.

I liken it to some of America's fastest growing entrepreneurial companies, who see sales rise exponentially in a short time and then must earnestly work to build the infrastructure to sustain those sales. This is the challenge that China's leaders now face – to make the jump in strategy and policy needed for an economy that is no longer in the first stages of growth.

A major risk China faces is that its government won't act quickly enough to take the policy steps necessary to deal with the economic and social imbalances created by its growth model. Without strong policy underpinnings and implementation, China's economic performance becomes unsustainable. We are encouraging key reforms that will help China manage the blistering pace of its economic growth; these include financial market liberalization and a plan for rebalancing growth. China has proven to the world that it can grow fast, but can it grow differently and, ultimately, grow smarter?

Bold structural policies are needed to shift China's growth away from heavy industry, high energy use, and dependence on exports – towards greater reliance on domestic demand, greater production of services, and greater provision of material well-being to China's population.

As I have said before, this will be much easier, and the prospects for achieving sustained, balanced growth in China and in the world economy much greater, if the Chinese increase the pace of RMB appreciation in the short term and implement a fully market-determined currency in the medium term. Currency appreciation to date has not slowed the Chinese economy.

Accelerating the rate of appreciation and introduction of flexibility will help China deal with the imbalances that have grown in the economy and make monetary policy much more effective in responding to inflation.

We must also recognize that currency is not the only driver of China's economic imbalances. Even more fundamental and important are internal structural issues, such as why Chinese households save so much and consume so little. Rebalancing China's growth is necessary for China to grow without generating large external imbalances.

A key to China's success here will be its willingness to accelerate the pace of its market-based economic reforms. Going beyond its WTO commitments, resisting protectionist sentiment, and opening up its economy to greater international competition for goods and services will help rebalance the Chinese economy and spread prosperity more broadly among the Chinese people.

These reforms are – and will continue to be – resisted by increasingly influential Chinese businesses. In my judgment, the greatest risk to China's long-term economic security is that protectionists prevail, and Chinese reforms proceed too slowly.

And finally, we are also encouraging China to act responsibly as a global economic power. China is influencing capital and resource markets all over the world; its economic influence is being felt from Chicago, to Sao Paolo, to Kinshasa.

We welcome China into key international financial institutions and are giving China a greater voice in them as well. Increased participation will allow China to advance its interests in those institutions, but it is also important that Beijing recognize the responsibilities of greater participation.

China has become a major source of foreign aid for many of the poorest countries. We look forward to working with China to assure that foreign aid and lending practices promote sustainable development.

This new era in U.S.-China economic relations requires new and dynamic ways of doing business. We are meeting these challenges through the creation of the political space and the institutional capacity for long-term stability in our bilateral economic relations.

Signposts and Benchmarks

While dialogue and negotiations are important, they are far from sufficient to ensure that we keep the bilateral relationship future-oriented and on an even keel. The SED is both long-term and strategic, but tangible progress in the form of sign posts and benchmarks is critically important to demonstrating that we are making progress in achieving our long term objectives.

I believe that we are making progress and we are able to point to steps that are enhancing and transforming our economic relationship in mutually beneficial ways. Three brief examples illustrate my point: civil aviation, energy and the environment, and financial services.

In May, we announced a new air services agreement that will make it easier, cheaper, and more convenient to fly people and to ship goods across the Pacific. Not only will this agreement stimulate an estimated $5 billion in new business over the next several years, the new routes will double passenger traffic by 2012 and allow full air cargo services by 2011. Perhaps as early as April 2008, there will be the first non-stop flight between Atlanta and Shanghai, the first from America's southeast for a U.S. airline.

The benefits of the civil aviation accord are many, including more commerce, greater cultural exchanges, and enhanced understanding.

We have also collaborated with China on a series of policies to help promote energy conservation and environmental protection. Those specific agreements foster demand for the development and deployment of clean and efficient, next-generation energy technology. This, in turn, will create a future in which two of the largest economies in the world become examples of bilateral cooperation towards sustainable development.

The SED has made consistent strides to further develop China's capital markets. As a result of our deliberations, the New York Stock Exchange and NASDAQ will open offices in China. China has also removed a barrier to the entry of new foreign securities firms, and will expand the scope of business open to foreign-invested securities firms.

These actions do not only expand the opportunities for international financial services firms. By allowing greater financial flows, they will help China move more quickly to a fully market-determined exchange rate. Competitive and efficient capital markets are also key to balanced, sustainable and higher quality economic growth – a critical Chinese goal over the next two decades.

In addition to the areas of positive cooperation, our enhanced dialogue means we must confront problems frankly and honestly – and often rapidly. Recent and repeated reports of tainted food and product imports are causing fear and uncertainty in American consumers and harming the "Made in China" brand here in the United States.

The effectiveness with which China manages these safety issues will have long term implications for U.S.-China trade relations, the integration of China into the global trading system, and the sustainability of China's economic growth trajectory. We are actively working together to enhance the safety of products coming from China and to protect the American consumer. We also need to make sure that policymakers in both countries are focused on science-based safety decisions, not protectionism or retaliation.

Towards a New Future for Bilateral Economic Relations

President Bush and President Hu have set a positive agenda for strengthening our economic relationship. The SED is a core part of that agenda because it is long-term in its vision, comprehensive in its scope, and immediate in its ability to deal with the most sensitive bilateral economic tensions.

I congratulate the Chinese on the successful conclusion of their 17th Party Congress and related events. My colleagues and I look forward to developing constructive and productive relationships with the new members of Chinese leadership team. In his political report to the 17th Party Congress last week, President Hu emphasized the dual goals of continuing market reform and global integration, while simultaneously working to alleviate the negative domestic consequences of rapid economic growth.

Our next meeting of the SED in December will discuss a number of these objectives. Specifically, we will focus on the integrity of trade, balanced economic development, energy conservation, financial sector reform, environmental sustainability, and advancing bilateral investment.

The economic and geopolitical landscape of the 21st century will be greatly influenced by the way in which the United States and China work together. That emerging future requires a distinct vision and effective mechanisms to achieve it. The SED has allowed both the United States and China to begin to write the next chapter of our strategic economic relationship.

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October 23, 2007
hp-634

U.S., Iceland Sign New Income Tax Treaty

Washington, DC-- The Treasury Department announced today that Deputy Secretary Robert M. Kimmitt and Icelandic Finance Minister Árni M. Mathiesen signed a new income tax treaty between the United States and Iceland.

In a ceremony held at the Treasury Department, the two officials signed a new tax treaty that brings the existing agreement into closer conformity with current U.S. tax treaty policy. For example, the new treaty contains a comprehensive limitation on benefits provision that is consistent with many recently concluded U.S. tax treaties.

The agreement also maintains the existing treaty's withholding tax exemption on cross-border interest payments and as well as the existing treaty's reductions in withholding taxes on cross-border dividend payments.

The final version of the treaty is attached.

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REPORTS

- U.S.-Iceland Income Tax Treaty

CONVENTION BETWEEN THE GOVERNMENT OF THE UNITED STATES OF AMERICA AND THE GOVERNMENT OF ICELAND FOR THE AVOIDANCE OF DOUBLE TAXATION AND THE PREVENTION OF FISCAL EVASION WITH RESPECT TO TAXES ON INCOME

The Government of the United States of America and the Government of Iceland, desiring to conclude a Convention for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income,

HAVE AGREED as follows:

ARTICLE 1

General Scope

1. This Convention shall apply only to persons who are residents of one or both of the Contracting States, except as otherwise provided in the Convention.

2. This Convention shall not restrict in any manner any benefit now or hereafter accorded:

a) by the laws of either Contracting State; or

b) by any other agreement between the Contracting States.

3. a) Notwithstanding the provisions of subparagraph b) of paragraph 2:

(i) the provisions of Article 24 (Mutual Agreement Procedure) of this Convention exclusively shall apply to any dispute concerning whether a measure is within the scope of this Convention, and the procedures under this Convention exclusively shall apply to that dispute; and

(ii) unless the competent authorities determine that a taxation measure is not within the scope of this Convention, the non-discrimination obligations of this Convention exclusively shall apply with respect to that measure, except for such national treatment or most-favored-nation obligations as may apply to trade in goods under the General Agreement on Tariffs and Trade. No national treatment or most-favored-nation obligation under any other agreement shall apply with respect to that measure.

b) For the purposes of this paragraph, a "measure" is a law, regulation, rule, procedure, decision, administrative action, or any similar provision or action.

4. Notwithstanding any provision of the Convention except paragraph 5 of this Article, a Contracting State may tax its residents (as determined under Article 4 (Resident)), and by reason of citizenship may tax its citizens, as if the Convention had not come into effect. Notwithstanding the other provisions of this Convention, a former citizen or long-term resident of the United States may, for the period of ten years following the loss of such status, be taxed in accordance with the laws of the United States.

5. The provisions of paragraph 4 shall not affect:

a) the benefits conferred by a Contracting State under paragraph 2 of Article 9 (Associated Enterprises), paragraphs 2 and 4 of Article 17 (Pensions, Social Security, and Annuities), and Articles 22 (Relief from Double Taxation), 23 (Non-Discrimination), and 24 (Mutual Agreement Procedure); and

b) the benefits conferred by a Contracting State under Articles 18 (Government Service), 19 (Students and Trainees), and 26 (Members of Diplomatic Missions and Consular Posts), upon individuals who are neither citizens of, nor have been admitted for permanent residence in, that State.

6. An item of income derived through an entity that is a partnership, trust or estate under the laws of either Contracting State shall be considered to be derived by a resident of a State to the extent that the item is treated for purposes of the taxation law of such Contracting State as the income of a resident, either in its hands or in the hands of its partners or beneficiaries.

ARTICLE 2

Taxes Covered

1. This Convention shall apply to taxes on income imposed on behalf of a Contracting State, irrespective of the manner in which they are levied.

2. There shall be regarded as taxes on income all taxes imposed on total income, on total capital, or on elements of income, including taxes on gains from the alienation of movable or immovable property (real property), taxes on the total amounts of wages or salaries paid by enterprises, but excluding social security taxes, as well as taxes on capital appreciation.

3. The existing taxes to which the Convention shall apply are:

a) in Iceland:

(i) the income taxes to the state *(tekjuskattar ríkissjóðs)*; and

(ii) the income tax to the municipalities *(útsvar)*.

(hereinafter referred to as "Icelandic tax");

b) in the United States:

(i) the Federal income taxes imposed by the Internal Revenue Code; and

(ii) the Federal excise taxes imposed with respect to private foundations

(hereinafter referred to as "United States tax").

4. The Convention shall apply also to any identical or substantially similar taxes that are imposed after the date of signature of the Convention in addition to, or in place of, the existing taxes. The competent authorities of the Contracting States shall notify each other of any significant changes that have been made in their respective taxation or other laws that significantly affect their obligations under this Convention.

ARTICLE 3

General Definitions

1. For the purposes of this Convention, unless the context otherwise requires:

a) the term "Iceland" means Iceland and, when used in a geographical sense, means the territory of Iceland, including its territorial sea, and any area beyond the territorial sea within which Iceland, in accordance with international law, exercises jurisdiction or sovereign rights with respect to the sea bed, its subsoil and its superjacent waters, and their natural resources;

b) the term "United States" means the United States of America, and includes the states thereof and the District of Columbia; such term also includes the territorial sea thereof and the sea bed and subsoil of the submarine areas adjacent to that territorial sea, over which the United States exercises sovereign rights in accordance with international law; the term, however, does not include Puerto Rico, the Virgin Islands, Guam or any other United States possession or territory;

c) the term "person" includes an individual, an estate, a trust, a partnership, a company and any other body of persons;

d) the term "company" means any body corporate or any entity that is treated as a body corporate for tax purposes according to the laws of the state in which it is organized;

e) the term "enterprise" applies to the carrying on of any business;

f) the terms "enterprise of a Contracting State" and "enterprise of the other Contracting State" mean respectively an enterprise carried on by a resident of a Contracting State and an enterprise carried on by a resident of the other Contracting State;

g) the terms "a Contracting State" and "the other Contracting State" mean Iceland or the United States as the context requires;

h) the term "international traffic" means any transport by a ship or aircraft, except when such transport is solely between places in a Contracting State;

i) the term "competent authority" means:

(i) in the case of Iceland: the Minister of Finance or his authorized representative; and

(ii) in the case of the United States: the Secretary of the Treasury or his delegate;

j) the term "national" means:

(i) any individual possessing the nationality or citizenship of a Contracting State;

(ii) any legal person, partnership or association deriving its status as such from the laws in force in a Contracting State;

k) the term "business" includes the performance of professional services and of other activities of an independent character;

l) the term "pension scheme" means any plan, scheme, fund, trust or other arrangement established in a Contracting State that:

(i) is generally exempt from income taxation in that State; and

(ii) operates principally to administer or provide pension or retirement benefits or to earn income for the benefit of one or more such arrangements.

2. As regards the application of the Convention at any time by a Contracting State any term not defined therein shall, unless the context otherwise requires, or the competent

authorities agree to a common meaning pursuant to the provisions of Article 24 (Mutual Agreement Procedure), have the meaning that it has at that time under the law of that State for the purposes of the taxes to which the Convention applies, any meaning under the applicable tax laws of that State prevailing over a meaning given to the term under other laws of that State.

ARTICLE 4
Resident

1. For the purposes of this Convention, the term "resident of a Contracting State" means any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, citizenship, place of management, place of incorporation or any other criterion of a similar nature, and also includes that State and any political subdivision or local authority thereof. This term, however, does not include any person who is liable to tax in that State in respect only of income from sources in that State or capital situated therein or of profits attributable to a permanent establishment in that State.

2. The term "resident of a Contracting State" includes:

a) a pension scheme;

b) a plan, scheme, fund, trust, company or other arrangement established in a Contracting State that is operated exclusively to administer or provide employee benefits and that, by reason of its nature as such, is generally exempt from income taxation in that State; and

c) an organization that is established exclusively for religious, charitable, scientific, artistic, cultural, or educational purposes and that is a resident of a Contracting State according to its laws,

notwithstanding that all or part of its income or gains may be exempt from tax under the domestic law of that State.

3. Where by reason of the provisions of paragraph 1 an individual is a resident of both Contracting States, then his status shall be determined as follows:

a) he shall be deemed to be a resident only of the State in which he has a permanent home available to him; if he has a permanent home available to him in both States, he shall be deemed to be a resident only of the State with which his personal and economic relations are closer (center of vital interests);

b) if the State in which he has his center of vital interests cannot be determined, or if he has not a permanent home available to him in either State, he shall be deemed to be a resident only of the State in which he has an habitual abode;

c) if he has an habitual abode in both States or in neither of them, he shall be deemed to be a resident only of the State of which he is a national;

d) if he is a national of both States or of neither of them, the competent authorities of the Contracting States shall settle the question by mutual agreement.

4. Where by reason of the provisions of paragraphs 1 and 2 of this Article a person other than an individual is a resident of both Contracting States, the competent authorities of the Contracting States shall endeavor to determine by mutual agreement the mode of application of this Convention to that person. If the competent authorities do not reach such an agreement, that person shall not be entitled to claim any benefit provided by this Convention, except those provided by Article 23 (Non-Discrimination) and Article 24 (Mutual Agreement Procedure).

ARTICLE 5
Permanent Establishment

1. For the purposes of this Convention, the term "permanent establishment" means a fixed place of business through which the business of an enterprise is wholly or partly carried on.

2. The term "permanent establishment" includes especially:

a) a place of management;

b) a branch;

c) an office;

d) a factory;

e) a workshop; and

f) a mine, an oil or gas well, a quarry or any other place of extraction of natural resources.

3. A building site or construction or installation project, or an installation or drilling rig or ship used for the exploration of natural resources constitutes a permanent establishment only if it lasts or the activity continues for more than twelve months.

4. Notwithstanding the preceding provisions of this Article, the term "permanent establishment" shall be deemed not to include:

a) the use of facilities solely for the purpose of storage, display or delivery of goods or merchandise belonging to the enterprise;

b) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage, display or delivery;

c) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise;

d) the maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise, or of collecting information for the enterprise;

e) the maintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise, any other activity of a preparatory or auxiliary character;

f) the maintenance of a fixed place of business solely for any combination of activities mentioned in subparagraphs a) to e), provided that the overall activity of the fixed place of business resulting from this combination is of a preparatory or auxiliary character.

5. Notwithstanding the provisions of paragraphs 1 and 2, where a person -- other than an agent of an independent status to whom paragraph 6 applies -- is acting on behalf of an enterprise and has, and habitually exercises, in a Contracting State an authority to conclude contracts in the name of the enterprise, that enterprise shall be deemed to have a permanent establishment in that State in respect of any activities which that person undertakes for the enterprise, unless the activities of such person are limited to those mentioned in paragraph 4 which, if exercised through a fixed place of business, would not make this fixed place of business a permanent establishment under the provisions of that paragraph.

6. An enterprise shall not be deemed to have a permanent establishment in a Contracting State merely because it carries on business in that State through a broker, general commission agent or any other agent of an independent status, provided that such persons are acting in the ordinary course of their business as independent agents.

7. The fact that a company which is a resident of a Contracting State controls or is controlled by a company which is a resident of the other Contracting State, or which carries on business in that other State (whether through a permanent establishment or otherwise), shall not constitute either company a permanent establishment of the other.

ARTICLE 6

Income from Immovable Property (Real Property)

1. Income derived by a resident of a Contracting State from immovable property (real property), including income from agriculture or forestry, situated in the other Contracting State may be taxed in that other State.

2. The term "immovable property (real property)" shall have the meaning which it has under the law of the Contracting State in which the property in question is situated. The term shall in any case include property accessory to immovable property (real property), livestock and equipment used in agriculture and forestry, rights to which the provisions of general law respecting landed property apply, usufruct of immovable property (real property) and rights to variable or fixed payments as consideration for the working of, or the right to work, mineral deposits, sources and other natural resources; ships, boats and aircraft shall not be regarded as immovable property (real property).

3. The provisions of paragraph 1 shall apply to income derived from the direct use, letting or use in any other form of immovable property (real property).

4. The provisions of paragraphs 1 and 3 shall also apply to the income from immovable property (real property) of an enterprise.

ARTICLE 7

Business Profits

1. The profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the profits of the enterprise may be taxed in the other State but only so much of them as is attributable to that permanent establishment.

2. Subject to the provisions of paragraph 3 of this Article, where an enterprise of a Contracting State carries 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 that it might be expected to make if it were a distinct and separate enterprise engaged in the same or similar activities under the same or similar conditions and dealing wholly independently with the enterprise of which it is a permanent establishment. For this purpose, the business profits to be attributed to the permanent establishment shall include only the profits derived from the assets used, risks assumed and activities performed by the permanent establishment.

3. In determining the profits of a permanent establishment, there shall be allowed as deductions expenses which are incurred for the purposes of the permanent establishment, including executive and general administrative expenses so incurred, whether in the State in which the permanent establishment is situated or elsewhere.

4. No profits shall be attributed to a permanent establishment by reason of the mere purchase by that permanent establishment of goods or merchandise for the enterprise.

5. For the purposes of the preceding paragraphs, the profits to be attributed to the permanent establishment shall be determined by the same method year by year unless there is good and sufficient reason to the contrary.

6. Where profits include items of income which are dealt with separately in other Articles of this Convention, then the provisions of those Articles shall not be affected by the provisions of this Article.

7. In applying this Article, paragraph 6 of Article 10 (Dividends), paragraph 3 of Article 11 (Interest), paragraph 4 of Article 12 (Royalties), paragraph 3 of Article 13 (Capital Gains) and paragraph 2 of Article 20 (Other Income), any income or gain attributable to a permanent establishment during its existence is taxable in the Contracting State where such permanent establishment is situated even if the payments are deferred until such permanent establishment has ceased to exist.

ARTICLE 8

Shipping and Air Transport

1. Profits of an enterprise of a Contracting State from the operation of ships or aircraft in international traffic shall be taxable only in that State.

2. For the purposes of this Article, profits from the operation of ships or aircraft include profits derived from the rental of ships or aircraft on a full (time or voyage) basis. They also include profits from the rental of ships or aircraft on a bareboat basis if such ships or aircraft are operated in international traffic by the lessee, or if the rental income is incidental to profits from the operation of ships or aircraft in international traffic. Profits derived by an enterprise from the inland transport of property or passengers within either Contracting State shall be treated as profits from the operation of ships or aircraft in international traffic if such transport is undertaken as part of international traffic.

3. Profits of an enterprise of a Contracting State from the use, maintenance, or rental of containers (including trailers, barges, and related equipment for the transport of containers) used in international traffic shall be taxable only in that State.

4. The provisions of paragraphs 1 and 3 shall also apply to profits from the participation in a pool, a joint business or an international operating agency.

ARTICLE 9

Associated Enterprises

1. Where

a) an enterprise of a Contracting State participates directly or indirectly in the management, control or capital of an enterprise of the other Contracting State, or

b) the same persons participate directly or indirectly in the management, control or capital of an enterprise of a Contracting State and an enterprise of the other Contracting State,

and in either case conditions are made or imposed between the two enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly.

2. Where a Contracting State includes in the profits of an enterprise of that State --and taxes accordingly -- profits on which an enterprise of the other Contracting State has been charged to tax in that other State and the other Contracting State agrees that the profits so included are profits which would have accrued to the enterprise of the first-mentioned State if the conditions made between the two enterprises had been those which would have been made between independent enterprises, then that other State shall make an appropriate adjustment to the amount of the tax charged therein on those profits. In determining such adjustment, due

regard shall be had to the other provisions of this Convention and the competent authorities of the Contracting States shall if necessary consult each other.

ARTICLE 10

Dividends

1. Dividends paid by a company which is a resident of a Contracting State to a resident of the other Contracting State may be taxed in that other State.

2. However, such dividends may also be taxed in the Contracting State of which the company paying the dividends is a resident and according to the laws of that State, but if the beneficial owner of the dividends is a resident of the other Contracting State, the tax so charged shall not exceed:

a) 5 per cent of the gross amount of the dividends if the beneficial owner is a company which holds directly at least 10 per cent of the share capital of the company paying the dividends;

b) 15 per cent of the gross amount of the dividends in all other cases.

This paragraph shall not affect the taxation of the company in respect of the profits out of which the dividends are paid.

3. Subparagraph a) of paragraph 2 shall not apply in the case of dividends paid by a Regulated Investment Company (RIC) or a Real Estate Investment Trust (REIT). In the case of dividends paid by a RIC, subparagraph b) of paragraph 2 shall apply. In the case of dividends paid by a REIT, subparagraph b) of paragraph 2 also shall not apply unless:

a) the beneficial owner of the dividends is an individual holding an interest of not more than 10 percent in the REIT;

b) 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 of any class of the REIT's stock; or

c) the beneficial owner of the dividends is a person holding an interest of not more than 10 percent in the REIT and the REIT is diversified.

The rules of this paragraph shall also apply to dividends paid by companies resident in Iceland that are similar to the United States companies referred to in this paragraph. Whether companies that are residents of Iceland are similar to the United States companies referred to in this paragraph will be determined by mutual agreement of the competent authorities.

4. Notwithstanding paragraphs 2 or 3, dividends shall not be taxed in the Contracting State of which the company paying the dividends is a resident if the beneficial owner of the dividends is resident in the other Contracting State and is described in subparagraph a) or b) of paragraph 2 of Article 4 (Resident), provided that such dividends are not derived from the carrying on of a business, directly or indirectly, by such pension scheme or employee benefit organization.

5. For purposes of this Article, the term "dividends" means income 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.

6. The provisions of paragraphs 1 through 4 shall not apply if the beneficial owner of the dividends, being a resident of a Contracting State, carries 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 with such permanent establishment. In such case the provisions of Article 7 (Business Profits) shall apply.

7. A Contracting State may not impose any tax on dividends paid by a resident of the other State, except insofar as the dividends are paid to a resident of the first-mentioned State or the dividends are attributable to a permanent establishment, nor may it impose tax on a corporation's undistributed profits, except as provided in paragraph 8, even if the dividends paid or the undistributed profits consist wholly or partly of profits or income arising in that State.

8. A company that is a resident of one of the States and that has a permanent establishment in the other State or that is subject to tax in the other State on a net basis on its income that may be taxed in the other State under Article 6 (Income from Immovable Property (Real Property)) or under paragraph 1 of Article 13 (Capital Gains) may be subject in that other State to a tax in addition to the tax allowable under the other provisions of this Convention. Such tax, however, may be imposed on only the portion of the business profits of the company attributable to the permanent establishment and the portion of the income referred to in the preceding sentence that is subject to tax under Article 6 or under paragraph 1 of Article 13 that, in the case of the United States, represents the dividend equivalent amount of such profits or income and, in the case of Iceland, is an amount that is analogous to the dividend equivalent amount.

9. The tax referred to in paragraph 8 may not be imposed at a rate in excess of the rate specified in subparagraph 2 a).

ARTICLE 11

Interest

1. Interest arising in a Contracting State and beneficially owned by a resident of the other Contracting State shall be taxable 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 and prizes attaching to such securities, bonds or

debentures, and all other income that is subjected to the same taxation treatment as income from money lent by the taxation law of the Contracting State in which the income arises. Income dealt with in Article 10 (Dividends) and penalty charges for late payment shall not be regarded as interest for the purpose of this Article.

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 business in the other Contracting State in which the interest arises, through a permanent establishment situated therein and the debt-claim in respect of which the interest is paid is effectively connected with such permanent establishment. In such case the provisions of Article 7 (Business Profits) shall apply.

4. 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.

5. Notwithstanding the provisions of paragraph 1:

a) interest paid by a resident of a Contracting State and that is determined with reference to receipts, sales, income, profits or other cash flow of the debtor or a related person, to any change in the value of any property of the debtor or a related person or to any dividend, partnership distribution or similar payment made by the debtor to a related person also may be taxed in the Contracting State in which it arises, and according to the laws of that State, but if the beneficial owner is a resident of the other Contracting State, 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 10 (Dividends); and

b) 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.

ARTICLE 12

Royalties

1. Royalties 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. Notwithstanding the provisions of paragraph 1, such royalties may also be taxed in the Contracting State in which they arise if they constitute consideration for the use of, or the right to use

a) a trademark and any information concerning industrial, commercial or scientific experience provided in connection with a rental or franchise agreement that includes rights to use a trademark, or

b) a motion picture film or work on film or videotape or other means of reproduction for use in connection with television,

however the tax so charged shall not exceed 5 percent of the gross amount of the royalties.

3. The term "royalties" as used in this Article means payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic, scientific or other work (including computer software, and cinematographic films), any patent, trade mark, design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific experience.

4. The provisions of paragraphs 1, 2 and 3 shall not apply if the beneficial owner of the royalties, being a resident of a Contracting State, carries 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 with such permanent establishment. In such case the provisions of Article 7 (Business Profits) shall apply.

5. For the purposes of this Article,

a) Royalties shall be deemed to arise in a Contracting State when the payer 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;

b) Where subparagraph a) does not operate to treat royalties as arising in either Contracting State, and the royalties are for the use of, or the right to use, in one of the Contracting States, any property or right described in paragraph 3, the royalties shall be deemed to arise in that State.

6. 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 royalties, having regard to the use, right or information for which they are 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.

ARTICLE 13

Capital Gains

1. Gains derived by a resident of a Contracting State from the alienation of immovable property (real property) situated in the other Contracting State may be taxed in that other State.

2. For the purposes of this Article the term "immovable property (real property) situated in the other Contracting State" shall include:

a) immovable property (real property) referred to in Article 6 (Income from Immovable Property (Real Property));

b) rights to assets to be produced by the exploration or exploitation of the sea bed and sub-soil of that other State and their natural resources, including rights to interests in or the benefit of such assets;

c) where that other State is the United States, a United States real property interest; and

d) where that other State is Iceland,

(i) shares, including rights to acquire shares, other than shares in which there is regular trading on a stock exchange, deriving their value or the greater part of their value directly or indirectly from immovable property (real property) situated in Iceland; and

(ii) an interest in a partnership or trust to the extent that the assets of the partnership or trust consist of immovable property (real property) situated in Iceland, or of shares referred to in clause i) of this subparagraph.

3. Gains from the alienation of movable property forming part of the business property of a permanent establishment which an enterprise of a Contracting State has in the other Contracting State and gains from the alienation of such a permanent establishment (alone or with the whole enterprise) may be taxed in that other State.

4. Gains derived by an enterprise of a Contracting State from the alienation of ships, aircraft, or containers operated or used in international traffic or personal property pertaining to the operation or use of such ships, aircraft, or containers shall be taxable only in that State.

5. Gains from the alienation of any property other than that referred to in the preceding paragraphs shall be taxable only in the Contracting State of which the alienator is a resident.

6. The provisions of paragraph 5 shall not affect the right of each of the Contracting States to levy according to its own law a tax on gains from the alienation of shares or rights in a company, the capital of which is wholly or partly divided into shares and which under the laws of that State is a resident of that State, derived by an individual who is a resident of the other Contracting State and has been a resident of the first-mentioned State in the course of the last five years preceding the alienation of the shares or rights.

ARTICLE 14

Income from Employment

1. Subject to the provisions of Articles 15 (Directors' Fees), 17 (Pensions, Social Security, and Annuities), and 18 (Government Service), salaries, wages and other similar 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) the recipient is present in the 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 or the taxable year concerned, and

b) the remuneration is paid by, or on behalf of, an employer who is not a resident of the other State, and

c) the remuneration is not borne by a permanent establishment which the employer has in the other State.

3. Notwithstanding the preceding provisions of this Article, remuneration described in paragraph 1 that is derived by a resident of a Contracting State in respect of an employment as a member of the regular complement of a ship or aircraft operated in international traffic shall be taxable only in that State.

ARTICLE 15

Directors' Fees

Directors' fees and other similar payments derived by a resident of a Contracting State in his capacity as a member of the board of directors of a company which is a resident of the other Contracting State may be taxed in that other State.

ARTICLE 16

Artistes and Sportsmen

1. Income derived by a resident of a Contracting State as an entertainer, such as a theater, motion picture, radio, or television artiste, or a musician, or as a sportsman, from his personal activities as such exercised in the other Contracting State, which income would be exempt from tax in that other Contracting State under the provisions of Articles 7 (Business Profits) and 14 (Income from Employment) may be taxed in that other State, except where the amount of the gross receipts derived by such entertainer or sportsman, including expenses

reimbursed to him, or borne on his behalf, from such activities does not exceed twenty thousand United States dollars ($20,000) or its equivalent in Icelandic kronur for the taxable year concerned.

2. Where income in respect of activities exercised by an entertainer or a sportsman in his capacity as such accrues not to the entertainer or sportsman himself but to another person, that income, notwithstanding the provisions of Article 7 (Business Profits), may be taxed in the Contracting State in which the activities of the entertainer or sportsman are exercised, unless such other person establishes that neither the entertainer or sportsman nor persons related thereto participate directly or indirectly in the profits of that other person in any manner, including the receipt of deferred remuneration, bonuses, fees, dividends, partnership distributions, or other distributions.

ARTICLE 17

Pensions, Social Security, and Annuities

1. Subject to the provisions of paragraph 2 of Article 18 (Government Service), pensions and other similar remuneration paid to a resident of a Contracting State in consideration of past employment shall be taxable only in that State.

2. Notwithstanding the provisions of paragraph 1, payments made by a Contracting State under provisions of the social security or similar legislation of that State to a resident of the other Contracting State or to a citizen of the United States shall be taxable only in the first-mentioned State.

3. Annuities derived and beneficially owned by an individual resident of a Contracting State shall be taxable only in that State. The term "annuities" as used in this paragraph means a stated sum paid periodically at stated times during a specified number of years, under an obligation to make the payments in return for adequate and full consideration (other than services rendered).

4. Where a resident of a Contracting State is a beneficiary of a pension scheme resident in the other Contracting State, income earned but not distributed by the pension scheme may be taxed in the first-mentioned State only at such time as and, subject to paragraph 1, to the extent that a distribution is made from the pension scheme.

ARTICLE 18

Government Service

1. a) Salaries, wages and other similar remuneration, other than a pension, paid from the public funds of a Contracting State or a political subdivision or a local authority thereof to an individual in respect of services rendered to that State or

subdivision or authority in the discharge of functions of a governmental nature shall be taxable only in that State.

b) However, such salaries, wages and other similar remuneration shall be taxable only in the other Contracting State if the services are rendered in that State and the individual is a resident of that State who:

(i) is a national of that State; or

(ii) did not become a resident of that State solely for the purpose of rendering the services.

2. a) Any pension paid by, or out of funds created by, a Contracting State or a political subdivision or a local authority thereof to an individual in respect of services rendered to that State or subdivision or authority in the discharge of functions of a governmental nature (other than a payment to which paragraph 2 of Article 17 (Pensions, Social Security, and Annuities) applies) shall be taxable only in that State.

b) However, such pension shall be taxable only in the other Contracting State if the individual is a resident of, and a national of, that State.

3. The provisions of Articles 14 (Income from Employment), 15 (Directors' Fees), 16 (Artistes and Sportsmen), and 17 (Pensions, Social Security, and Annuities) shall apply to salaries, wages and other similar remuneration and to pensions in respect of services rendered in connection with a business carried on by a Contracting State or a political subdivision or a local authority thereof.

ARTICLE 19

Students and Trainees

1. a) An individual who is a resident of one of the Contracting States at the time he becomes temporarily present in the other Contracting State and who is temporarily present in that other Contracting State for the primary purpose of:

(i) studying at a university or other recognized educational institution in that other Contracting State, or

(ii) securing training required to qualify him to practice a profession or professional specialty, or

(iii) studying or doing research as a recipient of a grant, allowance, or award from a governmental, religious, charitable, scientific, literary, or educational organization,

shall be exempt from tax by that other Contracting State with respect to amounts described in subparagraph b) for a period not exceeding 5 taxable years from the date of his arrival in that other Contracting State.

b) The amounts referred to in subparagraph a) are:

(i) gifts from abroad for the purpose of his maintenance, education, study, research, or training;

(ii) the grant, allowance, or award; and

(iii) income from personal services performed in that other Contracting State in an amount not in excess of nine thousand United States dollars ($9,000) or its equivalent in Icelandic kronur for any taxable year.

2. An individual who is a resident of one of the Contracting States at the time he becomes temporarily present in the other Contracting State and who is temporarily present in that other Contracting State as an employee of, or under Contract with, a resident of the first-mentioned Contracting State, for the primary purpose of:

a) acquiring technical, professional, or business experience from a person other than that resident of the first-mentioned Contracting State or other than a person related to such resident, or

b) studying at a university or other recognized educational institution in that other Contracting State,

shall be exempt from tax by that other Contracting State for a period of 12 consecutive months with respect to his income from personal services in an aggregate amount not in excess of nine thousand United States dollars ($9,000) or its equivalent in Icelandic kronur.

3. An individual who is a resident of one of the Contracting States at the time he becomes temporarily present in the other Contracting State and who is temporarily present in that other Contracting State for a period not exceeding 1 year, as a participant in a program sponsored by the Government of that other Contracting State, for the primary purpose of training, research, or study, shall be exempt from tax by that other Contracting State with respect to his income from personal services in respect of such training, research, or study performed in that other Contracting State in an aggregate amount not in excess of nine thousand United States dollars ($9,000) or its equivalent in Icelandic kronur.

ARTICLE 20

Other Income

1. Items of income beneficially owned by a resident of a Contracting State, wherever arising, not dealt with in the foregoing Articles of this Convention shall be taxable only in that State.

2. The provisions of paragraph 1 shall not apply to income, other than income from immovable property (real property) as defined in paragraph 2 of Article 6 (Income from Immovable Property (Real Property)), if the beneficial owner of such income, being a resident of a Contracting State, carries on business in the other Contracting State through a permanent establishment situated therein and the right or property in respect of which the income is paid is

effectively connected with such permanent establishment. In such case the provisions of Article 7 (Business Profits) shall apply.

ARTICLE 21

Limitation on Benefits

1. A resident of a Contracting State shall be entitled to benefits otherwise accorded to residents of a Contracting State by this Convention only to the extent provided in this Article.

2. A resident of a Contracting State shall be entitled to all the benefits of this Convention if the resident is:

a) an individual;

b) a Contracting State or any political subdivision or local authority thereof;

c) a company if,

(i) its principal class of shares is regularly traded on one or more recognized stock exchanges, and either

A) its principal class of shares is primarily traded on a recognized stock exchange located in the Contracting State of which the company is a resident; or

B) the company's primary place of management and control is in the Contracting State of which it is a resident; or

(ii) at least 50 percent of the aggregate vote and at least 50 percent of the aggregate value of the shares in the company are owned directly or indirectly by five or fewer companies entitled to benefits under clause (i) of this subparagraph, provided that, in the case of indirect ownership, each intermediate owner is a resident of either Contracting State;

d) a person described in paragraph 2 of Article 4 (Resident) of this Convention, provided that, in the case of a person described in subparagraph a) or subparagraph b) of that paragraph, more than 50 percent of the person's beneficiaries, members or participants are individuals resident in either Contracting State; or

e) a person other than an individual, if:

(i) on at least half the days of the taxable year at least 50 percent of each class of shares or other beneficial interests in the person is owned, directly or indirectly, by residents of that State that are entitled to the benefits of this Convention under subparagraph a), subparagraph b), clause (i) of subparagraph c), or subparagraph d) of this paragraph, provided that, in the case of indirect ownership, each intermediate owner is a resident of that Contracting State; and

(ii) less than 50 percent of the person's gross income for the taxable year, as determined in the person's State of residence, is paid or accrued, directly or indirectly, to persons who are not residents of either Contracting

State entitled to the benefits of this Convention under subparagraph a), subparagraph b), clause (i) of subparagraph c), or subparagraph d) of this paragraph in the form of payments that are deductible for purposes of the taxes covered by this Convention in the person's State of residence (but not including arm's length payments in the ordinary course of business for services or tangible property and payments in respect of financial obligations to a bank, provided that where such a bank is not a resident of a Contracting State such payment is attributable to a permanent establishment of that bank located in one of the Contracting States).

3. a) A company that is a resident of a Contracting State shall also be entitled to the benefits of the Convention if:

(i) at least 95 percent of the aggregate vote and at least 95 percent of the value of all its shares is owned, directly or indirectly, by seven or fewer persons that are residents of Member States of the European Union, or of the European Economic Area, or parties to the North American Free Trade Agreement or the European Free Trade Agreement that, in any case, meet the requirements of subparagraph b), or any combination thereof; and

(ii) less than 50 percent of the company's gross income for the taxable year is paid or accrued, in the form of deductible payments, directly or indirectly, to persons who are not residents of Member States of the European Union, or of the European Economic Area, or parties to the North American Free Trade Agreement or the European Free Trade Agreement that, in any case, meet the requirements of subparagraph b), or any combination thereof.

b) For purposes of subparagraph a), a person will be treated as a resident of a Member State of the European Union or of the European Economic Area or party to the North American Free Trade Agreement or the European Free Trade Agreement only if such person:

(i) is a resident of a Contracting State entitled to the benefits of this Convention by reason of subparagraph a), subparagraph b), clause (i) of subparagraph c), or subparagraph d) of paragraph 2; or

(ii) (A) would be entitled to the benefits of a comprehensive income tax convention in force between any Member State of the European Union or of the European Economic Area or party to the North American Free Trade Agreement or the European Free Trade Agreement and the Contracting State from which the benefits of this Convention are claimed, analogous to subparagraph a), subparagraph b), clause (i) of subparagraph c) or subparagraph d) of paragraph 2, provided that if such other convention does not contain a comprehensive limitation on benefits article, the person would be entitled to the benefits of this Convention under subparagraph a), subparagraph b), clause (i) of subparagraph

c), or subparagraph d) of paragraph 2 if such person were a resident of one of the Contracting States under Article 4 (Resident) of this Convention; and

(B) with respect to income referred to in Articles 10 (Dividends), 11 (Interest) or 12 (Royalties), would be entitled under the convention referred to in clause (ii) of this subparagraph to a rate of tax with respect to 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.

4. a) A resident of a Contracting State will be entitled to benefits of the Convention with respect to an item of income derived from the other State, regardless of whether the resident is entitled to benefits under paragraph 2 or 3 of this Article, if the resident is engaged in the active conduct of a trade or business in the first-mentioned State (other than the business of making or managing investments for the resident's own account, unless these activities are banking, insurance or securities activities carried on by a bank, insurance company or registered securities dealer), and the income derived from the other Contracting State is derived in connection with, or is incidental to, that trade or business and that resident satisfies any other conditions for obtaining such benefits.

b) If the resident or any of its associated enterprises carries on a trade or business activity in the other Contracting State which gives rise to an item of income, subparagraph a) of this paragraph shall apply to such item only if the trade or business activity in the first-mentioned State is substantial in relation to the trade or business activity in the other State. Whether a trade or business activity is substantial for purposes of this paragraph will be determined based on all the facts and circumstances.

c) In determining whether a person is "engaged in the active conduct of a trade or business" in a Contracting State under subparagraph a) of this paragraph, activities conducted by a partnership in which that person is a partner and activities conducted by persons connected to such person shall be deemed to be conducted by such person. A person shall be connected to another if one possesses at least 50 percent of the beneficial interest in the other (or, in the case of a company, at least 50 percent of the aggregate vote and at least 50 percent of the aggregate value of the shares in the company or of the beneficial equity interest in the company) or another person possesses, directly or indirectly, at least 50 percent of the beneficial interest (or, in the case of a company, at least 50 percent of the aggregate vote and at least 50 percent of the aggregate value of the shares in the company or of the beneficial equity interest in the company) in each person. In any case, a person shall be considered to be connected to another if, based on all the relevant facts and circumstances, one has control of the other or both are under the control of the same person or persons.

5. Notwithstanding the preceding provisions of this Article, where an enterprise of a Contracting State derives income from the other Contracting State, and that income is

attributable to a permanent establishment which that enterprise has in a third jurisdiction, the tax benefits that would otherwise apply under the other provisions of the Convention will not apply to any item of income if the combined tax that is actually paid with respect to such income in the first-mentioned State and in the third jurisdiction is less than 60 percent of the tax that would have been payable in the first-mentioned State if the income were earned in that State by the enterprise and were not attributable to the permanent establishment in the third jurisdiction. Any dividends, interest or royalties to which the provisions of this paragraph apply shall be subject to tax at a rate that shall not exceed 15 percent of the gross amount thereof. Any other income to which the provisions of this paragraph apply will be subject to tax under the provisions of the domestic law of the other Contracting State, notwithstanding any other provision of the Convention. The provisions of this paragraph shall not apply if:

a) in the case of royalties, the royalties are received as compensation for the use of, or the right to use, intangible property produced or developed by the permanent establishment itself; or

b) in the case of any other income, the income derived from the other Contracting State is derived in connection with, or is incidental to, the active conduct of a trade or business carried on by the permanent establishment in the third jurisdiction (other than the business of making, managing or simply holding investments for the person's own account, unless these activities are banking or securities activities carried on by a bank or registered securities dealer).

6. Notwithstanding the preceding provisions of this Article, if a company that is a resident of a Contracting State, or a company that controls directly or indirectly such a company, has outstanding a class of shares:

a) which is subject to terms or other arrangements which entitle its holders to a portion of the income of the company derived from the other Contracting State that is larger than the portion such holders would receive absent such terms or arrangements ("the disproportionate part of the income"); and

b) 50 percent or more of which is owned by persons who are not entitled to benefits under paragraph 2 of this Article;

the benefits of this Convention shall not apply to the disproportionate part of the income.

7. A resident of a Contracting State that is not entitled to benefits pursuant to the preceding paragraphs of this Article shall, nevertheless, be granted benefits of the Convention if the competent authority of the other Contracting State determines that the establishment, acquisition or maintenance of such person and the conduct of its operations did not have as one of its principal purposes the obtaining of benefits under the Convention. The competent authority of the other Contracting State shall consult with the competent authority of the first-mentioned State before denying the benefits of the Convention under this paragraph.

8. a) For purposes of this Article the term "principal class of shares" 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 company. If no single class of ordinary or common shares represents the majority of the aggregate voting power and value of the company, the "principal class of shares" is that class or those classes that in the aggregate represent a majority of the aggregate voting power and value of the company.

b) For purposes of this Article 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 U.S. Securities and Exchange Commission as a national securities exchange under the U.S. Securities Exchange Act of 1934;

(ii) the Icelandic Stock Exchange;

(iii) the stock exchanges of Amsterdam, Brussels, Copenhagen, Frankfurt, Hamburg, Helsinki, London, Oslo, Paris, Stockholm, Sydney, Tokyo, and Toronto; and

(iv) any other stock exchange agreed upon by the competent authorities of both Contracting States.

c) For purposes of this Article a company's primary place of management and control will be in the State of which it is a resident only if executive officers and senior management employees exercise day-to-day responsibility for more of the strategic, financial and operational policy decision making for the company (including its direct and indirect subsidiaries) in that State than in any other state, and the staffs conduct more of the day-to-day activities necessary for preparing and making those decisions in that State than in any other state.

ARTICLE 22

Relief from Double Taxation

1. In accordance with the provisions and subject to the limitations of the law of the United States (as it may be amended from time to time without changing the general principle hereof), the United States shall allow to a resident or citizen of the United States as a credit against the United States tax on income:

a) the income tax paid or accrued to Iceland on behalf of such citizen or resident; and

b) in the case of a United States company owning at least 10 percent of the voting stock of a company that is a resident of Iceland and from which the United States company receives dividends, the income tax paid or accrued to Iceland by or on behalf of the payer with respect to the profits out of which the dividends are paid.

For the purposes of this paragraph, the taxes referred to in subparagraph a) of paragraph 3 and paragraph 4 of Article 2 (Taxes Covered) shall be considered income taxes.

2. For the purposes of applying paragraph 1 of this Article,

a) subject to subparagraph b) of this paragraph, an item of gross income, as determined under the laws of the United States, derived by a resident of the United States that, under this Convention, may be taxed in Iceland shall be deemed to be income from sources in Iceland;

b) however, gains derived by an individual while that individual was a resident of the United States, that are taxed by the United States in accordance with the Convention, and that may also be taxed in Iceland by reason only of paragraph 5 of Article 13 (Capital Gains), shall be deemed to be gains from sources in the United States.

3. In the case of Iceland, double taxation shall be avoided as follows:

a) When a resident of Iceland derives income which, in accordance with the provisions of this Convention, may be taxed in the United States, Iceland shall allow as a deduction from the tax on the income of that resident an amount equal to the income tax paid in the United States;

b) Such deduction shall not, however, exceed that part of the income tax, as computed before the deduction is given, which is attributable to the income that may be taxed in the United States;

c) When a resident of Iceland derives income which, in accordance with the provisions of this Convention, shall be taxable only in the United States, Iceland may include this income in the tax base but shall allow as a deduction from income tax that part of the income tax which is attributable to the income derived from the United States.

For the purposes of this paragraph, the United States taxes referred to in subparagraph b) of paragraph 3 and paragraph 4 of Article 2 (Taxes Covered) shall be considered income taxes, and shall be allowed as a deduction against the Icelandic tax on income.

4. Where a United States citizen is a resident of Iceland:

a) with respect to items of income that under the provisions of this Convention are exempt from United States tax or that are subject to a reduced rate of United States tax when derived by a resident of Iceland who is not a United States citizen, Iceland shall allow as a credit against Icelandic tax, only the tax paid, if any, that the United States may impose under the provisions of this Convention, other than taxes that may be imposed solely by reason of citizenship under the saving clause of paragraph 4 of Article 1 (General Scope);

b) for purposes of computing United States tax on those items of income referred to in subparagraph a), the United States shall allow as a credit against United States tax the income tax paid to Iceland after the credit referred to in subparagraph a); the credit so allowed shall not reduce the portion of the United States tax that is creditable against the Icelandic tax in accordance with subparagraph a); and

c) for the exclusive purpose of relieving double taxation in the United States under subparagraph b), items of income referred to in subparagraph a) shall be deemed to arise in Iceland to the extent necessary to avoid double taxation of such income under subparagraph b).

ARTICLE 23
Non-Discrimination

1. Nationals of a Contracting State shall not be subjected in the other Contracting State to any taxation or any requirement connected therewith, which is other or more burdensome than the taxation and connected requirements to which nationals of that other State in the same circumstances, in particular with respect to residence, are or may be subjected. This provision shall, notwithstanding the provisions of Article 1 (General Scope), also apply to persons who are not residents of one or both of the Contracting States. However, for the purposes of United States taxation, United States nationals who are subject to tax on a worldwide basis are not in the same circumstances as nationals of Iceland who are not residents of the United States.

2. The taxation on a permanent establishment which an enterprise of a Contracting State has in the other Contracting State shall not be less favourably levied in that other State than the taxation levied on enterprises of that other State carrying on the same activities. This provision shall not be construed as obliging a Contracting State to grant to residents of the other Contracting State any personal allowances, reliefs and reductions for taxation purposes on account of civil status or family responsibilities which it grants to its own residents.

3. Except where the provisions of paragraph 1 of Article 9 (Associated Enterprises), paragraph 4 of Article 11 (Interest), or paragraph 6 of Article 12 (Royalties), apply, interest, royalties and other disbursements paid by an enterprise of a Contracting State to a resident of the other Contracting State shall, for the purpose of determining the taxable profits of such enterprise, be deductible under the same conditions as if they had been paid to a resident of the first-mentioned State. Similarly, any debts of an enterprise of a Contracting State to a resident of the other Contracting State shall, for the purpose of determining the taxable capital of such enterprise, be deductible under the same conditions as if they had been contracted to a resident of the first-mentioned State.

4. Enterprises of a Contracting State, the capital of which is wholly or partly owned or controlled, directly or indirectly, by one or more residents of the other Contracting State, shall not be subjected in the first-mentioned State to any taxation or any requirement connected therewith which is other or more burdensome than the taxation and connected requirements to which other similar enterprises of the first-mentioned State are or may be subjected.

5. Nothing in this Article shall be construed as preventing either Contracting State from imposing a tax as described in paragraph 8 of Article 10 (Dividends).

6. The provisions of this Article shall, notwithstanding the provisions of Article 2 (Taxes Covered), apply to taxes of every kind and description imposed by a Contracting State or a political subdivision or local authority thereof.

ARTICLE 24

Mutual Agreement Procedure

1. Where a person considers that the actions of one or both of the Contracting States result or will result for him in taxation not in accordance with the provisions of this Convention, he may, irrespective of the remedies provided by the domestic law of those States, and the time limits prescribed in such laws for presenting claims for refunds, present his case to the competent authority of either State.

2. The competent authority shall endeavor, if the objection appears to it to be justified and if it is not itself able to arrive at a satisfactory solution, to resolve the case by mutual agreement with the competent authority of the other Contracting State, with a view to the avoidance of taxation which is not in accordance with the Convention. Any agreement reached shall be implemented notwithstanding any time limits or other procedural limitations in the domestic law of the Contracting States.

3. The competent authorities of the Contracting States shall endeavor to resolve by mutual agreement any difficulties or doubts arising as to the interpretation or application of the Convention. In particular the competent authorities of the Contracting States may agree:

a) to the same attribution of income, deductions, credits, or allowances of an enterprise of a Contracting State to its permanent establishment situated in the other Contracting State;

b) to the same allocation of income, deductions, credits, or allowances between persons;

c) to the same characterization of particular items of income, including the same characterization of income that is assimilated to income from shares by the taxation law of one of the Contracting States and that is treated as a different class of income in the other State;

d) to the same characterization of persons;

e) to the same application of source rules with respect to particular items of income;

f) to a common meaning of a term; and

g) to the application of the provisions of domestic law regarding penalties, fines, and interest in a manner consistent with the purposes of the Convention.

They may also consult together for the elimination of double taxation in cases not provided for in the Convention.

4. The competent authorities of the Contracting States may communicate with each other directly, for the purpose of reaching an agreement in the sense of the preceding paragraphs.

ARTICLE 25

Exchange of Information and Administrative Assistance

1. The competent authorities of the Contracting States shall exchange such information as is relevant for carrying out the provisions of this Convention or of the domestic laws concerning taxes of every kind imposed by a Contracting States, insofar as the taxation thereunder is not contrary to the Convention including information relating to the assessment or collection of, the enforcement or prosecution in respect of, or the determination of appeals in relation to, the taxes covered by the Convention. The exchange of information is not restricted by paragraph 1 of Article 1 (General Scope) and Article 2 (Taxes Covered). Any information received by a Contracting State shall be treated as secret in the same manner as information obtained under the domestic laws of that State and shall be disclosed only to persons or authorities (including courts and administrative bodies) involved in the assessment, collection or administration of, the enforcement or prosecution in respect of, or the determination of appeals in relation to the taxes referred to above, or the oversight of the above. Such persons or authorities shall use the information only for such purposes. They may disclose the information in public court proceedings or in judicial decisions.

2. If information is requested by a Contracting State in accordance with this Article, the other Contracting State shall obtain that information in the same manner and to the same extent as if the tax of the first-mentioned State were the tax of that other State and were being imposed by that other State, notwithstanding that the other State may not, at that time, need such information for purposes of its own tax.

3. In no case shall the provisions of paragraphs 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 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 or of the other Contracting State;

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. 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), to the same extent such

depositions and documents can be obtained under the laws and administrative practices of that other State with respect to its own taxes.

5. Each of the Contracting States shall endeavor to collect on behalf of the other Contracting State such amounts as may be necessary to ensure that relief granted by the Convention from taxation imposed by that other State does not inure to the benefit of persons not entitled thereto. This paragraph shall not impose upon either of the Contracting States the obligation to carry out administrative measures that would be contrary to its sovereignty, security, or public policy.

6. The competent authority of a Contracting State intending to send officials of that State to the other Contracting State to interview individuals and examine books and records with the consent of the persons subject to examination shall notify the competent authority of the other Contracting State of that intention.

ARTICLE 26

Members of Diplomatic Missions and Consular Posts

Nothing in this Convention shall affect the fiscal privileges of members of diplomatic missions or consular posts under the general rules of international law or under the provisions of special agreements.

ARTICLE 27

Entry Into Force

1. This Convention shall be subject to ratification in accordance with the applicable procedures of each Contracting State. The Contracting States shall notify each other in writing, through diplomatic channels, when their respective applicable procedures have been satisfied.

2. The Convention shall enter into force on the date of the later of the notifications referred to in paragraph 1, and its provisions shall have effect in both Contracting States:

a) in respect of taxes withheld at source, on income derived on or after 1 January in the calendar year next following the year in which the Convention enters into force;

b) in respect of other taxes, for taxes chargeable for any tax year beginning on or after 1 January in the calendar year next following the year in which the Convention enters into force.

3. The Convention between the United States of America and the Republic of Iceland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital, signed May 7, 1975, ("the prior Convention") shall cease to have effect in relation to any tax from the date on which this Convention has effect in relation to that tax in accordance with paragraph 2 of this Article. Notwithstanding the preceding sentence,

where any person entitled to benefits under the prior Convention would have been entitled to greater benefits thereunder than under this Convention, the prior Convention shall, at the election of such person, continue to have effect in its entirety with respect to such person for a twelve-month period from the date on which the provisions of this Convention otherwise would have effect under paragraph 2 of this Article. The prior Convention shall terminate on the last date on which it has effect in relation to any tax in accordance with the foregoing provisions of this paragraph.

4. Notwithstanding the entry into force of this Convention, an individual who was entitled to benefits of Article 21 (Teachers) of the prior Convention at the time of the entry into force of this Convention shall continue to be entitled to such benefits until such time as the individual would cease to be entitled to benefits if the prior Convention remained in force.

ARTICLE 28

Termination

This Convention shall remain in force until terminated by a Contracting State. Either Contracting State may terminate the Convention, through diplomatic channels, by giving notice of termination in writing at least six months before the end of any calendar year. In such event, the Convention shall cease to have effect in both Contracting States:

a) in respect of taxes withheld at source, on income derived on or after 1 January in the calendar year next following the.year in which the notice is given;

b) in respect of other taxes, for taxes chargeable for any tax year beginning on or after 1 January in the calendar year next following the year in which the notice is given.

IN WITNESS WHEREOF the undersigned, being duly authorized thereto by their respective Governments, have signed this Convention.

Done in duplicate at Washington on this twenty-third day of October 2007, in the English and Icelandic languages, both texts being equally authentic.

FOR THE GOVERNMENT OF THE UNITED STATES OF AMERICA:	FOR THE GOVERNMENT OF ICELAND:
Robert M. Kimmitt	[illegible]

Protocol

At the signing of the Convention concluded today between the Government of the United States of America and the Government of Iceland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, the undersigned have agreed upon the following additional provisions which shall form an integral part of the said Convention.

1. With reference to Article 3 (General Definitions)

The following shall be considered to meet the requirements of subparagraph l) of paragraph 1:
a) in Iceland: any pension fund or pension plan qualified under the Pension Act or any identical or substantially similar schemes which are created under any law enacted after the signature of the Convention.

b) in the United States, qualified plans under section 401(a) of the Internal Revenue Code, individual retirement plans (including individual retirement plans that are part of a simplified employee pension plan that satisfies section 408(k), individual retirement accounts, individual retirement annuities, section 408(p) accounts, and Roth IRAs under section 408A), section 457(g) governmental plans, section 403(a) qualified annuity plans, and section 403(b) plans, or any identical or substantially similar schemes which are created under any law enacted after the signature of the Convention.

2. With reference to Article 7 (Business Profits)
The principles of the OECD Transfer Pricing Guidelines shall apply, by analogy, for the purposes of determining the profits attributable to a permanent establishment. Accordingly, any of the methods described therein, including profits methods, may be used to determine the income of a permanent establishment so long as those methods are applied in accordance with the Guidelines.

3. Articles 7 (Business Profits) and 23 (Non-Discrimination) shall not prevent Iceland from continuing to tax permanent establishments of United States insurance companies in accordance with Article 70, paragraph 2, section 3 of the Icelandic Tax Code, nor shall it prevent the United States from continuing to tax permanent establishments of Icelandic insurance companies in accordance with section 842 (b) of the Internal Revenue Code.

4. With reference to paragraphs 8 and 9 of Article 10 (Dividends)
The general principle of the "dividend equivalent amount", as used in United States law, is to approximate that portion of the income mentioned in paragraph 7 of Article 10 that is comparable to the amount that would be distributed as a dividend if such income were earned by a subsidiary incorporated in the United States. For any year, a foreign corporation's dividend equivalent amount is equal to the after-tax earnings attributable to the foreign corporation's (i) income attributable to a permanent establishment in the United States, (ii) income from real property in the United States that is taxed on a net basis under Article 6 (Income from Immovable Property (Real Property)), and (iii) gain from a real property interest taxable by the United States under paragraph 1 of Article 13 (Capital Gains), reduced by any increase in the foreign corporation's net investment in U.S. assets or increased by any reduction in the foreign corporation's net investment in U.S. assets.

5. With reference to Article 16 (Artistes and Sportsmen)
Nothing shall preclude a Contracting State from withholding tax from such payments according to its domestic laws. However, if according to the provisions of this Article, such remuneration or income may only be taxed in the other Contracting State, the first-mentioned Contracting State shall make a refund of the tax so withheld upon a duly filed claim. Such claim must be filed with the tax authorities that have collected the withholding tax within five years after the close of the calendar year in which the tax was withheld.

6. With reference to Article 21 (Limitation on Benefits)
The competent authorities of the Contracting States shall consult together with a view to developing a commonly agreed application of the provisions of this Article. The competent authorities shall, in accordance with the provisions of Article 25 (Exchange of Information and Administrative Assistance), exchange such information as is necessary for carrying out the provisions of this Article.

7. With reference to Article 25 (Exchange of Information and Administrative Assistance)
The powers of each Contracting State's competent authority to obtain information include powers to obtain information held by financial institutions, nominees, or persons acting in an agency or fiduciary capacity (not including information that would reveal confidential communications between a client and an attorney, solicitor or other legal representative, where the client seeks legal advice), and information relating to the ownership of legal persons, and that each Contracting State's competent authority are able to exchange such information in accordance with the Article.

IN WITNESS WHEREOF the undersigned, being duly authorized thereto by their respective Governments, have signed this Protocol.

Done in duplicate at Washington on this twenty-third day of October 2007 in the English and Icelandic languages, both texts being equally authentic.

FOR THE GOVERNMENT OF THE UNITED STATES OF AMERICA:	**FOR THE GOVERNMENT OF ICELAND:**

October 26, 2007
hp-635

Treasury Secretary Paulson to Visit India

Treasury Secretary Henry M. Paulson, Jr. will travel to India this week to meet with government officials and business leaders. The Secretary will also deliver remarks at a conference on infrastructure in Mumbai and participate in a discussion in New Delhi on India's rise as an important player on the global economic stage.

The Secretary will be in Kolkata on Oct. 28 to meet with West Bengal Chief Minister Bhattacharya and local business leaders. He will then travel to Mumbai where he will deliver remarks to the U.S.-India CEO Forum Infrastructure Conference and meet with various officials including Reserve Bank of India Governor Reddy and Securities and Exchange Board of India Chairman Damodaran. From there, he travels to New Delhi where he will participate in a discussion at the Fortune Global Forum. He will also meet with government leaders including Finance Minister Chidambaram.

The following events are open to the media:

Who	U.S. Treasury Secretary Henry M. Paulson, Jr.
What	Roundtable with SmartCard Customers and Demonstration on Mobility of SmartCard Device in Rural India
When	Sunday, October 28, 10 a.m. Local Time
Where	Grameen Sanchar Society Amtala, Kriparampuz, D-H Road P.S. Bishmupur Block - Bishmupur II Kolkata

Who	U. S. Treasury Secretary Henry M. Paulson, Jr.
What	Remarks to U.S.-India CEO Forum Infrastructure Conference
When	Monday, October 29, 9 a.m. Local Time
Where	Taj Mahal Palace and Tower Hotel Apollo Bunder Mumbai

Who	U. S. Treasury Secretary Henry M. Paulson, Jr.
What	Discussion on India's Economy at Fortune Global Forum
When	Tuesday, October 30, 9:40 a.m. Local Time
Where	The Imperial New Delhi Janpath New Delhi

-30-

October 24, 2007
HP-636

**Remarks by Secretary Henry M. Paulson, Jr.
on the Economic Power and Promise of India
before The Council on Foreign Relations**

Washington, DC--Thank you, Peter. It is good to be with the Council here in Washington. I appreciate the opportunity to talk with you today about the economic power and promise of India.

Earlier this year, Prime Minister Singh referred to India's history as "An open house, an open society, open to the free flow of ideas and scholarship." I will travel to India next week, and look forward to being a guest in India's house. My objective is to contribute to the strong, growing partnership between India and the United States. I hope to help the Indian government advance their economic reform agenda, which will benefit India's citizens and the world.

India is a vibrant nation, whose strength lies in its commitment to equal rights – and to speech, religious and economic freedoms that enrich the lives of all citizens. India is not only the world's largest democracy; it is also a secular, pluralistic society, committed to inclusive growth.

Through President Bush and Prime Minister Singh's leadership, political, economic, and cultural ties between the United States and India have never been stronger. These ties enjoy bipartisan support in both countries. In the last few years, we have launched important initiatives in areas including counter-terrorism cooperation, space research, clean energy, agriculture, education, and economic development.

The historic agreement on civilian nuclear cooperation is an important part of the U.S. – India relationship, and it is beneficial to both countries. India is one of the world's largest and most peaceful states with advanced nuclear technologies, and has been isolated from the rest of the world on nuclear issues. This agreement will bring India into the nuclear nonproliferation mainstream, providing access to the technology which can help it reach its economic and environmental objectives. The United States remains committed to this agreement.

The ties of our governments are, in some sense, catching up to the long history of personal and professional friendships among Indians and Americans. For decades, Indians have immigrated to the United States, joined our communities and raised their families while maintaining their cultural heritage. Indian–Americans are physicians, engineers, CEOs, professors, teachers, entrepreneurs. They are a vital part of the United States' economic and social fabric. Because of this long history, the bonds among our people and our cultures will remain strong.

India's Economic Emergence

Prime Minister Singh is to be commended for beginning the process of transforming India into a global economic power by initiating economic liberalization in the early 1990's. These economic reforms have continued at varying speed throughout the past 15 years, regardless of the party in power. Observers do not question whether India's reforms will continue; they ask only about the pace.

The great Indian poet Tagore wrote that he had become his own version of an optimist. He said, "If I can't make it through one door, I'll go through another door – or I'll make a door." The revolution in Indian economic thinking is "making doors" and invigorating the Indian economy. India is a young country, with a young population that will be looking for stable, well-paying jobs to support their families. These reforms will help provide the jobs they will need.

Through dramatic increases in mutual trade and foreign direct investment, the United States has been a partner in India's economic emergence. In the last few years, Indian exports to the United States have almost doubled to $21 billion, while U.S. exports to India have doubled to $10 billion. Similarly, investment flows have increased dramatically. Indian firms have invested $2 billion in the United States. And U.S. companies invested about $2 billion in India last year.

As the Indian government has embraced greater economic openness, the creativity and expertise of the Indian workforce has been unleashed onto the world economic stage. We share Indian policymakers' belief that market-based policies and programs will spread opportunity to all levels of society – reaching aam aadmi, the common man.

The success of India's software industry is often told, and the story bears repeating here. Through the combination of expertise gained at the Indian Institutes of Technology, and through innovative thinking, Indian industry has demonstrated that it can, as the CEO of an Indian software company recently said, "Take the work from any part of the world and do it in any part of the world."

India's GDP grew nearly 10 percent in 2006, compared to the world average of five and a half percent. India's economic reforms have taken root, and by accelerating them, the government can help ensure that India's growth rate will be, as projected, at least 8 percent for the foreseeable future. I am optimistic about India's prospects.

Similar Values and Challenges

In pursuing economic growth, India and the United States share similar values and similar challenges. We understand that the global economy is here to stay. To keep growing and leading the world in innovation and opportunity, the United States and India must trade freely, openly, and according to the principles of the global marketplace. Trade also brings a wider variety of lower priced goods, and this especially benefits lower-income citizens.

I look forward to talking with the Indian government about making progress in the Doha Development Round. Working together to successfully conclude a Doha agreement will be the single most effective thing we can do to help raise living standards in India and around the world. A Doha agreement is within reach, and the potential is so great, that we must not let it slip through our grasp.

We also understand how rapidly-changing economies can lead to uncertainty, causing many to doubt that trade brings greater benefits than costs. Together, India and the United States must resist this protectionist sentiment. I am committed to working to maintain an open trade and investment climate in the U.S.

Both India and the United States recognize that an integrated world economy requires protecting the global financial network against those who want to harm our people and our free economic systems by financing terrorism, weapons proliferation or other, dangerous illicit activity. We will continue implementing financial system safeguards to help ensure our countries' and our citizens' security.

The U.S. and India also share the challenge of ensuring secure and clean energy supplies. We understand that economic growth and environmental responsibility are necessary, compatible goals. Moving forward with the civilian nuclear agreement is one part of the solution. Working together on a post-2012 framework through the UN climate change process is another.

It is in the best interest of India, the United States and the world for India to continue, and even accelerate, the pace of economic reform and openness. As with any democratic transformative effort, India faces political challenges – something the United States also knows well.

The government is to be applauded for what it has already accomplished, and encouraged to move forward. We stand with them as a partner as they do. Other countries are also developing financial sophistication and global integration. If India slows its pace now, it risks losing the ground it has worked so hard to gain.

The United States as a Partner India's Transformation

Now, let me talk about two areas where the United States, and particularly the Department of Treasury, wants to be a partner in advancing reform and inclusive economic growth.

First, by assisting the government's plans to finance physical infrastructure improvements, which will benefit Indian families' daily lives and fuel the economy. Second, by supporting steps to strengthen and expand India's financial system by building an International Financial Center, a so-called IFC, in Mumbai.

Achieving these two goals will require a firm commitment to adopt international standards and to move forward aggressively with reforms, despite political risks.

Physical Infrastructure Improvements

The Indian government estimates that to further transform its economy, it needs to spend close to $500 billion over the next five years to build physical infrastructure that will deliver power to cities and villages, and transport people and goods to markets. Given India's fiscal constraints, it is looking to the private sector to fund up to one-third of this needed investment.

The United States wants to support this effort to attract private financing. During my trip, I will participate in the India Infrastructure Finance Conference in Mumbai. At that conference and afterwards, we will highlight the opportunities of India's infrastructure initiatives to U.S. businesses.

This infrastructure investment is important to helping India achieve its second Green Revolution, as Prime Minister Singh has called for. Our private sectors must take an active role in developing a sophisticated agricultural market in India, where farmers can tap modern supply chains and processing technologies to improve their productivity and the lives of their families.

The government can do more to encourage this private investment by establishing more hospitable investment, regulatory and financial regimes. Capital limitations, combined with on-going uncertainty about contract enforcement and regulatory consistency, will make infrastructure investment more difficult to obtain.

International Financial Center in Mumbai

Let me turn now to the expansion of India's financial sector, specifically, establishing a financial center in Mumbai. In 2006, Prime Minister Singh said that it is possible for Mumbai to "emerge as a new financial capital of Asia, and be the bridge between Asia and the West in the world of finance."

Properly-regulated and well-functioning financial markets are critical for balanced development and strong, inclusive growth. This is an area of enormous opportunity for India. Efficient markets link capital with ideas and ambition – they are the economic lifeblood through which people find the means to rise out of poverty. This is true in India, in the United States and around the world.

Today, Indian firms in Bangalore play a key role in the back office operations of global, multinational firms. In this, India has revolutionized, forever, the way the world does business. The next step is for India to develop front offices in Mumbai that provide financial services to companies and investors in India and across the region.

By establishing an IFC in Mumbai, India will build a financial system that will help large and small businesses. Shopkeepers, farmers and craftsmen need access to credit, financial and insurance products, as much as the large, industrial manufacturer does.

The Indian government has recognized this need, and commissioned a report from a High Powered Expert Committee. The Committee's report outlined the requirements and a timetable for developing an IFC in Mumbai. The Report is bold,

thorough and ambitious. I believe it is the right path. A financial footprint in Mumbai makes a door through which the world can invest in India, and India can invest in the world. Equally important, it gives India an important stake in the rapidly growing financial services industry.

The Report identifies the needed changes to fiscal and monetary policy, and to financial regulation. It also outlines that Mumbai's own urban infrastructure must be improved. This demonstrates the wisdom of the Indian government's emphasis on physical and financial infrastructure improvements. Both goals must be met in order to achieve the transition that will provide inclusive growth.

India has already made significant accomplishments in developing its financial sector, and the economy has responded positively. India's stock and commodity exchanges are thriving. Since deregulation, the asset management industry has grown and now manages over $100 billion in assets.

By reducing constraints on financial firms, India's government can foster a more efficient allocation of financial resources. This will free capital to finance infrastructure investment, develop new innovations in other industries, and extend financial services to a larger portion of the population.

India's large and growing middle class stands to benefit from new financial products that will help them to achieve homeownership and to invest in the best possible education for their children.

Many of the world's leading financial firms have already opened offices in Mumbai; they are eager to do their part in building an International Financial Center. I urge my Indian colleagues to move forward quickly on the recommendations of their expert committee report.

On-going Efforts by the United States

The United States will continue as a partner with India in its economic transformation. Treasury and the Finance Ministry have led an ongoing dialogue for several years among U.S. and Indian regulators to share experiences and best practices. We will kick-off another session to help advance the Indian government's economic reform agenda when I am in New Delhi next week. Mumbai's development into an IFC is an important element of that agenda.

U.S. experience can help Indian government and industry as they work to develop an IFC in Mumbai. And the private sector stands ready to share their experiences in dealing with the development of domestic bond markets and other elements that create the backbone of a financial center.

We understand that Indian officials are concerned that greater capital flows associated with a financial center could add to inflationary pressures, destabilize the domestic financial sector or add to exchange rate volatility. For the most part, India is on the right path to reduce these risks. India has allowed greater flexibility in the exchange rate in recent months, and the appreciation in the rupee has helped to reduce inflationary pressures.

India has also taken administrative steps to adjust the pace of capital outflows and inflows. As recent experience in the region has shown, administrative restrictions of capital flows are blunt instruments and can have unintended consequences. They tend to inhibit efficiency and lose their effectiveness over time. I encourage India to continue liberalizing such restrictions. Steps to broaden and deepen the domestic financial sector will also help to mitigate the risks posed by greater capital flows.

India's development plans will require additional capital, innovative financial instruments and a commitment to financial openness. Recent growth in India's savings base and in the number of global firms setting up shop in India suggest that all of this is possible --- that India can be a significant exporter of financial flows and investment in the years ahead.

The development of Mumbai as a financial center will take some years to come to fruition. Nonetheless, it is a path worth taking, a path that will yield benefits all along

the way for India and for the global economy.

Conclusion

The remarkable growth brought about by India's economic reforms has proven the wisdom of those reforms and their promise for the future. As Prime Minister Singh said, India is "an open house." It can become more open, more integrated into the global community. This will bring the inclusive growth which is India's aim – an economy in which the small farmer, the craftsman and the next Indian entrepreneur with a dream makes a door, and fulfills that dream.

India and the United States have made a very good start at delivering on our new partnership, and we can do more to reach our full strategic and economic potential. I look forward to learning from my Indian colleagues during my visit, and to working with them on these, and future, initiatives.

Thank you and I welcome your questions.

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October 24, 2007
HP-643

Treasury, Private Sector Release Initial Results of Flu Pandemic Exercise Nearly All Participants Find Critical Gaps in Plans

Washington - The Treasury Department, the Financial Services Sector Coordinating Council for Critical Infrastructure Protection and Homeland Security, and the Securities Industry and Financial Management Association today released the preliminary results of the industry-wide pandemic flu exercise.

"The strong public-private coordination on this exercise allowed us to reach more institutions than we ever expected," said Valerie Abend, Treasury's Deputy Assistant Secretary for Critical Infrastructure Protection. "And by allowing almost all participants to find critical gaps in their planning, this exercise was an unquestionable success in helping the industry prepare for such a crisis."

More than 2,700 organizations registered to participate anonymously in the online financial services industry exercise, which began in September and ran for three weeks. While banks made up the majority of participants, insurance companies, securities firms and exchanges and state and federal regulators also took part in the exercise.

The exercise simulated a pandemic wave with a peak absenteeism rate of 49 percent. The exercise examined a number of issues including human resources, continuity of operations, and dependencies on other sectors such as transportation, energy and telecommunications.

The results released today offer a basic first look at the potential impact of a pandemic flu outbreak. More detailed results on the pandemic's impact and the industry's response will be released in the coming months, as data is analyzed.

President Bush directed Treasury in May 2006 to coordinate with the banking and finance sector to better prepare its response to a pandemic crisis.

REPORTS

- Presentation on Initial Results

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REPORTS

- Presentation on Initial Results

FBIIC/FSSCC Pandemic Flu Exercise

Media Briefing

FBIIC/FSSCC Pandemic Flu Exercise of 2007

- From September 24 through October 12, the Financial Banking Information Infrastructure Committee (FBIIC) and the Financial Services Sector Coordinating Council (FSSCC) conducted a pandemic flu exercise for the financial services sector in the United States

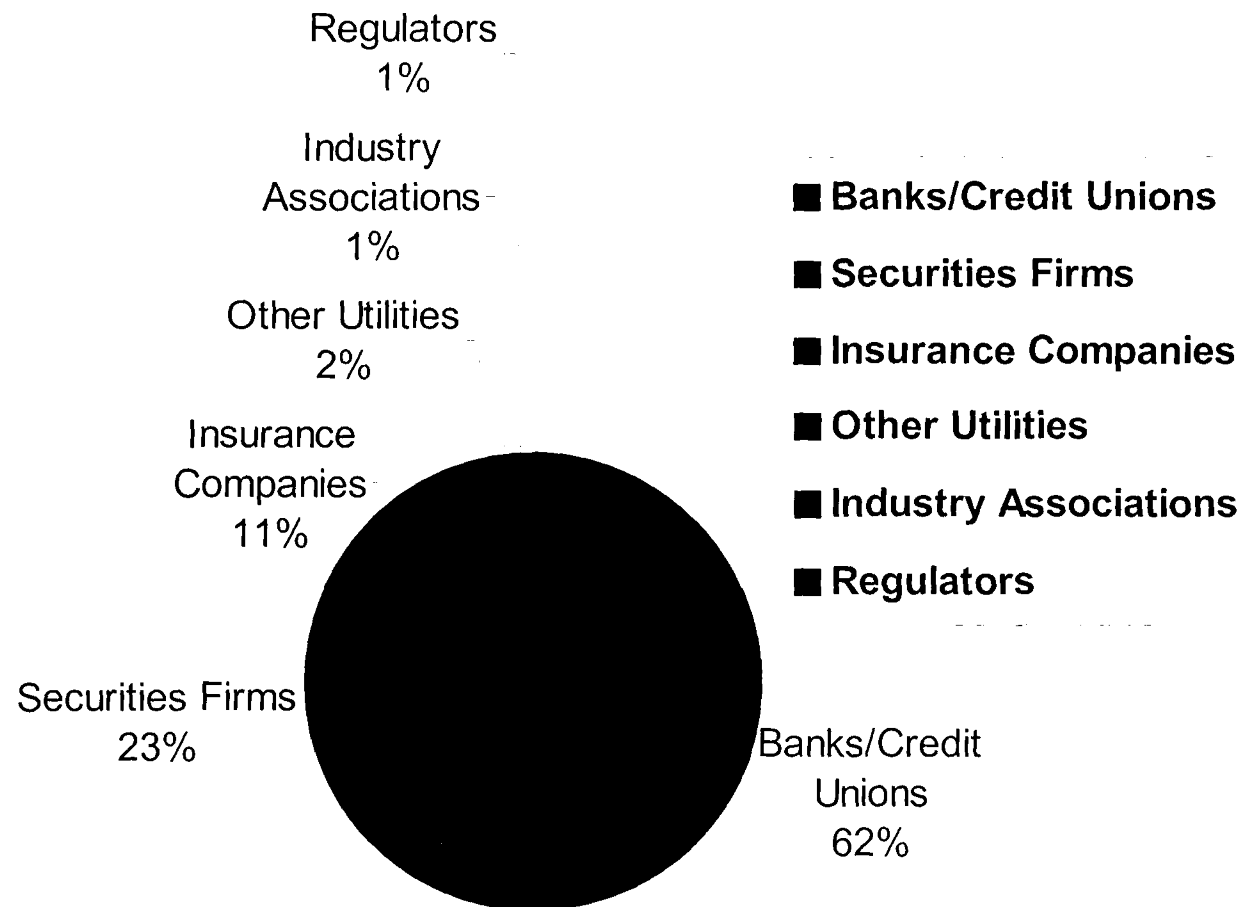
- A total of 2775 organizations registered for the exercise

- Exercise objectives:

  1. Enhance the understanding of systemic risks to the sector
  2. Provide an opportunity for firms to test their pandemic plans
  3. Examine how the effect of a pandemic flu on other critical infrastructures will impact the financial services sector

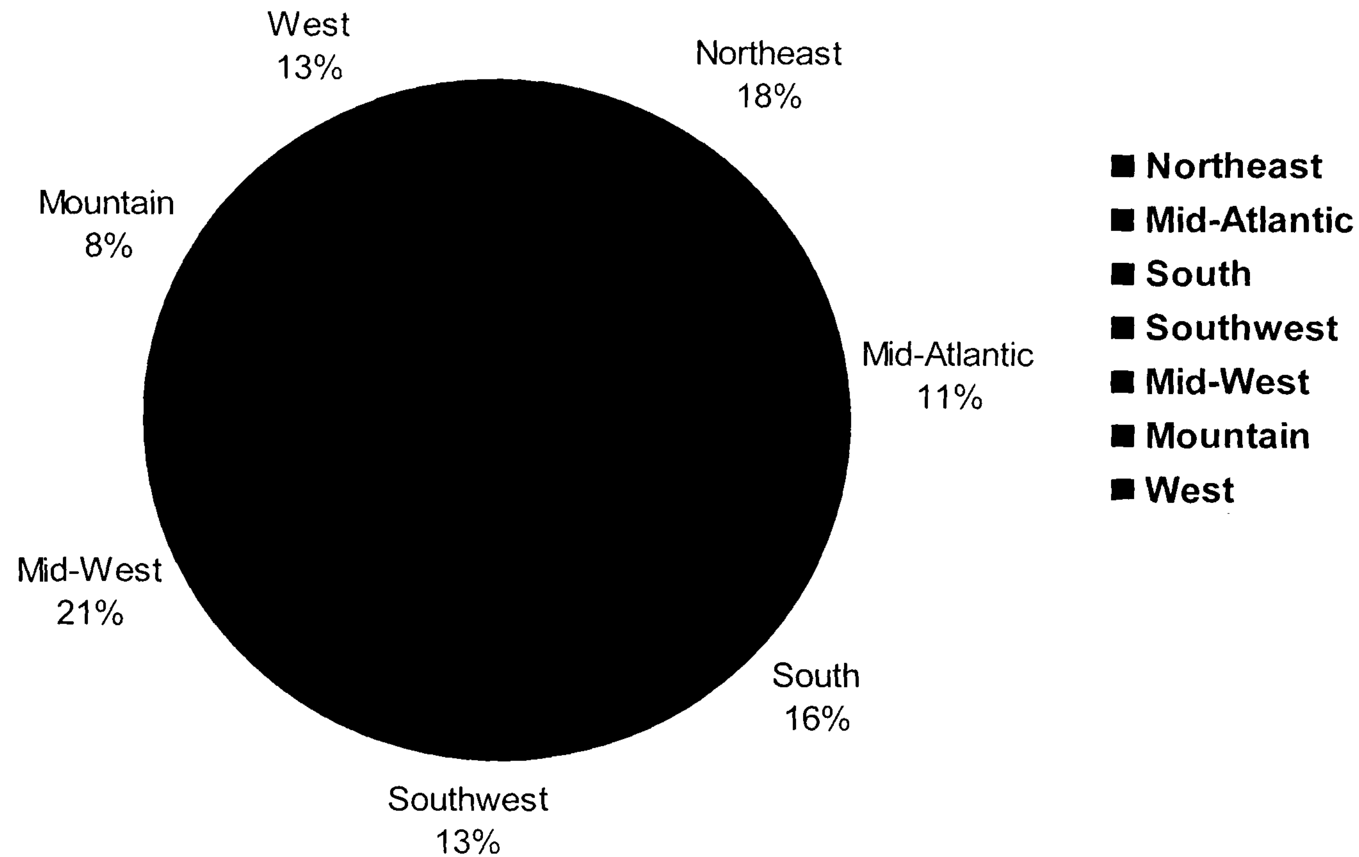
Distribution of Exercise Registrants

- This chart shows the sectors in which the registrants conduct their primary business. Registrants were asked to check all that apply.

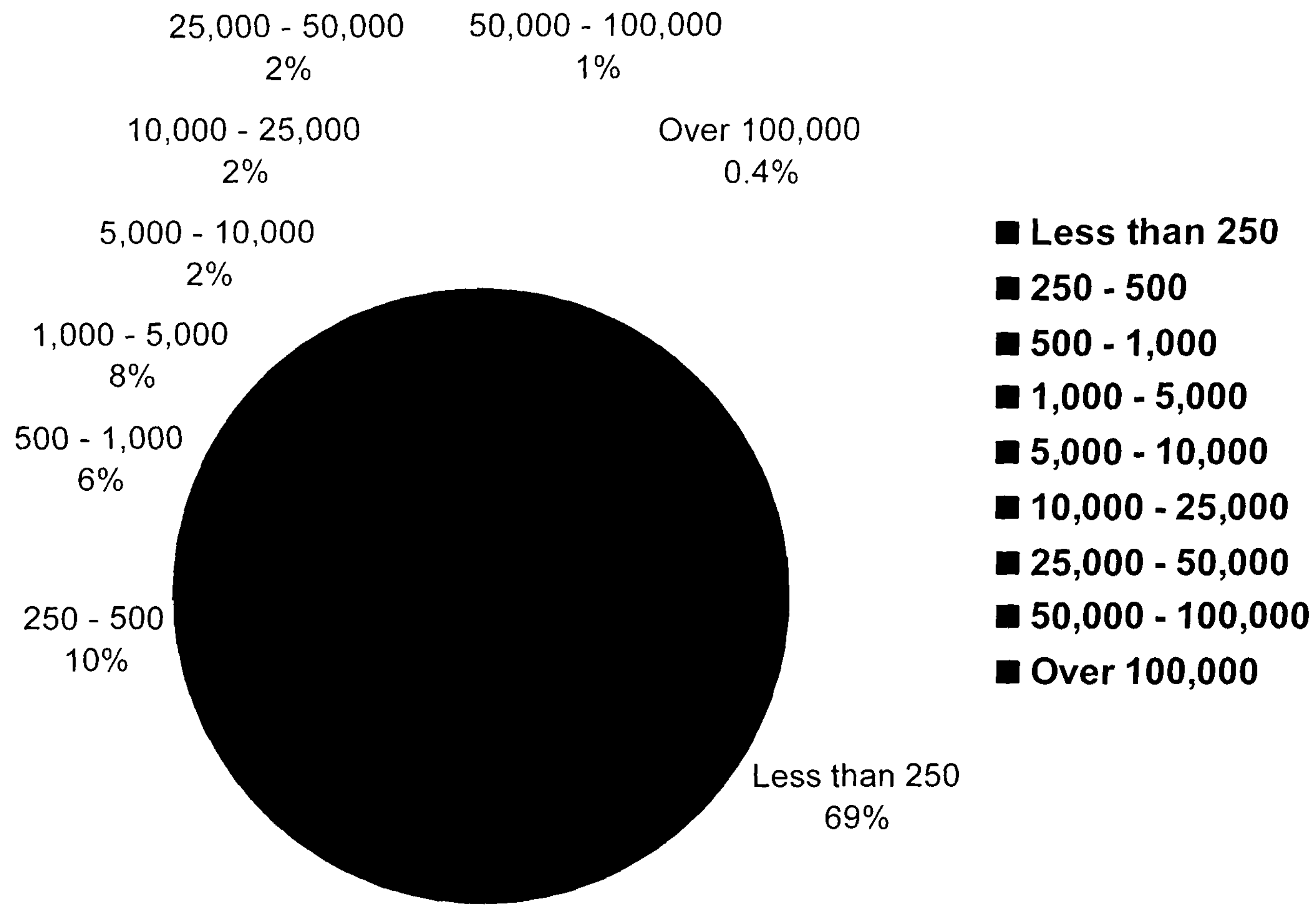


Geographic Distribution of Exercise Registrants

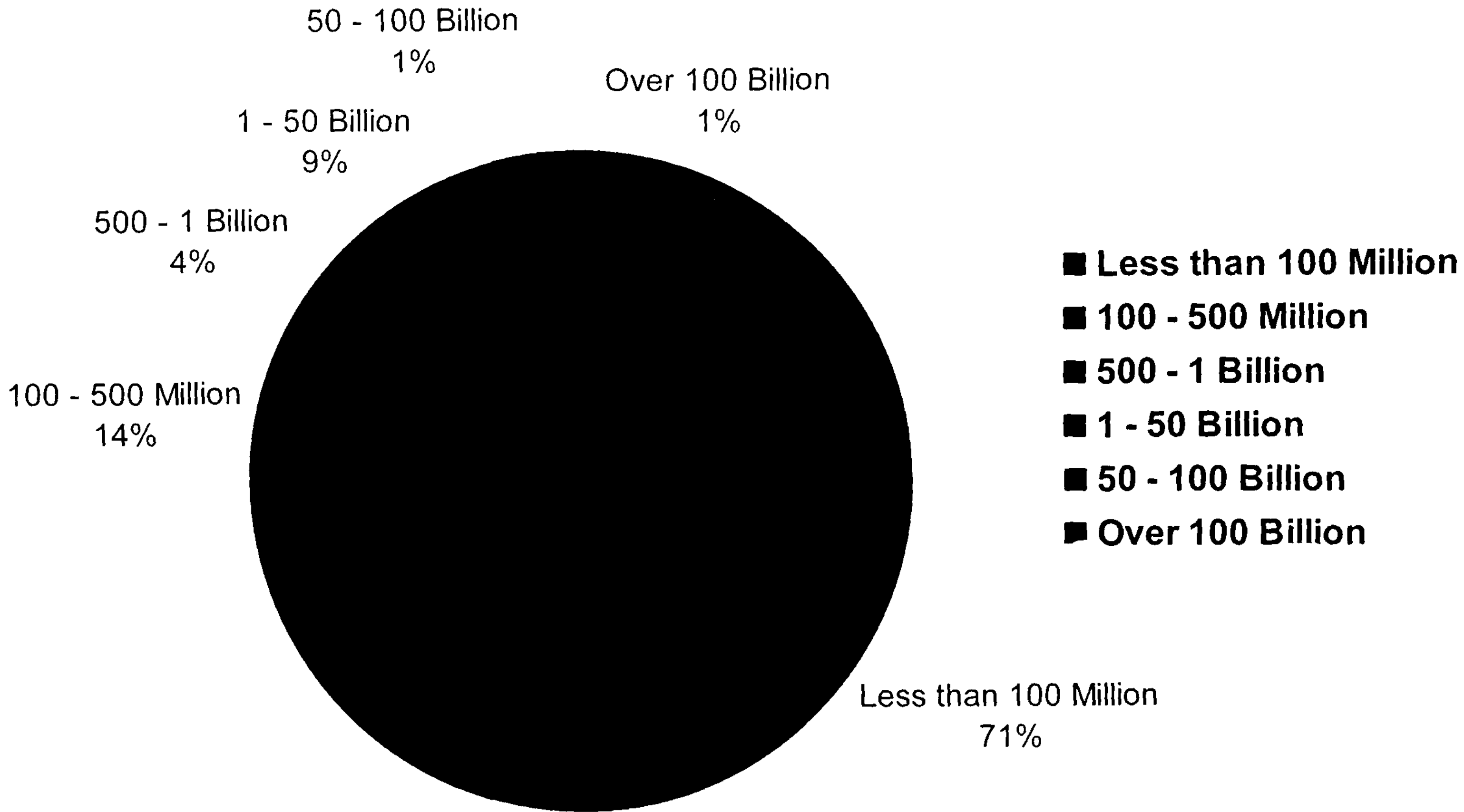
- This chart shows the geographic areas in which the registrants conduct their primary business. Registrants were asked to check all that apply.



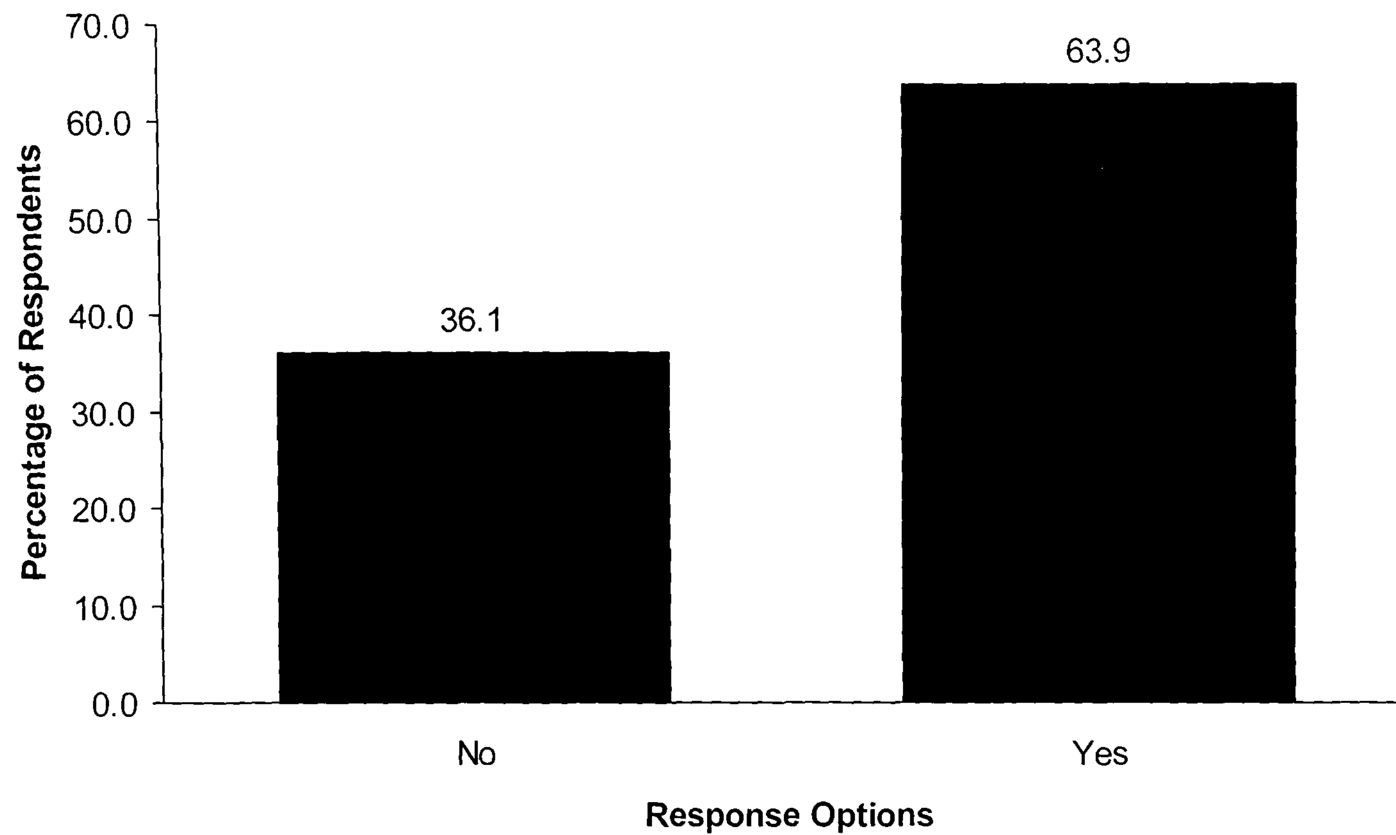
Employee Numbers



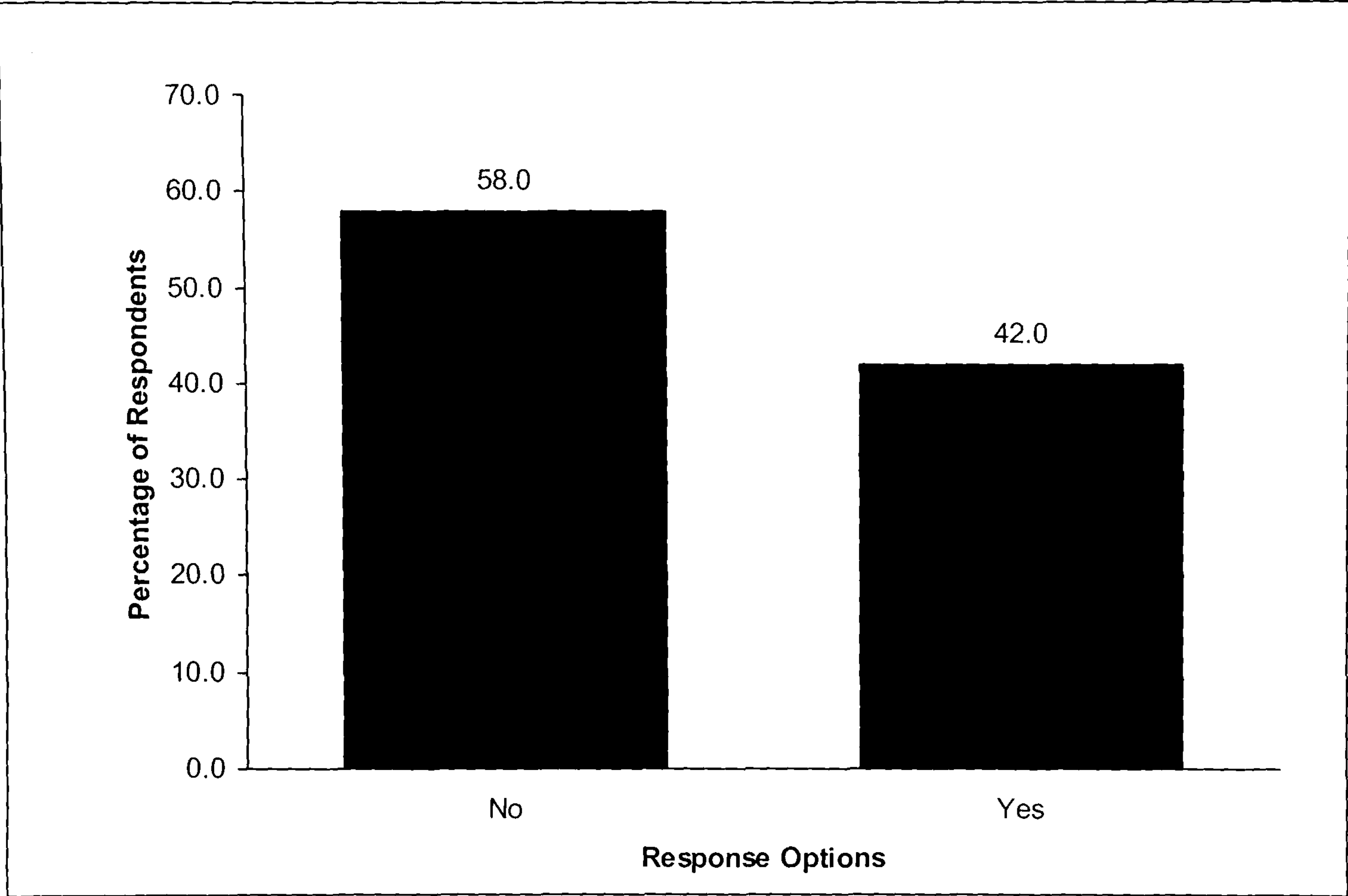
Revenue



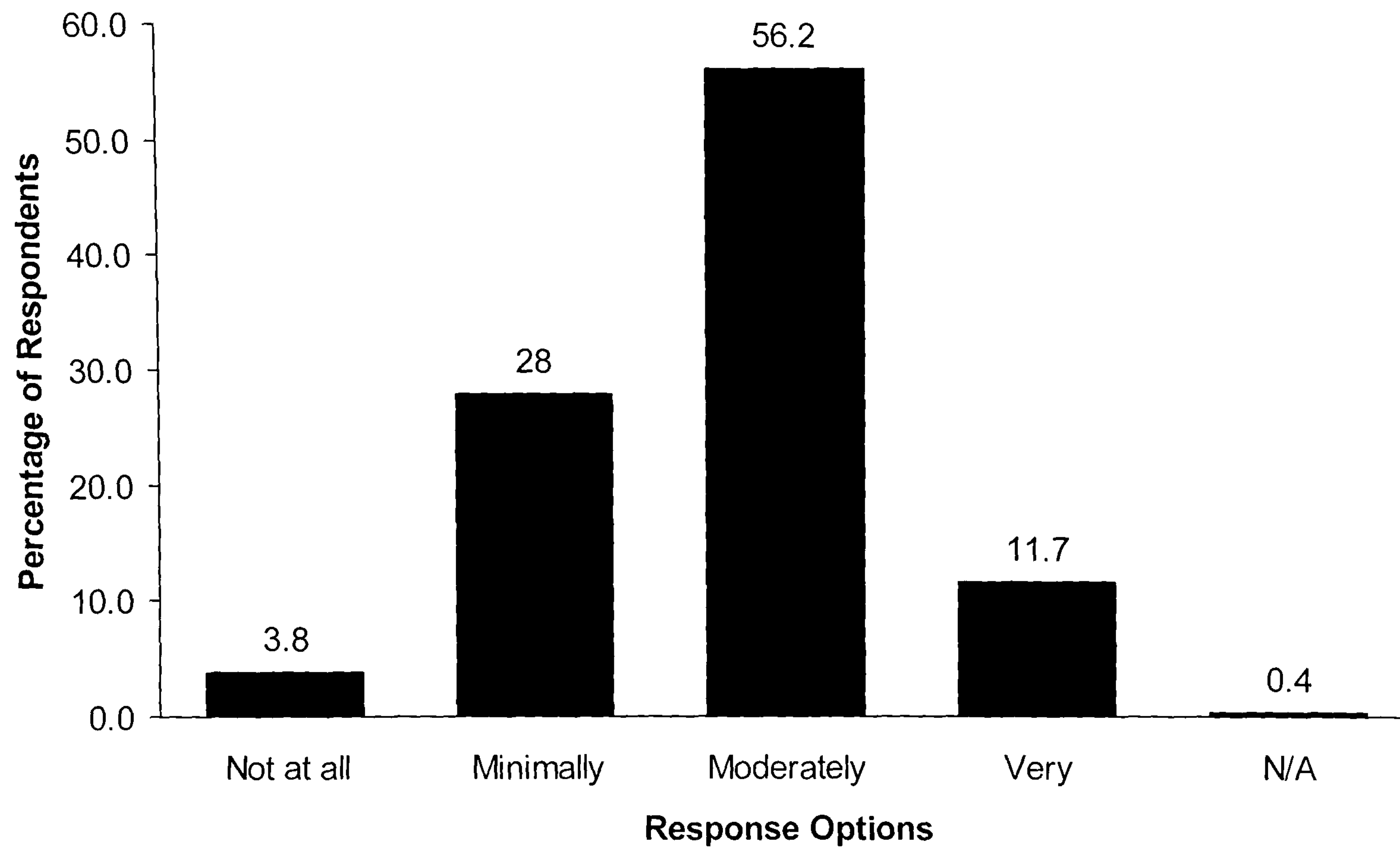
Does your organization have business continuity plans for a pandemic?



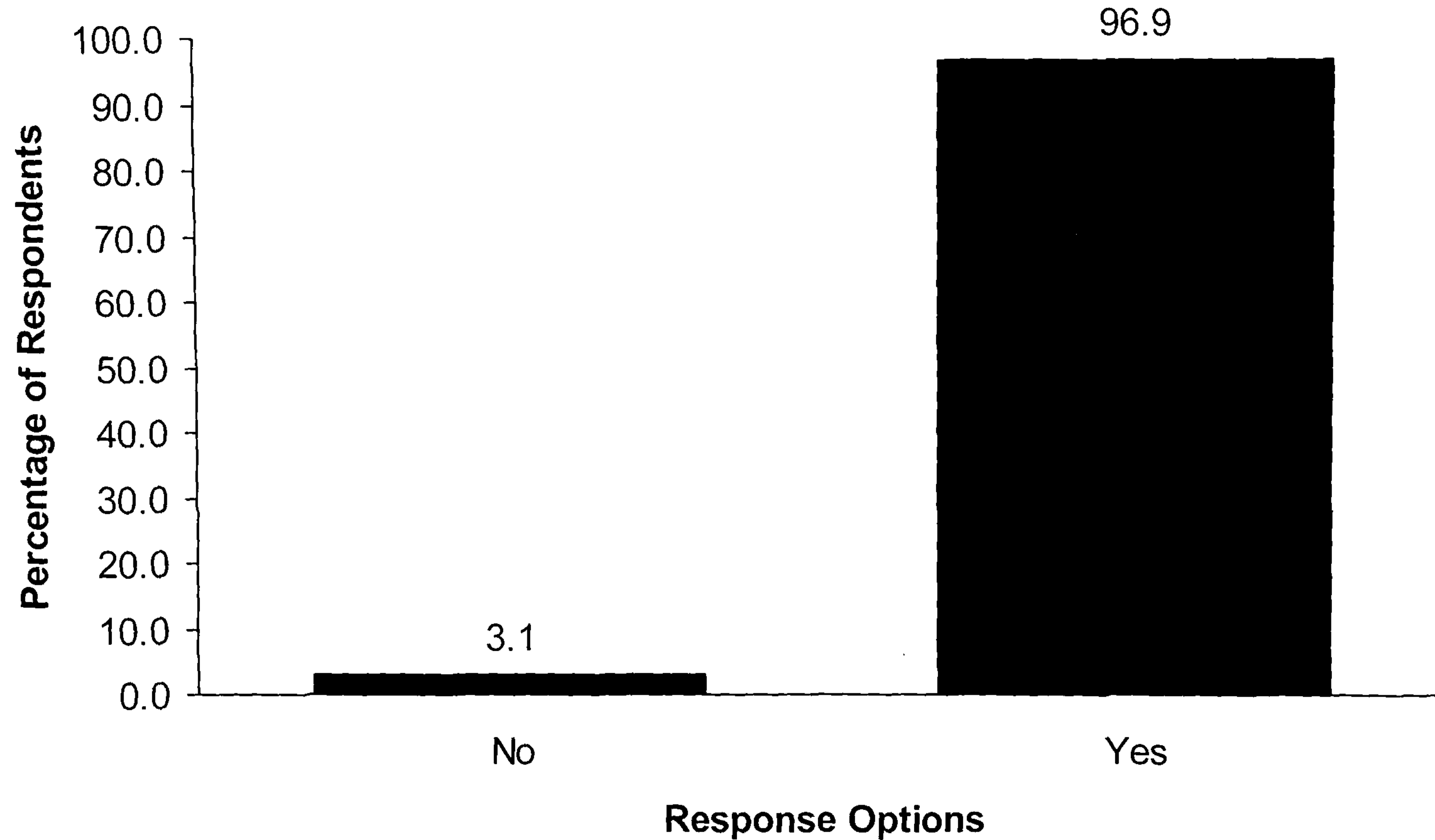
Does your organization have Human Resources (HR) pandemic policies/plans designed to meet the needs of your workforce during a pandemic?



Based on lessons learned from the exercise, how effective are your organization's business continuity plans for a pandemic?

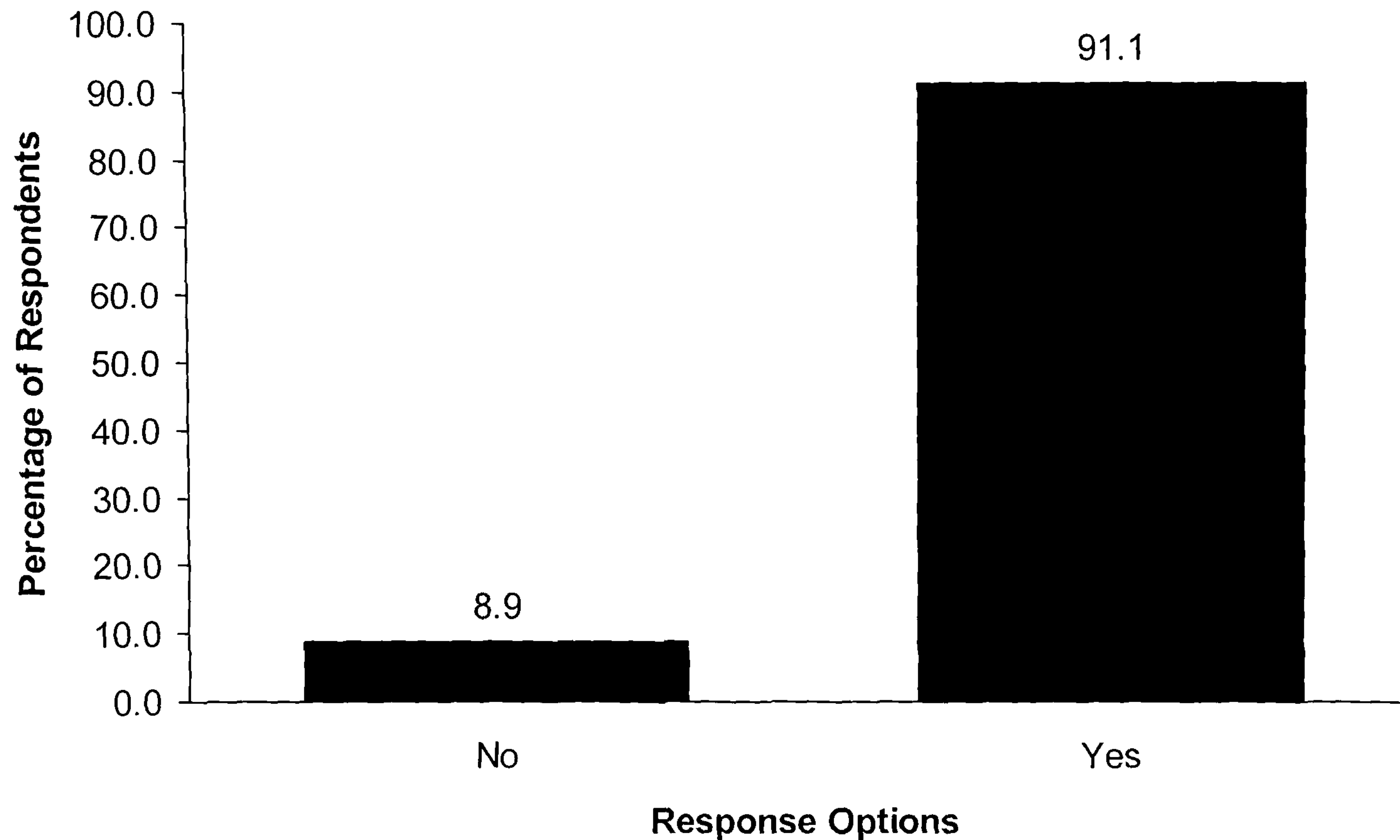


Did the exercise allow your organization to identify critical dependencies, gaps, and seams that warrant additional attention?

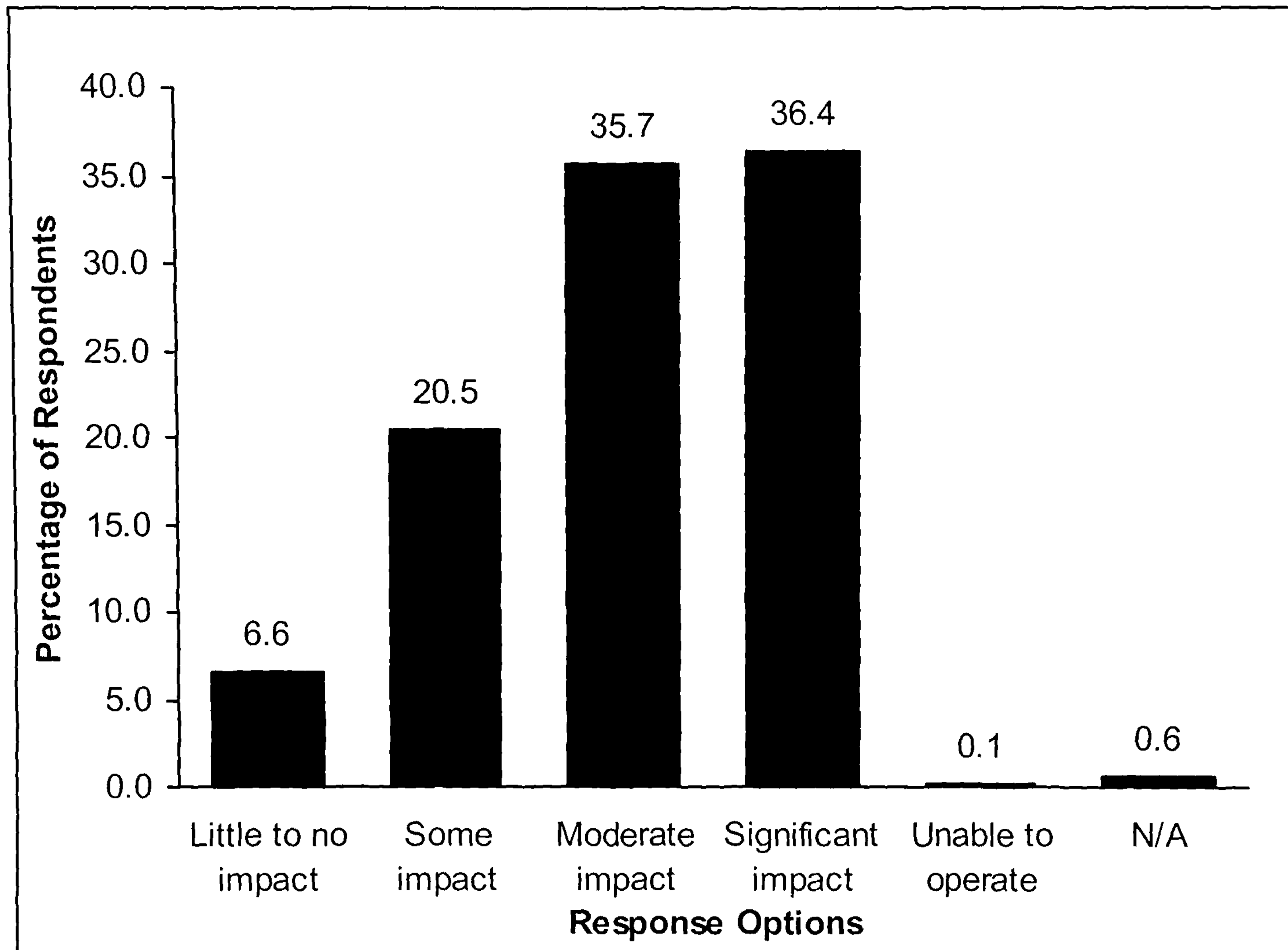


Note: Dependencies may include telecommunications, energy, transportation, information technology, and other service providers

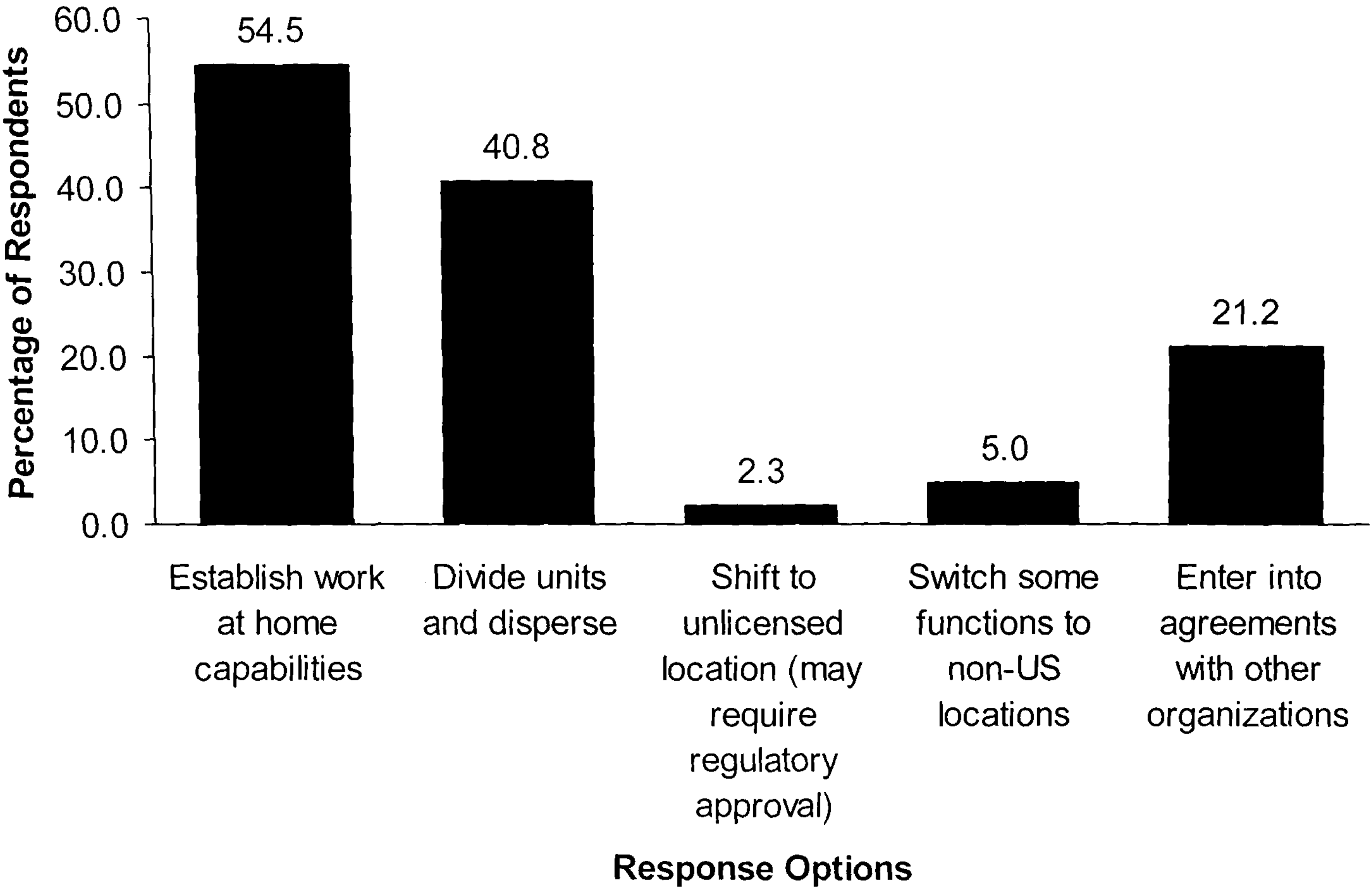
Will your organization initiate additional all-hazard plan refinement based upon your organization's lessons learned during the exercise?



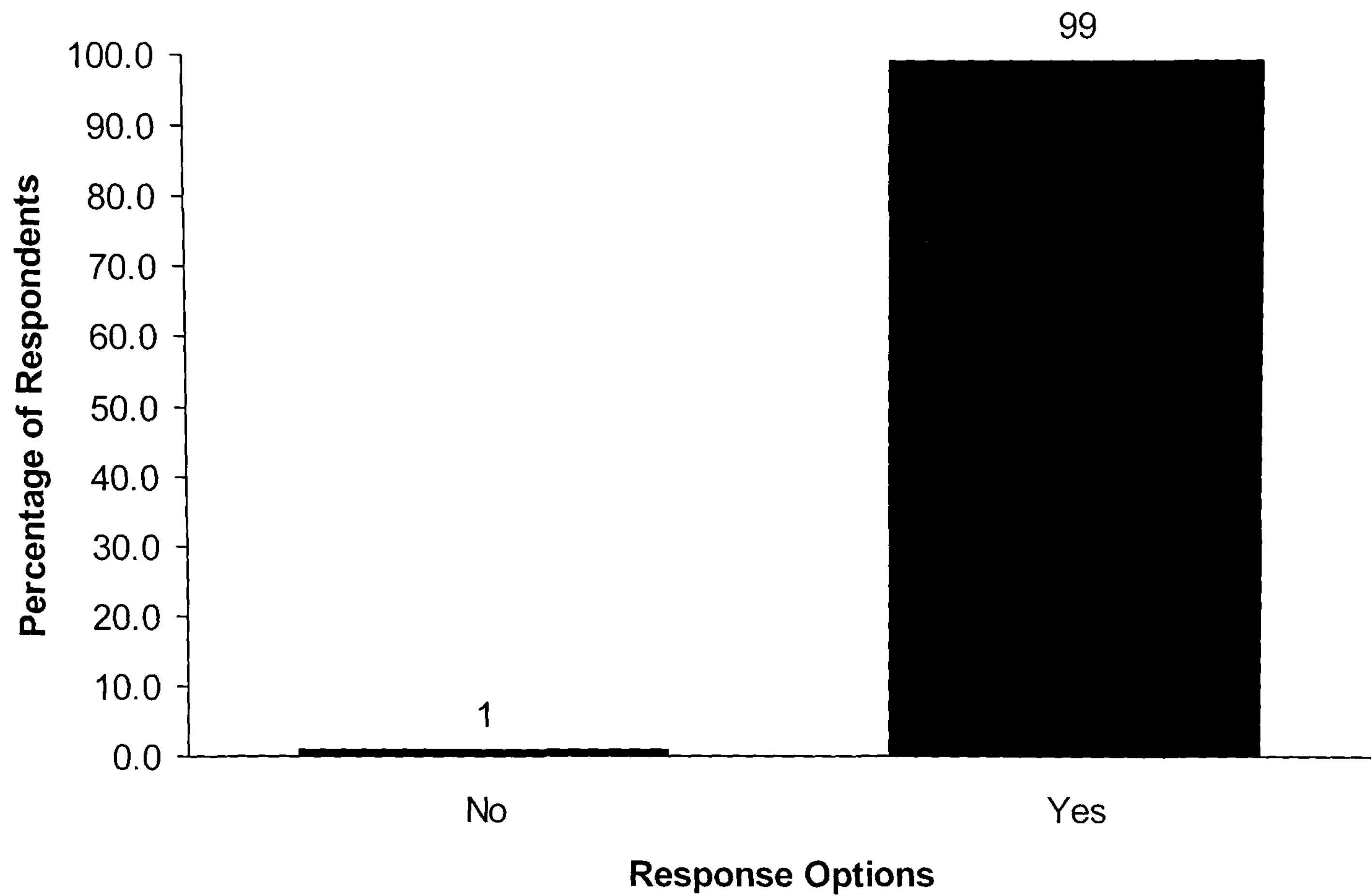
How significantly has the closing of all schools affected your organization?



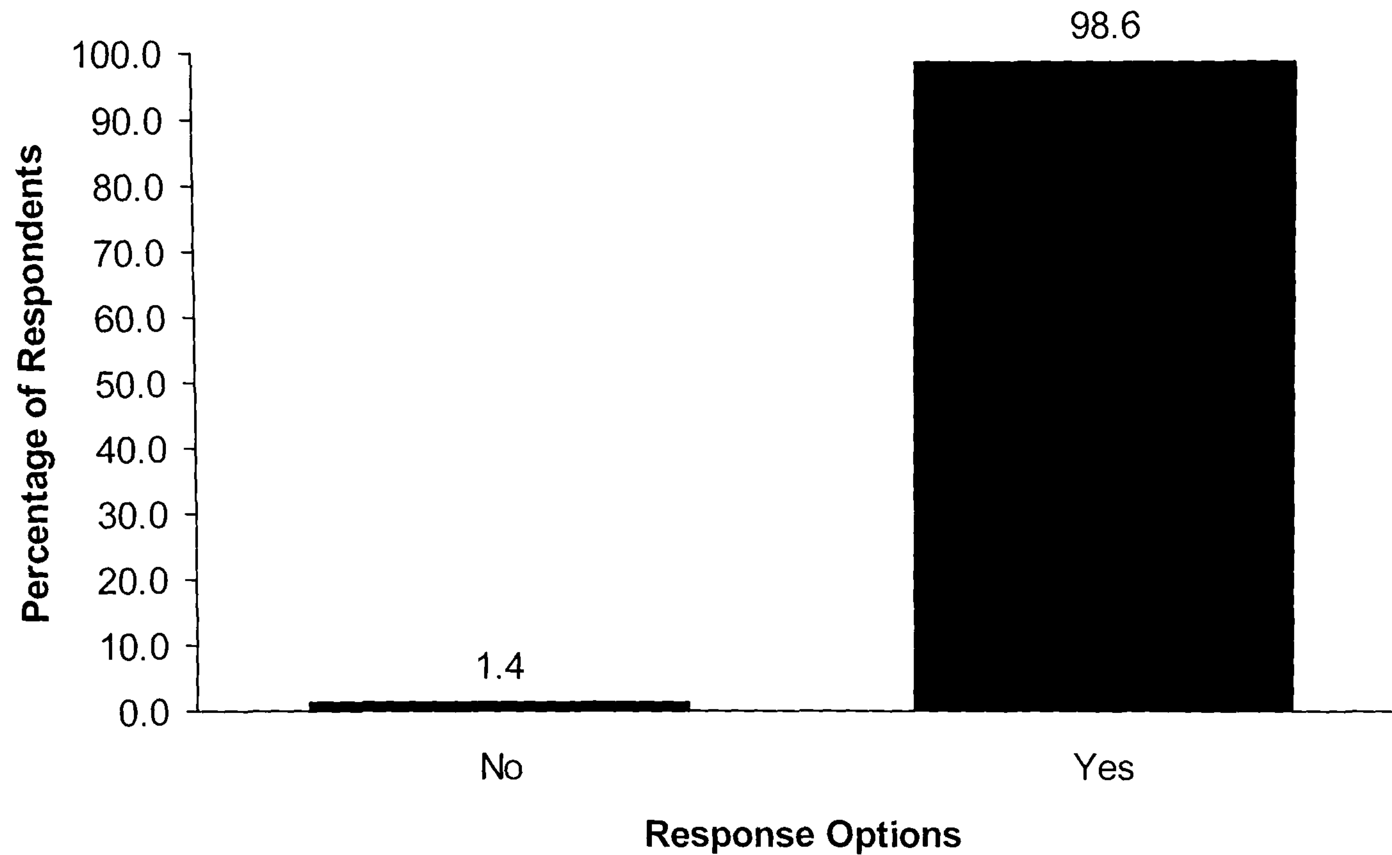
What steps is your organization taking to ensure that it is meeting business and regulatory obligations during [the height] of the pandemic? Check all that apply.



Did the exercise meet its stated objectives?



Was this exercise useful to your organization in assessing your pandemic business planning needs?



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October 25, 2007
hp-644

Fact Sheet: Designation of Iranian Entities and Individuals for Proliferation Activities and Support for Terrorism

The U.S. Government is taking several major actions today to counter Iran's bid for nuclear capabilities and support for terrorism by exposing Iranian banks, companies and individuals that have been involved in these dangerous activities and by cutting them off from the U.S. financial system.

Today, the Department of State designated under Executive Order 13382 two key Iranian entities of proliferation concern: the Islamic Revolutionary Guard Corps (IRGC; aka Iranian Revolutionary Guard Corps) and the Ministry of Defense and Armed Forces Logistics (MODAFL). Additionally, the Department of the Treasury designated for proliferation activities under E.O. 13382 nine IRGC-affiliated entities and five IRGC-affiliated individuals as derivatives of the IRGC, Iran's state-owned Banks Melli and Mellat, and three individuals affiliated with Iran's Aerospace Industries Organization (AIO).

The Treasury Department also designated the IRGC-Qods Force (IRGC-QF) under E.O. 13224 for providing material support to the Taliban and other terrorist organizations, and Iran's state-owned Bank Saderat as a terrorist financier.

Elements of the IRGC and MODAFL were listed in the Annexes to UN Security Council Resolutions 1737 and 1747. All UN Member States are required to freeze the assets of entities and individuals listed in the Annexes of those resolutions, as well as assets of entities owned or controlled by them, and to prevent funds or economic resources from being made available to them.

The Financial Action Task Force, the world's premier standard-setting body for countering terrorist financing and money laundering, recently highlighted the threat posed by Iran to the international financial system. FATF called on its members to advise institutions dealing with Iran to seriously weigh the risks resulting from Iran's failure to comply with international standards. Last week, the Treasury Department issued a warning to U.S. banks setting forth the risks posed by Iran. (For the text of the Treasury Department statement see: http://www.fincen.gov/guidance_fi_increasing_mlt_iranian.pdf.) Today's actions are consistent with this warning, and provide additional information to help financial institutions protect themselves from deceptive financial practices by Iranian entities and individuals engaged in or supporting proliferation and terrorism.

Effect of Today's Actions

As a result of our actions today, all transactions involving any of the designees and any U.S. person will be prohibited and any assets the designees may have under U.S. jurisdiction will be frozen. Noting the UN Security Council's grave concern over Iran's nuclear and ballistic missile program activities, the United States also encourages all jurisdictions to take similar actions to ensure full and effective implementation of UN Security Council Resolutions 1737 and 1747.

Today's designations also notify the international private sector of the dangers of doing business with three of Iran's largest banks, as well as the many IRGC-affiliated companies that pervade several basic Iranian industries.

Proliferation Finance – Executive Order 13382 Designations

E.O. 13382, signed by the President on June 29, 2005, is an authority aimed at freezing the assets of proliferators of weapons of mass destruction and their supporters, and at isolating them from the U.S. financial and commercial systems. Designations under the Order prohibit all transactions between the designees and any U.S. person, and freeze any assets the designees may have under U.S. jurisdiction.

The Islamic Revolutionary Guard Corps (IRGC): Considered the military vanguard of Iran, the Islamic Revolutionary Guard Corps (IRGC; aka Iranian Revolutionary Guard Corps) is composed of five branches (Ground Forces, Air Force, Navy, Basij militia, and Qods Force special operations) in addition to a counterintelligence directorate and representatives of the Supreme Leader. It runs prisons, and has numerous economic interests involving defense production, construction, and the oil industry. Several of the IRGC's leaders have been sanctioned under UN Security Council Resolution 1747.

The IRGC has been outspoken about its willingness to proliferate ballistic missiles capable of carrying WMD. The IRGC's ballistic missile inventory includes missiles, which could be modified to deliver WMD. The IRGC is one of the primary regime organizations tied to developing and testing the Shahab-3. The IRGC attempted, as recently as 2006, to procure sophisticated and costly equipment that could be used to support Iran's ballistic missile and nuclear programs.

Ministry of Defense and Armed Forces Logistics (MODAFL): The Ministry of Defense and Armed Forces Logistics (MODAFL) controls the Defense Industries Organization, an Iranian entity identified in the Annex to UN Security Council Resolution 1737 and designated by the United States under E.O. 13382 on March 30, 2007. MODAFL also was sanctioned, pursuant to the Arms Export Control Act and the Export Administration Act, in November 2000 for its involvement in missile technology proliferation activities.

MODAFL has ultimate authority over Iran's Aerospace Industries Organization (AIO), which was designated under E.O. 13382 on June 28, 2005. The AIO is the Iranian organization responsible for ballistic missile research, development and production activities and organizations, including the Shahid Hemmat Industries Group (SHIG) and the Shahid Bakeri Industries Group (SBIG), which were both listed under UN Security Council Resolution 1737 and designated under E.O. 13382. The head of MODAFL has publicly indicated Iran's willingness to continue to work on ballistic missiles. Defense Minister Brigadier General Mostafa Mohammad Najjar said that one of MODAFL's major projects is the manufacturing of Shahab-3 missiles and that it will not be halted. MODAFL representatives have acted as facilitators for Iranian assistance to an E.O. 13382- designated entity and, over the past two years, have brokered a number of transactions involving materials and technologies with ballistic missile applications.

Bank Melli, its branches, and subsidiaries: Bank Melli is Iran's largest bank. Bank Melli provides banking services to entities involved in Iran's nuclear and ballistic missile programs, including entities listed by the U.N. for their involvement in those programs. This includes handling transactions in recent months for Bank Sepah, Defense Industries Organization, and Shahid Hemmat Industrial Group. Following the designation of Bank Sepah under UNSCR 1747, Bank Melli took precautions not to identify Sepah in transactions. Through its role as a financial conduit, Bank Melli has facilitated numerous purchases of sensitive materials for Iran's nuclear and missile programs. In doing so, Bank Melli has provided a range of financial services on behalf of Iran's nuclear and missile industries, including opening letters of credit and maintaining accounts.

Bank Melli also provides banking services to the IRGC and the Qods Force. Entities owned or controlled by the IRGC or the Qods Force use Bank Melli for a variety of financial services. From 2002 to 2006, Bank Melli was used to send at least $100 million to the Qods Force. When handling financial transactions on behalf of the IRGC, Bank Melli has employed deceptive banking practices to obscure its involvement from the international banking system. For example, Bank Melli has requested that its name be removed from financial transactions.

Bank Mellat, its branches, and subsidiaries: Bank Mellat provides banking services in support of Iran's nuclear entities, namely the Atomic Energy Organization of Iran (AEOI) and Novin Energy Company. Both AEOI and Novin Energy have been

designated by the United States under E.O. 13382 and by the UN Security Council under UNSCRs 1737 and 1747. Bank Mellat services and maintains AEOI accounts, mainly through AEOI's financial conduit, Novin Energy. Bank Mellat has facilitated the movement of millions of dollars for Iran's nuclear program since at least 2003. Transfers from Bank Mellat to Iranian nuclear-related companies have occurred as recently as this year.

IRGC-owned or -controlled companies: Treasury is designating the companies listed below under E.O. 13382 on the basis of their relationship to the IRGC. These entities are owned or controlled by the IRGC and its leaders. The IRGC has significant political and economic power in Iran, with ties to companies controlling billions of dollars in business and construction and a growing presence in Iran's financial and commercial sectors. Through its companies, the IRGC is involved in a diverse array of activities, including petroleum production and major construction projects across the country. In 2006, Khatam al-Anbiya secured deals worth at least $7 billion in the oil, gas, and transportation sectors, among others.

- Khatam al-Anbya Construction Headquarters
- Oriental Oil Kish
- Ghorb Nooh
- Sahel Consultant Engineering
- Ghorb-e Karbala
- Sepasad Engineering Co
- Omran Sahel
- Hara Company
- Ghárargahe Sazandegi Ghaem

IRGC Individuals: Treasury is designating the individuals below under E.O 13382 on the basis of their relationship to the IRGC. One of the five is listed on the Annex of UNSCR 1737 and the other four are listed on the Annex of UNSCR 1747 as key IRGC individuals.

- General Hosein Salimi, Commander of the Air Force, IRGC
- Brigadier General Morteza Rezaie, Deputy Commander of the IRGC
- Vice Admiral Ali Akhbar Ahmadian, Most recently former Chief of the IRGC Joint Staff
- Brigadier Gen. Mohammad Hejazi, Most recently former Commander of Bassij resistance force
- Brigadier General Qasem Soleimani, Commander of the Qods Force

Other Individuals involved in Iran's ballistic missile programs: E.O. 13382 derivative proliferation designation by Treasury of each of the individuals listed below for their relationship to the Aerospace Industries Organization, an entity previously designated under E.O. 13382. Each individual is listed on the Annex of UNSCR 1737 for being involved in Iran's ballistic missile program.

- Ahmad Vahid Dastjerdi, Head of the Aerospace Industry Organization (AIO)
- Reza-Gholi Esmaeli, Head of Trade & International Affairs Dept., AIO
- Bahmanyar Morteza Bahmanyar, Head of Finance & Budget Department, AIO

Support for Terrorism -- Executive Order 13224 Designations

E.O. 13224 is an authority aimed at freezing the assets of terrorists and their supporters, and at isolating them from the U.S. financial and commercial systems. Designations under the E.O. prohibit all transactions between the designees and any U.S. person, and freeze any assets the designees may have under U.S. jurisdiction.

IRGC-Qods Force (IRGC-QF): The Qods Force, a branch of the Islamic Revolutionary Guard Corps (IRGC; aka Iranian Revolutionary Guard Corps), provides material support to the Taliban, Lebanese Hizballah, Hamas, Palestinian Islamic Jihad, and the Popular Front for the Liberation of Palestine-General Command (PFLP-GC).

The Qods Force is the Iranian regime's primary instrument for providing lethal support to the Taliban. The Qods Force provides weapons and financial support to

the Taliban to support anti-U.S. and anti-Coalition activity in Afghanistan. Since at least 2006, Iran has arranged frequent shipments of small arms and associated ammunition, rocket propelled grenades, mortar rounds, 107mm rockets, plastic explosives, and probably man-portable defense systems to the Taliban. This support contravenes Chapter VII UN Security Council obligations. UN Security Council resolution 1267 established sanctions against the Taliban and UN Security Council resolutions 1333 and 1735 imposed arms embargoes against the Taliban. Through Qods Force material support to the Taliban, we believe Iran is seeking to inflict casualties on U.S. and NATO forces.

The Qods Force has had a long history of supporting Hizballah's military, paramilitary, and terrorist activities, providing it with guidance, funding, weapons, intelligence, and logistical support. The Qods Force operates training camps for Hizballah in Lebanon's Bekaa Valley and has reportedly trained more than 3,000 Hizballah fighters at IRGC training facilities in Iran. The Qods Force provides roughly $100 to $200 million in funding a year to Hizballah and has assisted Hizballah in rearming in violation of UN Security Council Resolution 1701.

In addition, the Qods Force provides lethal support in the form of weapons, training, funding, and guidance to select groups of Iraqi Shi'a militants who target and kill Coalition and Iraqi forces and innocent Iraqi civilians.

Bank Saderat, its branches, and subsidiaries: Bank Saderat, which has approximately 3200 branch offices, has been used by the Government of Iran to channel funds to terrorist organizations, including Hizballah and EU-designated terrorist groups Hamas, PFLP-GC, and Palestinian Islamic Jihad. For example, from 2001 to 2006, Bank Saderat transferred $50 million from the Central Bank of Iran through its subsidiary in London to its branch in Beirut for the benefit of Hizballah fronts in Lebanon that support acts of violence. Hizballah has used Bank Saderat to send money to other terrorist organizations, including millions of dollars on occasion, to support the activities of Hamas. As of early 2005, Hamas had substantial assets deposited in Bank Saderat, and, in the past year, Bank Saderat has transferred several million dollars to Hamas.

REPORTS

- Treasury and State Department Iran Designations Identifier

Treasury and State Department Iran Designations Identifier Information
Pursuant to E.O. 13224 (Terrorism) and E.O. 13382 (WMD)
October 25, 2007

E.O. 13224

1. **Entity**:	**BANK SADERAT IRAN**
AKA:	Iran Export Bank
AKA:	Bank Saderat PLC
Location:	PO Box 15745-631, Bank Saderat Tower, 43 Somayeh Avenue, Tehran, Iran, and all offices worldwide, including:
Location:	16 rue de la Paix, 75002 Paris, France
Location:	Postfach 160151, Friedenstr 4, D-603111 Frankfurt am Main, Germany
Location:	Postfach 112227, Deichstrasse 11, 20459 Hamburg, Germany
Location:	PO Box 4308, 25-29 Venizelou St, GR 105 64 Athens, Attica, Greece
Location:	3rd Floor, Aliktisad Bldg, Ras El Ein Street, Baalbak, Baalbak, Lebanon
Location:	1st Floor, Alrose Bldg, Verdun Rashid Karame St, Beirut, Lebanon
Location:	PO Box 5126, Beirut, Lebanon
Location:	Alghobeiri Branch - Aljawhara Bldg, Ghobiery Blvd, Beirut, Lebanon
Location:	Borj Albarajneh Branch - Alholom Bldg, Sahat Mreijeh Kafaat St, Beirut, Lebanon
Location:	Sida Riad Elsoleh St, Martyrs Square, Saida, Lebanon
Location:	PO Box 1269, 112 Muscat, Oman
Location:	PO Box 2256, Doha, Qatar
Location:	No 181, Makhtoomgholi Ave, 2nd Floor, Ashgabat, Turkmenistan
Location:	PO Box 700, Abu Dhabi, UAE
Location:	PO Box 16, Liwara Street, Ajman, UAE
Location:	PO Box 1140, Al-Am Road, Al-Ein Al Ain, Abu Dhabi, UAE
Location:	PO Box 4182, Murshid Bazar Branch, Dubai City, UAE
Location:	Sheikh Zayed Rd, Dubai City, UAE
Location:	Khaled Bin Al Walid St, Dubai City, UAE
Location:	PO Box 4182, Almaktoum Rd, Dubai City, UAE
Location:	PO Box 316, Bank Saderat Bldg, Al Arooba St, Borj Ave, Sharjah, UAE
Location:	5 Lothbury, London, EC2R 7HD, UK
Location:	PO Box 15175/584, 6th Floor, Sadaf Bldg, 1137 Vali Asr Ave, 15119-43885, Tehran, Iran

2. **Entity**:	**ISLAMIC REVOLUTIONARY GUARDS CORPS (IRGC)- QODS FORCE**
AKA:	Pasdaran-e Enghelab-e Islami (Pasdaran)
AKA:	Sepah-e Qods (Jerusalem Force)

DESIGNATIONS BY THE STATE DEPARTMENT
PURSUANT TO E.O. 13382

1. **Entity:** **ISLAMIC REVOLUTIONARY GUARD CORPS**

AKA:	IRGC
AKA:	IRG
AKA:	AGIR
AKA:	The Iranian Revolutionary Guards
AKA:	The Army of the Guardians of the Islamic Revolution
AKA:	Sepah-e Pasdaran-e Enqelab-e Eslami
AKA:	Pasdaran-e Enghelab-e Islami
AKA:	Pasdaran-e Inqilab
AKA:	Revolutionary Guards
AKA:	Revolutionary Guard
AKA:	Sepah
AKA:	Pasdaran
AKA:	Sepah Pasdaran
AKA:	Islamic Revolutionary Corps
AKA:	Iranian Revolutionary Guard Corps
Location:	Tehran, Iran

2. <u>**Entity**</u>	**MINISTRY OF DEFENSE AND ARMED FORCES LOGISTICS**
AKA:	Ministry of Defense and Support for Armed Forces Logistics
AKA:	MODAFL
AKA:	MODSAF
Location:	Located on the West Side of Dabestan Street, Abbas Abad District, Tehran, Iran

DESIGNATIONS BY THE TREASURY DEPARTMENT PURSUANT TO E.O. 13382

<u>**Bank Melli**</u>

1. <u>**Entity:**</u>	**BANK MELLI IRAN**
Location:	Ferdowsi Avenue, P.O. Box 11365-171, Tehran, Iran, and all offices worldwide, including:
Location:	43, Avenue Montaigne, Paris 75008, France
Location:	Holzbrucke 2, 20459 Hamburg, Germany
Location:	Nobel Avenue 14, Baku, Azerbaijan Republic
Location:	P.O. Box 2643 PC 112, Muscat, Oman
Location:	P.O. Box 5270, Oman Street, Al Nakheel, Ras al Khaimah, UAE
Location:	P.O. Box 248, Al Marash R/A, Hamad Bin Abdullah Street, Fujairah, UAE
Location:	P.O. Box 459, Al Burj Street, Sharjah, UAE
Location:	P.O. Box 1888, Clock Tower, Industrial Road, Al Ain, Abu Dhabi, UAE
Location:	P.O. Box 2656, Hamdan Street, Abu Dhabi, UAE
Location:	P.O. Box 3093, Khalid Bin Waleed Street, Bur Dubai, UAE
Location:	P.O. 1894, Beniyas Street, Dubai, UAE
Location:	No. 111-27, Alley - 929, District - Arasat Street, Baghdad, Iraq

Location: 704-6 Wheelock House, 20 Pedder Street, Hong Kong, China

2. **Entity:** **BANK KARGOSHAEE**
AKA: Kargosa'i Bank
Location: 587 Mohammadiye Square, Mowlavi St., Tehran, 11986, Iran

3. **Entity:** **BANK MELLI IRAN ZAO**
Location: Number 9/1, Ulitsa Mashkova, Moscow 103064, Russia

4. **Entity:** **MELLI BANK PLC**
Location: 1 London Wall, London, EC2Y 5EA, United Kingdom

5. **Entity:** **ARIAN BANK** (Joint Venture between Banks Melli and Saderat)
AKA: Aryan Bank
Location: House 2, Number 13, Wazir Akbar Khan, Kabul, Afghanistan

Bank Mellat

6. **Entity:** **BANK MELLAT**
Location: 327 Taleghani Avenue, 15817 Tehran, Iran, and all offices worldwide, including:
Location: P.O. Box 375010, Amiryan Street #6, P/N-24, Yerevan, Armenia
Location: Keumkang Tower, 13th and 14th Floors, 889-13 Daechi-Dong, Gangnam-Ku, Seoul 135-280, South Korea
Location: P.O. Box 79106425, Ziya Gokalp Bulvari No. 12, Kizilay, Ankara, Turkey
Location: Cumhuriyet Bulvari No. 88/A, PK 7103521, Konak, Izmir, Turkey
Location: Buyukdere Cad, Cicek Sokak No. 1-1, Levent, Istanbul, Turkey

7. **Entity:** **MELLAT BANK SB CJSC**
AKA: Mellat Bank DB AOZT
Location: P.O. Box 24, Yerevan 0010, Republic of Armenia

8. **Entity:** **Persia International Bank PLC.**
Location: Number 6 Lothbury, Post Code: EC2R 7HH, United Kingdom

IRGC Entities:

9. **Entity:** **KHATAM OL ANBIA GHARARGAH SAZANDEGI NOOH**
AKA: Khatam Ol Ambia
AKA: Ghorb Khatam
AKA: Khatam Al-Anbya
Location: Number 221, North Falamak-Zarafshan Intersection, 4th Phase, Shahrak-E-Ghods, Tehran 14678, Iran

10. **Entity:**	**ORIENTAL OIL KISH**
Location:	2nd Floor, 96-98 East Atefi St., Africa Blvd., Tehran, Iran
Alternate location:	Dubai, UAE
11. **Entity:**	**GHORB KARBALA**
AKA:	Gharargah Sazandegi Karbala-Moasseseh Taha
AKA:	Gharargah Karbala
Location:	No. 2 Firouzeh Alley, Shahid Hadjipour St., Resalat Highway, Tehran, Iran
12. **Entity:**	**SEPASAD ENGINEERING COMPANY**
Location:	Number 4 corner of Shad Street, Mollasadra Ave., Vanak Square, Tehran, Iran
13. **Entity:**	**GHORB NOOH**
Location:	P.O. Box 16765-3476, Tehran, Iran
14. **Entity:**	**OMRAN SAHEL**
Location:	Tehran, Iran
15. **Entity:**	**SAHEL CONSULTANT ENGINEERS**
Location:	Number 57, Eftekhar Street, Larestan Street, Motahhari Avenue, Tehran, Iran
Mailing address:	P.O. Box 16765-34, Tehran, Iran
16. **Entity:**	**HARA COMPANY**
AKA:	Hara Institute
Location:	Tehran, Iran
17. **Entity:**	**GHARARGAHE SAZANDEGI GHAEM**
AKA:	Gharargah Ghaem
Location:	Number 25, Valiasr Street, Azadi Square, Tehran, Iran

AIO Individuals:

18. **Individual:**	**BAHMANYAR MORTEZA BAHMANYAR**
DOB:	December 31, 1952
POB:	Tehran, Iran
Passport:	I0005159 (Iran)
Alternate Passport:	10005159 (Iran)
19. **Individual:**	**AHMAD VAHID DASTJERDI**
AKA:	AHMED DASTJERDI VAHID
DOB:	January 15, 1954
Passport:	Diplomatic Passport A0002987 (Iran)

20. **Individual:**	**REZA-GHOLI ESMAELI**
DOB:	April 3, 1961
POB:	Tehran, Iran
Passport:	A0002302 (Iran)

IRGC Individuals:

21. **Individual:**	**MORTEZA REZAIE**
AKA:	Morteza Rezai
DOB:	circa 1956

22. **Individual:**	**MOHAMMAD HEJAZI**
DOB:	circa 1959

23. **Individual:**	**ALI AKBAR AHMADIAN**
AKA:	Ali Akbar Ahmadiyan
DOB:	circa 1961
POB:	Kerman, Iran

24. **Individual:**	**HOSEIN SALIMI**
AKA:	Hossein Salami
AKA:	Hoseyn Salami
AKA:	Hussayn Salami
Passport:	D08531177 (Iran)

25. **Individual:**	**QASEM SOLEIMANI**
AKA:	Ghasem Soleymani
AKA:	Qasmi Sulayman
AKA:	Qasem Soleymani
AKA:	Qasem Solaimani
AKA:	Qasem Salimani
AKA:	Qasem Solemani
AKA:	Qasem Sulaimani
AKA:	Qasem Sulemani
DOB:	March 11, 1957
POB:	Qom, Iran
Passport:	1999 Diplomatic Passport 008827 (Iran)

October 25, 2007
HP-645

Statement by Secretary Paulson on Iran Designations

Washington, DC-- Treasury released the following statement by Secretary Henry M. Paulson, Jr. on Iran designations announced today:

"Iran exploits its global financial ties to pursue nuclear capabilities, develop ballistic missiles and fund terrorism. Today, we are taking additional steps to combat Iran's dangerous conduct and to engage financial institutions worldwide to make the most informed decisions about those with whom they choose to do business.

"The Iranian regime's ability to pursue nuclear and ballistic missile programs in defiance of UN Security Council Resolutions depends on its access to the international commercial and financial systems. Iran also funnels hundreds of millions of dollars each year through the international financial system to terrorists. Iran's banks aid this conduct, using a range of deceptive financial practices intended to evade even the most stringent risk-management controls. In dealing with Iran, it is nearly impossible to know one's customer and be assured that one is not unwittingly facilitating the regime's reckless conduct. The recent warning by the Financial Action Task Force, the world's premier standard-setting body for countering terrorist financing and money laundering, confirms the extraordinary risks that accompany doing business with Iran.

"We have been working closely and intensely with our international partners to prevent one of the world's most dangerous regimes from developing the world's most dangerous weapons. Part of that strategy involves denying supporters of Iran's illicit conduct access to the international financial system; these actors should find no safe haven in the reputable world of finance and commerce. The UN Security Council has required member states to freeze the assets of, and prohibit persons from doing business with, a number of entities and individuals supporting Iran's nuclear or ballistic missile activities, including Iran's state-owned Bank Sepah.

"Today, we are designating Iran's Bank Melli, Bank Mellat, and Bank Saderat. These are three of Iran's largest banks, and they all have facilitated Iran's proliferation activities or its support for terrorism. We are also designating the Islamic Revolutionary Guard Corps for proliferation activities and its Qods Force for providing material support to the Taliban and other terrorist organizations. The IRGC is so deeply entrenched in Iran's economy and commercial enterprises, it is increasingly likely that, if you are doing business with Iran, you are doing business with the IRGC. We call on responsible banks and companies around the world to terminate any business with Bank Melli, Bank Mellat, Bank Saderat, and all companies and entities of the IRGC.

"As awareness of Iran's deceptive behavior has grown, many banks around the world have decided as a matter of prudence and integrity that Iran's business is simply not worth the risk. It is plain and simple: reputable institutions do not want to be the bankers for this dangerous regime. We will continue to work with our international partners to prevent Iran from abusing the international financial system to advance its illicit conduct."

October 25, 2007
HP-646

Paulson Statement on Chairman Rangel's Tax Proposals

Washington, DC--The Treasury Department released the following statement from Secretary Henry M. Paulson, Jr. on the introduction of Chairman Rangel's tax overhaul legislation.

"In February the President proposed in his budget an AMT patch without raising any other taxes. This is the right policy.

"It is obvious that Congress does not have the time this year to undertake a large, complex tax bill, and I am increasingly concerned that we are not seeing timely action on an AMT patch. We have only weeks to act to avoid the risk of unintended tax increases or significant delays for taxpayers receiving refunds.

"The legislation unveiled today would dramatically raise taxes in ways that in my judgment would hinder America's ability to compete in the global economy. The proposed new surtax on individual income would burden millions of small businesses, and undermine job creation. The corporate proposals will hurt the ability of our businesses and workers to compete in a global economy.

"I appreciate that Chairman Rangel wants to look at our corporate tax structure in the context of competitiveness, and I have had constructive preliminary conversations with the committee on this subject, building on Treasury's own work on business tax competitiveness. I have said we need to do more work on this, and we look forward to continuing that discussion. This is a separate and longer-term discussion.

"As our economy grapples with a housing downturn, the last thing we need is a tax increase. I urge the Congress to take up the AMT patch as quickly as possible."

October 26, 2007
HP-647

Under Secretary for International Affairs McCormick to Deliver Speech in Kuwait

Treasury Under Secretary for International Affairs David H. McCormick will speak Sunday in Kuwait on trade and open investment. He will address economic and marketing finance students at American University of Kuwait.

- **Who:** Treasury Under Secretary for International Affairs David H. McCormick
- **What:** Remarks on Trade and Open Investment
- **When:** 3:30 p.m., local time, Sunday, October 28
- **Where:** American University of Kuwait
  Kuwait City, Kuwait

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October 29, 2007
HP-648

**Remarks by Secretary Henry M. Paulson, Jr.
on the United States as a Partner in India's
Continued Growth at the US-India Forum**

Mumbai, INDIA--Thank you, Bill. It is a pleasure to be here with my friends Minister Chidambaram and Deputy Chairman Ahluwalia. The U.S.-India CEO Forum has worked particularly well because of strong leadership and the natural affinity between the people of our two nations. Montek and my colleague, Al Hubbard, have done an excellent job facilitating government engagement with the CEO Forum. And, of course, Ratan Tata and Bill Harrison have provided real leadership for the highly engaged group of CEOs that has provided concrete, actionable recommendations towards reaching a number of ambitious goals, including the doubling of U.S.-Indian trade in three years.

I have participated in U.S.–India CEO Forum events in the United States. Thank you, Chairman Tata, for gathering us in Mumbai. Since President Bush and Prime Minister Singh ushered in a new era of cooperation between India and the United States, we have seen just a glimpse of what that cooperative future can bring. The Forum is an important part of this, by providing a venue for Indian and American businesses to raise issues that impact our economic relationship.

Through President Bush and Prime Minister Singh's leadership, political, economic, and cultural ties between the United States and India have never been stronger. These ties enjoy bipartisan support in both countries. In the last few years, we have launched important initiatives in areas including counter-terrorism cooperation, space research, clean energy, agriculture, education, and economic development.

The historic agreement on civilian nuclear cooperation is an important part of the U.S. – India relationship, and it is beneficial to both countries. India is one of the world's largest and most peaceful states with advanced nuclear technologies, and has been isolated from the rest of the world on nuclear issues. This agreement will provide India access to the technology which can help it reach its economic and environmental objectives. The United States remains committed to this agreement.

The U.S. and India share the challenge of ensuring secure and clean energy supplies. We understand that economic growth and environmental responsibility are necessary, compatible goals. Moving forward with the civilian nuclear agreement is one part of the solution. Working together on a post-2012 framework through the UN climate change process is another. And, if we are to be successful in meeting our energy and environmental challenges, it must be against the backdrop of a strong economy.

The Prime Minister and Finance Minister are to be commended for beginning the process of transforming India into a global economic power by initiating economic liberalization in the early 1990s. These economic reforms have continued at varying speed throughout the past 15 years, regardless of the party in power. Observers do not question whether India's reforms will continue; they ask only about the pace.

And the United States will continue to partner with India, as India moves forward with its economic reform agenda that will spread growth to the benefit of all of India's people. The United States understands that this is a democratic, transformative effort and that India faces political challenges. That is something our governments also share, and we share the history of meeting and overcoming difficulties.

I urge my Indian colleagues to continue, and accelerate, their efforts to liberalize the

economy and develop the financial system -- to assure that the vibrancy and growth that the Indian economy now enjoys continues well into the future.

U.S. – India Economic Policies

In pursuing economic growth, India and the United States share similar values and similar challenges. We understand that a globalized economy is here to stay. Trade links India with the world, and brings diverse and attractively-priced goods to the Indian people. During my trip, I hope to have productive talks with the Indian government about making progress in the Doha Development Round. A Doha agreement is within reach, and the potential benefits are so great, that we must not let it slip through our grasp. Working together to successfully conclude a Doha agreement will be the single most effective thing we can do to help raise living standards in India and around the world.

We also understand how the dislocations from trade and rapidly-changing production technology can lead some to doubt the benefits from competition and trade. Together, India and the United States must resist protectionist, anti-trade policies that mean slower growth, fewer jobs, and lower incomes in the U.S., India, and around the world. Openness to competition has made the U.S. economy dynamic, has created better jobs and higher incomes, and has kept the United States on the cutting edge of innovation. We must remember that pro-growth policies will smooth transitions by supporting job creation.

The United States welcomes foreign investment. It creates high-quality jobs, spurs healthy competition that leads to greater innovation by American workers and companies. It contributes to our domestic economic expansion and supports local communities across a wide span of industries. It is important that the United States and India work together to resist protectionist sentiment that would limit foreign investment in both our countries.

We also welcome the contributions of the many Indians who have come to study, work, and live in the United States. For decades, Indians have immigrated to the United States, joined our communities and raised their families while maintaining their cultural heritage. Indian–Americans are physicians, engineers, CEOs, professors, teachers, entrepreneurs. As a result, there is a long history of personal and professional friendships among Indians and Americans. Indians are a vital part of the U.S. economic and social fabric.

The President asked the U.S. Congress to help meet the need for high-skilled workers as a part of comprehensive immigration reform. That bill has not yet become law; political constraints are a reality in the United States as they are in India. Our government has also taken steps to reduce the backlog of visa applications from India.

Now, let me talk about two of the ambitious and worthy goals the Indian government has outlined towards further economic transition and inclusive growth, which the United States supports and hopes we can assist.

First, as this conference highlights, is the improvement of physical infrastructure. Second, and I think necessary to accomplish the first, is improving India's financial infrastructure. A critical part of this will be taking the steps to build Mumbai into an International Financial Center.

Improving India's Physical Infrastructure

Over 30 U.S. firms are represented at this conference dedicated to investment opportunities in Indian infrastructure. They are a resource for completing the $500 billion the Indian government estimates it needs to invest over the next five years on roads, ports, housing, railways, airports and telecommunications. Given India's fiscal constraints, India is looking to the private sector to fund up to one-third of this investment. In response, the government has developed an ambitious public-private partnership framework.

The United States supports this effort to attract private financing. I trust that the discussions – among financial investors, project developers and government officials – will be productive. After this conference, we will continue to highlight the

opportunities of India's infrastructure initiatives to U.S. businesses.

The Indian Government has made an impressive effort to promote awareness of these investment opportunities. It has prioritized those projects considered most critical to India's growth, and provided best practice guidance to states developing private sector contracts. These efforts are to be commended – and judging by the conference's attendance – I would say they have already met with some success.

Looking forward, the result of India's efforts will ultimately be seen in the kilometers of new roads added to India's highway system, the megawatts of capacity added to India's power grid, and the homes that gain access to clean water. Already, India can point to successful examples, such as the Golden Quadrilateral highway system and the Delhi metro.

Our private sectors must also play a more active role in developing a sophisticated agricultural market in India. This investment will help India achieve its second Green Revolution. It will help farmers tap modern supply chains and processing technologies that will improve their productivity and the lives of their families.

Continued economic reform will also encourage investment more broadly. Investors, especially those who must make long-term commitments as in most infrastructure projects, want certainty in their operating environments. This means transparent and independent regulatory frameworks. In sectors where government entities act as both regulators and providers of financial services, this sort of independence is difficult to achieve, and private sector investment will be difficult to attract.

Investors also want to know that contracts can be legally enforced, and that they have recourse to a fair and timely arbitration or judicial process when needed. In order to meet infrastructure investment needs, real efforts must be made to address this area.

Mumbai as an International Financial Center

The Department of Treasury also supports steps to strengthen and expand India's financial system by developing Mumbai into an International Financial Center, a so-called IFC. In 2006, Prime Minister Singh said that it is possible for Mumbai to "emerge as a new financial capital of Asia, and be the bridge between Asia and the West in the world of finance."

Expansion of the financial sector through the development of Mumbai into an IFC is an enormous opportunity for India. Properly-regulated and well-functioning financial markets are the economic arteries through which balanced development and inclusive growth flows. Efficient markets provide the means to help all people, including the ones most in need, improve their lives. This is true in India, in the United States and around the world.

Today, Indian firms in Bangalore and other cities play a key role in the back office operations of global, multinational firms. In this, India has revolutionized the way the world does business. The next step is for India to develop front offices in Mumbai that provide financial services to companies and investors in India and across the region.

Experience with new financial centers in other countries demonstrates that the overwhelming majority of jobs created will be for Indians. In addition to financial services positions, many new jobs will be created in sectors providing support to the financial services industry. As new workers locate in Mumbai, they will also create additional jobs as they seek housing, food, transportation and other services.

Mumbai's development as a financial center will help not just large, but also small businesses. Shopkeepers, farmers and craftsmen need access to credit, financial services, and insurance products, as much as large, industrial manufacturers do. India's middle class will also benefit from new financial products that can lead to homeownership and funding for the best possible education for their children.

In recognition of this need, the Indian government commissioned a report from a

High Powered Expert Committee. The Committee's report outlined the requirements and a timetable for developing Mumbai into an IFC. The Report is bold, thorough and ambitious. I believe it demonstrates the right path. With Mumbai as an internationally competitive financial center, the world can invest in India, and India can invest in the world. Equally important, an IFC would give India an important stake in the rapidly growing global financial services industry.

U.S. experience can inform the Indian government as it works to develop Mumbai into an IFC. Our private sector stands ready to share their experiences in dealing with the development of domestic bond markets and other elements that create the backbone of a financial center. Infrastructure investment requires long-term financing. The development of corporate bond markets will provide opportunities for such long-term investment by insurance companies and pension funds.

For several years, the Department of Treasury and the Finance Ministry have led an ongoing dialogue among U.S. and Indian regulators to share experiences and best practices. We will begin another session tomorrow in New Delhi. Issues related to developing Mumbai as an IFC are an important element of that agenda.

We understand that Indian officials are concerned that greater capital flows associated with a financial center could add to inflationary pressures, destabilize domestic financial markets or add to exchange rate volatility. For the most part, India is on the right path to reduce these risks. India has allowed greater flexibility in the exchange rate in recent months, and the appreciation in the rupee has helped to reduce inflationary pressures.

India has also taken administrative steps to adjust the pace of capital outflows and inflows. As recent experience in the region has shown, administrative restrictions of capital flows are blunt instruments and can have unintended consequences. They tend to inhibit efficiency and lose their effectiveness over time. I encourage India to continue liberalizing such restrictions. Steps to broaden and deepen the domestic financial sector will also help to mitigate the risks posed by greater capital flows.

In the long term, India can take a number of steps to become even more competitive, such as reducing requirements that financial institutions hold large amounts of government debt, reducing requirements for banks to provide credit to certain priority sectors, and removing various restrictions and caps on foreign investment. Limits on debt and equity financing, and asset allocation restrictions on financial institutions, are impediments to putting resources to their most productive use.

Conclusion

India's remarkable growth has proven the wisdom of economic reforms and their promise for the future. The United States looks forward to working closely with India in advancing your economic reform agenda to provide inclusive growth.

The development of India's infrastructure and capital markets will take some years to come to fruition. We recognize this, and do not minimize the challenges ahead. Experience shows, however, that once on the path, it is better to move steadily and expeditiously toward that goal. India's people will see many benefits all along the way.

I expect that, when I have completed this three day visit to Kolkata, Mumbai and New Delhi, I will be even more optimistic about India's future. As the Finance Minister said recently, "The goal of a country committed to democratic development is to measure up to the rising aspirations of its people." The Indian people's aspirations are many, and the country is rising to meet them.

I look forward to my upcoming meetings with my Indian colleagues, and to working with them on these, and future, initiatives.

Thank you.

October 28, 2007
HP-649

Statement by Secretary Paulson After Meeting with Smartcard Recipients in Kolkata

Kolkata, India-- U.S. Treasury Secretary Henry M. Paulson, Jr. issued the following statement after a meeting with recipients of smartcards in Kolkata to highlight the importance of financial inclusion and extending the benefits of financial services to more Indian people:

"I just participated in a private sector initiative to bring financial services directly to people in rural India. I commend Financial Information Network and Operations (FINO), ICICI Bank and Grameen Sanchar Society (GRASSO) for their valuable work in bringing financial service tools to people, enabling them to join the economic mainstream. Technology plays an important role here and we saw that first-hand today.

"The Indian government is focused on making sure that the benefits of economic growth are shared throughout the country with all Indian people so that they can access credit, facilitate savings vehicles and obtain insurance. Private sector initiatives such as this are critical to that effort."

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PRESS ROOM

October 28, 2007
HP-650

**Statement by US Treasury Secretary Henry M. Paulson, Jr.
After Meeting with West Bengal Chief Minister Bhattacharjee**

Kolkata, India-U.S. Treasury Secretary Henry M. Paulson, Jr. issued the following statement following a meeting with West Bengal Chief Minister Bhattacharjee:

"The United States admires India's progress over the last decade as a result of economic reforms from leaders such as the Honorable Chief Minister. We discussed ways to increase investment in West Bengal. The U.S. is very interested in increasing such investment.

"The Chief Minister and I discussed the civil nuclear deal. The U.S. believes it will help India meet its energy and environmental objectives. We remain committed to the deal. We respect India's deomcratic process and we hope India will decide to implement the agreement as soon as possible."

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October 29, 2007
hp-651

Treasury Announces Market Financing Estimates

Washington- Treasury announced today its current estimates of net marketable financing for the October – December 2007 and January – March 2008 quarters:

- Over the October – December 2007 quarter, the Treasury expects to borrow $68 billion of net marketable debt, assuming an end-of-December cash balance of $45 billion. The current estimate is $6 billion less than announced in July 2007. The reduction in borrowing is primarily the result of lower outlays.
- Over the January – March 2008 quarter, the Treasury expects to borrow $133 billion of net marketable debt, assuming an end-of-March cash balance of $25 billion.

During the July – September 2007 quarter, Treasury borrowed $105 billion of net marketable debt, finishing with a cash balance of $75 billion at the end of September. In July 2007, Treasury announced net marketable borrowing of $73 billion, assuming an end-of-September cash balance of $60 billion. The increase in borrowing was primarily the result of lower receipts, lower net issuances of State and Local Government Series securities, and adjustments in cash balances.

Since 1997, the average absolute forecast error in net borrowing of marketable debt for the current quarter is $12 billion and the average absolute forecast error for the end-of-quarter cash balance is $9 billion. Similarly, the average absolute forecast error for the following quarter is $33 billion and the average absolute forecast error for the end-of-quarter cash balance is $11 billion.

Additional financing details relating to Treasury's Quarterly Refunding will be released at 9:00 a.m. on Wednesday, October 31.

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REPORTS

- Sources and Uses Table

Sources and Uses Reconciliation Table							
			Financing				*Memo*
		Financing Need	Marketable Borrowing	All Other Sources	Total	Change in Cash Balance	*End-Of-Quarter Cash Balance*
Quarter	*Announcement Date*	(1)	(2)	(3)	(4) = (2) + (3)	(5) = (4) - (1)	(6)
Oct - Dec 2005	**Actual**	**97**	93	6	**98**	**1**	37
Jan - Mar 2006	**Actual**	**173**	158	(14)	144	**(28)**	**8**
Apr - Jun 2006	**Actual**	**(137)**	(92)	(7)	(99)	**38**	**46**
Jul - Sep 2006	**Actual**	**19**	45	(19)	26	**6**	52
Oct - Dec 2006	**Actual**	**70**	42	6	48	**(21)**	31
Jan - Mar 2007	**Actual**	**159**	126	9	134	**(25)**	6
Apr - Jun 2007	**Actual**	**(153)**	(139)	5	(133)	19	25
Jul - Sep 2007	**July 30, 2007**	**22**	73	(16)	57	**35**	**60**
	Actual	**35**	**105**	**(20)**	**85**	**50**	**75**
	Memo: Forecast Revision	13	32	(4)	28	15	15
Oct - Dec 2007	**July 30, 2007**	**92**	**74**	**(12)**	**62**	**(30)**	**30**
	October 29, 2007	**85**	**68**	**(13)**	**55**	**(30)**	**45**
	Memo: Forecast Revision	(7)	(6)	(1)	(7)	(0)	15
Jan - Mar 2008	**October 29, 2007**	**142**	**133**	**(11)**	**122**	**(20)**	**25**

Notes: All data reported on a cash basis

October 29, 2007
hp-652

**Treasury Assistant Secretary for Economic Policy
Phillip Swagel
Statement for the Treasury Borrowing Advisory Committee of the
Securities Industry and Financial Markets Association**

Washington- A variety of indicators suggest that the economy grew at a healthy pace in the third quarter, notwithstanding the housing slump, credit market disruptions, and high energy prices. While the weak housing sector looks to be a drag on GDP for the next several quarters, the housing downturn does not appear to have had serious impacts on other parts of the economy. The labor market remains broadly healthy, with low unemployment, continuing job creation, and wage gains that should support consumer spending. World output growth has boosted net exports. Core inflation appears to be contained. Looking forward, however, the ongoing drag from construction, the problems in credit markets, and higher oil prices have led private forecasters to reduce their projections for GDP growth in the fourth quarter of 2007 and into 2008.

The downturn in the housing sector has not ended as quickly as appeared to be possible at the end of 2006. The housing correction comes after an eight-year period of exceptional home price appreciation, in which strong demand for housing was fueled in part by ample liquidity. Rising homebuilding activity helped to propel GDP growth, adding an average of about half a percentage point to GDP growth rates in each quarter from 2003 to 2005. Easy credit took the form of increased use of adjustable-rate mortgages (ARMs), hybrid-ARMs with low teaser rates, interest-only features, low- or no-down payments, and even negative amortization. These practices exposed mortgage holders to greater risk than with a traditional 30-year fixed rate mortgage with a 20 percent down payment. A significant percentage of non-traditional ARMs went to subprime borrowers, as the subprime component of total lending grew from about 2 percent of mortgages in 1998 to nearly 14 percent in mid-2007.

The housing correction began in early 2006. Home prices have decelerated considerably over the past year, with some measures of nationwide home prices showing outright declines over the past four quarters. Sales of existing single-family homes are down by 30 percent from the peak in 2005, and the inventory of unsold homes has increased to levels last seen in the early 1990s. While the subprime delinquency rate today is near the level seen in 2001, there are over seven times more subprime mortgages today than there were in 2001. It appears likely that the increased number of delinquencies will translate into further increases in mortgage defaults and foreclosures. Current trends suggest there will be just over 1 million foreclosures started this year, of which two-thirds will be in the subprime market.

Declining residential building activity has subtracted substantially from GDP growth since the correction began. Annual housing starts peaked at an annual rate of almost 2.3 million units in early 2006 before falling nearly 50 percent through September of this year. Employment in residential building, including specialty trade contractors, has dropped by almost 200,000 since early 2006, offsetting about one-quarter of the jobs gained in the housing boom. Although it appeared that homebuilding activity had reached a bottom in the first half of this year, starts and permits have both fallen further since June and the elevated level of inventories of unsold homes suggest that home construction will remain weak going forward.

Despite the downdraft from housing, other sectors of the economy have been broadly healthy--indeed, this is the first housing downturn in the past three decades in which U.S. GDP growth has not turned negative. Business investment has expanded in recent months, exports are growing strongly, and continued job creation has helped support consumer spending. Data available through August suggest that real personal consumption expenditures are on track to contribute

about 2 percentage points to real GDP growth in the third quarter (at an annual rate), more than consumption contributed in the second quarter, when real GDP rose by 3.8 percent at an annual rate. Solid income gains and healthy household balance sheets have helped support household spending: Real disposable income rose 4.4 percent over the twelve months ended in August, and household net worth remained high relative to income in the second quarter.

In the business sector, core capital goods shipments rose smartly in August and September, signaling a pickup in equipment and software investment toward the end of the third quarter. Orders for core durable goods remain ahead of shipments, though the volatility of the orders data means that this provides only a modest suggestion of future strength in the durable goods categories that are most closely linked to business investment.

Export growth remained solid well into the third quarter, supported in large part by strong economic growth overseas. Over the year ended in August, U.S. exports of goods and services rose 12.8 percent. Strong export growth and slower growth of imports has narrowed the trade deficit considerably in recent months. Net exports are poised to make another substantial contribution to Q3 real GDP growth after adding 1.3 percentage points to growth in the second quarter.

Job growth moderated in the third quarter and the unemployment rate ticked higher but labor markets still appear healthy overall. Nonfarm payrolls expanded by an average of 97,000 a month in the third quarter, down from the average monthly job gain of 134,000 in the first half of the year. The unemployment rate edged up to 4.6 percent in the third quarter from 4.5 percent in the previous three quarters. Real wages in September were 1.3 percent higher than a year earlier. The level of initial claims for unemployment insurance moved up somewhat in October, but remains at a level consistent with ongoing job creation.

The federal government's fiscal position continued to improve in the fiscal year that just ended. The federal budget deficit shrank by $85 billion in FY2007 to $163 billion, due to a combination of strong receipts growth and a moderate rise in spending. The FY2007 deficit was equivalent to 1.2 percent of GDP--half of the 40-year average of 2.4 percent. At the same time, the fiscal challenge of rising entitlement spending looms just over the horizon.

Headline consumer price inflation has moved higher but core inflation remains broadly contained. Headline consumer price inflation was 2.8 percent over the twelve months ended in September, up from a 2.1 percent pace over the year-earlier period. Energy prices increased 5.4 percent over the latest twelve months, although prices have been volatile in this period, and crude oil prices have surged in the most recent few weeks. Food prices accelerated notably over the past year; September's twelve-month change of 4.4 percent was up from 2.6 percent a year ago. Excluding food and energy, consumer prices advanced 2.1 percent over the last 12 months, down from 2.9 percent in the previous 12 months.

The sharp run-up in oil prices since mid-August has prompted forecasters to lower their projections for near-term growth. The one-month futures price of West Texas Intermediate crude oil broke through the $90 a barrel mark late last week and is nearing the inflation-adjusted peak recorded in 1980. Production in the U.S. economy is less energy-intensive than was the case thirty years ago, so that the current high level of oil prices is not expected to exact the same heavy toll on the economy as in the 1970s and 1980s. Even so, high energy prices remain a challenge for consumer and business spending, while tight inventories and limited global production capacity mean that the possibility of sharply higher oil prices from a supply disruption is a key downside risk for the economy.

In sum, the U.S. economy looks set to grow at a moderate pace, even while the downdraft from the homebuilding sector and recent credit market disruptions exact a penalty on growth.

October 29, 2007
2007-10-29-16-27-52-1493

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 $69,668 million as of the end of that week, compared to $69,181 million as of the end of the prior week.

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

	October 26, 2007		
A. Official reserve assets (in US millions unless otherwise specified)	Euro	Yen	Total
(1) Foreign currency reserves (in convertible foreign currencies)			69,668
(a) Securities	14,055	11,186	25,241
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	14,026	5,503	19,529
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	4,493		
(3) SDRs	9,364		
(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				
(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)	69,668
--currencies in SDR basket	69,668
--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.

October 30, 2007
HP-653

Treasury Assistant Secretary David Nason
Remarks before the Women in Housing and Finance

Washington- Thank you for inviting me to join you today at this luncheon. I am honored to have the opportunity to speak to this distinguished group of financial services industry professionals and policy leaders. It is great to see so many familiar faces here. Women in Housing and Finance is a significant contributor to the success of many women in the financial services arena, particularly here in our Nation's capital.

It has been an especially busy time at the Treasury Department so there are plenty of issues that are ripe for our discussion today. I would like to begin my remarks with a brief economic update after which I will cover two issues that are currently front and center at the Treasury Department, particularly for Domestic Finance: housing policy issues and capital markets competitiveness.

General Economic and Market Conditions

As you know, there have been adjustments taking place in the credit and mortgage markets. Largely because of lax underwriting, the mortgage market, especially the subprime market, has been experiencing a high number of delinquencies and defaults. As a result, subprime mortgage-backed securities have performed poorly. This has led investors to reassess the risk and as a corollary reassess the pricing of these securities.

At the Treasury Department, we have been engaged actively in this developing situation. Secretary Paulson has been working with financial regulators and market participants. At a time like this when markets are reappraising risk and imposing market discipline, confidence is key. Our country and the Treasury Department are fortunate to have a Treasury Secretary who has spent his life in the financial markets, through good times and bad times.

Fortunately, this market stress is occurring against the backdrop of a strong global economy. However, as Secretary Paulson noted recently, the ongoing housing correction, rooted in an eight year period of exceptional housing price appreciation, will continue to impact the economy adversely. We continually analyze this situation, knowing that it will take time to work itself out. In our view, the underlying strength of the economy should enable further continued growth. However, despite these strong fundamentals it is the Treasury Department's view that the housing decline is the most significant current risk to our economy.

Housing Policy Issues

The Administration's Response

The Administration recognizes the importance of housing to our economy and the fact that a significant number of homeowners will experience strain due to resetting mortgage rates and housing pricing pressures. In August, President Bush laid out an aggressive plan to stem the rising tide of foreclosures. His plan is motivated by the realization that many distressed homeowners can avoid foreclosure with additional flexibility.

The Administration's foreclosure avoidance plan has three main parts. First, the Administration renewed its call on Congress to modernize the Federal Housing Administration (FHA). This FHA modernization proposal would lower down payment requirements, allow FHA to insure bigger loans, and give FHA more pricing

flexibility. Second, we called on Congress to change the Federal Tax Code temporarily so it does not punish homeowners who have mortgage debt cancelled. Third, we announced a foreclosure avoidance initiative, which sought the assistance and expertise of housing counselors and coordinated the response efforts of mortgage industry market participants in a way that is flexible and adaptive to the subprime mortgage market challenges.

I would like to discuss the foreclosure initiative in greater detail, but first it is important to make two general observations about the Administration's plan. The components of the plan enjoy wide bipartisan support on Capitol Hill. FHA modernization language has passed the House twice. In the Senate, FHA modernization legislation passed the Senate Banking Committee and has wide bipartisan support. The Administration's tax code proposal is also bipartisan, with Republican and Democratic support in each chamber.

The second general point I would like to make is that time is of the essence. Adjustable rate mortgage resets will occur in the coming months regardless of Congressional action. It is important to act quickly. Homeowners not reached before their resets occur are at a much higher risk of defaulting. Our plan supports an increased role for housing counselors, but their efforts will be less meaningful if the appropriate tools are not available.

The Joint Economic Committee, under the leadership of Chairman Charles Schumer and Vice Chair Carolyn Maloney, issued several reports on the current housing market. Their reports repeatedly recognize the appropriateness of the ideas in the Administration's plan to minimize foreclosures. The Committee's policy recommendations include passing FHA modernization legislation, changing the Federal Tax Code so cancelled mortgage debt is not treated as income, and acknowledging the importance of housing counselors to the loan modification process. Just last week, the Joint Economic Committee, in another published report, repeated its call for these issues (and others) to be addressed. Congress should send legislation to the President on these bipartisan efforts as soon as possible.

HOPE NOW Alliance

On October 10, consistent with President Bush's call for action, Secretary Paulson and Department of Housing and Urban Development Secretary Jackson joined a group of mortgage servicers, counselors and investors as they launched an effort, called the HOPE NOW Alliance, to coordinate efforts to reach more homeowners and find long-term solutions. I would like to discuss with you the issues that the Alliance has identified and its strategy for success.

First, as I already stated, but it is worth restating, the earlier we identify struggling borrowers, the more likely they will be able to modify their mortgage or refinance into a sustainable mortgage. If we wait until borrowers default, their credit will be damaged and they will have far fewer options.

Second, borrowers are fearful of foreclosure and not aware that their lenders may be able to work out a solution. Many borrowers mistakenly believe that lenders want to repossess their homes through foreclosure. Foreclosure is very costly for lenders too. According to most of the servicers and counselors with whom we have spoken, 50 percent of those who lose their homes to foreclosure never contacted their mortgage servicers or mortgage counselors. We must work around the unfortunate stigma that many homeowners mistakenly associate with asking for mortgage help.

Third, while bringing benefits to our economy and homeowners, innovation in the mortgage sector has also introduced some challenges. Today, the mortgage process is disaggregated. A mortgage loan is likely to be originated, serviced, and owned by three different entities. In today's system, a homeowner having trouble making payments often does not know where to turn for assistance.

The Alliance members believe they can keep more Americans in their homes by joining together to address the problems in the subprime mortgage market. They have identified a set of specific actions to pursue:

- *Counseling* – Local housing counselors are already in place and have the required expertise. The Alliance is working with counseling organizations such as NeighborWorks to establish a simple, clear, and uniform message for homeowners that they counsel.
- *Communication* – Servicers indicated that they have poor success rates when they reach out to homeowners directly, sometimes as low as 3 to 5 percent. Homeowners are far more responsive to independent counselors, so the Alliance will develop in the near future a direct mail campaign directing distressed homeowners to counselors.
- *Process* – Servicers and counselors lack established protocols and standards for working together. Members of the Alliance have agreed to adopt standard practices to increase process efficiency.
- *Investors* – In the past housing counselors were funded by federal, state and local governments, but the investor community has now recognized that counselors play an important role in foreclosure avoidance. The American Securitization Forum has joined the Alliance and announced that counseling fees can be reimbursed from securitization transactions in appropriate circumstances.
- *Performance Measurements* – Today the industry does not have a thorough, standardized set of metrics with which to evaluate servicers' loss-mitigation performance or to evaluate counselors' effectiveness. The Alliance is developing these standard metrics which policymakers, homeowners, and investors need in order to monitor performance and develop loss mitigation strategies.
- *Technology* – The servicers have agreed to work toward cross-industry web-enabled technology solutions to connect servicers and counselors more effectively in order to better serve the homeowner. This should increase the speed of the loan modification process.

Recently, there has been a great deal of discussion about voluntary modifications. Preventing foreclosures is in investors' and homeowners' interests. Investors must take an active role in demanding that all mortgage servicers, large or small, are pursuing all available loss-mitigation strategies. We have an immediate need to see more loan modifications and refinancing and other flexibility. But, genuine voluntary actions are best taken under informed circumstances. The HOPE NOW Alliance is well suited to help homeowners and investors understand the value of their impaired assets by developing reliable housing data and encouraging the creation of industry guidance to increase effectiveness and standardize loss mitigation efforts.

There are many dedicated people working very hard on this initiative and their efforts should be appreciated. This is a very complex set of problems without an easy solution. I encourage you and your members to think creatively on these issues and communicate your ideas to us and Congress.

Capital Markets Competitiveness

When Secretary Paulson arrived at the Treasury Department, he immediately and appropriately focused his attention on financial preparedness and the competitiveness of our capital markets. Capital markets are the lifeblood of the United States economy. They enable capital investments to seed new companies, leading to job creation and economic prosperity. American consumers and investors benefit from a vibrant and healthy financial services sector that provides opportunities to access credit, save and invest for the future, and insure against risks. It is important, therefore, that our capital markets remain the best in the world. Accordingly, I would like to discuss three competitiveness-related initiatives that are underway at the Treasury Department.

Auditing Profession

In an address last November, Secretary Paulson specifically pointed out a strong and viable auditing profession as a crucial component of capital markets competitiveness. For nearly 75 years, the auditing profession has been charged with certifying public company financial statements. The fulfillment of this charge is critical to investor confidence in financial reporting, critical to the flow of capital, and thus critical to capital markets competitiveness.

Recognizing the challenges facing the auditing profession, Secretary Paulson

announced last May the creation of a federal advisory committee to examine and develop recommendations relating to the sustainability of the auditing profession. Co-Chaired by former Securities and Exchange Commission (SEC) Chairman Arthur Levitt, Jr. and former SEC Chief Accountant Donald T. Nicolaisen and made up of a diverse group of impressive members representing investors, auditors, large and small public companies, insurance companies, lawyers and regulators, the Advisory Committee on the Auditing Profession convened its first meeting two weeks ago. By all accounts, the meeting was a success and we are thankful that this extraordinary group has agreed to take on these challenging issues.

The Advisory Committee will be considering several issues confronting the auditing profession. These issues include: the auditing profession's ability to attract and retain the human capital necessary to meet developments in the business and financial reporting environment, audit market competition and concentration, and the financial resources of the auditing profession. By early Summer 2008, the Advisory Committee expects to deliver recommendations to the Treasury Department.

Restatement Study

The second capital markets competitiveness initiative I would like to discuss is the Treasury Department's public company financial restatement study. Numerous studies have pointed to a significant increase in the number of financial restatements over the past decade.

On the one hand, many reports attribute the growing number of restatements to increased management and auditor focus on accurate financial reporting due to the mandates in the Sarbanes-Oxley Act of 2002 and greater financial reporting review by the SEC and the Public Company Accounting Oversight Board.

However some studies suggest that while some financial restatements are clearly material, immaterial financial restatements might pose significant and unwarranted challenges to the capital markets. Immaterial restatements might unnecessarily harm investor confidence by calling into question the credibility of company management, auditors, and the financial reporting system as a whole.

Earlier this month, the Treasury Department announced the selection of University of Kansas Professor Susan Scholz to conduct its examination of the impact of and the reasons behind public company financial restatements. Professor Scholz will describe these restatements, examine the factors triggering these restatements, and analyze their significance on investors and the capital markets.

The study will analyze restatement data from 1997 to 2006 in order to perform a thorough assessment of several recent changes in the financial reporting system, including the impact of the Sarbanes-Oxley internal control requirements and SEC Staff Accounting Bulletin No. 99--Materiality. Through this process, our goal is to understand the significance of restatements upon investors and capital markets. The Treasury Department intends to make the study's results public by early 2008.

Regulatory Blueprint

Finally, I would like to discuss regulatory structure issues associated with the U.S. financial services industry. The regulatory policies in place for financial institutions must effectively protect consumers and investors, while at the same time promote entrepreneurialism and capitalism that is the foundation of our national economic success. These qualities are not at all mutually exclusive. Our regulatory system has adapted to the changing market by expanding, but perhaps not always by focusing on the broader objective of regulatory effectiveness and protecting consumers and investors. We should analyze and understand the rationale or justification for our current regulatory structure as well as the inefficiencies it can breed along with the benefit and burden of our regulations.

Therefore, under Secretary Paulson's leadership, the Treasury Department is engaged in a comprehensive review of our regulatory structure to evaluate these issues and propose solutions that achieve the right balance. Over the next several months, we will produce a regulatory reform blueprint that will outline recommendations on how to modernize our regulatory regime.

While this project was contemplated well before we entered this period of mortgage market stress, the complexity of the mortgage market regulatory structure provides an interesting backdrop. More people are now willing to consider and discuss regulatory structure and these issues associated with the current situation in the mortgage market are directly related to some of the specific questions posed in the Treasury Department's recent Federal Register notice seeking comments on our comprehensive review of regulatory structure.

In particular, the notice asked about what role states should have in the regulation of financial institutions. This issue has been debated for a long time, but is taking even greater prominence with the consideration of current proposals related to mortgage originators and long-term structural issues.

Much like evaluating federal versus state issues in other areas of regulation, in financial services, consideration of what areas are appropriate for federal standards, and if so, what role should the states have in setting or enforcing those standards is the appropriate approach. The notice also specifically asks if the current regulatory structure adequately addresses consumer or investor protection issues. Much of the current debate on issues related to mortgage origination focuses on enhancing consumer protection in the mortgage origination process, with current proposals focusing on tightening current standards or providing new regulatory authority to a number of agencies. Again, as the Treasury Department looks to the future in this report, one aspect that the Department will focus on is what regulatory structure is the most effective from a consumer protection perspective, and what type of regulatory structure is necessary to perform that function effectively.

These are significant issues that many policymakers have considered over the years. Success of this initiative will not and should not be tied to short-term accomplishments. We will recommend specific changes to our financial services industry regulatory structure. Some of the recommendations will be immediately relevant to legislative and regulatory policy issues. On these matters, our hope is that the Treasury Department's report will spur near-term tangible results. Implementation of other, longer-term recommendations will be subject to outside factors, but will be ready should support for these reforms develop. Finally, our hope is that some of the recommendations will shape debates in the future when regulatory structure issues are considered.

The Treasury Department is pursuing each of these three initiatives as part of the Secretary's broader competitiveness agenda, which seeks to ensure that U.S. capital markets remain efficient, innovative, and continue to drive capital to its most productive uses. Our markets must retain the integrity and efficiency that has contributed greatly to prosperity in America and around the world. Thank you for listening. I would be happy to take a few questions.

October 30, 2007
HP-654

Statement of Daniel Heath Nominee for U.S. Alternate Executive Director International Monetary Fund Before the Senate Foreign Relations Committee

Chairman Menendez, Ranking Member Hagel, and members of the Committee, thank you for the opportunity to appear before you today. I am honored that President Bush has nominated me to serve as the United States Alternate Executive Director at the International Monetary Fund, and if confirmed, I pledge to work with this Committee, the full Congress, Secretary Paulson and the rest of the Administration in furthering U.S. international economic policy goals and the well-being of the American people.

First, I would like to thank my wife Jane and our sons for their support of my commitment to public service. For much of the past six years I served as Associate Director of the National Economic Council. In this capacity, it has been my privilege to promote policies leading to economic growth and stability for the good of all Americans. Throughout my previous roles in Federal government and the private sector in Europe, I worked to expand international trade and investment of benefit to our country. If confirmed, I look forward to bringing my skills, knowledge and experience to help pursue policies that are a priority for the United States.

As you know, the IMF is entering a new period, marked by new leaders, credit market turbulence, and strength of emerging market countries. Its mandate to promote international monetary cooperation and expand job-creating trade will require the IMF to intensify its own leadership towards transparency in public policy, market-based reforms to generate sustained growth, and fiscal and monetary policies that strengthen government accounts and reduce the risk of crisis. With its near global membership, and effective U.S. guidance, the IMF is well-positioned to set standards in these important areas. The United States strongly supports recent IMF decisions to better assess countries' economic policies, including exchange rate activities. If confirmed, I look forward to working with my colleagues to implement these vital reforms.

Mr. Chairman, dedicated Administration officials and Congressional leaders over many years have helped to expand economic opportunity in the U.S. through domestic policies and the policy fundamentals for economic growth and stability in other countries. There are new challenges to global economic performance, and if confirmed, I will demonstrate enthusiasm and good judgment in doing my part to improve IMF policies and practices needed in our time.

I am grateful to have the privilege of your considering my nomination. I would be pleased to answer any questions. Thank you.

October 31, 2007
HP-655

Treasury Assistant Secretary for Financial Markets
Anthony W. Ryan
November 2007 Quarterly Refunding Statement

Washington - We are offering $18.0 billion of Treasury securities to refund approximately $51.5 billion of privately held securities maturing or called on November 15 and to pay down approximately $33.5 billion. The securities are:

- A new 10-year note in the amount of $13.0 billion, maturing November 15, 2017;
- A reopening of the 29 3/4-year bond in the amount of $5.0 billion, maturing May 15, 2037.

These securities will be auctioned on a yield basis at 1:00 p.m. EDT on Wednesday, November 7, and Thursday, November 8, respectively. Both auctions will settle on Thursday, November 15. The balance of our financing requirements will be met with weekly bills, monthly 2-year and 5-year notes, the December 10-year note reopening, and the January 10-year and 20-year TIPS. Treasury also is likely to issue cash management bills in mid and late November, early December and possibly in early January.

New Treasury Auction System

In the first half of 2008, as part of its Cash and Debt Management Modernization initiative, Treasury expects to introduce its new Treasury Automated Auction Processing System (TAAPS). This enhanced auction system will significantly upgrade Treasury's auction process by improving system flexibility, reliability, security, analytics and transparency.

We will be providing more information on the conversion to the new processing system as a part of our next quarterly financing release on January 30, 2008.

Treasury auction participants should already have completed submitter agreements and local administration forms to ensure a smooth transition to the new auction system. Any concerns should be addressed to the Bureau of Public Debt at (202) 504-3550 or emailed to auctions@bpd.treas.gov.

Lowering the Minimum Denomination in Treasury Auctions

We are lowering the minimum purchase amounts for Treasury auctions from $1,000 to $100. This change will be made subsequent to the rollout of the new auction processing system.

We will provide further details regarding this change in our February quarterly financing release.

The next quarterly refunding announcement will take place on Wednesday, January 30, 2008.

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October 31, 2007
HP-656

Report to The Secretary of the Treasury from The Treasury Borrowing Advisory Committee of The Securities Industry and Financial Markets Association

October 30, 2007

Dear Mr. Secretary:

Since the Committee's previous meeting in July, credit conditions have become more challenging and the outlook for the economy has turned less certain. Economic growth this summer withstood the re-pricing of risk in some segments of the financial markets. But the combination of less secure financial underpinnings, and the ongoing housing downturn, suggest that GDP will remain on a fairly modest track ahead and that the outlook is subject to greater uncertainty than in recent quarters.

Inflation has remained somewhat elevated this year due to price increases for food and energy. The slowing in economic growth has had a moderating effect on a wide array of other consumer prices, most notably motor vehicles and other large household goods. As a result, core consumer price measures have cooled from a 2-½% to 3% range to a 1-¾% to 2-¼% rate. Some additional improvement is possible, but the falling U.S. dollar and high and rising commodity prices have kept alive concerns about inflationary pressures.

Financial market disturbances, and the protracted weakness in housing, led the Federal Reserve to lower the Federal funds target by 50 basis points to 4-¾% in September. Policymakers also narrowed the spread between the funds target and the discount rate in an effort to restore stability to money markets. Futures markets anticipate further reductions in the policy rate ahead, while expectations for a lower funds rate have contributed to a steeper yield curve. Yields across the U.S. Treasury curve are below August levels with short- to intermediate-term yields having declined the most.

The Federal Government's budgetary deficit improved in the fiscal year ended September 30 amid strong revenue collection and a modest expansion in public expenditures. Looking forward however, there is increasing evidence that the growth in individual and corporate tax receipts has and may continue to moderate as economic conditions slow. Consequently, market expectations for the budget deficit for FY 2008 center around $200 billion which is a moderate increase over the FY 2007 figure of approximately $163 billion.

After a brief presentation by Treasury summarizing recent changes in the components of the budget deficit, the issuance pattern of Treasury debt, and other important market developments, the Committee addressed the charges presented to it.

In its first charge, the Treasury solicited the Committee's advice on the composition of Treasury debt issuance in light of intermediate and long-term fiscal and market trends.

The general view of the Committee was that the coming year's upward deficit forecast should alleviate the pressure on Treasury towards reducing and eliminating coupon issuance to keep bill issuance at minimum levels and to ensure sufficient short-term market liquidity.

One member noted that the amount of bills outstanding as a percentage of overall Treasury debt had fallen to multi-year lows recently simultaneous to increased volatility in the credit markets, which increased the demand for "risk-free" short-term U.S. Government debt. Most members agreed that if additional debt issuance is needed that the bill market is well poised to absorb these increases.

Financing needs in the amounts anticipated by deficit projections and even larger amounts of as much as an additional $100 billion over current levels could easily be absorbed by the bill market over the next year if done in a deliberate and transparent way.

In the second charge, the Committee was asked to address their views regarding recent market dislocations in the short-term credit markets and their relationship, if any, with Treasury markets. A Committee member delivered an extensive review of the securitization markets and their subsequent influence on the volatility of the overall credit markets.

This member cited the dramatic increase in securitization issuance and the diverse set of asset classes through which those structures are formed. There was specific reference to that issuance as being global, with a large percentage (roughly one third) of the product emanating out of Europe. The member cited that while this is a global phenomenon, much of the stress associated with these structures was due to pressures within the U.S. subprime mortgage market.

References were made to the high demand for yield-oriented product in the markets influencing increasing levels of asset-creation and consequently more lax underwriting standards. The result being a large universe of subprime issuance into the capital markets as opposed to in the traditional domain of the banking system. One member commented that the banking system has historically had to deal internally with these market cycles, yet the re-pricing of asset-backed securities and other structured securities had to now be solved within the open market.

There was discussion and a general skepticism regarding the role of the rating agencies in the securitization market. The presenting member suggested some potential flaws in the model-based assumptions underlying some of the structures. Data was presented to show unusually high ratings changes in the 2006 vintage production for subprime origination. A number of members mentioned that the complexity of the implicit data, and the nature of the ratings agencies mandate to serve a number of constituents, potentially compromised the quality of the ultimate ratings.

The ensuing instability in the asset-backed and short-term credit markets was suggested to be a result of a heavy reliance on the quality of those ratings and a need to mark-to-market what soon would become very illiquid securities. There was extensive discussion among the members regarding the lack of transparency underlying some of these structures and the nature of "fat tail" risk events which tend to follow the ultimate need to reduce exposure to non-cash flow transparent assets.

The presenting member described the implicit need in the markets for effective securitization, which is largely to disperse risk and more efficiently utilize limited financial capital. A number of proposals were put forth to enhance the nature of securitization going forward including improvement of underwriting practices and/or some form of external monitoring of the ratings process.

A discussion followed regarding the impact from increased volatility in the short-term credit market on Treasury securities as the demand for "risk-free" assets increased as investors sought safety and liquidity.

The Committee was also asked for its thoughts regarding current and future demand for Treasury securities. One member made a prepared presentation on this subject as a backdrop.

This member noted that while budget and trade deficits were largely funded internally by U.S. investors in the 1980's and early 1990's, foreign investors have provided the bulk of needed funding for much of the past decade. This foreign

demand has come from both private and official sources, and while the official flows seem to garner the most publicity, it has actually been the private flows that dwarf these official flows.

It was also noted that the composition of these foreign flows has changed considerably over time. Japan, for example, was the largest foreign buyer of U.S. Treasury debt for many years but recently other countries such as the UK, developing countries such as the BRICs and OPEC-related countries have increased their participation in the purchase of U.S. Treasuries and other U.S. fixed-income securities. (It was noted and largely accepted that much of the purchased debt that is credited to the UK in the TIC data is actually for the accounts of other individuals and institutions outside the UK but doing business in the UK.)

This member suggested that the primary drivers behind the demand for U.S. debt varies but is largely the result of (1) the reinvestment of trade flows, (2) the investment of FX reserves into the U.S. dollar, and (3) net investment flows.

The recent TIC data highlights the reduction in demand for U.S. Treasuries by foreign participants and, in fact, showed a surprising drop in holdings in the most recent release. Most members seemed to agree that while the demand has been falling modestly over the resent past, the August data may not be indicative or even reliable as a measure of a change in the trend.

There was, of course, significant market volatility in August and it is likely as one member pointed out that some investors may simply have let some short-term bills mature rather than roll given the significant premium that was priced into the market for liquidity at this time. Others suggested that the data is very subject to revisions and that they would wait before concluding that a "sea change" had taken place in the foreign demand for U.S. fixed-income securities.

That said, a number of Committee members agreed that foreign demand for U.S. Treasuries had eased over the last years and in particular as a percentage of overall foreign purchases of U.S. fixed-income securities.

Members cited several reasons for this change including (1) the absence of Japanese foreign exchange flows, (2) the diversification of investors including sovereign wealth funds to higher yielding fixed-income securities and (3) the movement of investors into other currencies.

Several members relayed anecdotal evidence that many foreign investors are still most attracted to U.S. Treasury securities given their tremendous liquidity and perceived safety. And the value of these securities become more attractive in volatile and uncertain times.

In the final section of the charge, the Committee considered the composition of marketable financing for the October-December quarter to refund the approximately $51.5bn of privately held notes and bonds maturing on November 15, 2007, as well as the composition of marketable financing for the remainder of the quarter, including cash management bills, as well as the composition of marketable financing for the January-March quarter.

To refund $51.5bn of privately held notes and bonds maturing on October 15, 2007 the Committee recommended a $13bn 10-year note due October 15, 2017 and a $5bn re-opening of the 30-year bond due May 15, 2037. For the remainder of the quarter, the Committee recommended $20bn 2-year notes in November and December, a $13bn 5-year in November, and an $8bn re-opening of the 10-year note December. The Committee also recommended a $10bn 8-day cash-management bill maturing November 23, 2007, a $15bn 17-day cash management bill maturing December 17, 2007 and a $15bn 4-day cash management bill maturing December 17, 2007.

For the January-March quarter, the Committee recommended financing as found in the attached table. Relevant figures include three 2-year note issuances monthly, three 5-year note issuances monthly, a 10-year note issuance in January followed by a re-opening in March, a 30-year bond opening in January, as well as a 10-year Tips opening in January, and a 20-year TIPS opening later that same month.

Respectfully submitted,

Keith T. Anderson
Chairman

Rick Rieder
Vice Chairman

Attachments (2)
Table Q4 07
Table Q1 08

REPORTS

- Table Q4 07
- Table Q1 08

US TREASURY FINANCING SCHEDULE FOR 4th QUARTER 2007
BILLIONS OF DOLLARS

ISSUE	ANNOUNCEMENT DATE	AUCTION DATE	SETTLEMENT DATE	OFFERED AMOUNT 4-WK	OFFERED AMOUNT 3-MO	OFFERED AMOUNT 6-MO	MATURING AMOUNT	NEW MONEY
4-WEEK AND 3&6 MONTH BILLS	9/27	10/1	10/4	10.00	16.00	14.00	54.00	-14.00
	10/4	10/9	10/11	8.00	16.00	15.00	46.00	-7.00
	10/11	10/15	10/18	8.00	16.00	15.00	42.00	-3.00
	10/18	10/22	10/25	10.00	18.00	16.00	41.00	3.00
	10/25	10/29	11/1	20.00	20.00	18.00	42.00	16.00
	11/1	11/5	11/8	*22.00*	*21.00*	*19.00*	*41.00*	*21.00*
	11/8	11/12	11/15	*30.00*	*22.00*	*20.00*	*42.00*	*30.00*
	11/15	11/19	11/21	*30.00*	*23.00*	*20.00*	*44.00*	*29.00*
	11/21	11/26	11/29	*22.00*	*23.00*	*20.00*	*58.00*	*7.00*
	11/29	12/3	12/6	*20.00*	*23.00*	*20.00*	*58.00*	*5.00*
	12/6	12/10	12/13	*12.00*	*23.00*	*20.00*	*64.00*	*-9.00*
	12/13	12/17	12/20	*12.00*	*22.00*	*19.00*	*62.00*	*-9.00*
	12/20	12/24	12/27	*12.00*	*22.00*	*19.00*	*52.00*	*1.00*
					716.00		*646.00*	*70.00*
CASH MANAGEMENT BILLS								
8-DAY BILL	Matures 11/23	11/14	11/15		*10.00*		*10.00*	*0.00*
17-DAY BILL	Matures 12/17	11/28	11/29		*15.00*		*15.00*	*0.00*
4-DAY BILL	Matures 12/17	12/12	12/13		*15.00*		*15.00*	*0.00*
								0.00
COUPONS						CHANGE IN SIZE		
10-Year TIPS-R	10/9	10/11	10/15		6.00			6.00
5-Year TIPS-R	10/18	10/23	10/31		6.00			
2-Year Note	10/22	10/24	10/31		20.00			
5-Year Note	10/22	10/25	10/31		13.00		19.00	20.00
10-Year Note	10/31	11/7	11/15		*13.00*			
30-Year Bond-R	10/31	11/8	11/15		*5.00*		*51.50*	*-33.50*
2-Year Note	11/26	11/27	11/30		*20.00*			
5-year Note	11/26	11/28	11/30		*13.00*		*19.20*	*13.80*
10-Year Note-R	12/10	12/13	12/17		*8.00*			*8.00*
2-Year Note	12/24	12/26	12/31		*20.00*			
5-year Note	12/24	12/27	12/31		*13.00*		*19.50*	*13.50*
					135.00		*109.40*	*25.60*

Estimates are italicized

NET CASH RAISED THIS QUARTER: 95.60

R = Reopening

US TREASURY FINANCING SCHEDULE FOR 1st QUARTER 2008
BILLIONS OF DOLLARS

ISSUE	ANNOUNCEMENT DATE	AUCTION DATE	SETTLEMENT DATE	OFFERED AMOUNT 4-WK	OFFERED AMOUNT 3-MO	OFFERED AMOUNT 6-MO	MATURING AMOUNT	NEW MONEY
4-WEEK AND 3&6 MONTH BILLS	12/27	12/31	1/3	*12.00*	*22.00*	*19.00*	*50.00*	*3.00*
	1/3	1/7	1/10	*12.00*	*22.00*	*19.00*	*43.00*	*10.00*
	1/10	1/14	1/17	*12.00*	*22.00*	*19.00*	*44.00*	*9.00*
	1/17	1/22	1/24	*12.00*	*22.00*	*19.00*	*46.00*	*7.00*
	1/24	1/28	1/31	*15.00*	*22.00*	*19.00*	*49.00*	*7.00*
	1/31	2/4	2/7	*20.00*	*24.00*	*21.00*	*51.00*	*14.00*
	2/7	2/11	2/14	*25.00*	*26.00*	*21.00*	*51.00*	*21.00*
	2/14	2/19	2/21	*30.00*	*26.00*	*21.00*	*52.00*	*25.00*
	2/21	2/25	2/28	*28.00*	*26.00*	*21.00*	*57.00*	*18.00*
	2/28	3/3	3/6	*25.00*	*24.00*	*21.00*	*60.00*	*10.00*
	3/6	3/10	3/13	*25.00*	*22.00*	*20.00*	*63.00*	*4.00*
	3/13	3/17	3/20	*25.00*	*22.00*	*19.00*	*65.00*	*1.00*
	3/20	3/24	3/27	*22.00*	*22.00*	*19.00*	*63.00*	*0.00*
					823.00		*694.00*	*129.00*
CASH MANAGEMENT BILLS								
18-DAY BILL		2/28	2/29		*25.00*		*25.00*	*0.00*
	Matures 3/17							
6-DAY BILL		3/11	3/17		*10.00*		*10.00*	*0.00*
	Matures 3/17							
								0.00
COUPONS						CHANGE IN SIZE		
10-Year TIPS	1/7	1/10	1/15		*8.00*		*19.10*	*-11.10*
20-Year TIPS	1/17	1/24	1/31		*8.00*			
2-Year Note	1/24	1/28	1/31		*20.00*			
5-Year Note	1/24	1/29	1/31		*13.00*		*21.60*	*19.40*
10-Year Note	1/30	2/6	2/15		*13.00*			
30-Year Bond	1/30	2/7	2/15		*9.00*		*54.60*	*-32.60*
2-Year Note	2/25	2/27	2/29		*20.00*			
5-year Note	2/25	2/28	2/29		*13.00*		*21.10*	*11.90*
10-Year Note-R	3/11	3/13	3/17		*8.00*			*8.00*
2-Year Note	3/24	3/26	3/31		*20.00*			
5-year Note	3/24	3/27	3/31		*13.00*		*20.20*	*12.80*
					143.00		*136.10*	*6.90*

Estimates are italicized

NET CASH RAISED THIS QUARTER: 135.90

R = Reopening

October 31, 2007
HP-657

Minutes of the Meeting of the Treasury Borrowing Advisory Committee of the Securities Industry and Financial Markets Association

October 30, 2007

The Committee convened in closed session at the Hay-Adams Hotel at 10:30 a.m. All Committee members except Gary Cohn were present. Assistant Secretary for Financial Markets Anthony Ryan, Deputy Assistant Secretary for Federal Finance Matthew Abbott, and Office of Debt Management Director Karthik Ramanathan welcomed the Committee and gave them the charge.

The Committee addressed the first item in the Committee charge (attached) regarding debt issuance in light of intermediate and longer-term fiscal trends. Director Ramanathan presented a series of charts related to the fiscal situation, and noted some current trends, including positive but slower revenue growth, reduced growth in outlays, and increased volatility in State and Local Government Securities (non-marketable debt) issuance. The charts also highlighted the recent volatility in Treasury cash balances as well as recent data outlining net purchases of Treasury securities by international investors.

Several themes related to the short end of the Treasury market and credit markets as a whole also emerged from the charts. While credit conditions have improved since summer, Director Ramanathan noted that Treasury needs to be cognizant of the potential challenges to economic growth as well as their implications on debt issuance. Given that, on average, deficit estimates can vary by nearly $100 billion in either direction twelve months in advance of the end of the fiscal year, debt managers need to maintain flexibility. In addition, shifts in revenues and outlays in FY 2008 may be less gradual than expected, and may necessitate increased reliance on bills from current, relatively low issuance levels.

In addition, Director Ramanathan reiterated his prior comments that Treasury continues to consider the four-week bill as a cash management tool which may be subject to greater variations in issuance when compared to other Treasury securities. Given the potential for adjustments to the economic outlook, such variations in bill issuance will continue in the future. Nonetheless, the volatility of issuance has not significantly differed versus prior years. While market participants encountered increased uncertainty in the bill sector this past summer, the actual volatility of issuance in the sector overall remains fairly stable. For example, one measure of relative volatility, the coefficient of variance of issuance for the four-week bill, has moved marginally to 34% in FY2007 from 33% at the end of FY2006, implying fairly consistent issuance patterns.

Following this discussion, Director Ramanathan focused on recent events in short-term credit markets, including volatility in money market rates such as LIBOR, commercial paper, asset backed commercial paper, and Treasury bills. The flight to quality in August 2007 as a result of credit events both domestically and in Europe benefited Treasury from the perspective of increased issuance of securities at low interest rates.

However, the large variations in rates and persistent demand for shorter dated securities – particularly in the Treasury bill market – were unprecedented, according to Director Ramanathan. As a result, the appetite for risk temporarily diminished, and in the process, impacted Treasury auctions. Market participants and investors perceived the auctions in August (including the four-week bill which tailed over 200 basis points) as anomalies. Moreover, these auction results did not warrant adjustments by Treasury, be it earlier auction times or adjustments to the auction calendar. In addition, auctions since August have been performed well, suggesting

that the auctions in August may have precipitated the repricing of risk to more rational levels.

Nonetheless, Director Ramanathan stated that the auctions in August drew the attention of Treasury, and led to an evaluation of the situation in short-term credit markets and the root causes of this flight to quality.

In conclusion, the charts noted that Treasury faces uncertainty given the fiscal and economic outlook, and that flexibility is critical to managing potential borrowing scenarios. According to Director Ramanathan, Treasury could raise over $200 billion with relative ease if necessary given the low level of bills outstanding and reduced coupon issuance sizes. Financing decisions will continue to be made in a transparent manner and in consultation with market participants.

The Committee began the discussion of the first charge with one member noting that events in the short-end of the market this summer were related to supply and demand imbalances exacerbated by an extreme movement out of commercial paper into risk-free Treasuries. As short rates richened, demand declined temporarily, and the market readjusted accordingly. Another member noted that credit markets faced the "perfect storm" in August and that all asset classes were impacted. This member noted that the flight to quality to Treasuries once again showed the importance of the Treasury market on a global basis.

The Committee then turned to the issue of how Treasury should proceed with adjustments to borrowing over the next fiscal year in light of recent intermediate to long-term fiscal trends. Deputy Secretary Abbott asked if the current auction calendar was sufficient to confront potential downside and upside variations to the deficit forecast. The Committee noted that over the last few years, the deficit has improved as receipts increased substantially while outlays grew at a slower than expected rate. The Treasury has managed the reduced borrowing need by reducing bill issuance along with coupon sizes. One member noted that there may be some risk to a higher than expected deficit given the potential for the growth in receipts to fall, the pace of outlays to increase in 2008 from current moderate levels, and the reversion of SLGS issuance to more normal levels from near record net issuance in FY2007,. In that case, the Committee recommended that Treasury address any upside surprise in funding needs mainly through increases in bill issuance and shorter dated securities.

One member noted that the market could easily absorb another $100 billion in bill issuance if it occurred gradually. Another member noted that bills as a percent of Treasuries outstanding were near 10-year lows and there was plenty of capacity to increase issuance. The member further noted that capacity was not the issue in the bill market provided that Treasury continues to be transparent about its issuance decisions. A few other members noted that there was a renewed appetite for risk-free credit assets, and that issuing more bills in this environment may benefit the market as a whole.

Another member asked if the risk to the deficit was asymmetric, i.e., could the deficit improve in FY 2008 if Congress and the President remain in deadlock over spending. A member stated in response that even if the pace of spending slows, revenue growth could fall even further which would lead to increased borrowing needs. Another member agreed and stated that the likelihood of a positive surprise remained low. However, the Committee acknowledged that risk needed to be considered and could be addressed through reductions in the bill sector or other means if necessary.

The Committee then addressed recent market dislocations in short term credit markets and their relationship, if any, with Treasury markets. A Committee member was asked to address this item and presented a series of slides showing that securitization has been beneficial to investors, generally offering higher yield spreads and diversification, while helping disperse throughout the global financial system risks that were once concentrated in a handful of large banks. However, according to the presenting Committee member, the recent developments stemming from trouble in the sub-prime mortgage market illustrate some of the potential threats of structured finance.

According to the presenting Committee member, securitization offers many benefits, but because it disperses risk so widely, the process has made it harder to

pinpoint where the risks reside and how investors may behave in times of market stress. Domestic sub-prime mortgage loans were marketed to investors in the form of asset-backed securities (ABS), which bundle together multiple subprime home loans. Some of the riskiest tranches of these ABS were subsequently resecuritized into CDOs, further increasing their complexity. Complex investments like structured investment vehicles purchased some securitized products, and were unable to roll over their asset backed commercial paper (ABCP) financing when markets seized this summer.

The presenting Committee member stated that ratings agencies have exacerbated the problem by giving investors a sense of comfort through ratings that have in many cases proven to be flawed. According to the presenting member, agencies should be encouraged to address conflicts of interest, perhaps by correlating payment for services to the long-term stability of ratings, or by asking issuers to prepay in full for ratings and disclose such ratings to all market participants.

The presenter concluded that more regulation to securitization is not the answer to resolving the problems in the capital markets, although lenders should be reminded of the moral hazards of short-term lending against long-term assets. A reevaluation of "truth in lending" may be needed in the mortgage banking business, which lacks the fiduciary culture that exists in the investment banking and broader financial industry.

In the discussion that followed the presentation, the Committee began by noting the reputation of securitization has been tainted by a small portion of the assets that are securitized – i.e. the majority of the assets underlying ABS are considered high quality, and the small minority of poor assets has effectively "contaminated" the whole sector. A larger problem is the lack of transparency regarding the credit quality of these underlying assets and other structured finance products. Another member agreed with this perspective, and added that models used by the rating agencies may be flawed in terms of data quality and economic assumptions; moreover, rating agencies may even have a conflict of interest in the rating process since the originator of the product they are rating is effectively "paying" for the rating.

Another member noted that structured financial products tend to "become fatal when they get sick" unlike traditional diversified investments. This member noted that the risk distribution in structured products does not follow a traditional bell shaped, normal distribution, but instead is characterized by a distribution with "fat tails".

One member, noting the status of the rating agencies and how the rating agencies potentially mishandled recent events, rhetorically suggested that ratings agencies may need to reconsider their private status. The member indicated that the analysis of credit risk on an independent basis was difficult because data needed to adequately assess risk was often only available to ratings agencies. The time and effort to do this analysis was also prohibitive for some investors.

Another member noted that risk was in the process of being repriced, and it would probably take another six months to a year for this to occur. As a result, liquidity and volatility in these markets will be impacted. The discussion then turned to the structure proposed by the private sector in relation to the ABCP market. Assistant Secretary Ryan gave a brief overview of the proposed structure, and Treasury's role in facilitating the development of this private sector initiative. The proposed structure, as well as the many other alternative structures being considered in the market at this time, may potentially preclude a low probability/ high impact event by providing backstop liquidity to the ABCP market. A private sector initiative that was designed to bring about orderliness to the repricing of risk and that could help in the price discovery process could potentially be useful.

Most Committee members agreed that an orderly unwind of these assets was a positive outcome given the alternative scenario. Some Committee members opined that the orderliness to the risk-repricing that the proposed structure was designed to achieve may delay the repricing of risk. Another member stated that, slowing the repricing of risk was not the issue that would settle markets; instead, more transparency into the structured transactions is what was needed before liquidity would return. .Another member added that given that economics would influence the participation or lack thereof of liquidity providers, and that participation by end

users also appeared to be voluntary, such a proposal would complement other responses being implemented in capital markets currently. Two members then concluded the discussion of the structure stating that the private sector initiative would be better evaluated when more details of the proposal were released.

In terms of the implications for the Treasury market, the Committee members generally felt that the events would enhance demand for Treasury securities. They noted that because many investors do not have the time or expertise to do risk analysis on their own for complicated structured products and because the rating agencies were having difficulty in establishing ratings in which investors have confidence, more market participants and traditional ABS buyers may shift into Treasury or agency products in the coming year.

Finally, the Committee was asked about their thoughts regarding current and future demand for Treasury securities. A Committee member presented a series of slides linking the current account deficit to strong demand for Treasury securities from foreign investors which has funded the federal deficit. Demand has not only come from the official sector but also private investors. The presenting member stated that structural factors - not market dynamics - have created demand for Treasuries from oil producing countries and Asian economies which trade with United States. Central banks and sovereign wealth funds have marginally diversified out of the dollar, but private investors continue to be net buyers of Treasuries.

The presenting member noted that one month of data may not indicate a change in trend, and given the slope of the demand curve over the past four years, a pullback was to be expected. Moreover, the presenting member noted that emerging nations, many not fully captured in publicly available data, remain strong buyers of US Treasuries in one form or another. These purchasers may believe that large foreign exchange reserves create increased stability in times of stress. The presenting member concluded by stating a number of factors needed to be evaluated to determine future Treasury demand including international currency policy, foreign exchange reserve accumulation, private sector flows, the global economic outlook, geopolitical issues, pension fund demand, and potential entitlement changes.

Committee members generally agreed with the presenting Committee member. One member noted that recent stresses in the credit market may precipitate further buying of Treasuries in the future. Another member noted that the composition of buyers in foreign jurisdictions such as the United Kingdom and the Caribbean may encompass many other nations or types of investors.

A Committee member asked why Treasury thought investors remained so committed to the domestic markets. Director Ramanathan stated that, in general, major investors and reserve managers prefer the liquidity, the transparency, and the depth of the US Treasury market, and preserving these fundamental characteristics was critical to ensuring continued demand in the future.

The Committee then reviewed the financing for the remainder of the October through December quarter and the January through March quarter.

The meeting adjourned at 12:08 p.m.

The Committee reconvened at the Hay-Adams Hotel at 5:00 p.m. All the Committee members except Gary Cohn were present. The Chairman presented the Committee report to Assistant Secretary Ryan. A brief discussion followed the Chairman's presentation but did not raise significant questions regarding the report's content.

The meeting adjourned at 5:15 p.m.

Karthik Ramanathan
Director
Office of Debt Management

October 30, 2007

Certified by:

Keith T. Anderson, Chairman
Treasury Borrowing Advisory Committee
of The Securities Industry and Financial Markets Association
October 30, 2007

Treasury Borrowing Advisory Committee Quarterly Meeting Committee Charge – October 30, 2007

Fiscal Outlook

In light of intermediate and longer-term fiscal trends as well as recent economic and market conditions, what advice would the Committee give in terms of Treasury's debt issuance?

Securitization, Rating Agencies and the Money Markets

What are the Committee's views regarding recent market dislocations in short term credit markets and their relationship, if any, with Treasury markets?

Treasury Market Dynamics

What are the Committee's thoughts regarding current and future demand for Treasury securities?

Financing this Quarter

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

- The composition of Treasury notes and bonds to refund approximately $51.5 billion of privately held securities maturing or callable on November 15, 2007.
- The composition of Treasury marketable financing for the remainder of the October-December quarter, including cash management bills.
- The composition of Treasury marketable financing for the January-March quarter.

October 31, 2007
HP-658

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, November 2, 2007, 10:00 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.

October 31, 2007
HP-659

Secretary Paulson Remarks Following Hope Now Meeting

Washington - Good afternoon. I've just met with the Hope Now alliance, to get an update on their efforts to reach struggling homeowners and avoid preventable foreclosures. Foreclosures are not only painful for homeowners, but are costly for servicers and investors, who in many cases are better off when they can modify or refinance a mortgage and keep the homeowner in his home. Early action by servicers and homeowners can preserve investor value and achieve sustainable results.

There are two parts to the effort to avoid foreclosures – first, making contact with a borrower who is in trouble, and second, determining if there is an affordable mortgage product for that borrower and taking action.

The members of this coalition are doing a lot of great work on both fronts. Most of the servicers have aggressive programs underway to reach borrowers who are having trouble paying their mortgages. But they are finding that the response rate isn't high enough. As the alliance is announcing today, they are producing a single letter on the Hope Now letterhead, providing at-risk borrowers a phone number to call for help. They are incorporating lessons each has learned from their individual mailing strategies, and they expect a stronger response from this unified approach, which could have a big impact in reaching homeowners who need help. Letters begin to go out on November 19th.

We in government also have a role to play – urging borrowers who receive this letter to act on it. I will do that, as will other senior Treasury officials, and I will urge members of Congress to highlight the letter to their constituents, so they know where they can find help if they need it.

The second piece of the puzzle, after making contact with struggling borrowers, is to determine if there is a mortgage they can afford. Many servicers today are already stepping up their efforts here as well. A few of the leading servicers have developed specific criteria for quickly assessing a borrower's financial situation, categorizing borrowers who qualify for loan modifications or refinancings and taking action.

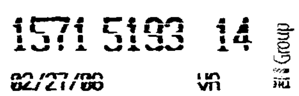
Today members of the alliance told me they are developing methods, criteria and metrics that any industry participant can use to systematically evaluate borrowers' ability to pay resetting adjustable rate mortgages. For example, borrowers who are current on payments at the lower rate might be candidates for fast tracking into a refinance or a loan modification. Others who struggled even with payments at the teaser rate may not have these options.

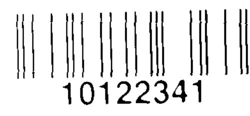
I am calling on industry participants to review their existing practices and adopt specific criteria that will quickly identify borrowers who can keep their homes and follow up with a refinancing, a loan modification or other flexibility. This approach will be the most effective means of handling the expected volume of inquiries. And developing clear criteria now will allow us to gauge the success of these efforts in avoiding preventable foreclosures. I look forward to hearing an update from the alliance at the earliest possible time. I am pleased to see that more industry participants have joined the alliance and adopted their commitments. I encourage other industry participants to join this effort.

Just as the alliance members expect to be more successful in reaching troubled borrowers, I am confident that working together through Hope Now, counselors and servicers can streamline and systematize their processes to more quickly meet the needs of more borrowers.

I want to help as many able homeowners as possible. To do that requires continuous learning. We must deepen our understanding of how many borrowers can be helped and the most effective mortgage solutions for them. As I have said before, this housing and mortgage market decline is still unfolding. Resetting ARM rates are one factor which will play out over the next 18 months. Declining home values will also significantly affect default rates going forward. We've also learned that default rates are far higher on mortgages made in 2006 and 2007, due to lax underwriting standards. We have work to do to understand how many of these borrowers are able to afford their homes.

I view the housing and mortgage market decline as the most significant current risk to our economy. Even so, today's GDP numbers reinforce my belief that we have a healthy, diversified economy that will continue to grow. I am eager to work with Congress, with HUD, with mortgage counselors and with mortgage market participants to take all reasonable steps to avoid unnecessary foreclosures and minimize the impact of recent market turmoil on homeowners and on our economy.

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