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Department of the Treasury

PRESS RELEASES

Number not used: HP-899

PRESS ROOM

March 3, 2008
HP-855

Remarks by Treasury Assistant Secretary for International Affairs Clay Lowery at the Annual Conference of the Institute of International Bankers

Global Financial Stability and Systemic Risk: The Current Financial Market Turmoil

Washington – Thank you for your kind introduction. I'm pleased that you have invited me to speak at today's forum. In 2006 I spoke at an IIB Dialogue in Singapore on "Promoting a More Open Global Financial System," and I'm glad to be back today – particularly given how calm everything is in the markets.

Today I will briefly review the U.S. and global economic situation and some of the factors contributing to today's financial turmoil. I will then describe some of the lessons we have learned so far and the steps the U.S. and the international financial community is taking to address the issues we face.

Economic overview

The U.S. economy is fundamentally sound, diverse and resilient. Economic growth over the past four years has averaged 2.9 percent. More than 8 million jobs have been created since August 2003. However, following several years of what, in retrospect, was unsustainable home price appreciation, the U.S. economy is undergoing a significant and necessary housing correction, which is weighing on near-term economic growth. Headwinds also are coming from higher energy prices and stress in the financial markets.

Looking beyond the U.S., global economic growth remains solid, in the vicinity of 4 percent, which is still well above the 3 ¼ percent average of the 1980s and 1990s, though not as robust as the 5 percent numbers of recent years. Much of the global slowdown is concentrated in G-7 economies, though emerging markets are likely to experience some dampening of their growth prospects as well. However, many parts of the emerging market world are still expected to grow in excess of 5 percent in 2008, with some, especially developing Asia, likely to grow in excess of 8 percent.

Underlying Weaknesses that Contributed to the Current Financial Market Turmoil

In the context of these global economic conditions, let me turn to the current financial market turmoil. I know that this has been a roller-coaster ride for you and the financial institutions you represent. Likewise, here at Treasury, we have been very much engaged in monitoring and analyzing the turmoil, both domestically and internationally.

Let me spend some time this morning giving you our perspectives on the underlying weaknesses that contributed to the turmoil and what the U.S. Administration is doing to address the problems. I will then turn to the international response that we have been working in cooperation with many other countries to craft. Of course, we are still in the midst of the turmoil, so it is premature to draw final lessons and make final recommendations.

There are a variety of ways to categorize the weaknesses, but let me try to take a lesson from a key observer of the international financial system – David Letterman – and give you my top ten list. Unlike Mr. Letterman, this will not be in any particular order.

1. Underwriting standards were seriously eroded during the housing boom. On

the positive side, securitization brought new capital to sub-prime borrowers and helped them buy homes they otherwise would not have been able to own. However, some mortgage originators encouraged excessive borrowing, or with disadvantageous loan terms.

2. Risk management practices did not keep pace with market developments. Risk managers for loan originators, securitization issuers, and investors did not properly evaluate all of the risks, including the liquidity risks, concentration risks, and reputation risks.
3. Investors did not perform appropriate due diligence for their investments. Some investors relied completely on external credit ratings to determine the risk rather than assessing risk themselves. Many investors misunderstood or ignored the different risk characteristics between structured products and corporate bonds. Some investors did not realize that credit ratings provide only a probability of default risk, and not other risks.
4. Disclosure throughout the securitization process was inadequate. Loan originators did not sufficiently or clearly disclose their terms to borrowers. Securitization issuers did not disclose adequate information for investors to judge the quality of mortgage loans underlying residential mortgage-backed securities and more complex products. And purchasers of often complex securities did not demand adequate information or perform appropriate analysis on the contents of what they were buying.
5. Credit rating agencies failed to adequately communicate risks. Credit rating agencies did not make it sufficiently clear that there are differences in the meaning of ratings between corporate bonds and structured finance products. The agencies also had not adequately considered the potential weaknesses in the underlying data and in their assumptions and models used to arrive at their credit rating decisions.
6. Misaligned incentives encouraged excessive risk-taking. The originate-to-distribute business model encouraged mortgage originators and securitization issuers to produce complex products to satisfy investors' increased demand for yield. The lucrative income stream from originations and securitizations encouraged some to incur risks.
7. The treatment of off-balance sheet exposures encouraged excessive risk-taking, leading to the creation of conduits and SIVs that we all know about so well now. Off-balance sheet exposures were generally opaque, which made risk analysis difficult for investors.
8. The liquidity assumptions of borrowers, securities issuers, and investors often were unfounded. Many borrowers had not considered the possibility that the housing market could decline. Mortgage originators and securitization issuers had assumed that a liquid market for the underlying mortgages and securitizations would continue unabated.
9. The valuation of complex securities proved to be more challenging than expected for many market participants. The application of fair-value accounting to liquid securities is not especially difficult--or at least, so I'm told, for accountants. However, the possibility that such securities could become substantially less liquid, or could even cease trading, in times of market stress was not fully considered in advance.
10. And finally, weaknesses in supervisory frameworks have been exposed. Supervisors in some countries did not have the tools they needed to adequately regulate financial institutions or deal with weak and failing banks.

United States policy response

With this long list of ten weaknesses I have just identified, it does suggest we might want to do something about it. So what should we do?

In the United States, I would say that we are doing three things that also helps feed into a fourth.

First, we have made adjustments to the macroeconomic policy mix to support the broad U.S. economy while the inevitable corrections take place in the housing and credit markets. The President and Congress responded with a bipartisan fiscal stimulus package totaling more than $150 billion, while the Federal Reserve has made adjustments in liquidity support and monetary policy.

Second, the Administration has supported a number of initiatives – both private sector led and public sector initiatives – in response to the housing correction, designed to prevent as many foreclosures as possible.

Third, the President's Working Group on Financial Markets – the PWG – an interagency policy coordination group chaired by Secretary Paulson and consisting of the Fed, the SEC, and the CFTC, is actively engaged in a comprehensive review of policy issues related to recent financial market turmoil. This review includes approaches to strengthen risk management practices at financial institutions, improve market discipline in the securitization process, and improve the issuance and use of credit ratings.

International plan

This is a summary of the actions that the U.S. Administration has supported so far. But the current financial market turmoil is not just a U.S. problem.

Indeed, the financial market turmoil has spread globally. We at the Treasury Department are closely tracking write-downs and losses that international financial firm have publicly disclosed. By our count, it now tallies over $200 billion. Only about half of this is reported by U.S. financial institutions; European institutions report another $75 billion and the rest is accounted for by banks in Asia, Canada, and elsewhere.

Last August, as the turmoil spread to Europe, we realized that we needed not just a U.S. response, but a global response. And what better mechanism to address the situation than the Financial Stability Forum – known as the FSF? And if you are keeping count, it is the work of the FSF that I consider the fourth step that we are taking.

The FSF was formed by the Group of Seven finance ministers and central bank governors in 1999 after the Asian financial crisis. The FSF is a unique body. It brings together supervisors, central banks, finance ministries, the IMF and World Bank, and international regulatory groups. Together, the members of the FSF assess international financial system vulnerabilities, identify actions needed to address these vulnerabilities, and help coordination among authorities responsible for financial stability. In short, the FSF is the coordination link between the global phenomenon of capital markets and the national system of regulatory entitities.

In October 2007, the G7 tasked the FSF to analyze the causes of the financial turbulence and recommend actions to address them. At last month's meeting in Tokyo, the FSF presented an interim report to the G7 finance ministers and central bank governors. The interim report identified six main policy directions.

- The first area is supervisory framework and oversight. The FSF interim report recommended that the Basel Committee on Banking Supervision assess the need for changes to the Basel II capital framework in light of the turmoil. The FSF also asked the Basel Committee to recommend strengthened industry and supervisory practices for liquidity risk management. Basel II and accounting practices provided incentives for the use of off-balance sheet vehicles, and the Basel Committee has agreed to review these.
- Second, the FSF said that the underpinnings of the originate-to-distribute model need to be strengthened. This should include origination and underwriting standards and transparency. The FSF is encouraging the development of market-based approaches to incentives in the originate-to-distribute model.
- Third, the FSF concluded that investors relied excessively on credit ratings. The credit rating agencies (the CRAs) must improve the information they provide to investors in structured financial products. Authorities should also review the role of credit ratings in their regulations and guidance to ensure that investors do not overly rely on them instead of performing their own due diligence. An IOSCO working group is updating its Sound Practices for credit rating agencies to address structured finance.
- Fourth, the FSF report said that market transparency should be improved. Financial institutions should disclose more useful information on risk exposures and values. Valuation methods and data, particularly for illiquid markets, are a concern. Market-led enhancements to market transparency and disclosure are needed, although the FSF noted that more prescriptive approaches are possible if these improvements are not forthcoming. Transparency is also an area of active work for the Basel Committee, the International Accounting Standards Board (IASB), and IOSCO.

- Fifth, supervisory and regulatory responsiveness to risks should be strengthened, with an increased bias to turning analysis into action. Skills of supervisors should keep pace with industry developments, and supervisors should clearly communicate concerns about risk management to financial institutions. International organizations should improve their decision-making processes. IOSCO is working on aspects of this area.
- Finally, the FSF report said that authorities' ability to respond to crises should be strengthened. Central banks are reviewing lessons from recent experiences to identify improvements in their operational frameworks, communications with markets, and coordination between central banks. Authorities also are considering their structures for dealing with failing banks internally, and cross-border. The Committee on the Global Financial System (CGFS) is evaluating these issues.

These are just the highlights from the FSF's interim report. The G7 finance ministers and central bank governors in Tokyo in February welcomed the report and the solid progress that the FSF is making. The chairman of the FSF, Mario Draghi, is doing an excellent job and providing great leadership to a complex area. The FSF will gather again this month and the final report is scheduled to be released at the April G7 meetings here in Washington.

In addition to the FSF, the European Commission, UK Prime Minister Gordon Brown, and German Finance Minister Peer Steinbrück have been offering proposals. The leaders of four major European countries and the President of the European Commission also met and issued a joint communiqué with a variety of suggestions. These ideas largely cover areas that are within the six overarching policy directions identified by the FSF and its framework.

These efforts underscore that the questions raised by the current market turmoil are complex. And given that volatility in the markets continues, the diagnosis, recommendations and ultimately solutions to those problems will need to be nuanced, probably won't be complete upon first draft, and must not impair future capital market efficiency or innovation. These are global issues that require bilateral and multilateral cooperation and we will continue to work closely with the G7 and the FSF on a wide range of issues to ensure that policy responses are coordinated.

Thank you.

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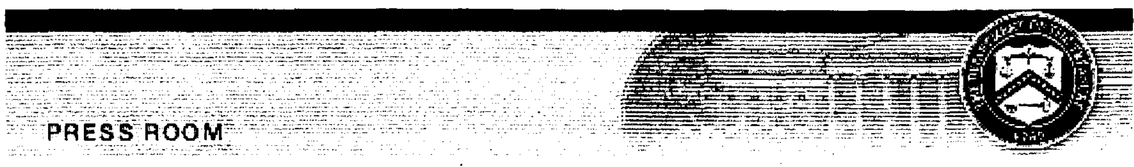

March 3, 2008
HP-856

Remarks by Secretary Henry M. Paulson, Jr.
U.S. Housing and Mortgage Market Update
before the National Association of Business Economists

Washington - Good morning. Thank you, Tom. It is a pleasure to be with you. Last week we had several significant data releases updating us on the status of the housing market correction. And just this morning, we are reviewing data released by the HOPE NOW alliance, marking the results of their efforts through January to reach and assist struggling borrowers who want to keep their homes. Industry efforts are making progress, and I will walk through these results in a moment.

I have said before that housing poses the biggest downside risk to our economy, and most forecasters expect a prolonged period of adjustment. It is an appropriate time to take a comprehensive look at the state of our housing and mortgage markets and their impact on the economy. I will do that today. My careful review has led me to three main conclusions.

Three Conclusions

First, many in Washington and many financial institutions have been floating proposals for a major government intervention in the housing market, with U.S. taxpayers assuming the costs of the riskiest mortgages. Today, 93 percent of American homeowners – 51 million households - pay their mortgages on time. Many are on tight budgets, sacrificing other things in order to make that payment. Only 2 percent are in foreclosure.

Most of the proposals I've seen would do more harm than good --- bailing out investors, lenders or speculators who, instead of getting a free-pass, should be accountable for the risks they took. Let me be clear: I oppose any bailout. I believe our efforts are best focused on helping homeowners who want to stay in their homes.

Second, this is a shared responsibility of industry, government and homeowners. We in government are working to expand options through the FHA, and we've worked with the industry to reach as many homeowners as possible to let them know that help is available. There is more that government and industry can do, and our efforts will continue to evolve. Homeowners have responsibilities as well. If borrowers won't ask about solutions, there is only so much that can be done on their behalf.

Third, the current public discussion often conflates the number of so-called "underwater" homeowners – that is, those with mortgages greater than the value of their house – with projections of foreclosures. Let's be precise: being underwater does not affect your ability to pay your mortgage, nor create a government responsibility for assistance. Homeowners who can afford their mortgage should honor their obligations --- and most do.

Obviously, being underwater is not insignificant to homeowners in that position. But negative equity does not necessarily result in foreclosure. Most people buy homes as a long-term investment, as a place to raise a family and put down roots in a community. Homeowners who can afford their payments and don't have to move, can choose to stay in their house. And let me emphasize, any homeowner who can afford his mortgage payment but chooses to walk away from an underwater property is simply a speculator – and one who is not honoring his obligations.

We know that speculation increased in recent years; a resulting increase in foreclosures is to be expected and does not warrant any relief. People who

speculated and bought investment properties in hot markets should take their losses just like day traders who speculated and bought soaring tech stocks in 2000.

Let me walk through my perspective on today's markets, which has led to these conclusions.

Current Housing Market Data

Recent housing data confirmed the ongoing housing correction. Existing single-family home sales fell to a 10-year low in January. At current sales rates there is now a 10.1 month supply of existing homes on the market, as compared to 4.5 months worth of inventory in a more normal market.

Similarly, new January data reported a 9.9 month supply of new homes currently on the market, more than twice the average supply during the first half of this decade. We also know that foreclosures add to inventories of unsold homes; by some estimates, more than half of properties go back on the market shortly after foreclosure.

Clearly, we have an overhang of supply. Working through the excess means that home prices will stagnate or fall, and we are seeing that now. The OFHEO index for purchased homes showed a 1.3 percent price decline in the fourth quarter of 2007 and is down 0.3 percent over the past year. The Case-Shiller composite index for the 20 largest metropolitan areas is down 9.1 percent over the past year; prices were down on an annual basis in 17 of the 20 metropolitan areas surveyed.

Of course, there is no national housing market, but instead a compilation of regional markets. The housing correction, and the run up to the correction, unfolded differently in different regions.

In recent years, many markets witnessed steep home price appreciation that was clearly unsustainable. For example, from 2002 to 2006, home prices in Bakersfield, California rose 122 percent. During that same time frame, prices rose 94 percent in Las Vegas, Nevada, and 107 percent in Miami, Florida. Not surprisingly, many areas that saw the biggest price increases are now seeing the biggest price declines.

Other markets experiencing high foreclosure rates today are those facing broader economic difficulties. Cities like Detroit, Michigan and Cleveland, Ohio didn't experience the large price appreciation, and current price declines in these markets have been triggered by weak local economic conditions.

Falling prices have impacted millions of homeowners. A recent Moody's report estimates that 8.8 million homeowners today have zero or negative equity.

While these equity considerations clearly impact homeowners' financial situation, they are not the primary concern in the effort to prevent avoidable foreclosures. And preventing avoidable foreclosures is the linchpin of our efforts to minimize the impact of the housing correction on the broader economy.

A greater determining factor in foreclosures of homeowners who want to stay in their home is the homeowner's ability to make the monthly mortgage payment, whether or not they have equity in their home. Those struggling to make their monthly payments may have had a change in life circumstance that reduces their ability to pay, or be facing a resetting adjustable rate that they cannot afford.

Essentially, these are the homeowners we are aiming to help – they want to stay in their homes, but have a mortgage product problem or an income problem.

Two-pronged Approach to Rising Foreclosures

We have a two-pronged policy approach that focuses on these two sources of rising foreclosures. First, we worked with Congress to enact a broad stimulus plan to support the economy, to maintain and create jobs so there will be fewer who suffer that income loss. The stimulus package will put $150 billion into the economy and

create more than 500,000 new jobs this year. We expect to deliver stimulus payments to over 130 million households starting in May, with the bulk of those dollars distributed by the first week in July. The boost from consumer spending and business investment will add strength to our economy while the housing and credit market adjustments proceed.

Second, a private sector alliance – HOPE NOW – has adopted a broad set of tools focused on assisting struggling borrowers who want to keep their homes. This morning they released data demonstrating the results of their efforts through the month of January.

HOPE NOW Results

HOPE NOW announced that since July more than 1 million struggling homeowners received a work-out – either a loan modification or a repayment plan that helped them avoid foreclosure. Of those, 638,000 were for subprime borrowers. This data does not include refinancings, which also provide borrowers with affordable, long-term mortgages.

According to today's information, HOPE NOW's progress is accelerating. In January, there were 167,000 work-outs, up 11 percent from December. Loan modifications alone increased 19 percent from December to January. By comparison, foreclosure starts increased just 5 percent during the same period. I am encouraged that the number of borrowers receiving help is rising faster than the number entering foreclosure.

Focus on Subprime Borrowers

One of the tools of HOPE NOW is the American Securitization Forum's fast-track framework for subprime ARM borrowers that was announced in December.

Why are we focused on this small group of borrowers? Because they represent a disproportionate share of foreclosures.

Even when both the economy and the housing market are strong, many foreclosures occur. For example, between 2001 and 2005, foreclosure starts averaged more than 650,000 per year. Based on data through the third quarter of last year, we are on track for about 1.5 million foreclosure starts in 2007 and some analysts see as many as 2 million foreclosure starts in 2008.

While subprime mortgages make up only 13 percent of outstanding mortgages, about 50 percent of the foreclosure starts in the third quarter 2007 were subprime loans. And more astonishing is the fact that, while subprime ARMs are only 6.5 percent of mortgages, they represent 40 percent of third-quarter 2007 foreclosure starts.

These numbers presented a volume problem - that the time-intensive process of examining the financial situation of every subprime borrower would overwhelm the available resources, and as more borrowers called for help some who, in a normal market, would get a modification or refinance would instead go into foreclosure simply because no one could respond to them in time.

The new protocol announced in December is designed to address this volume problem by streamlining some borrowers into refinancing or modification, so that resources are available for more difficult situations.

The SEC signed off on this protocol on January 8th. Although it is complex, some servicers were able to implement it right away, while others required more time to work through the legal, operational and accounting issues. Overall, more than half of the HOPE NOW servicers had implemented the protocol by the end of January.

Those of you who know me know that I am not a patient person. I certainly would have liked to see more servicers implement the protocol faster, and I want to praise those industry leaders who acted quickly. They met their commitments, and that is welcome. I am pleased that as of today, all of the HOPE NOW members who service subprime mortgages have the protocol in place, ahead of the rising volume

of resets in the coming months. Having the protocol in place industry-wide should also mean – and I will monitor this – accelerated results for subprime borrowers in the coming months.

Given the time it took to implement the ASF framework, HOPE NOW concluded it was too soon to have meaningful results specific to this fast-track plan. Instead, the results are included in the aggregate HOPE NOW reporting on subprime workouts.

In January, HOPE NOW members – through the ASF protocol and other workout programs – modified 45,000 subprime loans, up 16 percent from December. I expect those numbers to increase further, now that the ASF protocol is in place industry-wide. Transparency of the ASF protocol results is critical. I understand that tracking results is complicated – every borrower is unique and attributing particular outcomes to particular causes is difficult. Still, enough of the servicers were following the ASF framework in February that I will press HOPE NOW to break out the ASF protocol results when their February data is released, so that we can all assess its effectiveness.

It is important that everyone who agreed to this protocol follows through on their commitment. I won't look kindly on industry free riders. My measure of success will be that a borrower who has made all the payments at the initial rate, but can't afford the reset and reaches out for help, avoids going into foreclosure.

Of course, the single most significant factor that has benefited all ARM borrowers is the recent decline in short-term interest rates, which are very significantly mitigating the effects of mortgage resets. A typical subprime mortgage resetting in December might have increased from 8.5 to 10.8 percent; in today's lower interest rate environment it may reset only to 9 percent. This means on a $200,000 mortgage, the typical monthly payment will increase by about $70, instead of growing by more than $300. Market participants estimate that as many as half the borrowers who at December rates would have been fast-tracked for a modification instead did not face a significant ARM reset in January. Lower rates, rather than loan modifications, helped these borrowers avoid foreclosure.

Outreach Efforts

As we continue to urge lenders to streamline the modification and refinance process, we must also continue to urge struggling homeowners to reach out for help.

Before the creation of HOPE NOW, servicers were sending letters to delinquent borrowers and getting only a 2 to 3 percent response rate. The alliance now sends out letters on HOPE NOW letterhead, and gets closer to a 20 percent response. They've sent over 1 million letters to struggling borrowers who had previously avoided contact, and the higher response rate means almost 200,000 borrowers have reached out for help.

That's a big improvement, but it also means that more than 80 percent of at-risk homeowners aren't responding - aren't taking any responsibility. For any government or industry initiative to be effective, homeowners must actively engage with their lenders and demonstrate that they want to keep their homes. The earlier they do so, the more flexibility their lender will have. If borrowers don't ask for help, they will have to bear the consequences --- which may very well mean losing their homes when that could have been prevented.

Conclusion

As the HOPE NOW alliance continues to report results, we will evaluate progress and make adjustments. We will also continue to listen to new ideas. I believe we have the right program in place – an evolving private sector effort to reach borrowers and find affordable mortgage solutions wherever possible. We will continue to pursue FHA modernization and GSE reform in Congress, to expand access to affordable mortgages. And I will continue to focus on the broader effort to keep our economy strong as we weather this necessary housing correction.

Thank you.

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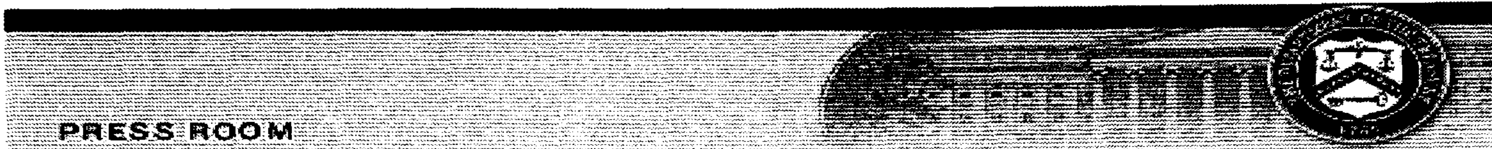


March 3, 2008
2008-3-3-14-50-32-24601

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 $73,521 million as of the end of that week, compared to $72,073 million as of the end of the prior week.

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

	February 29, 2008		
A. Official reserve assets (in US millions unless otherwise specified)	Euro	Yen	Total
(1) Foreign currency reserves (in convertible foreign currencies)			73,521
(a) Securities	15,197	12,306	27,503
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	15,009	6,033	21,042
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	4,277		
(3) SDRs	9,658		
(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				
(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	

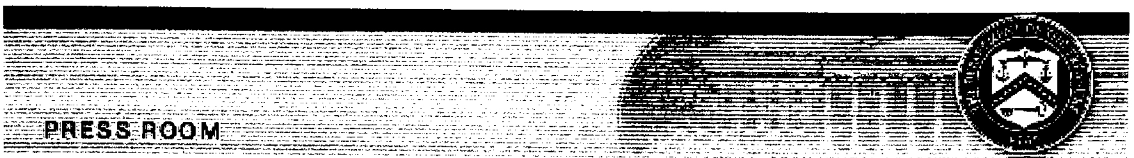
(d) securities lent and on repo	
--lent or repoed and included in Section I	
--lent or repoed but not included in Section I	
--borrowed or acquired and included in Section I	
--borrowed or acquired but not included in Section I	
(e) financial derivative assets (net, marked to market)	
--forwards	
--futures	
--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)	73,521
--currencies in SDR basket	73,521
--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.



March 3, 2008
HP-857

U.S. Treasurer to Host Discussion on African-American Financial Education

The U.S. Treasury Department will host a discussion tomorrow on financial education in African-American communities. U.S. Treasurer Anna Escobedo Cabral and Deputy Assistant Secretary for Financial Education Dan Iannicola, Jr. will co-chair the discussion and moderate expert panels on the best ways to provide financial education to African-American communities.

Less than half of African-American workers have saved for retirement and generally have less saved when compared to all workers. Only 27 percent of African-American workers have tried to calculate how much they will need to save for retirement.

The roundtable is the third in a series of four discussions being held as part of the Financial Literacy and Education Commission's implementation of the National Strategy for Financial Literacy. For more information about the Commission, visit its website at www.mymoney.gov.

The following event is open to the media:

Who
U. S. Treasurer Anna Escobedo Cabral
Deputy Assistant Secretary for Financial Education Dan Iannicola, Jr.
What
Roundtable Discussion on Financial Education in African-American Communities
When
Tuesday, March 4, 8:30 a.m. EST
Where
Treasury Department
Cash Room
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.

PRESS ROOM

March 5, 2008
HP-858

**Opening Statement by Secretary Henry M. Paulson, Jr.
on the Department of the Treasury FY 2009 Budget Request
before the House Committee on Appropriations
Subcommittee on Financial Services and General Government**

Washington -- Chairman Serrano, Representative Regula, Members of the Committee: Thank you for the opportunity to discuss the Treasury Department's proposed fiscal year 2009 budget. Our budget request reflects the Department's continued commitment to promoting a healthy U.S. economy, fiscal discipline and national security. The Department has broad responsibility in federal cash management, tax administration and plays an integral role in combating terrorist financing and advocating the integrity of the U.S. and global financial systems.

Our spending priorities for the 2009 fiscal year fall into six main categories. I will briefly describe the priorities and then take your questions.

U.S. Economic Steward

Treasury has an important role to play as steward of the U.S. economy, and our offices provide technical analysis, economic forecasting and policy guidance on issues ranging from federal financing to domestic and global financial systems.

Those functions are especially critical now as the U.S. economy, through a combination of a significant housing correction, high energy prices and capital market turmoil has slowed appreciably. Our long term economic fundamentals are solid, and I believe our economy will continue to grow this year, although not as rapidly as in recent years.

In response to economic signals, early this year the Administration and the Congress worked together to quickly pass, on a bipartisan basis, the Economic Stimulus Act of 2008. And I would like to thank this subcommittee for approving funds for the IRS and the FMS to administer the stimulus check rebate program under that Act.

As you know, the stimulus payments to households and the incentives to businesses in the Act, together, are estimated to lead to the creation of half a million jobs by year-end. This will provide timely and effective support for families and our economy, and it wouldn't be possible without your leadership.

Strengthening National Security

Treasury's Office of Terrorism and Financial Intelligence (TFI) uses financial intelligence, sanctions, and regulatory authorities to track and combat threats to our security and safeguard the U.S. financial system from abuse by terrorists, proliferators of weapons of mass destruction and other illicit actors.

To continue and build on our efforts to combat these threats, we are requesting an $11 million increase for TFI, including $5.5 million for the Financial Crimes Enforcement Network to ensure effective management of the Bank Secrecy Act.

Efficient Management of the Treasury Department

The budget request emphasizes infrastructure and technology investments to modernize business processes and improve efficiency throughout the Treasury Department. We will continue to make information technology management a

priority, and have taken several significant steps to strengthen our systems and oversight.

Fiscal Discipline

Treasury is committed to managing the nation's finances effectively, ensuring the most efficient use of taxpayer dollars and collecting the revenue due to the federal government.

Enforcing the Nation's Tax Laws Fairly and Efficiently

The Internal Revenue Service, of course, plays an integral role in this. The budget requests a 4.3 percent increase in IRS funding.

As in the past three budget requests, we are proposing to increase IRS enforcement funding as a Budget Enforcement Act program integrity cap adjustment. IRS enforcement efforts have yielded record revenue collections. With the requested funding, the IRS will collect an estimated $55 billion in direct enforcement revenue in 2009.

The budget also includes a number of legislative proposals intended to target the tax gap and improve tax compliance, with an appropriate balance between enforcement and taxpayer service. These proposals are estimated to generate $36 billion over the next ten years.

International Programs

We will continue to focus efforts on supporting a stable and growing global economy, through on-going dialogue and initiatives with developing economies throughout Asia, Latin America and Africa.

In addition we are asking your colleagues on the Foreign Operations Subcommittee to support key objectives of the President's international assistance agenda. This includes funding for the multilateral development banks – notably new replenishments for the World Bank's International Development Association and the African Development Fund.

Also included as a Foreign Operations priority is a $400 million request for the first installment of a multi-billion dollar clean technology fund that, with additional funding from the United Kingdom, Japan and other donors, will help finance clean energy projects in the developing world and make strides towards addressing global climate change.

Conclusion

Overall, the budget request reflects a prudent and forward-leaning approach to fulfilling the Treasury Department's core responsibilities to support our economy, managing the government's finances and ensuring financial system security. I thank you for your past support and consideration of our work, and look forward to working with you during your deliberations.

Thank you and I welcome your questions.

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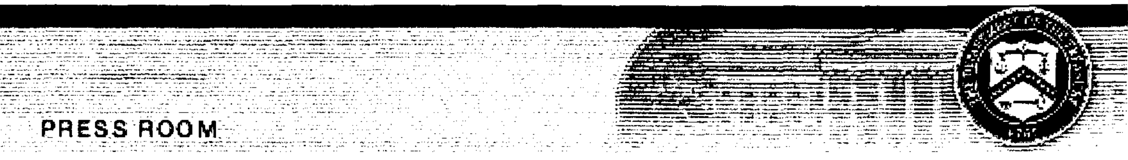

March 5, 2008
hp-859

Prepared Testimony of Treasury Tax Legislative Counsel Michael Desmond before the Subcommittee on Select Revenue Measures of the House Committee on Ways and Means

Washington -- Mr. Chairman, Ranking Member English, and distinguished Members of the Subcommittee:

Thank you for the opportunity to discuss with you today the Federal tax treatment of certain derivative products, including prepaid forward contracts. With the growing complexity and sophistication of our financial markets, the tax treatment of derivatives plays an increasingly important role in the efforts of the Treasury Department and the Internal Revenue Service ("IRS") to administer the nation's tax laws, and we appreciate this Subcommittee's focus on these issues.

The tax treatment of prepaid forward contracts is of continuing interest to the Treasury Department. Last December, we issued Notice 2008-2 (the "Notice"),[1] announcing that we are considering the subject and requesting public comments with respect to a number of specific issues. The period for submitting formal comments remains open, and the Notice has generated significant discussion on this important issue.

Although it is premature to offer any conclusions or positions with respect to how we might move forward with respect to the issues raised by the Notice, we look forward to continuing to work with this Subcommittee as you consider proposals that would affect the tax treatment of derivatives and, in particular, proposals to change the tax law with respect to prepaid forward contracts. To that end, it may be productive to describe the context in which we have seen this issue arise and some of the challenges we see in addressing it. It may also be helpful to provide some background regarding the Notice in order to clarify the context in which we are considering the issue and to develop a mutual understanding of the issues presented.

General Background Regarding Forward Contracts

Historically, forward contracts developed as a means for parties to hedge against the risk of price fluctuations in ordinary business operations. For example, a manufacturer might enter into a forward contract on steel that is used as a component in its production process to hedge against the risk that the price of steel will rise. For similar reasons, an airline might enter into a forward contract on jet fuel to hedge against the risk of fuel price increases. By fixing the price at which some asset will be acquired (or sold) in the future, a forward contract can reduce the risk of adverse price changes and, thereby, reduce the cost of doing business. Forward contracts, however, are not solely used in hedging transactions. Parties can (and do) use forward contracts to speculate on the future value of a reference asset.

A traditional forward contract is an agreement in which one party (in the "long position") agrees to purchase, and the other party (in the "short position") agrees to sell and deliver, a specific asset (the "reference asset") at a specific time for a specific price (the "forward price"). Generally, the party in the long position will profit from an increase in the price of the reference asset, while the party in the short position will profit from a decrease in the price.

Parties to a forward contract often settle their obligations under the contract with a single, net, cash-settlement payment (rather than through physical delivery of the reference asset and payment of the full forward price). In typical "cash-settled" contracts, at the time the contract settles, the forward price set forth in the contract is compared to the then-current (or "spot") price of the reference asset. If that spot

price is less than the forward price, then the long position pays the difference; if that spot price is more than the forward price, then the short position pays the difference.

The forward price for a nonperishable commodity or a financial instrument generally equals the reference asset's spot price at the time the contract is executed, plus the "cost to carry" (or hold) the asset for the term of the contract. "Cost to carry" represents interest (and other costs[2]) that a party would have to pay if it were to borrow to purchase and "carry" the reference asset during the term of the arrangement.[3] Consequently, the forward price implicitly includes a component that is calculated by reference to the time value of money – that is, interest. If the time value of money were not properly factored in to the forward price, arbitrageurs would be able to earn risk-free profits.[4]

Some contracts (referred to as "prepaid forward contracts") require the party in the long position to pay the purchase price upon execution of the contract, rather than on the later delivery date. In these circumstances, the amount paid typically reflects only the spot price of the asset to which the contract refers (plus any warehousing or similar expenses), but does not reflect a time value component. Again, if this were not the case, arbitrageurs could earn a risk-free profit.

General Background Regarding Taxation of Derivatives

The Internal Revenue Code and Treasury regulations contain a number of specific rules governing the Federal tax treatment of stock, debt, options, traditional forward contracts, futures contracts, certain swaps, and various other financial instruments. Different rules may apply to identical instruments in different contexts. Thus, for example, a forward contract may be taxed differently if it is executed by an investor,[5] a trader,[6] a dealer,[7] or a business hedger.[8] An identical forward contract may also be taxed differently depending on whether it is executed by a domestic or a foreign person,[9] or whether it derives its value from certain reference assets (such as foreign currency).[10] In addition, a single forward contract may involve different types of taxpayers as counterparties on opposite sides of the same contract. Thus, a single forward contract often generates asymmetrical tax consequences for the parties.

The resulting set of complex rules reflects various policy choices that Congress and the Treasury Department have made over the years with respect to the timing of income and loss, the character (capital or ordinary) of income and loss, and the source (domestic or foreign) of income and loss.

Financial innovation challenges the current system of taxing derivatives, because the system generally approaches new financial transactions by attempting to assign them to various categories (of the nature described above) for which there are clearly established rules. These categories are often colloquially referred to as "cubbyholes." Absent clear guidance as to which category a new transaction might fit in to, taxpayers are left to deal with uncertainty in structuring their affairs and the IRS is presented with difficulties in administering the tax law.

Unavoidably, this "cubbyhole" approach results in different tax consequences for economically equivalent transactions. For example, if a "triple-A" rated company issues preferred stock that is required by its terms to be redeemed on a specific date, that stock may be economically indistinguishable from that company's subordinated debt with the same maturity date. For both the company and its investors, however, these two transactions are taxed differently. Financial innovation amplifies this phenomenon (that is, different tax treatment of economically equivalent transactions) by increasing the number of situations in which it materializes. A single "hybrid" instrument that cannot be easily classified under the existing taxonomy may combine traditional instruments such as stock and debt. Alternatively, combinations of separate transactions may produce net cash flows that replicate a traditional instrument, thus creating a "synthetic" version of the traditional one, but with different tax consequences.

The following three examples illustrate this phenomenon in the specific context of prepaid forward contracts:

Example 1. On date 1, X (a hypothetical domestic investor) buys a share of stock

of ABC Inc. for $100. Two years later (on date 2), X sells the stock for its fair market value of $125.

Example 2. On date 1, X buys a "zero coupon bond"[11] (the "bond") for $100. The bond was issued by Corp Q on date 1 and matures in two years (on date 2) for $112, reflecting an interest rate of approximately 6%. On date 1, X also enters into a cash-settled forward contract to purchase a share of stock of ABC Inc. from Y in two years (on date 2) for $112. Two years later (on date 2), the fair market value of a share of stock of ABC Inc. is $125. On date 2, X receives a total of $125, consisting of $112 from Corp Q in redemption of the bond, and $13 from Y in settlement of the forward contract.

Example 3. On date 1, X enters into a cash-settled prepaid forward contract to purchase a share of stock of ABC Inc. in two years (on date 2). Pursuant to the contract, X pays Y $100 on date 1. In exchange, Y agrees to pay X on date 2 the fair market value on that date of a share of stock of ABC Inc. The contract does not require Y to own or acquire any stock of ABC Inc. Two years later (on date 2), the fair market value of a share of stock of ABC Inc. is $125. On date 2, X receives $125 from Y in settlement of the forward contract.

Aside from their tax consequences, these transactions are economically equivalent. In each case, X paid $100 on date 1 and received $125 on date 2, for an economic return of $25. However, on an after-tax basis, these transactions differ considerably.

In Example 1, X pays tax on its entire $25 economic return on a deferred basis (on date 2) at the long-term capital gains rate. This result follows from the current realization-based system of taxation.

In Example 2, X accrues $12 (attributable to the bond) into taxable income on a current basis and pays tax on these accruals in years 1 and 2 at ordinary income rates. X pays tax on the $13 attributable to the forward contract on a deferred basis at long-term capital gain rates. This result follows from the respect the current tax system generally affords to the separate transactions (the bond and the forward) and the specific tax rules that apply once each is assigned to a separate category.

What do these principles say about the manner in which Example 3 (the prepaid forward contract) should be taxed? In particular, does current law require X to bifurcate (or does it prevent X from bifurcating) the single contract into separate economic components for tax purposes? As a matter of market practice, investors in X's position in Example 3 typically do not bifurcate. Instead, they generally attempt to assign the transaction to only one of the traditional categories for which the tax system has prescribed rules. Investors in X's position often conclude that the transaction is not indebtedness under common law tax principles. They emphasize that, unlike traditional debt, which guarantees a return of principal, there is a meaningful likelihood that a significant portion of the $100 amount advanced may not be repaid because the value of ABC Inc. stock may go down. Furthermore, investors in X's position often conclude that their counterparty in the transaction is not acting as their agent, holding ABC Inc. stock on their behalf, stressing that X cannot be sure whether its counterparty (Y) even owns stock of ABC Inc. during the term of the transaction.

Having concluded that neither the debt nor the agency characterization is proper, investors in X's position generally assert that the transaction should be treated as a forward contract, taxed only upon realization. This result in Example 3 is consistent with the result in Example 1 (where tax is not paid until realization), but not with the result in Example 2 (where the investor is required to pay tax on accrued but unpaid income), even though all three examples involve economically equivalent transactions.

Notice 2008-2

The Treasury Department and the IRS have been aware for some time of the difficult issues raised with respect to the tax treatment of prepaid forward contracts. In 1993, in a preamble to regulations dealing with certain swap transactions, the Treasury Department and IRS first announced that they were studying the tax treatment of prepaid forward contracts and requested public comments. Specific

projects to address prepaid forward contracts were placed on the administrative guidance "business plan" in 1993 and again in 2001. To date, however, published guidance has not been issued.[12]

In 2007, the Treasury Department and IRS became aware of an instrument that was beginning to be offered to retail investors in the capital markets that purported to be a prepaid cash-settled forward contract with respect to foreign currency. The offering materials filed with the Securities and Exchange Commission (SEC) suggested that for Federal tax purposes the instrument did not require current income inclusions by investors and had the potential of generating long-term capital gains. In response, Revenue Ruling 2008-1, 2008-2 I.R.B. 248 (Jan. 14, 2008), was released in December 2007, holding that these instruments are foreign-currency-denominated debt under general tax principles, and that investors must accrue currently interest income.

In 2006, we also learned of recent significant growth in the number of prepaid forward contracts being offered to retail investors with respect to reference assets other than foreign currency. Language in the offering documents filed with the SEC with respect to these instruments suggested that they are not debt under general tax principles. In the retail space, these instruments are sometimes referred to as exchange traded notes ("ETNs"). Typically, ETNs differ from the simple situation described in Example 3, above, in that they reference large portfolios of stocks and/or commodities rather than a single stock or asset. These portfolios are periodically redefined and, in the case of stock indices, may pay dividends which are credited to the contract, but are not currently paid to the holder of the contract. These features present unique questions as to whether deferral of tax is appropriate.

Because of the large number of taxpayers potentially affected and their relative level of sophistication, the migration of prepaid forward contracts into the portfolios of retail investors served as an occasion for us to revisit the core issue related to prepaid forward contracts -- whether or not a current accrual of income should be required. We issued the Notice to inform the public that we are continuing to examine this issue and to solicit comments. As the popularity of prepaid forward contracts grows, more taxpayers are affected by the current lack of clarity and need guidance regarding how to compute their tax liability. We were also mindful of the fact that the market segment into which these transactions is expanding is one that is, perhaps, less capable of appreciating the risks associated with this uncertainty.

Although it would be very desirable for us to clarify this area, we have reached no conclusion about how to proceed, about what result should be reached, or about whether we are able to reach that result with administrative guidance.

Thank you Mr. Chairman, Ranking Member English and Members of the Subcommittee for providing an opportunity for us to participate in today's hearing on this important subject. I would be pleased to respond to your questions.

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[1] 2008-2 I.R.B. 252 (Jan. 14, 2008).

[2] For example, the "cost to carry" includes any warehousing, insurance, and similar expenses that a party would have to pay if it were to hold (or "carry") the asset during the term of forward contract. These costs arise more frequently in the context of forward contracts on commodities.

[3] Any expected cash yield on the asset underlying the forward contract (for example, dividends on stock) is typically subtracted from the forward price. (Because it is a benefit, rather than a cost, of holding the asset over the term of the contract, it is like a negative "cost to carry.")

[4] For example, if the forward price were too high (i.e., if it were in excess of the spot price plus the cost to carry, including this time value component), an arbitrageur could borrow at market interest rates to purchase the reference asset at

its spot price today and simultaneously take the short position on the forward contract. Similarly, if the forward price were too low (i.e., if it were below the spot price plus the cost to carry, including this time value component), an arbitrageur could short sell the reference asset today (i.e., borrow the asset and sell it in the market for its current price) to generate cash proceeds to purchase a bond paying market interest rates and simultaneously take a long position on the forward contract.

[5] If an investor executes a traditional forward contract with respect to an asset that is a capital asset for that investor, the contract is treated as an "open transaction" for tax purposes -- that is, it has no tax effect until the transaction is ultimately settled. See, e.g., Lucas v. North Texas Lumber Co., 281 U.S. 11 (1930). If the forward contract is settled by physical delivery of the reference asset, the seller (that is, the short position) recognizes capital gain or loss at the time it delivers the asset. The amount of gain or loss is determined by reference to the seller's basis in the asset and the forward price received. Likewise, the buyer (that is, the long position) takes a basis in the asset equal to the forward price it pays, and realizes capital gain or loss upon its ultimate disposition of the asset. If, instead, the forward contract is cash settled (that is, the "losing" party makes a cash payment), the recipient recognizes capital gain and the payor recognizes a commensurate amount of capital loss at the time the payment is made. See section 1234A. Special rules change these results in certain circumstances (e.g., if the forward contract is part of a straddle (section 1092), a conversion transaction (section 1258), a constructive sale (section 1259), or a constructive ownership transaction (section 1260)).

[6] A "trader" that elects to have section 475(f) apply must "mark to market" the forward contract (that is, treat the position as if it is sold for its fair market value at the end of each tax year) and treat the resulting gain or loss as ordinary (rather than capital) in character.

[7] A "securities dealer" must "mark to market" forward contracts with respect to securities (that is, treat the position as if it is sold for its fair market value at the end of each tax year) and treat the resulting gain or loss as ordinary (rather than capital) in character. A "commodities dealer" may elect this treatment. See section 475.

[8] A "hedger" must match the timing of the gain or loss recognition on the forward contract with the timing of the gain or loss recognition on the item being hedged. See Treas. Reg. §1.446-4. The gain or loss is typically ordinary, so long as appropriate identifications are made. See section 1221(a)(7).

[9] For example, foreign persons are taxed at graduated rates on net income that is "effectively connected" with a U.S. trade or business. See sections 871(b) and 882. In the absence of a U.S. trade or business, foreign persons are generally taxed at a flat 30-percent rate on certain gross income from U.S. sources. See sections 871(a) and 881. Tax treaties often change these results. If the foreign person is a "controlled foreign corporation," the tax consequences to U.S. shareholders depend on a number of complicated variables, such as whether the asset underlying the forward contract is a commodity, and whether it is a hedging transaction.

[10] In certain circumstances, a forward contract on foreign currency is "marked to market." See section 1256. Gain or loss on these contracts is typically ordinary in character, but, in certain circumstances, taxpayers can elect to treat the gain or loss as capital. See section 988.

[11] A zero-coupon bond is a debt security that does not pay interest on a current basis but instead, is issued at a discount to its nominal (or "face") value. (The discount generally reflects the prevailing market interest rate.) For U.S. tax purposes, all holders of bonds that are originally issued with such a discount (such as X, in Example 2) must generally accrue the "original issue discount" into income as interest over the term of the bond. Thus, the holders will have an income tax liability based on this accrued income even though they do not have any current cash flow from the bond. See section 1272.

[12] The IRS and Treasury Department have addressed a very different tax issue in connection with a transaction called a "variable prepaid forward contract." That transaction involves a situation similar to Example 3, except that X plays the role of seller, not buyer, of ABC Inc. stock under a contract. Because X separately owns appreciated ABC Inc. stock, the key tax issue presented is whether the contract and

other aspects of the transaction amount to a current sale (or constructive sale) of the stock. (There are meaningful differences between the simplified prepaid forward contract described in Example 3 and typical variable prepaid forward contracts that bear on this key tax issue.) Revenue Ruling 2003-7, 2003-1 C.B. 363 (Feb. 3, 2003), holds that no such sale results from the arrangement described in the ruling. A matter of current controversy between the IRS and certain taxpayers is whether particular transactions are within the scope of the revenue ruling.

March 5, 2008
hp-860

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 the media:

Who U. S. Treasury Assistant Secretary Phillip Swagel

What Economic Media Briefing

When Friday, March 7, 2008, 10:00 a.m. EST

Where Treasury Department
Media Room (Room 4121)
1500 Pennsylvania Ave,
NWWashington, 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.

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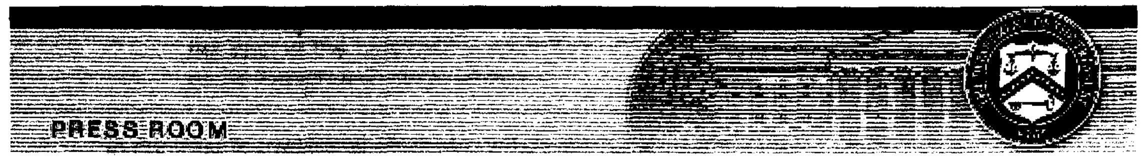


March 5, 2008
hp-861

Under Secretary for International Affairs David H. McCormick
Testimony before the House Committee on Financial Services

Subcommittee on Domestic and International Monetary Policy, Trade and Technology and Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises

Washington – Chairman Gutierrez, Chairman Kanjorski, Ranking Member Paul, Ranking Member Pryce, Members of the Committee, good afternoon. I very much appreciate the opportunity to appear before you today to discuss sovereign wealth funds. This is a timely hearing on a very important topic. At Treasury, we have been increasingly focused on sovereign wealth funds for more than a year now. I am pleased to be able to share with the Committee some of our views.

History and Context

Although the term "sovereign wealth fund" was coined just a few years ago, the funds it describes are not new. Sovereign wealth funds have existed in various forms for decades in places as diverse as the central Pacific, Southeast Asia, Europe and the Persian Gulf. At the turn of the century, there were about 20 sovereign wealth funds worldwide managing total assets of several hundred billion dollars.

Today, what is new is the rapid increase in both the number and size of sovereign wealth funds. Twenty new funds have been created since 2000, more than half of these since 2005, which brings the total number to nearly 40 funds that now manage total assets in a range of $1.9-2.9 trillion. Private sector analysts have projected that sovereign wealth fund assets could grow to $10-15 trillion by 2015. Two trends have contributed to this ongoing growth. The first is sustained high commodity prices. The second is the accumulation of official reserves and the transfers from official reserves to investment funds in non-commodity exporters. Within this group of countries, foreign exchange reserves are now sufficient by all standard metrics of reserve adequacy. For these non-commodity exporters, more flexible exchange rates are often necessary, and Treasury actively pushes for increased flexibility.

So what are sovereign wealth funds? At the Department of the Treasury, we have defined them as government investment vehicles funded by foreign exchange assets, which manage those assets separately from official reserves. Sovereign wealth funds generally fall into two categories based on the source of the foreign exchange assets:

- Commodity funds are established through commodity exports, either owned or taxed by the government. They serve different purposes, including stabilization of fiscal revenues, intergenerational saving, and balance of payments sterilization. Given the recent extended sharp rise in commodity prices, many funds initially established for fiscal stabilization purposes have evolved into savings funds. In the case of commodity funds, foreign currency typically accrues to the government and does not increase the money supply and create unwanted inflationary pressure.

- Non-commodity funds are typically established through transfers of assets from official foreign exchange reserves. Large balance of payments surpluses have enabled non-commodity exporting countries to transfer "excess" foreign exchange reserves to stand-alone funds. In the case of non-commodity funds, foreign exchange assets often derive from exchange rate intervention, which then increases a country's money supply. Monetary authorities take additional steps to lower the money supply and stave off

inflation by issuing new debt, but there may be a cost associated with this if the cost of the new debt is more than the returns that the government earns on its foreign exchange assets.

In contrast to traditional reserves, which are typically invested for liquidity and safety, sovereign wealth funds seek a higher rate of return and may be invested in a wider range of asset classes. Sovereign wealth fund managers have a higher risk tolerance than their counterparts managing official reserves. They emphasize expected returns over liquidity, and their investments can take the form of stakes in U.S. companies, as has been witnessed in recent months with increased regularity.

However, sovereign wealth fund assets are currently fairly concentrated. By some market estimates, a handful of funds account for the majority of total sovereign wealth fund assets. Roughly two-thirds of sovereign wealth fund assets are commodity fund assets ($1.3-1.9 trillion), while the remaining one-third are non-commodity funds transferred from official reserves ($0.6-1.0 trillion).

To get a better perspective of the relative importance of sovereign wealth funds, it is useful to consider how they measure up against private pools of global capital. Total sovereign wealth fund assets of $1.9-2.9 trillion may be small relative to a $190 trillion stock of global financial assets, or the roughly $62 trillion managed by private institutional investors. But sovereign wealth fund assets are currently larger than the total assets under management by either hedge funds or private equity funds and are set to grow at a much faster pace.

In sum, sovereign wealth funds represent a large and rapidly growing stock of government-controlled assets, invested more aggressively than traditional reserves. Attention to sovereign wealth funds is inevitable given that their rise clearly has implications for the international financial system. Sovereign wealth funds bring benefits to the system but also raise potential concerns.

Benefits

A useful starting point when discussing the benefits of sovereign wealth funds is to stress that the United States remains committed to open investment. On May 10, 2007, President Bush publicly reaffirmed, in his Statement on Open Economies, the U.S. commitment to advancing open economies at home and abroad, including through open investment and trade. Lower trade and investment barriers benefit not only the United States, but also the global economy as a whole. The depth, liquidity and efficiency of our capital markets should continue to make the United States the most attractive country in the world in which to invest.

In 2006, there was a net increase of $2.5 trillion in foreign-owned assets in the United States, while U.S. net international investment abroad increased by $2.2 trillion. International investment in the United States fuels U.S. economic prosperity by creating well-paid jobs, importing new technology and business methods, helping to finance U.S. priorities, and providing healthy competition that fosters innovation, productivity gains, lower prices, and greater variety for consumers. Over five million Americans –

4.6 percent of the U.S. private sector – are employed by foreign-owned firms' U.S. operations. Over 39 percent of these five million jobs at foreign-owned firms are in manufacturing, a sector that accounts for 13 percent of U.S. private sector jobs. These five million jobs pay 25 percent higher compensation on average than jobs at other U.S. firms. Another roughly five million jobs are indirectly supported by foreign investment. Additionally, foreign-owned firms contributed almost six percent of U.S. output and 14 percent of U.S. R&D spending in 2006. Foreign-owned firms re-invested over half of their U.S. income – $71 billion – back into the U.S. economy in 2006. A disproportionate 13 percent of U.S. tax payments and 19 percent of U.S. exports are made by foreign-owned firms. Without international investment, Americans would be faced with painful choices regarding taxes, spending on government programs, and their level of savings and consumption. Another benefit of FDI is that foreign investors' economic interests become more dependent on the health of the U.S. economy – giving the investor an incentive to support U.S. economic interests.

As many observers have pointed out, sovereign wealth funds have the potential to

promote financial stability. They are, in principle, long term, stable investors that provide significant capital to the system. They are typically not highly leveraged and cannot be forced by capital requirements or investor withdrawals to liquidate positions rapidly. Sovereign wealth funds, as public sector entities, should have an interest in and a responsibility for financial market stability.

Potential Concerns

Yet, sovereign wealth funds also raise potential concerns.

First, transactions involving investment by sovereign wealth funds, as with other types of foreign investment, may raise legitimate national security concerns. The Committee on Foreign Investment in the United States (CFIUS), which is chaired by Treasury, conducts robust reviews of certain investments that could result in foreign control of a U.S. business to identify and resolve any genuine national security concerns. The Foreign Investment and National Security Act (FINSA) became effective on October 24, 2007, and strengthened the CFIUS process. CFIUS is able to review investments from sovereign wealth funds, just as it would other foreign government-controlled investments, and it has and will continue to exercise this authority to ensure national security. CFIUS reviews are of course limited to identifying and resolving genuine national security concerns.

Separately, Treasury is also considering non-national security issues related to potential distortions from a larger role of foreign governments in markets. Through inefficient allocation of capital, perceived unfair competition with private firms, or the pursuit of broader strategic rather than strictly economic return-oriented investments, sovereign wealth funds could potentially distort markets. Sovereign wealth funds may also indirectly invest abroad through domestic state-owned enterprises. However, such action by a SWF is more likely to be viewed as a direct extension of government policy. Clearly, both sovereign wealth funds and the countries in which they invest will be best served if investment decisions are made solely on commercial grounds.

The investment policy issues I have just described – both the national security and non-national security issues – have the potential to provoke protectionist responses from recipient country governments. It is my view that protectionist sentiment stems partly from a lack of information and understanding of sovereign wealth funds, which in turn is partly due to a lack of transparency and clear communication on the part of many of the funds themselves. Further, concerns about cross-border investment by state-owned enterprises are often misdirected at sovereign wealth funds as a group. Better information and understanding on both sides of the investment relationship is therefore needed.

Finally, sovereign wealth funds may raise concerns related to financial stability. Sovereign wealth funds can represent large, concentrated, and often non-transparent positions in certain markets and asset classes. Actual shifts in their asset allocations can cause market volatility. In fact, even perceived shifts or rumors can cause volatility as the market reacts to what it perceives sovereign wealth funds to be doing.

Policy Response

Treasury has taken a number of steps to help ensure that the United States can continue to benefit from open investment while addressing these potential concerns.

First, we are aggressively implementing reforms that strengthen the CFIUS process, reflected in FINSA and Executive Order 11858, issued by the President on January 23. We are proceeding steadily through a vigorous drafting process for new regulations which will become effective later this Spring following public notice and comment. One of the reforms codified by FINSA, which we have already implemented, is an elevated level of accountability within CFIUS for review of foreign government-controlled transactions. I want to be clear that CFIUS has – as early as 1989 – and will continue to review the investment transactions of sovereign wealth funds, based on the consideration of genuine national security concerns, just as it does for other foreign government-controlled investment. FINSA protects our national security while keeping investment barriers low and reaffirming investor

confidence and the longstanding U.S. open investment policy. CFIUS will continue to vigorously implement this law.

Second, we have proposed that the international community collaborate on the development of a multilateral framework for best practices. The International Monetary Fund, with support from the World Bank, should develop voluntary best practices for sovereign wealth funds, building on existing best practices for foreign exchange reserve management. These would provide guidance to new funds on how to structure themselves, reduce any potential systemic risk, and help demonstrate to critics that sovereign wealth funds can be responsible, constructive participants in the international financial system.

Here, I would note that the logic of voluntary best practices for sovereign wealth funds is to create a dynamic rise to the top. International agreement on a set of best practices will create a strong incentive among funds to hold themselves to high standards. Sovereign wealth funds themselves are increasingly aware that the increase in the number and size of these funds has, rightly or wrongly, raised reputational issues for them all.

Third, we have proposed that the Organisation for Economic Co-operation and Development (OECD) should identify best practices for countries that receive foreign government-controlled investment, based on its extensive work on promoting open investment regimes. These should have a focus on avoiding protectionism and should be guided by the well-established principles embraced by OECD and its members for the treatment of foreign investment.

We have already seen meaningful progress along these lines. On May 12-13 of last year, Treasury hosted a G-20 meeting of Finance Ministry and Central Bank officials on commodity cycles and financial stability, which included perhaps the first multilateral discussion of sovereign wealth funds among countries with these funds and countries in which they invest. Following a period of extensive direct bilateral outreach with sovereign wealth funds, Secretary Paulson hosted a G-7 outreach meeting on October 19, 2007 with Finance Ministers and heads of sovereign wealth funds from eight countries (China, Korea, Kuwait, Norway, Russia, Saudi Arabia, Singapore, and the United Arab Emirates) to build support for best practices.

On October 20, 2007, the International Monetary and Financial Committee – a ministerial level advisory committee to the IMF – issued a statement calling on the IMF to begin a dialogue to identify best practices for sovereign wealth funds. On November 15-16, 2007, the IMF hosted a roundtable meeting for sovereign asset and reserve managers. In response to the IMFC statement, the IMF added a special session on policy and operational issues relating to SWFs for official sector delegates. This marks the beginning of an important process in the IMF. IMF Managing Director Dominique Strauss-Kahn opened the roundtable meeting and underlined that some form of agreement on best practices for the operations of SWFs could help maintain an open global financial system.

A separate dialogue is well underway in the OECD on investment policy issues with regard to SWFs, building on the discussions on Freedom of Investment, National Security, and "Strategic" Industries. Later this month, the OECD Investment Committee will discuss an interim report on broader investment issues that will also cover SWFs. The OECD expects to issue a "special statement" regarding investment policy principles and sovereign investment at its June Ministerial.

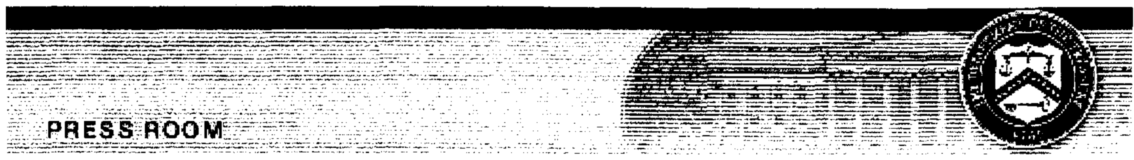
Fourth, Treasury has taken a number of steps internally and within the U.S. Government to enhance our understanding of sovereign wealth funds. Treasury has created a working group on sovereign wealth funds that draws on the expertise of Treasury's offices of International Affairs and Domestic Finance. Treasury's new market room is ensuring vigilant, ongoing monitoring of sovereign wealth fund trends and transactions. Through the President's Working Group on Financial Markets, chaired by Secretary Paulson, we continue to discuss and review sovereign wealth funds. We have also engaged sovereign wealth funds directly on numerous occasions, at numerous levels within our government and at numerous forums.

Treasury is actively coordinating with Congress through staff briefings and committee hearings. As you may know, I testified on these issues before the Senate Banking Committee in November. Also, in June and December of last year

we provided Congress with updates on our sovereign wealth fund-related work in an appendix to the Report on International Economic and Exchange Rate Policies, and we will continue to provide updates on a semi-annual basis.

The Treasury Department will continue its work on sovereign wealth funds through sound analysis and focused bilateral and multilateral efforts to help ensure the United States shapes an appropriate international response to this issue, addresses legitimate areas of concern, and together with other countries, remains open to foreign investment.

-30-



March 5, 2008
HP-862

**Opening Statement by Secretary Henry M. Paulson, Jr.
on the Department of the Treasury FY 2009 Budget Request
before the Senate Committee on Appropriations
Subcommittee on Financial Services and General Government**

Washington -- Chairman Durbin, Senator Brownback, Members of the Committee: Thank you for the opportunity to discuss the Treasury Department's proposed fiscal year 2009 budget. Our budget request reflects the Department's continued commitment to promoting a healthy U.S. economy, fiscal discipline and national security. The Department has broad responsibility in federal cash management, tax administration and plays an integral role in combating terrorist financing and advocating the integrity of the U.S. and global financial systems.

Our spending priorities for the 2009 fiscal year fall into six main categories. I will briefly describe the priorities and then take your questions.

U.S. Economic Steward

Treasury has an important role to play as steward of the U.S. economy, and our offices provide technical analysis, economic forecasting and policy guidance on issues ranging from federal financing to domestic and global financial systems.

Those functions are especially critical now as the U.S. economy, through a combination of a significant housing correction, high energy prices and capital market turmoil has slowed appreciably. Our long term economic fundamentals are solid, and I believe our economy will continue to grow this year, although not as rapidly as in recent years.

In response to economic signals, early this year the Administration and the Congress worked together to quickly pass, on a bipartisan basis, the Economic Stimulus Act of 2008. And I would like to thank this subcommittee for approving funds for the IRS and the FMS to administer the stimulus check rebate program under that Act.

As you know, the stimulus payments to households and the incentives to businesses in the Act, together, are estimated to lead to the creation of half a million jobs by year-end. This will provide timely and effective support for families and our economy, and it wouldn't be possible without your leadership.

Strengthening National Security

Treasury's Office of Terrorism and Financial Intelligence (TFI) uses financial intelligence, sanctions, and regulatory authorities to track and combat threats to our security and safeguard the U.S. financial system from abuse by terrorists, proliferators of weapons of mass destruction and other illicit actors.

To continue and build on our efforts to combat these threats, we are requesting an $11 million increase for TFI, including $5.5 million for the Financial Crimes Enforcement Network to ensure effective management of the Bank Secrecy Act.

Efficient Management of the Treasury Department

The budget request emphasizes infrastructure and technology investments to modernize business processes and improve efficiency throughout the Treasury Department. We will continue to make information technology management a

priority, and have taken several significant steps to strengthen our systems and oversight.

Fiscal Discipline

Treasury is committed to managing the nation's finances effectively, ensuring the most efficient use of taxpayer dollars and collecting the revenue due to the federal government.

Enforcing the Nation's Tax Laws Fairly and Efficiently

The Internal Revenue Service, of course, plays an integral role in this. The budget requests a 4.3 percent increase in IRS funding.

As in the past three budget requests, we are proposing to increase IRS enforcement funding as a Budget Enforcement Act program integrity cap adjustment. IRS enforcement efforts have yielded record revenue collections. With the requested funding, the IRS will collect an estimated $55 billion in direct enforcement revenue in 2009.

The budget also includes a number of legislative proposals intended to target the tax gap and improve tax compliance, with an appropriate balance between enforcement and taxpayer service. These proposals are estimated to generate $36 billion over the next ten years.

International Programs

We will continue to focus efforts on supporting a stable and growing global economy, through on-going dialogue and initiatives with developing economies throughout Asia, Latin America and Africa.

In addition we are asking your colleagues on the Foreign Operations Subcommittee to support key objectives of the President's international assistance agenda. This includes funding for the multilateral development banks --- notably new replenishments for the World Bank's International Development Association (IDA) and the African Development Fund.

Also included as a Foreign Operations priority is a $400 million request for the first installment of a multi-billion dollar clean technology fund that, with additional funding from the United Kingdom, Japan and other donors, will help finance clean energy projects in the developing world and make strides towards addressing global climate change.

Conclusion

Overall, the budget request reflects a prudent and forward-leaning approach to fulfilling the Treasury Department's core responsibilities to support our economy, managing the government's finances and ensuring financial system security. I thank you for your past support and consideration of our work, and look forward to working with you during your deliberations.

Thank you and I welcome your questions.

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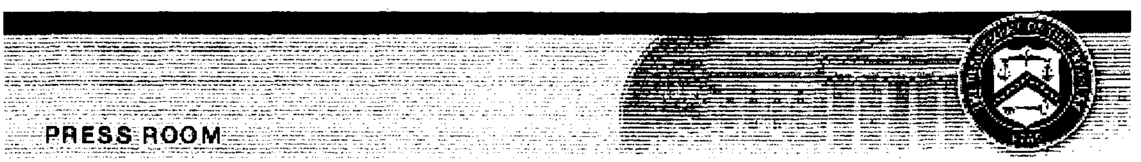

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March 6, 2008
HP-863

Prepared Remarks by Stuart A. Levey, Under Secretary for Terrorism and Financial Intelligence, Before the American Bar Association's 22nd Annual National Institute on White Collar Crime

Miami – It is truly an honor for me to be asked to address this audience which includes so many current and former colleagues and personal friends. Throughout my legal career, the ABA White Collar Crime Institute has been the key annual forum for prosecutors, defense lawyers and judges to share views about cutting edge issues in the field of white collar crime.

This audience is well-acquainted with how, within the Justice Department, there is a new focus on, and preventative approach to, terrorism and other national security matters. We simply cannot afford to wait for these threats to fully materialize before acting against them. Since 2000, Justice has dramatically increased its number of terrorism- and national security-related prosecutions.

What you may be less familiar with is how Treasury also has a preventative role in combating key threats by targeting the financial networks of terrorists and other illicit actors. After 9/11, and particularly after a majority of Treasury's law enforcement functions were moved to the Departments of Justice and Homeland Security in 2003, it was not obvious that Treasury would have any significant national security role. But, over time, it has become clear that Treasury's continued role in protecting the safety and soundness of the international financial system is intrinsically linked to the protection of our national security.

My office – which was created in 2004 – marshals the Treasury Department's policy, enforcement, regulatory, and intelligence functions to combat international terrorists, weapons of mass destruction (WMD) proliferators, rogue regimes, narcotics traffickers, money launderers, and other threats to our security.

The guiding principle of the Treasury Department's approach is that these threats all have one thing in common: they rely on financial support networks. These networks are a key source of intelligence. Money trails don't lie; financial intelligence is uniquely reliable. That is why we have established at the Treasury Department a fully functioning intelligence and analysis office headed by an Assistant Secretary– the first office of its kind in any finance ministry worldwide. Our intelligence office maps illicit financial networks and helps us identify opportunities to pressure, disrupt and weaken them. As I will explain, we have learned that isolation from the global financial system can have a devastating impact on the ability of illicit actors to function.

For much of the first 15 years of my legal career, I grappled with many of the issues that are the subject of this conference, first as a defense lawyer in private practice and then while working for former Deputy Attorneys General Larry Thompson and Jim Comey. Four years ago, I was given the challenge of doing something completely different – to set up this new office at the Treasury Department. Four years after its creation, I think it is fair to say that Treasury is more a part of our national security strategy than it has ever been in the past. I have learned a number of lessons doing this job and also had some new experiences that I never anticipated. I would like to share a few of those with you today.

Let me start with a vivid example. In June 2005, I found myself at the airport in Tripoli, Libya, a place I never thought I would be. I was winding up a two-day visit to try to encourage the Libyans to cooperate with us on various counterterrorism issues. At the time, I was the highest level U.S. official to visit Libya since it had

renounced its nuclear weapons program and sought to normalize its relations with the U.S. When I arrived at the airport, instead of boarding my flight to Turkey, I was ushered onto Colonel Gaddafi's personal jet. It was decked out with shag carpets, white leather armchairs and couches, and golden seat belt buckles. I was flown about an hour away and then driven through the desert to an oasis where Colonel Gaddafi was waiting to meet with me. The scene was surreal. He was sitting under an umbrella on a dock jutting out into a pond. He was dressed in a white track suit, a white sailor's cap and orange sunglasses. We spent an hour or so discussing terrorism in the Middle East and ways in which he said Libya would cooperate in fighting it. After the meeting, as I was being driven back to his plane, I realized that I had long missed my flight to Turkey. When I mentioned this to one of Gaddafi's ministers who was in the car with me, he just laughed and told me not to worry. It turns out that the Libyans had the plane held. We arrived back at the Tripoli airport three or four hours after we left, and it was still sitting waiting on the very hot tarmac, full of some very irritated passengers.

That stop in Libya is one of approximately 75 foreign visits I have made in the past four years to more than 30 different countries – from China to Latvia and from Russia to Vietnam. A large part of my job consists of building an international coalition of both governments and private sector financial institutions to fight various types of illicit activity in the global financial system. That coalition at first may seem like it consists of strange bedfellows – it has been joined by many governments that are not necessarily allied with the United States politically. But whatever their political views, they typically want their financial sectors to prosper, and they therefore share a common interest with us in keeping them clean and untainted by illicit conduct.

Targeted Measures – A Different Kind of Sanction

In the course of trying to build that government and private sector coalition, we have adopted a new strategy. More and more, we are using targeted, conduct-based financial measures aimed at particular bad actors. I intentionally refer to these targeted actions as "financial measures" rather than "sanctions" because the word "sanctions" often evokes such a negative reaction. Sanctions are typically associated with traditional country sanctions, which attempt to stop trade or investment altogether in order to weaken the economy of an entire state. It is hard to persuade other governments to join such broad sanctions, and the international private sector often views them as merely political statements that are not in their interests to comply with and thus, at best, they will do only what is minimally required of them.

The dynamic is very different when we employ targeted financial measures aimed at specific actors engaged in illicit conduct. Because they single out those responsible for supporting terrorism, proliferation, and other criminal activities, rather than affecting an entire country, they are more likely to be accepted by other governments that we want to join us in taking action. But the key difference is the reaction by the private sector. Rather than grudgingly complying with, or even trying to evade these measures, we have seen many members of the banking industry in particular voluntarily go above and beyond their legal requirements because they do not want to handle illicit business. This is a product of good corporate citizenship and a desire to protect their institutions' reputations. The end result is that private sector voluntary actions amplify the effectiveness of government-imposed measures.

Once some in the private sector decide to cut off companies or individuals we have targeted, it becomes an even greater reputational risk for others not to follow, and so they often do. Such voluntary implementation in turn makes it even more palatable for governments to impose similar measures, thus creating a mutually-reinforcing cycle of public and private action. In the end, if we do our jobs well, especially by sharing critical information with the key governmental and private sector parties around the world, there is the potential for us to create a multilateral coalition to apply significant pressure on those who threaten our security.

The tools we have developed and implemented have turned out to be some of the most useful and flexible means that we have to exert leverage against intransigent regimes and to help increase the effectiveness of our traditional diplomacy. I will talk about this more in the context of our North Korea and Iran strategies.

Targeted Measures Put to Use

But first let me say a few words about how this works in the context of terrorism. Our efforts to track, deter, and disrupt terrorist financing are a key component of the government's overall counterterrorism strategy. After the September 11 attacks, the President signed an Executive Order that authorized the designation of terrorists and their facilitators worldwide. When it comes to al Qaida and the Taliban, there is a corresponding UN Security Council Resolution that makes similar designations global in their application. There are other UN resolutions dealing with terrorist financing more generally, but for HAMAS, Hizballah and other terrorist organizations, there is no comparable UN list. We nevertheless have found that our unilateral designations are followed voluntarily by many banks around the world who have decided that they simply do not want to do business with these actors.

The significance of these efforts is that terrorist networks and organizations require real financing to survive. The support they require goes far beyond funding attacks. They need money to pay operatives, support their families, train, travel, and bribe officials. When we restrict the flow of funds to terrorist groups or disrupt a link in their financing chain, they are forced to shift their focus from planning attacks to worrying about their financial viability. These designations can also deter other would-be financiers who want to remain part of the legitimate business world while supporting terrorism on the side.

One very challenging issue is how we apply these rules to the problem of charities that are being used to support terrorist organizations. Historically, al Qaida and other terrorist groups have exploited charities, often preying on unwitting donors trying to fulfill their religious obligation of charitable giving. Indeed, most terrorist-supporting charities go to great lengths in attempting to obscure their support for violence to fool these donors who believe their contributions are being devoted to laudable causes. But, occasionally, we find one that makes no such effort. The Islamic Resistance Support Organization, or IRSO, offers one of the starkest examples of a charity openly supporting terrorism and soliciting donations from individuals intending to support terror. As you can see [donor receipts (Arabic), donor receipts (translation)], IRSO's materials present donors with options of sending funds to equip Hizballah fighters or to purchase rockets that Hizballah uses to target civilian populations. The group's leaflet is equally reprehensible.

Treasury designated IRSO in August of 2006 for its role as a key Hizballah fundraising organization. While this was a unilateral US designation – other countries do not recognize Hizballah as a terrorist organization – it nevertheless exposes the true nature of IRSO to the world, isolates it from reputable banks around the world, and warns any well-intentioned donors to direct their money elsewhere.

Terrorists, of course, are not the only illicit actors abusing the financial system to support their dangerous activities; the targeted authorities that we employ against them have proven useful in other contexts as well.

We have, for example, targeted these measures at kleptocrats and others engaging in high-level political corruption. In August 2006, the President announced a comprehensive U.S. government strategy to combat high-level corruption as an ongoing threat to international security. This strategy relies on Treasury's ability to take targeted financial action against specific regimes and actors of concern. The most recent example is our designation of Rami Makhluf – the cousin of Syrian President Bashar al-Asad and a powerful Syrian businessman and regime insider – who has used intimidation and his close ties to the regime to obtain improper business advantages at the expense of ordinary Syrians. We have also targeted the corrupt behavior of senior figures from the regimes in Burma and Belarus.

Targeted financial measures have also given us more options in dealing with proliferators of weapons of mass destruction and intransigent regimes, such as those in North Korea and Iran.

North Korea offers an example of how powerful targeted financial measures can be. Confronted with a range of North Korean-related illicit conduct from WMD and missile proliferation activities to the counterfeiting of US currency, we took two important public actions. First, we targeted a number of North Korean firms under our proliferation Executive order, E.O. 13382. That authority – which the President

signed in June 2005 and is modeled after our terrorism Executive order – allows us to designate proliferators and their supporters, freezing any assets they have under U.S. jurisdiction and preventing U.S. persons from doing business with them. Second, we took a regulatory action under Section 311 of the USA PATRIOT Act to protect our financial system from abuse by Banco Delta Asia (BDA), a Macau-based bank that is a serious money-laundering concern and that also knowingly allowed its North Korean clients to use the bank to facilitate a range of illicit conduct and engage in deceptive financial practices.

The real impact has come from the information made public in conjunction with these actions. Many private financial institutions worldwide responded by terminating their business relationships not only with designated entities, but with North Korean clients altogether. They determined that the risks associated with this business far outweighed any benefit. The result has been North Korea's virtual isolation from the global financial system. That, in turn, put enormous pressure on the regime – even the most reclusive government depends on access to the international financial system. This pressure provided the State Department a great deal of leverage in its diplomacy over the nuclear issue with North Korea.

We are currently in the midst of an effort to apply these same lessons to the very real threat posed by Iran. Iran presents a more complex challenge than North Korea because of its greater integration into the international financial community. Iran exploits its global financial ties to pursue nuclear capabilities and to develop ballistic missiles in violation of UN Security Council resolutions, as well as to funnel hundreds of millions of dollars each year to fund and arm terrorists. And it uses its state-owned banks to do so. The Security Council has designated Iran's Bank Sepah for its involvement in Iran's ballistic missile programs. The United States has designated Iranian banks Melli and Mellat for their involvement in Iran's nuclear and missile activities, including their support of UN-sanctioned Iranian proliferation entities. And we designated another Iranian bank, Bank Saderat, for its role in funneling money to Hizballah, HAMAS and the Palestinian Islamic Jihad. Not only do these banks facilitate illicit transactions, they engage in a wide variety of deceptive financial conduct to cover their tracks. For example, they often request that other financial institutions take their names off of transactions when processing them in the international financial system. This practice is specifically designed to deceive those who might refuse to handle the transaction if they knew who, or what, was really involved.

The world is taking note of Iran's financial misconduct. On Monday, the UN Security Council adopted a third sanctions resolution on Iran. A key section of that resolution calls upon all States to exercise vigilance over the activities of financial institutions in their territories with all banks domiciled in Iran, particularly with Banks Melli and Saderat. And the world's premier standard-setting body on countering the financing of terrorism and money laundering – the Financial Action Task Force, or FATF – has now twice confirmed the extraordinary risks to the financial system that accompany doing business with Iran. Just last week, FATF called on all governments to issue advisories to their financial institutions warning them of these risks.

Voluntary action by the private sector to cut off risky clients is reinforcing this multilateral governmental pressure. In the fall of 2006, Treasury Secretary Paulson launched an effort to inform the public, government partners, and private sector leaders about the danger that Iran's financial deception poses to the international financial system. Over the past 18 months, I have met with scores of banks and with government officials all over the world on this topic.

Let me give youan example I sometimes share to illustrate how the Iranian government will deceive and abuse banks that do business with them. An affiliate of the Atomic Energy Organization of Iran – an entity that was designated by the UN Security Council in Resolution 1737 – placed an ad in the International Herald Tribune requesting bids to build two nuclear power plants in Iran. It is hard to imagine a transaction with bigger and brighter red flags for a financial institution. Bidders were asked to deposit a non-refundable fee in an account at a particular bank. I have spared that bank, which is a well-established, high-quality bank, the embarrassment of identification here. When I saw the ad, I called them, and they told me that this account had been opened at the request of the Iranian Foreign Ministry to support Iranian diplomats accredited to the International Atomic Energy Agency in Vienna. They said they were dismayed when they saw the ad and learned that the Iranians were attempting to use their bank for this purpose. This

kind of example is very powerful because all banks want to avoid being involved in illicit transactions. More and more, banks are coming to realize that it is difficult to do that if one is dealing with Iran, especially the Iranian government.

The result of our global outreach and the formal actions of the UN and the FATF is that Iran has found itself increasingly isolated from the international financial system as banks around the world decide that maintaining their Iranian clientele is not worth the risk of unwittingly facilitating proliferation or terrorism. The world's leading financial institutions have essentially stopped dealing with Iran, and especially Iranian banks, in any currency, a situation that many in Iran's elite are finding very painful. That self-imposed isolation combined with the Iranian regime's mismanagement of their country's economy is beginning to generate a debate about the wisdom of the current regime's policies.

Our use of targeted measures is certainly not limited to what I've described here today. We have demonstrated the agility and adaptability of these measures to address other threats to international peace and security – from narcotics trafficking to abusive regimes in Zimbabwe and Sudan. In all of these contexts, we can help put pressure on specific bad actors and try to rally the private sector to isolate them from the international financial system. I do not claim that these financial measures will alone solve these intractable problems. I do believe, however, that they can play a far more important and useful role than was previously thought possible to pressure illicit actors and to create leverage for our diplomats. *Washington Post* columnist David Ignatius summed it up like this in a recent column: "Everybody knows that economic sanctions don't work. . . . But guess what? In the recent cases of North Korea and Iran, a new variety of U.S. Treasury sanctions is having a potent effect, suggesting that the conventional wisdom may be wrong. These new, targeted financial measures are to traditional sanctions what Super Glue is to Elmer's Glue-All. That is, they really stick."

Partnership With DOJ

It is also worth noting that these targeted measures and the work of the Justice Department and law enforcement often go hand in hand. Perhaps the best recent example is the Justice Department's September 2006 announcement that Miguel and Gilberto Rodriguez-Orejuela, the brothers who ran the infamous Cali Cartel in Colombia, had pleaded guilty to a charge of conspiracy to import cocaine into the United States and had agreed to plead guilty to conspiracy to commit money laundering by hiding the proceeds of narcotics trafficking. Treasury's Office of Foreign Assets Control and law enforcement officials had for years worked to uncover and immobilize the hidden assets of the Cali Cartel, with OFAC designating hundreds of front companies and individuals in Colombia and ten other countries. In the end, the Rodriguez-Orejuela brothers were willing to plead guilty and spend the rest of their lives in jail just to make their family members eligible to be removed from OFAC's designation list.

It is clear that our national security increasingly depends on the success of these financial measures, which, in turn, depend on the vigilance of the private sector. As I have described, much of the global private sector's conduct in this regard is voluntary, with financial institutions acting even when they are not legally obliged to do so. But strong enforcement of our laws relating to money laundering and our sanctions programs also plays an important role.

The Departments of the Treasury and Justice, along with our other law enforcement colleagues, work together as a team to administer and enforce these laws. Most enforcement in this area is civil, involving the banking regulators, OFAC or the Financial Crimes Enforcement Network (FinCEN). In cases of serious violations, however, criminal enforcement may be warranted.

In the summer of 2005, the Department of Justice amended the United States Attorneys' Manual to require that all money laundering prosecutions of financial institutions be coordinated with, and approved by, the Criminal Division in Washington. The United States Attorneys' Manual contains a similar consultation and approval requirement with respect to the prosecution of cases affecting or involving national security, including prosecutions under the International Emergency Economics Power Act – or IEEPA, as it is commonly referred to – which is the primary statute pursuant to which economic sanctions are imposed. These provisions promote consistency and uniformity in the use of these statutes and help

ensure that unintended consequences from relevant cases are minimized. In that regard, they were specifically designed to enable Justice to consult with other agencies, including the Treasury Department. As evidenced by recent enforcement actions involving violations of the Bank Secrecy Act, the recent trend has been for Justice and Treasury to proceed concurrently against financial institutions. While both agencies must operate under their respective authorities and due process procedures, whenever possible, we will proceed concurrently on enforcement matters to promote consistency and avoid multiple actions against the same financial institution at different times for similar and related conduct.

The continued consultation between Justice and Treasury is vitally important given the complexities surrounding potential criminal charges against banks and other financial institutions, including the potential impact of such cases on the U.S. financial system. The good news is that, under Assistant Attorney General Alice Fisher's leadership, the right atmosphere has been created for that consultation. In the end, we need to strike a delicate balance. We need to ensure the proper respect for the laws that safeguard the integrity of our financial system, but do so in a way that allows our regulatory system to function effectively and maintains our position of leadership in the global financial system. This requires the exercise of well-informed and wise prosecutorial discretion. It is hard to overstate the importance of real collaboration between Justice and Treasury in making that happen.

Conclusion

When I was at the Justice Department in 2004 and the idea was floated to create this new office at Treasury, there were many skeptics who questioned whether Treasury still had an important national security function after the creation of the Department of Homeland Security. I know this for a fact because I was one of them. I now know I was wrong – Treasury has a critical national security role to play. I am confident it will continue to do so not only in this Administration but in future ones as well.

REPORTS

- Islamic Resistance Support Organization donor receipt (Arabic):
- Islamic Resistance Support Organization donor receipt (English translation):

Front page of receipts

Unofficial Translation

Donation Receipt

No. 415626 (Second receipt is numbered: 034500)

[Organization's logo]

Date: [Redacted]

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

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

Recipient's signature: [Redacted]

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

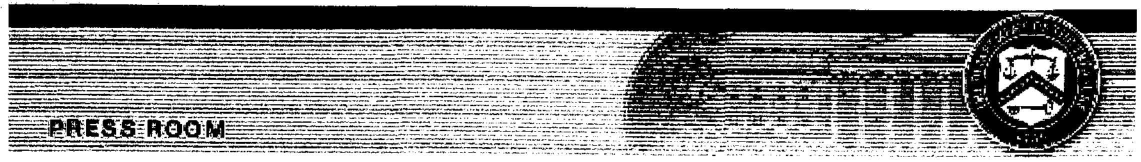
Back Page of Receipts

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

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

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

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



March 6, 2008
HP-864

Secretary Paulson Recognizes Individual for Dedication to Volunteer Service

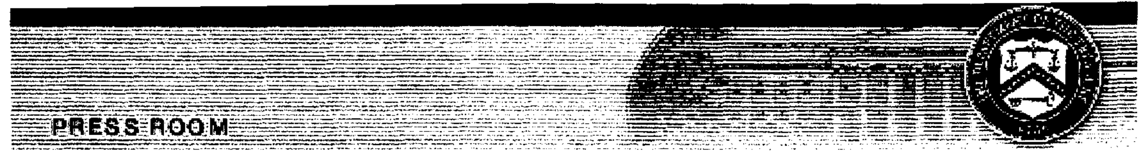
Oakland, Calif. – Secretary Henry M. Paulson, Jr. presented the President's Volunteer Service Award to Gayliene Omary as part of the USA Freedom Corps Volunteer Service Recognition Program today in Oakland, Calif. Omary has completed 27,000 hours of volunteer service.

Gayliene Omary is a Wholesale Account Executive for the Bank of America through which she began her involvement with Operation Hope's "Banking on Our Future" and taught the importance of using your money wisely in grade schools, middle schools, and high schools. She received the Banking on Our Future Volunteer of the Year 2007 award for her efforts. In addition, Omary is a volunteer trainer for the Contra Costa Child Abuse Prevention Council, where she trains adults who are in contact with children to spot, and hopefully, end, any abuse to a child.

In his January 2002 State of the Union Address, President Bush called on all Americans to make a difference in their communities through volunteer service. He created USA Freedom Corps, an Office of the White House, to strengthen and expand volunteer service. Americans are responding to the President's Call to Service. Go to www.volunteer.gov or call 1-877-USA-CORPS to find an existing volunteer service opportunity in your area or to find more information about service programs, including national service programs such as the Peace Corps, AmeriCorps, Senior Corps, and Citizen Corps. USA Freedom Corps is also highlighting youth volunteer service. Visit www.volunteerkids.gov for games and ideas designed to show how America's youth are making a difference.

The President's Volunteer Service Award was created at the President's direction by the President's Council on Service and Civic Participation. The Award is available to youth ages 14 and under who have completed 50 or more hours of volunteer service; to individuals 15 and older who have completed 100 or more hours; and to families or groups who have completed 200 or more hours. For more information about the Award, please visit www.presidentialserviceawards.gov.

-30-



March 7, 2008
HP-865

Treasury Economic Update 3.7.08

"Today's job market report reflects the impacts of the housing correction, credit market strains, and high energy prices. We have known for some time that these factors have been weighing on the economy, and this is why the President took action with the stimulus package. We expect the stimulus to start taking effect in the second quarter; it will support consumer and business spending while adjustments continue in housing and credit markets.

Assistant Secretary Phillip Swagel, March 7, 2008

Employment Fell in February:

Job Growth: Payroll employment fell by 63,000 in February, following a decrease of 22,000 jobs in January, The United States has added 8.2 million jobs since August 2003. Employment increased in 47 states and the District of Columbia over the year ending in December. *(Last updated: March 7, 2008)*

Low Unemployment: The unemployment rate edged down to 4.8 percent in February from 4.9 percent in January. Unemployment rates declined in 12 states and the District of Columbia over the year ending in December. *(Last updated: March 7, 2008)*

There Are Still Many Signs of Economic Strength:

Business Investment: Business spending on commercial structures and equipment rose solidly in the fourth quarter. Healthy corporate balance sheets should support continued investment growth. *(Last updated: February 27, 2008)*

Exports: Strong global growth is boosting U.S. exports, which grew by 7.9 percent over the past 4 quarters. *(Last updated: February 27, 2008)*

Inflation: Core inflation remains contained. The consumer price index excluding food and energy rose 2.5 percent over the 12 months ending in January. *(Last updated: February 20, 2008)*

The Economic Stimulus Package Will Provide a Temporary Boost to Our Economy:

The package will help our economy weather the housing correction and other challenges. The Economic Stimulus Act of 2008, signed into lay by President Bush on February 13, has two main elements--temporary individual tax relief so that working Americans have more money to spend and temporary tax incentives for businesses to invest and grow. Together, the legislation will provide about $150 billion of tax relief for the economy in 2008, leading to the creation of over half a million additional jobs by the end of this year. *(Last updated: February 29, 2008)*

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 strong economic growth. 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.

Printer Friendly Version of the U.S. Economic Strength

The U.S. economy is fundamentally strong, but the housing correction, credit turmoil, and high oil prices are weighing on growth this year and short-term risks are to the downside. The Economic Stimulus Act of 2008, signed into law on February 13, will help protect the strength of our economy as we weather the housing downturn and other challenges. This agreement includes short-term incentives to bolster business investment and consumer spending to keep our economy growing and creating jobs this year.

LATEST NEWS

Treasury Assistant Secretary Swagel to Hold Monthly Economic Briefing

FOCUS ON

Economic Growth Package

- Fact Sheet: State-by-State Benefit of the Economic Stimulus Act of 2008
- Fact Sheet: Examples of How the Economic Growth Package will Benefit Americans
- Paulson Statement on Senate Passage of Economic Growth Package
- Paulson Statement on House Passage of Economic Growth Legislation
- Paulson Answers Questions on Economic Growth Agreement
- Paulson Press Briefing on the Bipartisan Economic Growth Agreement
- White House Fact Sheet: New Growth Package Meets Criteria to Keep Our Economy Healthy
- Bush Statement on Economic Growth Agreement
- Paulson Remarks on the Economy
- Paulson Takes Questions at the White House
- Paulson Remarks at White House Press Briefing
- White House Fact Sheet: Taking Action to Keep Our Economy Healthy
- Transcript: President's Remarks

Treasury Releases Social Security Papers

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.

search

"The rebate checks and investm incentives in the stimulus packag provide important support to fam business spending at a time whe broad range of indicators, includi today's employment report, point slowing economy." Assistant Sec Phillip Swagel, April 4, 2008

MORE INFORMATION

- Economic Report of the Presi
- The White House Economy a Budget
- Bureau of Economic Analysis
- Bureau of Labor Statistics
- The Federal Reserve
- Economic Data Tables

RELATED OFFICES

- Treasury's Office of Economi Policy

- 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
- **Issue Brief 3** : Social Security Reform: Benchmarks for Assessing Fairness and Benefit Adequacy

U.S. Economic Strength

Employment Fell in March:
Job Growth: Payroll employment fell by 80,000 in March, following a decrease of 76,000 jobs in February. The United States has added 8.0 million jobs since August 2003. Employment increased in 43 states and the District of Columbia over the year ending in February. *(Last updated: April 4, 2008)*

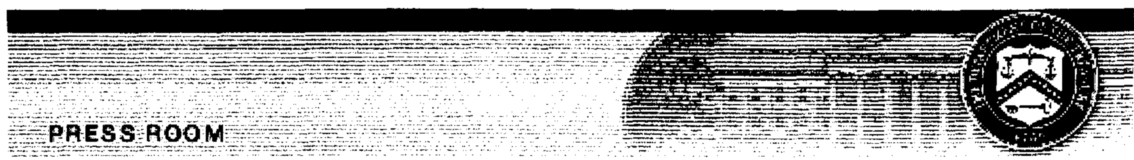
Low Unemployment: The unemployment rate rose to 5.1 percent in March from 4.8 percent in February. Unemployment rates declined or remained steady in 24 states over the year ending in February. *(Last updated: April 4, 2008)*

Signs of Economic Strength Include Exports and Low Inflation:
Exports: Strong global growth is boosting U.S. exports, which grew by 8.4 percent over the past 4 quarters. *(Last updated: March 27, 2008)*
Inflation: Core inflation remains contained. The consumer price index excluding food and energy rose 2.3 percent over the 12 months ending in February. *(Last updated: March 14, 2008)*

The Economic Stimulus Package Will Provide a Temporary Boost to Our Economy:
The package will help our economy weather the housing correction and other challenges. The Economic Stimulus Act of 2008, signed into law by President Bush has two main elements—temporary individual tax relief so that working Americans have more money to spend and temporary tax incentives for businesses to invest and grow. Together, the legislation will provide about $150 billion of tax relief for the economy in 2008, leading to the creation of over half a million additional jobs by the end of this year.*(Last updated: February 29, 2008)*

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 strong economic growth. 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: April 4, 2008



March 7, 2008
HP-866

Assistant Secretary Ryan to Speak on Strengthening Financial Markets

Assistant Secretary for Financial Markets Anthony W. Ryan will deliver remarks Monday to the National Association of State Treasurers at their 2008 Legislative Conference in Washington. His remarks will focus on strengthening financial markets and fiduciary responsibility.

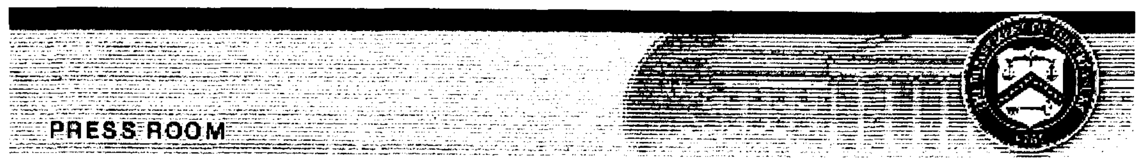
The following event is open to the media:

Who
Assistant Secretary for Financial Markets Anthony W. Ryan

What
Remarks to the National Association of State Treasurers
Legislative Conference

When
Monday, March 10, 10:15 a.m. EDT

Where
Willard InterContinental Hotel
1401 Pennsylvania Avenue, NW
Washington, D.C.



March 10, 2008
HP-867

Assistant Secretary Anthony W. Ryan
Remarks before the National Association of State Treasurers

Washington - Good morning. Thank you for inviting me to join you. It's my pleasure to be here.

Our presence here today on the banks of the Potomac River is tied to a political deal and the relationship between the federal government and the states comprising our union. In 1790, the first Secretary of the U.S. Treasury, Alexander Hamilton, made a controversial proposal that the Federal Government assume state debts incurred during the Revolutionary War.

His bold proposal drew sharp criticism from Thomas Jefferson and James Madison. A deal was proposed and made. Hamilton agreed to use his influence to place the capital of the country here in deference to Jefferson and Madison. In turn, they agreed to encourage their constituents and colleagues in Congress to back Hamilton's debt assumption plan, which together with his proposals for funding the debt, subsequently became law.

The U.S. Treasury continues to work with states on many issues including tax policy and facilitating the financing of municipal debt through our State and Local Government Series (SLGS). Today, I would like to focus on another potential collaboration where together we can strengthen efforts to help protect your beneficiaries and enhance the capital markets in which both your citizens and states invest their assets.

We have the best capital markets in the world. The quality, breadth and depth of our markets enable capital to be allocated in ever more efficient ways over the long term. Our markets' diversity and operating integrity inspire investor confidence and attract liquidity. Our capital markets stimulate competition and innovation -- enabling not just economic viability in each of your states, but vitality.

As public sector executives you know first hand the benefits of dynamic economic growth, and thus have a vested interest in capital markets that enhance investor confidence and market liquidity - - both of which have been significantly challenged in recent months.

One reason investor confidence is being hit so hard, is that many investors were sanguine over the last few years. This sanguine state – perhaps even over-confidence - was a result of many factors. But recent events underscore the importance of prudent regulatory policies, strong market discipline and robust risk management. Efforts to enhance these core components also serve to foster greater market liquidity which reduces costs and improves returns.

The headlines over the past several months include numerous reports of the challenges being confronted by states and municipalities. These range from hedge fund investments by public pension plans gone awry, to municipal officials grappling with investments they made in complicated structures like conduits and SIVs, to valuation challenges of holdings in opaque asset backed securities in cash investment funds, to concerns over bond issues wrapped by financial guarantors, to exorbitant interest rates being paid by state and local authorities as a result of failed auctions of auction rate securities. These reports raise many issues: some old, some new. Collectively, there is a lot we can do to influence what the headlines of tomorrow will be.

As a public sector representative, you fulfill many roles including the management of state fiscal matters. This morning, I'd like to focus on one of your most important

roles: the responsibility you have in keeping retirement promises made to state workers.

The total value of our nation's retirement investments--including 401(k)s and IRAs--has been estimated at a staggering $11 trillion. Approximately $5 trillion reside in public-sector retirement plans.

With trillions of dollars in assets, our nation's retirement plans are major players in the economy. Public pension plans hold $2.1 trillion of stock in our corporations, over $158 billion in U.S. Treasury marketable debt, over $311 billion in U.S. agency debt, and over $256 billion in corporate debt.

I choose to focus on this role that you play - not just to illustrate that the health of our nation's public pension assets and our nation's economy is deeply intertwined - but to highlight the importance of the role of institutional investors such as public pension plans not just can play, but must play in contributing to market discipline, and to underscore a fundamental investment concept: prudence in the role of a fiduciary.

The Prudent Man Rule was established by a Massachusetts court decision in 1830 in which trustees were directed to "observe how men of prudence, discretion and intelligence manage their own affairs, not in regard to speculation, but in regard to the permanent disposition of their funds, considering the probable income, as well as the probable safety of the capital to be invested."

The standard has evolved over time as prudent man became prudent expert, and income and safety expanded into return and risk, but after almost two centuries, the principle still resonates. The challenge for fiduciaries is not to focus just on returns or even to avoid risks. Rather, prudence dictates that fiduciaries seek to balance potential future returns with a corresponding identification, assessment and management of risks.

Fiduciaries seeking to fulfill their obligations must appreciate that they represent the first and most important line of defense for the interests of their beneficiaries. No one should suggest that plan trustees or portfolio managers should not take risks – in fact they must take risks in order to generate desired returns. Investors must have the opportunity to succeed, and in doing so they also have the freedom to fail.

However, given the characteristics of many of the investment strategies and securities in which pension plans have investments today, fiduciaries must return to some of the fundamentals of investment management. They must seek to excel in risk management as much as return management. Risk management is not some part-time responsibility – it's a fundamental obligation of a fiduciary's duty. And it's not just investors' responsibility. Risk management is everybody's business.

Every investment strategy introduces risks. We should acknowledge that the risks are many. They range beyond volatility to include market, liquidity, counterparty, credit, operational risk and reputation risk. But, despite more tools and greater experience, the responsibility seems to be becoming harder to fulfill.

Investors must appreciate risk in its myriad dimensions and seek to identify, assess, and manage it. Successfully doing so requires continuous evaluation from multiple perspectives, and humility to know the limitations of any single or even comprehensive assessment of risk.

Sound practices on the part of fiduciaries are critical to fulfilling their obligations. Fiduciaries have an ongoing responsibility to perform due diligence and must continually ensure that their investment decisions are prudent and conform to sound practices, including diversification.

While pension laws have a dramatic impact on pension plan management, we have also witnessed how the presence and scale of institutional investors has influenced many market practices.

Today, many public pension plans are invested in strategies and securities that are very complex and opaque. These characteristics create additional challenges. To

address these challenges many fiduciaries are demanding more detailed information, higher quality business standards and operational practices, effective compliance and increased transparency.

Fiduciary responsibility is real, and fiduciaries should be held accountable. Nobody likes having responsibility without the corresponding authority. Appropriately, fiduciaries define and exercise their authority in several ways including their governance models and investment guidelines. Such implementation mechanisms should be carefully considered and reviewed to accomplish not only the intended objectives, but also to mitigate the likelihood of unintended, deleterious consequences such as relying solely on a credit rating to be a sufficient standard for assessing investment risks.

It is understandable that many fiduciaries struggle with complexity in the financial markets. Let's acknowledge that complexity may be a very legitimate reason a potential investor decides not to make a certain investment. However, we must also acknowledge that complexity can be no excuse for an existing investor or buyer of such a security to justify a loss. Investors and their fiduciaries must understand the risks associated with a potential investment. This is true of any investment – whether it is in a structure like a structured investment vehicle or in a security like a collateralized debt obligation or auction rate security.

Given such an innovative and evolving financial marketplace, a commitment to continual education seems appropriate so fiduciaries can fulfill their responsibilities and possess the requisite skills and knowledge to make informed investment decisions.

These efforts help to define market discipline. Federal policy makers are very supportive of efforts that strengthen market discipline, since such efforts serve to mitigate systemic risk.

Fiduciaries play two critical roles. In addition to contributing to market discipline, fiduciaries -- both trustees and asset managers -- play a powerful and important investor protection role. They help protect their beneficiaries' financial interests by continuously evaluating and monitoring their investments in the capital markets.

At the Treasury Department, we are vigilant in monitoring the global capital markets, and the past eighteen months have provided us with many issues to evaluate and address. These issues range from financial markets preparedness, to hedge funds, to market infrastructure, to challenges in the housing sector of our economy and the resulting implications in the capital markets.

The latter category includes funding challenges in the short term credit markets, enhancing financial institutions' risk management including liquidity and counterparty credit risk, reporting and disclosure issues, as well as the use of ratings and investor practices.

We also work closely with our colleagues comprising the President's Working Group on Financial Markets (PWG), which is chaired by Treasury Secretary Paulson and includes the Chairmen of the Federal Reserve, the Securities and Exchange Commission, and the Commodity Futures Trading Commission.

One marketplace development that we continue to address is directly related to institutional investors' (such as public pension plans) increasing allocations to alternative investments and investments in private pools of capital such as hedge funds and private equity.

In February 2007, the President's Working Group on Financial Markets produced principles and guidelines regarding such investments. Last September, Secretary Paulson announced the establishment of two separate yet complementary private sector committees. The first is comprised of investors such as state pension funds and the second committee is comprised of asset managers.

The first task for each group was to develop detailed guidelines that would define "best practices" for their respective communities. These guidelines have as a foundation, and are consistent with, the principles and guidelines developed by the PWG. They have also built upon existing industry work where possible. These will

be released for public comment in the weeks ahead, and I would urge all of you to review them, share them with your colleagues and consultants, and provide feedback to the respective committees.

Implementing these practices will help strengthen market discipline, mitigate systemic risk, augment regulatory safeguards regarding investor protection, and complement regulatory efforts to enhance market integrity.

The PWG is also reviewing the underlying policy issues contributing to the current stress in our capital markets. While working through the current situation is our first concern, getting the long-term policy right is just as important.

Conclusion

As fiduciaries and leaders, I want to encourage you to not only stay engaged, but to redouble your efforts. There is much work to do and I encourage you to take the necessary steps to protect your beneficiaries' interests and enhance market discipline.

As stewards of the public trust we all must continually uphold and enhance the highest quality standards of excellence. It is both a privilege and responsibility to help strengthen the vitality, stability and integrity of the public's investments and our capital markets. Let our efforts, as well as those of the private sector to meet those goals, be the headlines of tomorrow. The system works when all stakeholders recognize the benefits, mitigate the risks, and choose to participate. Thank you again for the opportunity to speak here today.

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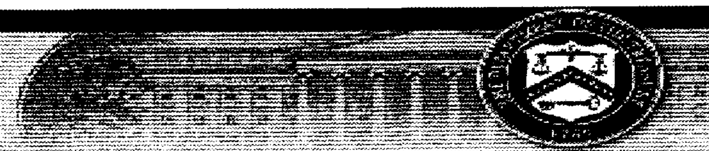


PRESS ROOM

March 10, 2008
2008-3-10-15-27-53-2152

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 $74,266 million as of the end of that week, compared to $73,521 million as of the end of the prior week.

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

	March 7, 2008		
A. Official reserve assets (in US millions unless otherwise specified)	Euro	Yen	Total
(1) Foreign currency reserves (in convertible foreign currencies)			74,266
(a) Securities	15,336	12,497	27,833
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	15,165	6,121	21,286
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	4,322		
(3) SDRs	9,784		
(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	

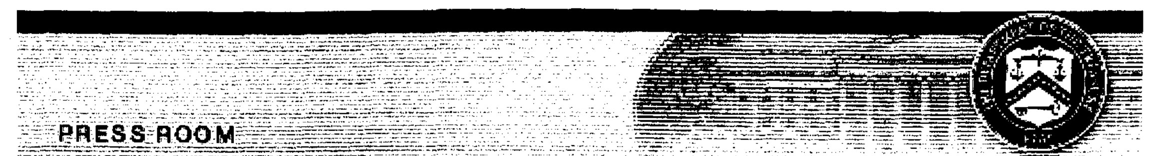
(d) securities lent and on repo	
--lent or repoed and included in Section I	
--lent or repoed but not included in Section I	
--borrowed or acquired and included in Section I	
--borrowed or acquired but not included in Section I	
(e) financial derivative assets (net, marked to market)	
--forwards	
--futures	
--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)	74,266
--currencies in SDR basket	74,266
--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.



March 12, 2008
HP-868

Secretary Paulson to Speak on Financial Markets

Secretary Henry M. Paulson, Jr. will deliver remarks Thursday at the National Press Club in Washington. His remarks will focus on financial market developments.

The following event is open to the media:

Who
Secretary Henry M. Paulson, Jr.

What
Remarks on Financial Markets

When
Thursday, March 13, 10:00 a.m. EDT

Where
National Press Club
First Amendment Lounge
529 14th Street, NW
Washington, D.C.

PRESS ROOM

March 12, 2008
HP-869

Treasury Designates Iran-Controlled Bank for Proliferation
Future Bank Controlled by Iran's Bank Melli

Washington – The U.S. Department of the Treasury today designated Future Bank B.S.C. for being controlled by Iran's Bank Melli, which was previously designated by the Treasury Department for facilitating Iran's proliferation activities.

"Bank Melli goes to extraordinary lengths to assist Iran's pursuit of a nuclear capability and ballistic missiles, while also helping other designated entities to dodge sanctions," said Stuart Levey, Under Secretary for Terrorism and Financial Intelligence (TFI). "Banks and other entities owned or controlled by Bank Melli pose a serious threat to the integrity of the international financial system."

Future Bank is being designated pursuant to Executive Order 13382, an authority aimed at freezing the assets of proliferators of weapons of mass destruction (WMD) and their supporters. Bank Melli was designated by the Treasury Department under E.O. 13382 on October 25, 2007.

Future Bank was established in 2004 as a joint venture between two Iranian banks, Bank Melli and Bank Saderat, and a private bank based in Bahrain. Bank Melli and Bank Saderat each hold 33.3 percent of Future Bank's outstanding shares. At the time of designation, Bank Melli and Future Bank publicly identify the same individual as chairman of both institutions. Other information available to the U.S. Government also demonstrates that Future Bank is controlled by Bank Melli.

The Government of Bahrain has taken responsible steps to try to prevent Future Bank from abusing the country's financial system.

"Bahraini authorities have been closely monitoring Future Bank and took some steps after Treasury's designations of Banks Melli and Saderat to attempt to prevent abuse by this institution," Levey continued.

This designation is consistent with United Nations Security Council Resolution (UNSCR) 1803 of March 3, 2008, which calls upon Member States to "exercise vigilance" with regard to activities between financial institutions in their countries and all banks domiciled in Iran, in particular, Iran's Bank Melli and Bank Saderat. UNSCR 1803 specifically calls on States to take such action in order to avoid these activities contributing to either proliferation sensitive nuclear activities or the development of nuclear weapons systems, as referred to in UNSCR 1737.

Treasury's Office of Foreign Assets Control (OFAC) designated Bank Melli pursuant to E.O. 13382 for providing, or attempting to provide, financial support for entities involved in Iran's nuclear and missile programs. These include: the Shahid Hemmat Industrial Group, the Defense Industries Organization (DIO), Bank Sepah, and the Islamic Revolutionary Guard Corps (IRGC). These entities have also been designated under E.O. 13382 and have been listed in UNSCRs 1737 and 1747. OFAC also designated four financial institutions that are owned or controlled by Bank Melli, including Melli Bank plc, Arian Bank, Bank Melli Iran ZAO, and Bank Kargoshaee.

On that same day, OFAC designated Bank Saderat pursuant to E.O. 13224 for providing support to the terrorist organizations Hizballah and Hamas.

Since President George W. Bush issued E.O. 13382 in June 2005 and identified eight entities in the Annex to the Order, a total of 51 entities and 12 individuals have been designated as proliferators of WMD. Specifically, the Treasury Department

has designated:

- 36 entities and 11 individuals tied to Iranian proliferation activity;
- Nine entities and one individual tied to North Korean proliferation activity; and
- Three entities tied to Syrian proliferation activity.

Additionally, the State Department has designated three Iranian organizations as entities of proliferation concern, including Iran's Ministry of Defense and Armed Forces Logistics (MODAFL), the DIO, and the IRGC.

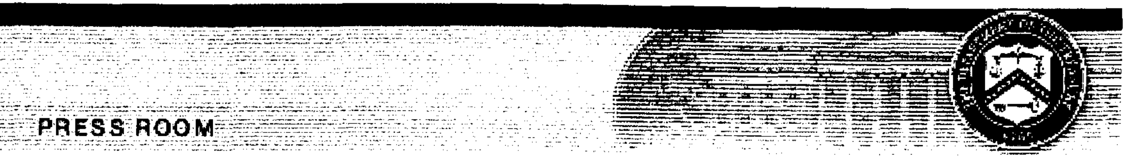
The designation announced today is part of the ongoing interagency effort by the United States Government to combat WMD trafficking by exposing and blocking the property of entities and individuals that engage in proliferation activities and their support networks.

Future Bank Identifying Information

FUTURE BANK B.S.C.

Addresses:
P.O. Box 785, City Centre Building, Government Avenue, Manama, Bahrain
Block 304, City Centre Building, Building 199, Government Avenue, Road 383, Manama, Bahrain
All branches worldwide

For more information on the designation of Bank Melli, please visit: http://www.treas.gov/press/releases/hp644.htm.



March 12, 2008
HP-870

Treasury to Host Background Briefing

Treasury will host a pen-and-pad background briefing Thursday on developments in financial markets. The briefing will be held at 11:30 a.m. in the Treasury Media Room, following Secretary Henry M. Paulson's remarks. No cameras will be permitted into the briefing.

The following event is open to the press:

- **What:** Pen-and-Pad Background Briefing
- **When**: Thursday, March 13 11:30 a.m. (EDT)
- **Where**: Department of the Treasury
  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.

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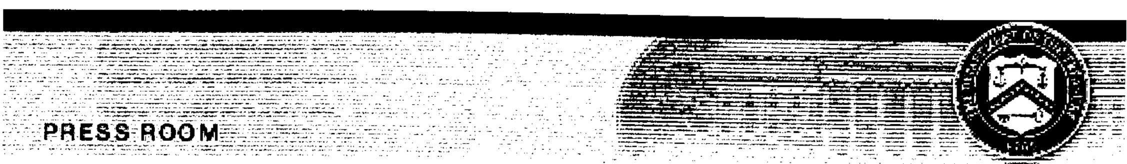

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March 13, 2008
hp-871

**President's Working Group Issues Policy Statement
To Improve Future State of Financial Markets**

Washington -The President's Working Group on Financial Markets issued a policy statement today with recommendations to improve the future state of U.S. and global financial markets. The statement offers the group's insight on causes of recent market issues and next steps for mitigating systemic risk, restoring investor confidence, and facilitating stable economic growth.

"The President's Working Group on Financial Markets has been reviewing policy issues to help reduce the likelihood that mistakes of the past are repeated. We have completed the assessment phase of our review, and are moving forward to focus on implementation," said Secretary Henry M. Paulson, Jr., chairman of the PWG, which includes the Treasury Department, the Federal Reserve, the Securities and Exchange Commission and the Commodity Futures Trading Commission. "I believe today's recommendations, when implemented, will strengthen market discipline, enhance risk management and improve the efficiency and stability of our capital markets."

"The recommendations set out in the Working Group's statement constitute an appropriate and effective response to the deficiencies in our financial framework that contributed to the current turmoil in financial markets. I strongly support them," said Federal Reserve Board Chairman Ben S. Bernanke.

SEC Chairman Christopher Cox said, "Several of the recommendations in today's Policy Statement fall within the purview of the SEC, including in particular those concerning the role of credit rating agencies. Congress has recently given the SEC new authority to address issues including conflicts of interest and the lack of competition in this industry-and we will use that authority to help restore investor confidence and healthy capital formation in our markets."

"These recommendations are a critical step in strengthening the US financial markets. The CFTC will continue to work with the other PWG members to implement the recommendations," said CFTC Acting Chairman Walt Lukken.

The PWG, working with the Office of the Comptroller of the Currency and the Federal Reserve Bank of New York, issued the statement to help enable market participants and regulators to better deal with the complexity that has resulted from market innovation. The recommendations offer steps to improve market transparency and disclosure, risk awareness and risk management, capital management and regulatory policies and market infrastructure for products such as over-the-counter derivatives. The statement focuses on changes needed from financial regulators and all market participants, including mortgage originators and brokers, financial institutions, issuers of securitized products, credit rating agencies and investors. The statement also discusses the challenges presented by securitization and over-the-counter derivatives.

"The OCC strongly supports the conclusions of the PWC policy statement and views it as an important step toward restoring stability in US markets," said Comptroller of the Currency John C. Dugan. "We are already pursuing implementation of its recommendations in the largest US banks that we supervise, and look forward to working with the other PWG participants on the wider reform agenda."

President Bush called on the PWG in August 2007 to review the underlying causes

of the recent market issues. Members of the group have frequently discussed the causes of the recent turmoil, including: lax underwriting standards for mortgages, particularly for subprime mortgages; an erosion of market discipline in the securitization process; flaws in credit rating agencies' assessments of some complex structured credit products; risk management weaknesses at global financial institutions; and regulatory policies that failed to mitigate risk management weaknesses.

The PWG will work with foreign regulators, finance ministries, and central banks through the international Financial Stability Forum and other venues to address these challenges globally.

The PWG is committed to progress toward implementation of the recommendations. Members will issue a progress statement in the fourth quarter of 2008 and consider whether further steps are needed to address weaknesses in financial markets, institutions and related supervisory policies.

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REPORTS

- Policy Statement of the President's Working Group on Financial Markets

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

SECRETARY OF THE TREASURY

March 13, 2008

MEMORANDUM FOR THE PRESIDENT

FROM: Henry M. Paulson, Jr.

SUBJECT: President's Working Group on Financial Markets Policy Statement

Last August, you called on the President's Working Group on Financial Markets (PWG) to review the underlying causes of developing financial market turmoil. I am pleased to transmit to you the policy statement of the PWG, which is led by me as the Secretary of the Treasury and includes the chairmen of the Federal Reserve Board, the Securities and Exchange Commission, and the Commodity Futures Trading Commission.

The PWG, working with the Office of the Comptroller of the Currency and the Federal Reserve Bank of New York, issued the statement to present the Group's findings on the causes of recent market turmoil and recommend changes to help avoid a repeat of recent events.

Obviously, market turmoil is still playing out, and all market participants and policy makers are deeply engaged in addressing the current situation. We must implement these recommendations with an eye toward not creating a burden that exacerbates today's market stresses.

We will monitor and report back to you on the implementation of these recommendations. In addition, we will make further recommendations later this year if we do not see the progress we are seeking.

Our objectives – which we believe these recommendations will achieve – are improved transparency and disclosure, better risk awareness and management, and stronger oversight. Collectively, these recommendations will mitigate systemic risk, help restore investor confidence, and facilitate economic growth.

PRESS ROOM

March 13, 2008
HP-872

Remarks by Secretary Henry M. Paulson, Jr. on Recommendations from the President's Working Group on Financial Markets

Washington -- Thank you. I appreciate this opportunity to talk with you about Treasury's work on financial markets. As you know, since the market turmoil began last summer we have been closely monitoring and taking steps to address current market conditions.

We are working to get through the current period of market turmoil while minimizing its impact on our economy. And, as we do so, risk is being re-priced and markets are de-leveraging. This is creating liquidity challenges and, as a result, credit markets are not functioning as normal. We are encouraging financial institutions to continue to strengthen balance sheets by raising capital and revisiting dividend policies; we need these institutions to continue to lend and facilitate economic growth.

As we continue to address current market stress, we must also examine the appropriate policy responses. The President's Working Group on Financial Markets, the PWG, has been reviewing policy issues to help reduce the likelihood that mistakes of the past are repeated. The objective here is to get the balance right – regulation needs to catch up with innovation and help restore investor confidence but not go so far as to create new problems, make our markets less efficient or cut off credit to those who need it.

The focus of my remarks will be the PWG recommendations being released today as part of the policy review. We are at the end of the beginning of that review, and moving forward to the next phase –implementation. Clearly, that implementation must be consistent with today's environment, recognizing that all market participants are under stress and acting prudently to address current strains. We will pursue implementation in a measured way, so as not to impose burdens which might exacerbate the present situation.

And let me be clear: The PWG will stay on top of this. We will continually assess, consider further steps, report as we proceed, and issue a summary progress statement in the fourth quarter of 2008.

Many of these issues are as global as our markets, and we are also working closely with the Financial Stability Forum (FSF) as they prepare their report and recommendations. The FSF efforts, under the leadership of Mario Draghi, will bring a globally coordinated response.

Market Innovation and Complexity
Innovation is a hallmark of our capital markets. Securitization of credit is one example of an innovation that has made more, more flexible and lower-cost capital available to consumers and companies, and stimulated competition.

Financial innovation has brought these and other benefits. Financial innovation has also brought, inevitably, the challenge of complexity. In my judgment, some financial products have become overly complex. Excessive complexity is the enemy of transparency and market efficiency. Investor sentiment has swung hard to risk aversion, and now markets are punishing not only complex, but non-complex products as well.

Complexity is one of the many excesses that exacerbated the current market turmoil – turmoil that was triggered by the dramatic weakening of underwriting standards for U.S. subprime mortgages. Weaker subprime credit standards were part of a much broader erosion of standards throughout corporate and consumer

credit markets. We have had a number of years of benign economic financial conditions and abundant liquidity; investors reached ever further for yield, and market participants and regulators became complacent about all types of risks.

As we did our contingency planning at Treasury prior to this period of market turmoil, we recognized the need to be continually vigilant because financial shocks or disruptions are a fact of life, and our markets seem to experience them every six to eight years. In our planning, we also recognized that the precipitating factor of any shock is virtually impossible to predict, except in hindsight, and we didn't try to do so. We did turn our attention to certain risks surrounding hedge funds, and to systemic risk and investor protection. We examined issues such as disclosure and margin requirements and, in February 2007, issued principles and guidelines for addressing issues related to private pools of capital, including hedge funds. Subsequently, we established two private-sector committees to develop industry best practices.

There is a certain irony that during this period it has been the regulated financial institutions which have been the focus of our attention. With a few exceptions, the hedge fund sector thus far has proven resilient to market volatility and protracted illiquidity. We know that a number of hedge funds are now also facing difficulties, as some are missing margin calls, and we are monitoring that closely. However, for a number of months last year much attention was given to various banks' off-balance sheet exposures to conduits and structured investment vehicles (SIVs). This risk exposure was partially due to the opacity of conduits and SIVs; existing capital rules may have also failed to mitigate, or even amplified, the stress associated with these vehicles.

PWG Policy Review Recommendations

We must have better policies, processes and mechanisms to understand and manage complexity, to discourage its excess, and to better understand and manage risk. Hopefully, the PWG policy recommendations will make progress in doing just that. Our recommendations have six key objectives:

- One, stronger transparency and disclosure. The challenges of complexity were exacerbated by opacity. The best antidote to opacity is transparency and disclosure.

- Two, stronger risk awareness. Regulators and all market participants must be more aware of and better able to respond to risks. Credit rating agency practices must improve, and the users of their services must rely less on, and appreciate more the limitations of, ratings products.

- Three, stronger risk management. We need improved risk management practices by investors, issuers, financial institutions, rating agencies, and regulators alike. Risk management is everyone's business.

- Four, stronger capital management. Well-capitalized institutions are better prepared to deal with challenges, foster economic growth and enhance market confidence.

- Five, stronger regulatory policies. Regulatory policies, including capital requirements, must address risk management weaknesses and improve the safety and soundness of our institutions and financial system.

- Six, stronger market infrastructure. Perhaps the best example of innovation is the over-the-counter (OTC) derivatives markets. These markets have grown tremendously; but the infrastructure has not kept up – and it must.

This effort is not about finding excuses and scapegoats. Those who committed fraud or wrongdoing have contributed to the current problems; authorities need to and are prosecuting them. But poor judgment and poor market practices led to mistakes by all participants.

Let me now summarize how the PWG recommendations will impact some of the issues we are facing in the marketplace and certain market participants. I will briefly

discuss mortgage origination, credit ratings, securitization, financial institutions, investors, credit default swaps and other OTC derivatives, and regulators.

Mortgage Originators and Brokers

The PWG is recommending three important changes for mortgage originators and brokers. First, federal and state regulators should strengthen oversight of all mortgage originators. Second, state financial regulators should implement strong nationwide licensing standards for mortgage brokers. Third, at the end of the current comment period, the Federal Reserve will issue revised rules for consumer protection and disclosure requirements. As part of a larger study of financial regulatory structure, Treasury will soon release additional recommendations to improve the mortgage origination process.

Credit Rating Agencies

Credit rating agencies play a major role in financial markets, and their ratings products must provide information investors need to make more fully informed decisions about risk. This will require reforming structured credit product rating processes to ensure integrity and transparency, and improving the quality of data, models, and assumptions. Credit rating agencies must enforce policies and procedures that manage and disclose conflicts of interest, and implement changes suggested by the SEC review of conflict of interest issues.

The credit rating process needs to clearly differentiate between structured products ratings and ratings for corporate and municipal securities. And agencies should require securitized credit issuers to perform robust due diligence of originators of assets that are securitized or used as collateral for structured credit products.

The PWG will form a private-sector committee to work toward implementation of these rating agency recommendations and develop additional ones, as needed. The PWG member agencies will reinforce credit rating agencies' efforts through revisions to supervisory policy and regulation, and revisit the need for stronger oversight if the industry-led reforms do not lead to the integrity and transparency we seek. Regulators must also review how they encourage the use of ratings in rules and guidance; at a minimum, regulatory policies should distinguish between structured credits and corporate and municipal bonds.

Securitization

The securitization of a number of credit products, including residential and commercial mortgages, credit card receivables, student loans and business loans have brought us greater availability and lower cost credit. This has been positive for our economy. But with innovation in securitization and structured credit products has come varying degrees of complexity and other challenges, particularly related to securitization of mortgages.

For illustrative purposes, I will describe how the PWG recommendations will impact mortgage securitization. But first a few words about the process.

Mortgage brokers shop home loan applications to financial institutions and other lenders. Lenders then originate the mortgage loan and provide funds so the borrower can buy a home. The next step is securitization, packaging mortgage loans into securities. The originators sell these loans to securitizers that pool them with other loans into mortgage-backed securities (MBS). The MBS can be pooled again into collateralized debt obligations (CDOs), and multiple CDOs can be pooled further into what are called a "CDO Squared." Along the way, the mortgage loans can also be sliced into tranches representing different cash flows and payment risks.

The PWG has determined that there is no single, simple solution to the problems that have emerged from the mortgage securitization process, yet we have determined that market participants' behavior must change. I expect that market participants and regulators will implement these recommendations; when they do, we will see changes at every step of the securitization process:

Mortgage Brokers will be held to strong national licensing and enforcement standards. There will be stricter safeguards against fraud, and full and clear disclosure to borrowers about home loan terms, including long-term affordability.

Credit Rating Agencies will clearly differentiate structured product ratings from ratings for corporate and municipal securities. They will also disclose reviews performed on asset originators, and strengthen data integrity, models and assumptions.

Issuers of Mortgage-Backed Securities will disclose the level and scope of due diligence performed on underlying assets, disclose more granular information regarding underlying credits. And, if issuers have shopped for ratings, disclose the what and why of that as well.

Investors will conduct more independent analysis and be less reliant on ratings. They will require, receive and use more information and more clearly differentiate between structured credits and corporate and municipal securities.

These practices will better align the interests of mortgage originators and homebuyers, of originators and securitizers, of securitizers and rating agencies and, ultimately, investors.

Regulators have a role to play in every change. They will issue new rules and seek regulatory authorities as needed, evaluate progress, provide guidance and enforce laws – to ensure that implementation follows recommendation.

Covered Bonds, which allow banks to retain originated mortgage loans while accessing financial market funding, are another alternative worth considering. Covered bonds may address the current lack of liquidity in, and bring more competition to, mortgage securitization. Rule-making, not legislation, is needed to facilitate the issuance of covered bonds. Through clarification of covered bonds' status in the event of a bank-issuer's insolvency, the FDIC can reduce uncertainty and consider appropriate measures that will protect the deposit insurance fund. These steps would encourage a covered bond market in the U.S.; similar changes in Europe have resulted in more covered bond activity.

Financial Institutions

As key participants in virtually every phase of the markets, financial institutions must identify and address any weaknesses in risk management practices, especially those revealed by the current turmoil. This means enhancing internal risk measurement and reporting systems, a robust valuation of instruments and exposures, and aggregation of exposures across business lines. It also means more comprehensive disclosure of fair value estimates for complex and illiquid instruments, and of credit or liquidity enhancements provided to off-balance sheet commitments, such as conduits and SIVs.

The PWG's guidance on risk management and disclosure issues for financial institutions is important, but the quality of the top management team responsible for executing this guidance is even more important. I know from first-hand experience how increasingly difficult, yet how critical, it is to successfully manage today's large, integrated global financial institutions. The leadership challenge here is enormous. Market difficulties often expose weaknesses; weaknesses which can often only be overcome with experience. And that experience often comes from lessons learned from prior challenges and prior mistakes.

The ultimate success of any CEO is largely determined by the answer to one question: Do we have the right people in the right jobs with the right incentive structure? And these large financial institutions have a large number of key jobs to fill. They must have people with talent, judgment, expertise and motivation that best serve their institutions and, by extension, contribute to the quality and strength of our markets. I cite this management issue because I do not believe that the top jobs in our large financial institutions are going to get easier any time soon, and the markets, not regulators, will ultimately sort this out.

Investors

I will speak for a moment about investors – many of whom bought products they didn't fully understand, or bought products based solely on credit ratings. Many investors became complacent about risk and they have learned a costly lesson, one that amplifies the need for thorough due diligence. In fact, it seems that today's risk aversion is an aftermath of yesterday's risk complacency.

Going forward, investors must demand and use better information about investment risk characteristics, when they buy and as they hold. They, and the markets, will be better served by independent evaluations and by understanding that different types of instruments have different types of risks.

Credit Default Swaps and OTC Derivatives

In recent years, innovation has also facilitated the tremendous expansion in the scale, diversity and impact of credit default swaps and over-the-counter (OTC) derivatives. These instruments and markets have become important for the hedging or transfer of credit and default risk. Heightened price volatility and surging trading volumes underscore the need for the OTC derivatives market infrastructure to evolve to support this expansion. Industry has taken some, but not enough steps.

We need a dedicated industry cooperative. Market volume and instrument complexity call for a clear, functional, well-designed infrastructure that can meet the needs of the OTC derivatives markets in the years ahead. We have similar facilities for other asset classes, such as the Depository Trust and Clearing Corporation (DTCC).

Such an industry cooperative must capture all significant processing events over the entire lifecycle of trades. It must have the capability to accommodate all major asset classes and product types. It must be operationally reliable and scaleable, and use automation to promote standardization that will create efficiency and moderate excessive complexity.

In addition, the infrastructure must have a flexible and open architecture for interoperability, upgrades, and improvements. The facility also should enhance counterparty risk management through netting and collateral agreements by promoting portfolio reconciliation and accurate valuation of trades.

Some steps can be implemented quickly; others will take longer, but we need movement on all. With the continued leadership of the Federal Reserve Bank of New York, we also need to work with market participants to establish ambitious standards for trade data and for accurate and timely trade resolution. The industry also should incorporate, without delay, cash settlement protocol into standard documentation. We don't need good ideas sitting on the shelf; we need good ideas put into practice. All market participants, not just the dealer community, need to participate in the solution.

Supervisors, PWG, and Treasury

The PWG recommendations would not be complete unless they also included steps for regulators, including PWG member agencies. Regulators should take steps to ensure that investors improve due diligence and have greater awareness of risk characteristics. To further support this, regulators should work closely with FASB, to review accounting issues and implement policies that ensure aggregation of exposure across business lines and rigorous valuation of instruments and exposures.

Supervisors and regulators of global and U.S. institutions must closely monitor to ensure that institutions address risk management weaknesses and take action as needed. Regulators should also review capital requirements, as this plays such an important role in financial institution behavior. To this end, the Basel Committee on Banking Supervision should review the Basel II capital requirements for resecuritizations and off-balance sheet commitments, and promptly complete its liquidity management guidance update.

Efforts in Addition to these Recommendations

Today's recommendations are part of a much larger effort that spans multiple fronts. Treasury has commissioned a study on the cause of financial restatements. As I mentioned earlier, there is a financial regulatory review that will be released as a regulatory blueprint in the weeks ahead. We also have private sector committees developing best practices for investors and hedge fund managers and anticipate publishing guidelines for public comment next month.

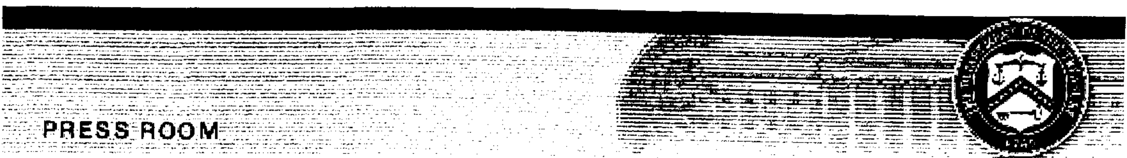
Investors in vibrant capital markets require accurate financial statements, and that can only occur with a vibrant accounting profession. Recognizing the challenges facing this industry, last spring the Treasury Department formed an advisory committee to review the sustainability of the auditing profession. The committee will report its final recommendations this summer.

Together, these additional committees and efforts will provide further guidance to enhance market integrity, investor protection and mitigate systemic risk.

Conclusion

We have learned many lessons from this period and we may learn still more as events unfold. Today I have summarized the results of a great deal of hard work by the PWG member agencies. We have laid down objectives and recommendations, which form a good start. Although we haven't yet worked completely through this period of market turmoil, and that is our highest priority today, it is not too early to suggest appropriate policy responses.

No silver bullet exists to prevent past excesses from recurring. In these remarks, I have focused a great deal on challenges related to excessive complexity, but complexity is only one of many issues we face. I believe today's recommendations put us on the path towards more transparent, better-functioning, and better-managed markets, which are integral to attracting and allocating capital to fuel our economic growth and prosperity. We will continue to re-assess conditions, monitor progress, put forward new recommendations and take additional steps as necessary.



March 14, 2008
hp-874

Statement by Treasury Secretary Henry M. Paulson, Jr.

Washington, DC -- Treasury Secretary Henry M. Paulson, Jr. today issued the following statement:

"As we have been saying for some time, there are challenges in our financial markets, and we continue to address them. This is another challenge that market participants and regulators are addressing. We are working closely with the Federal Reserve and the SEC. I appreciate the leadership of the Federal Reserve in enhancing the stability and orderliness of our markets. Our financial system is flexible and resilient and I am confident that the efforts of regulators and market participants will minimize disruption to the system."

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FROM THE OFFICE OF PUBLIC AFFAIRS

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March 17, 2008
HP-875

Treasury International Capital (TIC) Data for January

Treasury International Capital (TIC) data for January 2008 are released today and posted on the U.S. Treasury web site (www.treas.g which will report on data for February, is scheduled for April 15, 2008.

Net foreign purchases of long-term securities were $62.0 billion.

- Net foreign purchases of long-term U.S. securities were $81.2 billion. Of this, net purchases by foreign official institutions were purchases by private foreign investors were $27.8 billion.
- U.S. residents purchased a net $19.2 billion of long-term foreign securities.

Net foreign acquisition of long-term securities, taking into account adjustments, is estimated to have been $47.2 billion.

Foreign holdings of dollar-denominated short-term U.S. securities, including Treasury bills, and other custody liabilities increased $73. holdings of Treasury bills increased $11.6 billion.

Banks' own net dollar-denominated liabilities to foreign residents decreased $83.6 billion.

Monthly net TIC flows were positive $37.4 billion. Of this, net foreign private flows were negative $38.2 billion, and net foreign official fl billion.

-30-

TIC Monthly Reports on Cross-Border Financial Flows

(Billions of dollars, not seasonally adjusted)

				12 Months Through			
		2006	2007	Jan-07	Jan-08	Oct-07	Nov
	Foreigners' Acquisitions of Long-term Securities						
1	Gross Purchases of Domestic U.S. Securities	21077.1	29689.0	21324.6	30989.8	2671.9	289
2	Gross Sales of Domestic U.S. Securities	19933.9	28683.2	20143.4	30027.2	2553.8	281
3	**Domestic Securities Purchased, net (line 1 less line 2) /1**	**1143.2**	**1005.8**	**1181.2**	**962.7**	**118.0**	**7**
4	**Private, net /2**	**946.6**	**818.1**	**991.3**	**733.6**	**96.2**	**5**
5	Treasury Bonds & Notes, net	125.9	198.1	151.6	178.5	45.9	2
6	Gov't Agency Bonds, net	193.8	107.0	194.8	105.8	4.8	2
7	Corporate Bonds, net	482.2	332.6	501.6	288.3	15.6	1
8	Equities, net	144.6	180.4	143.3	161.0	29.9	
9	**Official, net /3**	**196.6**	**187.7**	**189.9**	**229.1**	**21.8**	**1**
10	Treasury Bonds & Notes, net	69.6	3.0	58.4	44.0	4.0	
11	Gov't Agency Bonds, net	92.6	119.1	98.8	103.4	10.0	

12	Corporate Bonds, net	28.6	50.6	28.5	52.2	7.4	
13	Equities, net	5.8	15.1	4.3	29.6	0.4	
14	Gross Purchases of Foreign Securities from U.S. Residents	5515.9	8177.0	5664.2	8398.8	809.4	72
15	Gross Sales of Foreign Securities to U.S. Residents	5766.8	8400.5	5912.7	8628.5	813.4	70
16	**Foreign Securities Purchased, net (line 14 less line 15) /4**	**-250.9**	**-223.5**	**-248.5**	**-229.7**	**-4.1**	**2**
17	Foreign Bonds Purchased, net	-144.5	-128.6	-141.0	-144.6	-9.1	1
18	Foreign Equities Purchased, net	-106.5	-94.9	-107.5	-85.1	5.0	
19	**Net Long-Term Securities Transactions (line 3 plus line**	**892.3**	**782.3**	**932.7**	**733.0**	**114.0**	**9**
20	**Other Acquisitions of Long-term Securities, net /5**	**-169.9**	**-188.9**	**-171.2**	**-186.9**	**-15.1**	**-1**
21	**Net Foreign Acquisition of Long-Term Securities** (lines 19 and 20):	**722.4**	**593.4**	**761.5**	**546.0**	**98.9**	**7**
22	**Increase in Foreign Holdings of Dollar-denominated Short-U.S. Securities and Other Custody Liabilities: /6**	**146.2**	**215.5**	**149.2**	**271.4**	**30.3**	**3**
23	**U.S. Treasury Bills**	**-9.0**	**48.8**	**-17.2**	**58.9**	**9.0**	**1**
24	Private, net	16.1	29.3	11.3	35.3	6.7	1
25	Official, net	-25.0	19.5	-28.5	23.6	2.3	
26	**Other Negotiable Instruments and Selected Other Liabilities: /7**	**155.1**	**166.7**	**166.4**	**212.5**	**21.3**	**2**
27	Private, net	174.9	90.6	183.2	126.3	1.3	
28	Official, net	-19.8	76.1	-16.8	86.2	20.0	1
29	**Change in Banks' Own Net Dollar-Denominated Liabilities**	**198.0**	**-106.3**	**15.7**	**-169.6**	**-26.5**	**2**
30	**Monthly Net TIC Flows (lines 21,22,29) /8**	**1066.5**	**702.6**	**926.4**	**647.9**	**102.6**	**13**
	of which						
31	Private, net	926.2	404.6	773.3	299.0	60.5	9
32	Official, net	140.3	298.0	153.1	348.9	42.2	4

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

/2 Includes international and regional organizations

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

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REPORTS

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

U.S. TREASURY DEPARTMENT OFFICE OF PUBLIC AFFAIRS

EMBARGOED UNTIL 9 a.m. (EST), March 17, 2008
CONTACT Brookly McLaughlin, (202) 622-2920

TREASURY INTERNATIONAL CAPITAL DATA FOR JANUARY

Treasury International Capital (TIC) data for January 2008 are released today and posted on the U.S. Treasury web site (www.treas.gov/tic). The next release, which will report on data for February, is scheduled for April 15, 2008.

Net foreign purchases of long-term securities were $62.0 billion.

- Net foreign purchases of long-term U.S. securities were $81.2 billion. Of this, net purchases by foreign official institutions were $53.4 billion, and net purchases by private foreign investors were $27.8 billion.

- U.S. residents purchased a net $19.2 billion of long-term foreign securities.

Net foreign acquisition of long-term securities, taking into account adjustments, is estimated to have been $47.2 billion.

Foreign holdings of dollar-denominated short-term U.S. securities, including Treasury bills, and other custody liabilities increased $73.8 billion. Foreign holdings of Treasury bills increased $11.6 billion.

Banks' own net dollar-denominated liabilities to foreign residents decreased $83.6 billion.

Monthly net TIC flows were positive $37.4 billion. Of this, net foreign private flows were negative $38.2 billion, and net foreign official flows were positive $75.5 billion.

TIC Monthly Reports on Cross-Border Financial Flows

(Billions of dollars, not seasonally adjusted)

		2006	2007	12 Months Through Jan-07	12 Months Through Jan-08	Oct-07	Nov-07	Dec-07	Jan-08
	Foreigners' Acquisitions of Long-term Securities								
1	Gross Purchases of Domestic U.S. Securities	21077.1	29689.0	21324.6	30989.8	2671.9	2890.2	2312.8	3134.4
2	Gross Sales of Domestic U.S. Securities	19933.9	28683.2	20143.4	30027.2	2553.8	2819.9	2243.7	3053.2
3	**Domestic Securities Purchased, net** (line 1 less line 2) /1	**1143.2**	**1005.8**	**1181.2**	**962.7**	**118.0**	**70.3**	**69.1**	**81.2**
4	**Private, net /2**	**946.6**	**818.1**	**991.3**	**733.6**	**96.2**	**58.5**	**33.3**	**27.8**
5	Treasury Bonds & Notes, net	125.9	198.1	151.6	178.5	45.9	23.2	-9.5	1.5
6	Gov't Agency Bonds, net	193.8	107.0	194.8	105.8	4.8	20.6	-7.4	20.0
7	Corporate Bonds, net	482.2	332.6	501.6	288.3	15.6	10.5	29.3	2.9
8	Equities, net	144.6	180.4	143.3	161.0	29.9	4.3	21.0	3.5
9	**Official, net /3**	**196.6**	**187.7**	**189.9**	**229.1**	**21.8**	**11.8**	**35.8**	**53.4**
10	Treasury Bonds & Notes, net	69.6	3.0	58.4	44.0	4.0	0.4	11.0	36.1
11	Gov't Agency Bonds, net	92.6	119.1	98.8	103.4	10.0	6.0	4.1	-0.6
12	Corporate Bonds, net	28.6	50.6	28.5	52.2	7.4	4.9	8.2	3.9
13	Equities, net	5.8	15.1	4.3	29.6	0.4	0.5	12.5	13.9
14	Gross Purchases of Foreign Securities from U.S. Residents	5515.9	8177.0	5664.2	8398.8	809.4	728.9	598.6	770.6
15	Gross Sales of Foreign Securities to U.S. Residents	5766.8	8400.5	5912.7	8628.5	813.4	708.3	611.2	789.8
16	**Foreign Securities Purchased, net** (line 14 less line 15) /4	**-250.9**	**-223.5**	**-248.5**	**-229.7**	**-4.1**	**20.6**	**-12.6**	**-19.2**
17	Foreign Bonds Purchased, net	-144.5	-128.6	-141.0	-144.6	-9.1	11.0	-13.1	-16.5
18	Foreign Equities Purchased, net	-106.5	-94.9	-107.5	-85.1	5.0	9.6	0.5	-2.7
19	**Net Long-Term Securities Transactions** (line 3 plus line 16):	**892.3**	**782.3**	**932.7**	**733.0**	**114.0**	**90.9**	**56.5**	**62.0**
20	**Other Acquisitions of Long-term Securities, net /5**	**-169.9**	**-188.9**	**-171.2**	**-186.9**	**-15.1**	**-13.6**	**-11.3**	**-14.8**
21	**Net Foreign Acquisition of Long-Term Securities** (lines 19 and 20):	**722.4**	**593.4**	**761.5**	**546.0**	**98.9**	**77.3**	**45.2**	**47.2**
22	**Increase in Foreign Holdings of Dollar-denominated Short-term U.S. Securities and Other Custody Liabilities: /6**	**146.2**	**215.5**	**149.2**	**271.4**	**30.3**	**37.2**	**33.3**	**73.8**
23	**U.S. Treasury Bills**	**-9.0**	**48.8**	**-17.2**	**58.9**	**9.0**	**15.6**	**15.1**	**11.6**
24	Private, net	16.1	29.3	11.3	35.3	6.7	10.8	4.0	2.9
25	Official, net	-25.0	19.5	-28.5	23.6	2.3	4.8	11.1	8.6
26	**Other Negotiable Instruments and Selected Other Liabilities: /7**	**155.1**	**166.7**	**166.4**	**212.5**	**21.3**	**21.5**	**18.2**	**62.3**
27	Private, net	174.9	90.6	183.2	126.3	1.3	4.3	17.1	56.0
28	Official, net	-19.8	76.1	-16.8	86.2	20.0	17.3	1.0	6.3
29	**Change in Banks' Own Net Dollar-Denominated Liabilities**	**198.0**	**-106.3**	**15.7**	**-169.6**	**-26.5**	**20.9**	**-5.8**	**-83.6**
30	**Monthly Net TIC Flows** (lines 21,22,29) /8	**1066.5**	**702.6**	**926.4**	**647.9**	**102.6**	**135.4**	**72.7**	**37.4**
	of which								
31	Private, net	926.2	404.6	773.3	299.0	60.5	90.4	21.0	-38.2
32	Official, net	140.3	298.0	153.1	348.9	42.2	45.0	51.7	75.5

/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.

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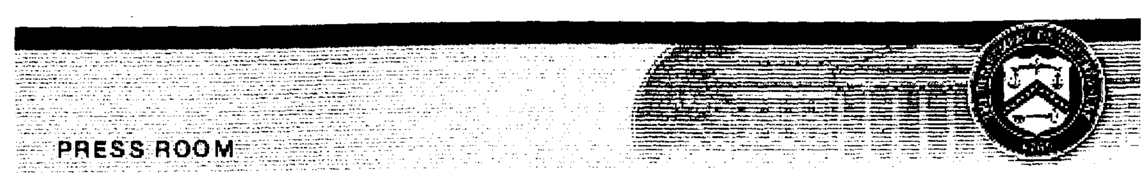


March 16, 2008
HP-876

Statement by Treasury Secretary Paulson

Treasury Secretary Henry M. Paulson, Jr. released the following statement today:

"Last Friday, I said that market participants are addressing challenges and I am pleased with recent developments. I appreciate the additional actions taken this evening by the Federal Reserve to enhance the stability, liquidity and orderliness of our markets."

-30-

March 17, 2008
2008-3-17-15-40-53-9474

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 $75,366 million as of the end of that week, compared to $74,266 million as of the end of the prior week.

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

	March 14, 2008		
A. Official reserve assets (in US millions unless otherwise specified)	Euro	Yen	Total
(1) Foreign currency reserves (in convertible foreign currencies)			75,366
(a) Securities	15,622	12,800	28,422
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	15,444	6,274	21,718
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	4,347		
(3) SDRs	9,838		
(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	

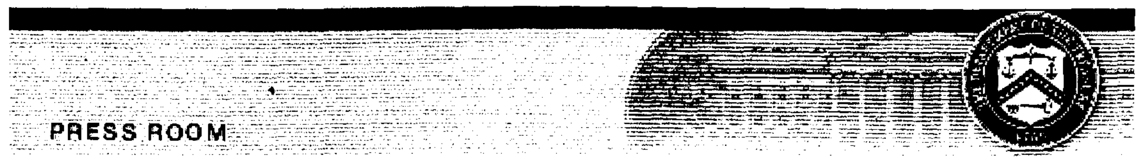
(d) securities lent and on repo	
--lent or repoed and included in Section I	
--lent or repoed but not included in Section I	
--borrowed or acquired and included in Section I	
--borrowed or acquired but not included in Section I	
(e) financial derivative assets (net, marked to market)	
--forwards	
--futures	
--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)	75,366
--currencies in SDR basket	75,366
--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.



March 19, 2008
HP-877

Paulson Statement on GSE, OFHEO Agreement to Inject Liquidity into Mortgage Markets

Washington – Secretary Henry M. Paulson, Jr. released the following statement today regarding the agreement among the Office of Federal Housing Enterprise Oversight, Fannie Mae and Freddie Mac to provide additional support to the U.S. mortgage market.

"Fannie Mae and Freddie Mac are significant participants in the mortgage market and I am encouraged that today's announcement will make more financing available in this area. Additional capital will enable the companies to help more homeowners and will strengthen the underlying fundamentals of the mortgage market.

"Today's announcement also reaffirms the commitment of all parties to work toward comprehensive GSE reform legislation as soon as possible. I look forward to working with Director Lockhart, Congress and the GSEs on this important legislation."

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PRESS ROOM

March 14, 2008
HP-878

Remarks by Treasury Deputy Assistant Secretary Mark Sobel at the Symposium of the Bretton Woods Committee on China

Washington, DC--At the outset, I wish to thank Bill Frenzel and the Bretton Woods Committee for affording me this opportunity to speak on a range of issues pertaining to Chinese currency developments.

Engagement with China

When one visits Beijing or Shanghai, one immediately feels the energy and vibrancy of a dynamic country and fast-growing economy. Indeed, China's growth in recent decades is an extraordinary success story that has sustained a particularly blistering pace of global growth this decade. But China's growing weight and presence on the global scene inevitably leaves an ever-noticeable footprint that is a source of admiration and angst.

As Secretary Paulson has often stated, ensuring a productive U.S.-China relationship is essential for managing the challenges of the 21st Century and that requires continuous high-level engagement. To this end, President Bush and Chinese President Hu created the Strategic Economic Dialogue, led by Secretary Paulson on the U.S. side, which brings a diversity of Cabinet-level officials in both China and the United States together.

Our economic discussions with China in the SED focus on a broad range of issues, including the need for China to rebalance its economy away from exports and investment by boosting domestic demand-led growth and reducing national saving; promoting financial sector reform; and achieving monetary policy autonomy, including through RMB appreciation and greater currency flexibility.

Let there be no doubt, important progress is being made. While it is sometimes hard to discern the progress amid the daily focus on China and its ups and downs, rapid change is a constant. The risk, though, to China is still that the pace of reform is too gradual.

- Chinese saving consumes over half of national income. This is the structural basis for China's large current account surpluses. Part of this can be explained by the dismantling of the social safety net once provided by China's large state-owned enterprises -- the so-called "iron rice bowl" – putting a heavy burden on households to save for basic needs such as health care, retirement, and education. China has begun to take some early but important steps towards addressing the problem, including through the introduction of universal free education through high school, upping the share of a patient's health spending covered by the state, and expanding the coverage of China's minimum income guarantee program. Enterprise saving is also high. Here, China announced a policy at the end of last year requiring state-owned enterprises to pay a portion of their profits as dividends back to the government. Much more work is needed -- but these are important steps forward.
- On the financial sector front, change is afoot. Major banks are making progress in reducing non-performing loans (NPLs) and improving risk management practices. This process has been aided by recapitalizations, foreign firms taking strategic stakes, and IPOs which have led to improved transparency and accounting standards. Efforts to develop the corporate bond market and consumer finance are picking up. Make no mistake, there is still a long road ahead, especially in offering consumers meaningful products and returns and in building a vibrant capital market which can provide a viable alternative to firms and individuals from bank dominated

finance. And absolutely critical, China can and should do far more to open its entire financial system to much greater foreign participation.

Perhaps the most nettlesome aspect of our rebalancing discussions lies in the realm of monetary policy, including the exchange rate regime. Simply put, a more autonomous and effective monetary policy -- which fundamentally requires RMB appreciation and much greater currency flexibility -- is in China's own self-interest. It is needed to better control domestic liquidity and inflation, dampen swings in the investment cycle, improve the health of the financial sector, and ultimately reduce prospects for boom-bust cycles. I think this central point is increasingly recognized by China's leadership.

In contrast, heavy foreign exchange market intervention by China to manage the currency has led to excess reserve accumulation and rapid increases in domestic liquidity, which is not easily sterilized. This is part of the story behind the recent sharp increases in Chinese consumer prices. China's current exchange rate policy heightens the risk of asset bubbles, renewed build-up in NPLs, and further banking sector stress. This policy also perpetuates a model of growth that depends heavily on exports and industrial investment rather than domestic household consumption. As Treasury stated in its last semi-annual Foreign Exchange Report, the substantial undervaluation of the RMB poses risks for the Chinese economy. As I have said before, Chinese currency adjustment is a matter of international responsibility, with significant implications for the smooth functioning of the international monetary and trading systems, of which China is increasingly a part.

Here too, progress is being made. Cumulative RMB appreciation since July 2005, including the RMB's revaluation at the time, totals 16-3/4%. This appreciation has accelerated markedly in the last months. For example, in the last 90 days, the RMB has appreciated at an annualized rate of nearly 17%. China's foreign exchange market is also developing – in recent years, RMB fluctuations have been greater, foreign currency hedging instruments are emerging, and the market is deepening.

That said, the RMB's trade-weighted appreciation has been much less. The RMB has actually depreciated against the euro. The RMB's adjustment is far from complete. While the recent accelerated pace of appreciation is welcome, it should continue.

While RMB appreciation may to some extent reduce the U.S. bilateral trade deficit with China, the U.S. and Chinese global trade imbalances are rooted in the structure of our economies, and in imbalances in our relative levels of saving and investment. That is why we need to continue engaging through the SED across the broad swath of policies.

Currency Legislation?

While we share the frustrations of many with the pace of reform in China, we believe that continued intensive bilateral and multilateral engagement is the best means of making meaningful progress in building a productive U.S.-Chinese relationship for the 21st Century. We do not believe that currency legislation would strengthen the hand of the United States in achieving the goal, which the Administration and Congress share, of faster Chinese economic reform.

Indeed, we believe legislation would be counterproductive and could lead to unintended adverse consequences.

Multilateral Engagement

Bilateral engagement is an essential element of U.S. financial diplomacy, and Secretary Paulson and other Treasury officials have pursued the need for RMB appreciation and greater currency flexibility relentlessly with the Chinese, both privately and publicly. But experience also teaches us that China can respond defensively to bilateral pressure and is often more open to multilateral engagement.

While the recent stepped-up pace of Chinese currency appreciation importantly reflects a Chinese response to rising inflation and the large current account surplus,

we are working on the multilateral front to accelerate the reform of China's currency practices. We are making progress and this work has had an impact.

- The G-7 has joined the United States, sharpening its message on Chinese currency practices. At its recent Tokyo meeting, the G-7 stated: "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 encourage accelerated appreciation of its effective exchange rate." This statement reflects the strong consensus in the G-7 on the need for greater appreciation and flexibility of the RMB.
- The United States has also worked hard to strengthen the IMF's focus on currency surveillance. In mid-2007, the IMF modernized its 30-year old operational rules for conducting this duty. The new decision sent a strong and welcome message that the IMF is to put firm exchange rate surveillance back at the core of its duties. Since then, the IMF has started sharpening its work on exchange rate analytics. But this is clearly a work in progress. As Under Secretary McCormick recently said: "The IMF must now step fully through the door it has opened and make exchange rate issues the priority they deserve to be."

More generally, I believe that the discussions held with many Chinese leaders over recent years on currency issues have been instrumental in persuading them and creating a growing consensus on the merits of currency appreciation, moving to greater currency flexibility and building the deeper financial markets needed to support a more autonomous monetary policy regime.

Legislative action aimed at China, in contrast, runs the risk that the results of our engagement, even if less than we desire, will be weakened and that China will retrench from engagement.

U.S. Economic Interests

The United States is increasingly a part of a global economy, in which technology and globalization are potent drivers of change. These forces have undoubtedly led to difficult adjustments for some American workers and we have enormous and deep sympathy for those facing these pressures. China must play by the rules of the game. Still, while China may be the poster child for globalization, neither RMB appreciation nor currency legislation will remove these underlying potent forces.

In recent years, export growth has been an important factor underlying U.S. economic growth. Indeed, growth in many emerging markets, including China, shows continued resilience, helping to support increased U.S. exports. China is our most rapidly growing export market, taking over $65 billion in U.S. exports last year, creating high-paying jobs for many Americans.

The adoption of currency legislation that might be perceived abroad as unilateralist and directed at China could pose significant further risks to and have profoundly adverse consequences for the U.S. economy, including increased costs for U.S. consumers. Unilateral action would likely undermine confidence in the openness of our capital markets, diminish capital inflow into the United States, and further upset financial markets, potentially putting upward pressure on interest rates and prices. Nothing could be more unwelcome at any time, but especially right now given U.S. and global financial market turmoil.

Further, we must recognize the precedent we might create and the possibility for foreign retaliation, if we adopt such legislation. Others might seize on a U.S. precedent to adopt unilateral measures against other countries, including the United States. If that were to occur, what might then happen to U.S. exports of aircraft, agricultural products, machinery and high-tech exports, and the jobs supported by these exports? This too would have severe adverse results for the smooth functioning of the international monetary system.

Currency Misalignment and the WTO

Many legislative proposals involve determinations as to the extent of "misalignment" of a currency as a basis for remedial measures, including through the WTO.

In assessing currency "misalignment", economists use models to calculate real "equilibrium exchange rates" and then the degree of under- or over-valuation as deviations from these real equilibrium exchange rates.

It is important to recognize that models make various assumptions. What is a "normal" payments position for a country? What price index should be used to deflate nominal prices? How should an effective exchange rate index be constructed? Depending on the answers to these and many more questions, one can get varying answers.

Equilibrium exchange rate analysis will not yield precise results. But it is still a worthwhile undertaking. Especially if many multilateral exchange rate models point in a similar direction and suggest a broadly comparable range of deviation, that is very valuable and useful information. Further, such results, when complemented by other analysis, can allow one to render more definitive judgments. For example, buttressing such analytic work with a review of current account positions, reserve accumulation, movement in exchange rates, and dependence on external demand, can create a basis for more consistent judgments. In the final analysis, there is an element of judgment inherent in rendering assessments of currency valuations, but that does not mean that one can shirk the responsibility of having a view.

On matters regarding the WTO, Treasury defers to USTR. We are advised, though, that using currency calculations, which admittedly lack precision and reliability, to determine trade remedies could raise serious concerns with respect to U.S. compliance with WTO obligations.

Conclusion

Let me conclude by commending Congressman Levin and others for consistently raising the issue of China's currency practices. It is a critical and completely legitimate public policy issue and it is one that should be – and is – high on radar screens. The United States is fully engaged with China through the Strategic Economic Dialogue across a broad front of issues. This engagement is yielding material results. Robust bilateral and multilateral engagement with China is the best path forward for the United States.

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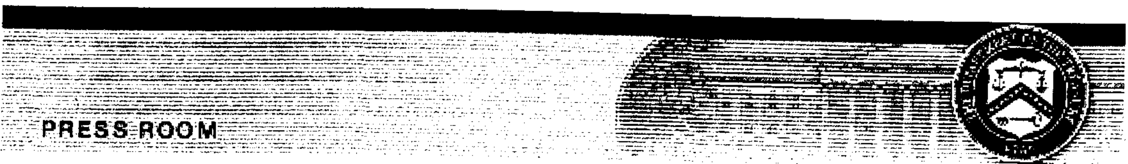

March 19, 2008
HP-879

Assistant Secretary Anthony W. Ryan
Remarks Before the Exchequer Club in Washington

Washington – Good afternoon. Thank you for inviting me to join you here today. The Exchequer Club has a rich history of fostering thoughtful discussion on key issues affecting our economy. The path to this podium is well worn by a long list of distinguished public servants whom you have invited to share their thoughts, and I am honored to be included among such an impressive list.

Our economy is the largest and most diverse in the world; but it is not immune to challenges. The difficulties in the housing market are the biggest threat to our economy, and the Treasury is focused on addressing this issue by enhancing efforts to help homeowners and by offering long term recommendations to get at the cause of these troubles.

We are working with HOPE NOW, a coalition of non-profit counselors, servicers, lenders and investors, so that we can help more homeowners, more quickly. Their progress reports show that modifications are rising, and those kinds of fast results are the direction we are taking at Treasury.

We've heard of proposals that would create new bureaucracies and will take years to implement. We've also seen proposals that will cause mortgages to be more expensive for borrowers in the future- not just those who are stressed today. But these types of proposals will do more harm than good. We need our colleagues in Congress to pass reform of the Federal Housing Administration and the Government Sponsored Enterprises.

In the long term, we are looking to get at the root causes of this stress by strengthening market discipline and oversight in the mortgage securitization process and by improving the future state of our capital markets.

Orderly financial markets are critical to the health of our economy – businesses rely on access to credit in order to invest and create jobs, and families draw on credit markets to finance their homes and borrow for education.

As financial industry professionals and policy leaders, you know first hand the benefits of dynamic economic growth, and thus have a vested interest in capital markets that enhance investor confidence and market liquidity - - both of which have been significantly challenged in recent months.

The health of our capital markets reflects the collective efforts of both the public and private sectors. To reap the benefits, both sectors must share responsibility. I have confidence in the resilience of our markets and that collectively, we will work through this period of stress, and make our markets even stronger.

At the U.S. Treasury Department, we are vigilant in monitoring the global capital markets, and the current period has provided us many issues to evaluate and address. These issues range from financial market preparedness, private pools of capital, market infrastructure, challenges in the housing sector, and the resulting implications for the capital markets.

Effective and efficient capital markets rely on private-sector representatives to play a complementary role. Investors and commercial institutions have influenced, and must continue to influence, market and business practices in a constructive manner.

As we continue to work through the current turmoil, we must also identify and address the weaknesses that caused, facilitated, and exacerbated the challenges in our capital markets. In doing so, we will collectively strengthen market discipline, mitigate systemic risk, restore investor confidence, and facilitate stable economic growth.

Background

After years of benign financial conditions around the globe, many providers of capital became complacent about risk. It manifested itself in many ways, including a significant loosening of credit standards and investors reaching ever further for yield.

For several months, we have witnessed our financial markets go through cycles where there have been real strains followed by periods of improvement. A great deal of de-leveraging is occurring, which has created liquidity challenges, thereby compromising our credit markets' ability to facilitate economic activities.

It took a long time to build up the excesses, but we are working through the consequences. Market participants are adjusting, disclosures are being made, capital is being raised, and assets are being re-priced.

Finding examples of sectors, structures, or institutions that have experienced stress has been fairly easy. But as I tell my children: 10 points for identifying the problem --that's the simple part; 90 points for finding the best solution.

In this case, it's 10 points for identifying the conditions that enabled the market turmoil to start, and more importantly, spread. There's 90 points for coming up with thoughtful recommendations, and extra credit for deft implementation.

Developing and implementing recommendations must happen thoughtfully as policy makers and market participants must seek to avoid exacerbating current strains.

Given the diversity of our capital markets and the breadth of global participants, we must begin with the recognition that no panacea exists to prevent the excesses of the past from re-occurring.

Innovation / Securitization

Successful capital markets continually innovate, and one of the greatest examples of financial innovation is the securitization of credit. Some have argued that securitization is the problem. It's not that simple. The ability to securitize credit has expanded the availability of credit for consumers, homeowners, and businesses – both large and small. Securitization has stimulated competition, reduced the cost of capital, and created more choice and flexibility for borrowers.

Prudent policy responses require an examination not just of overall processes such as securitization, but a rigorous review of the underlying weaknesses. Working closely with our colleagues comprising the President's Working Group on Financial Markets (PWG), that is exactly what we have done. Last week, Secretary Paulson, in his capacity as Chairman of the PWG, released a policy paper that diagnosed the underlying weaknesses contributing to the turmoil in our capital markets and specific recommendations to address them.

When implemented, these recommendations will change behavior and strengthen our markets through greater risk awareness, enhanced risk management, strong capital positions, prudent regulatory policies, and greater transparency.

Root Causes

This afternoon, I will briefly address the triggering events, but I will focus my remarks on three of the underlying weaknesses that enabled the market turmoil to spread.

The turmoil was triggered by an unexpected and alarming rate of mortgage

delinquencies by loans originated from late 2004 through 2006. It is easy to identify the weakness that enabled the turmoil to start - a breakdown in underwriting standards for mortgage origination, particularly for sub-prime mortgages.

To address this weakness, the PWG recommended strengthening government oversight of all entities that originate mortgages, the implementation of strong nationwide licensing and enforcement standards for mortgage brokers, and a stronger set of national rules for consumer protection and disclosure.

Challenges, however, were not limited to sub-prime mortgages. Financial market innovation, interrelated markets, and broadening investment horizons – both from a geographic and asset class perspective – linked the challenges across capital structures and the globe. Every user or provider of capital has been impacted – either directly or indirectly.

Other underlying weaknesses enabled the market turmoil to spread, and the PWG has put forth specific recommendations to address each one, all of which call upon market participants and regulators to make changes. Let me highlight three areas where we need to see existing practices strengthened: credit ratings, disclosure, and risk management.

Credit Rating Agencies and Ratings Practices

Credit rating agencies have been long-standing and important participants in the financial markets, but their practices, particularly surrounding structured credit products, warrant attention. That being said, the need for change regarding ratings practices is not constrained to just the credit rating agencies. The weaknesses of the rating agencies were compounded by investors over-relying on the rating agencies' assessments and by the practices of other market participants, including originators and securitizers.

The PWG put forth a series of recommendations regarding ratings practices that focused on improving the quality and integrity of underlying data and models, independence of the ratings process, and participant awareness of the purpose, risk, and limits in utilizing ratings.

To start, rating assessments are dependent on the quality and integrity of the underlying data received from both the originator of credit and the packager of securitized products. As a result, the PWG has called for rating agencies to disclose what qualitative reviews they perform on originators and for rating agencies to require securitizers to represent the level and scope of due diligence performed on the underlying assets.

Second, given the role they play, the rating agencies must have and enforce policies and procedures that disclose and manage conflicts of interest.

There also exists the need for rating agencies to produce rating products that provide the information investors need to make better informed decisions about risk. The use of the same rating categories for both structured products and corporate bonds facilitated investors' complacency. Investors acted as if they did not appreciate that risk characteristics differed. They most certainly do differ, and we need to see a clearer distinction made by the rating agencies, investors, and regulators. One way of doing so could be a separate nomenclature, an identifying suffix, or other information that highlights the unique risk characteristics of structured credit products.

The PWG will facilitate the formation of a private-sector committee comprised of investors, issuers, and rating agencies to develop additional recommendations that issuers, rating agencies, and policymakers could implement to ensure the integrity and transparency of ratings, and to foster appropriate use of ratings in risk assessment.

We must also reduce investors' reliance on ratings. Investors also have a responsibility to conduct independent analysis and must not rely solely on ratings.

Additionally, regulators must avoid creating an over-reliance on ratings through

regulations and supervisory rules. At a minimum, regulators should systematically distinguish between ratings of structured credit products and ratings of corporate bonds in regulatory and supervisory policies, including regulatory capital requirements that reference ratings. We need to see these recommendations implemented, which will result in stronger rating processes and practices.

Disclosure

Markets also are challenged by the complexity and opacity of many securitized products. Additional and clearer disclosure can enhance transparency, but disclosure for the sake of disclosure is insufficient. The PWG has called for additional disclosure by originators, underwriters, and credit rating agencies so that investors have information available to better assess risk.

Part of good risk management is having good information. Let me share some specific recommendations the PWG made with respect to disclosure.

Securitizers need to enhance disclosure regarding the originators of assets, including, for example, assessing the originator's experience, quality of management, underwriting standards, process by which loans are sourced, and track record of providing accurate and robust information on originated assets. They should also publicly disclose whether they engage in ratings shopping, and if they do, disclose the reason for not publishing preliminary ratings.

The PWG also called on financial institutions to make more detailed and comprehensive disclosures of off-balance sheet commitments, including commitments to support ABCP conduits and other off-balance sheet vehicles.

To facilitate better disclosure, the PWG will ask a private-sector committee made up of investors, rating agencies, and issuers to develop best practices regarding disclosure.

Disclosure is only useful if it is understandable and acted upon. We must remember that most of the buyers of these complex securities were professional, institutional investors. Given the characteristics of many of the structures and securities, investors must seek to excel in risk analysis and risk management as much as return management.

Investors must obtain from issuers of securitized credits better information about the risk characteristics of such credits, including the information about the underlying asset pools, on both an initial and ongoing basis. Investing without having the knowledge, expertise, systems, or personnel to assess risk, or not receiving the information needed to overcome opacity, is a surefire way to lose a lot of money. That's a game for speculators, not prudent investors.

Financial Institutions / Risk Management

One of the most important implications of the capital market turmoil has been the balance-sheet pressure felt by our financial institutions. Bank capital has been squeezed by losses associated with the value of securities they held; by balance sheets swollen with credit products they were unable to sell; and by commitments to provide liquidity and financing.

These developments can lead to a reduction in the supply of capital that financial institutions provide to borrowers. Still, we are fortunate that financial institutions came into this episode with healthy capital ratios and that many have raised additional capital in recent weeks. We encourage them to continue doing so where appropriate.

Much of this comes back to risk management. Again, identifying the root cause is the easier part. We had regulatory policies, including capital requirements that failed to mitigate certain risk management weaknesses. Here, market participants and regulators at all levels need to be part of the solution. We need to see global financial institutions promptly identify and address any weaknesses in risk management practices that the current turmoil has revealed.

U.S. banking regulators and the SEC are developing common guidance to address risk management weaknesses, including improving stress testing, the governance of the risk management and control framework, and internal risk reporting and measurement.

We need to see improved risk management practices by investors, issuers, rating agencies, and regulators alike. Risk management is everyone's business.

Conclusion

We will continually assess conditions and monitor how practices are changing. We may put forward additional recommendations as events unfold and new insights are gained.

Looking ahead, we expect practices to be different. Financial products will be less complex and more transparent, and the mechanisms for dealing with complexity will improve. This will include better credit rating practices, improved capital cushions, better liquidity management, and enhanced disclosure and due diligence.

The recently released PWG policy recommendations represent our latest efforts, and we remain engaged on other issues as well. In the weeks ahead, we will be releasing a financial regulatory blueprint, and we anticipate that the private-sector committees that the PWG established last September to develop best practices for investors and hedge fund managers will publish their guidelines for public comment. Collectively, these efforts will serve to enhance market efficiency and investor protection, and help mitigate systemic risk.

At the U.S. Treasury Department, we are addressing both the current and strategic challenges, and doing all we can to ensure high quality, competitive, and orderly capital markets. We encourage the private sector to do the same. Thank you.

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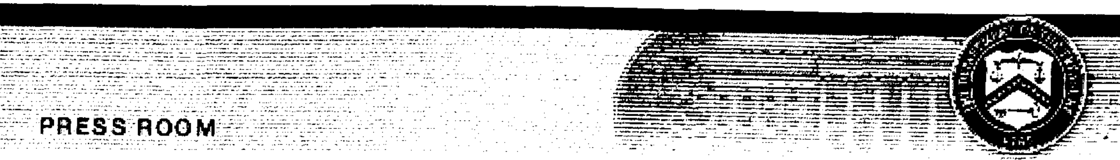


March 20, 2008
HP-880

Secretary Paulson to Meet with Abu Dhabi and Singapore Officials on Sovereign Wealth Funds

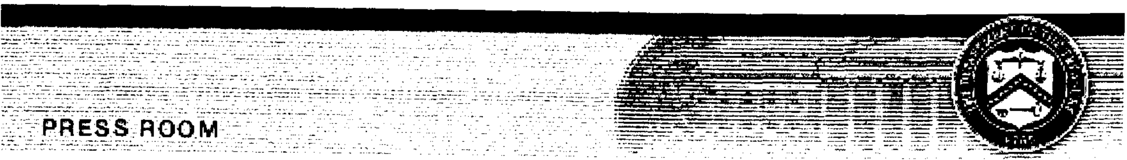
Treasury Secretary Henry M. Paulson, Jr. and Deputy Secretary Robert M. Kimmitt will welcome officials from the governments of Abu Dhabi and Singapore today to the Treasury Department for a meeting to discuss issues surrounding sovereign wealth funds, recipient country inward investment regimes, and efforts to develop best practices. Joining Paulson will be Government of Abu Dhabi Executive Council Member Hamad Al Hurr Al Suwaidi, ADIA Executive Director Hareb Masood Al-Darmaki, Singapore Finance Minister Tharman Shanmugaratnam, and GIC Deputy Chairman Tony Tan.

A photo op will take place at the conclusion of the meeting, at approximately 3:45 p.m. Contact Eileen Gilligan for more information at 202-622-1374 or Eileen.Gilligan@do.treas.gov.

Following the meeting, Assistant Secretary for International Affairs Clay Lowery will hold a pen and pad briefing.

Who
Treasury Assistant Secretary for International Affairs Clay Lowery
What
Pen-and-pad briefing on sovereign wealth fund meeting
When
Thursday, March 20, 4:15 p.m. EDT
Where
Treasury Media Room, 4121

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. No cameras will be permitted into the briefing.



March 20, 2008
hp-881

Treasury Reaches Agreement on Principles for Sovereign Wealth Fund Investment with Singapore and Abu Dhabi

Washington, DC--Officials from the U.S. Treasury, the governments of Singapore and Abu Dhabi, and sovereign wealth funds ADIA and GIC met today in Washington, DC to discuss issues surrounding sovereign wealth funds, recipient country inward investment regimes, and efforts to develop best practices. Joining Treasury Secretary Henry M. Paulson, Jr. and Deputy Secretary Robert M. Kimmitt were Government of Abu Dhabi Executive Council Member Hamad Al Hurr Al Suwaidi, ADIA Executive Director Hareb Masood Al-Darmaki, Singapore Finance Minister Tharman Shanmugaratnam and GIC Deputy Chairman Tony Tan.

"We had a good discussion today on the issues surrounding sovereign wealth funds. Singapore and UAE have long-established, well-respected funds and are showing real leadership by joining with us today. The U.S. welcomes sovereign wealth fund investment and looks forward to continuing to work with these two countries and others to support the initiatives underway at the IMF and OECD to develop best practices for sovereign wealth funds and recipient countries," said Paulson. "The principles we agreed to here today will further those efforts."

Following today's meeting the three nations released the following joint statement and accompanying policy principles:

Sovereign wealth funds (SWFs) represent government-owned investment vehicles, funded by foreign exchange assets and commodity export receipts, etc., which invest internationally for financial objectives such as stabilization and intergenerational savings.

The United States, Abu Dhabi, and Singapore, being a group of nations with SWFs and a country receiving investments from SWFs, have a common interest in an open and stable international financial system. We support the processes underway in the International Monetary Fund (IMF) and the Organization for Economic Cooperation and Development (OECD) to develop voluntary best practices for SWFs and inward investment regimes for government-controlled investment in recipient countries, respectively. International agreement on a set of voluntary best practices will create a strong incentive among SWFs and investment-recipient countries to hold themselves to high standards. We hope that the IMF and OECD's work can build upon these basic principles:

Policy Principles for Sovereign Wealth Funds (SWFs)

1. SWF investment decisions should be based solely on commercial grounds, rather than to advance, directly or indirectly, the geopolitical goals of the controlling government. SWFs should make this statement formally as part of their basic investment management policies.

2. Greater information disclosure by SWFs, in areas such as purpose, investment objectives, institutional arrangements, and financial information – particularly asset allocation, benchmarks, and rates of return over appropriate historical periods – can help reduce uncertainty in financial markets and build trust in recipient countries.

3. SWFs should have in place strong governance structures, internal controls, and operational and risk management systems.

4. SWFs and the private sector should compete fairly.

5. SWFs should respect host-country rules by complying with all applicable

regulatory and disclosure requirements of the countries in which they invest.

Policy Principles for Countries Receiving SWF Investment

1. Countries receiving SWF investment should not erect protectionist barriers to portfolio or foreign direct investment.

2. Recipient countries should ensure predictable investment frameworks. Inward investment rules should be publicly available, clearly articulated, predictable, and supported by strong and consistent rule of law.

3. Recipient countries should not discriminate among investors. Inward investment policies should treat like-situated investors equally.

4. Recipient countries should respect investor decisions by being as unintrusive as possible, rather than seeking to direct SWF investment. Any restrictions imposed on investments for national security reasons should be proportional to genuine national security risks raised by the transaction.

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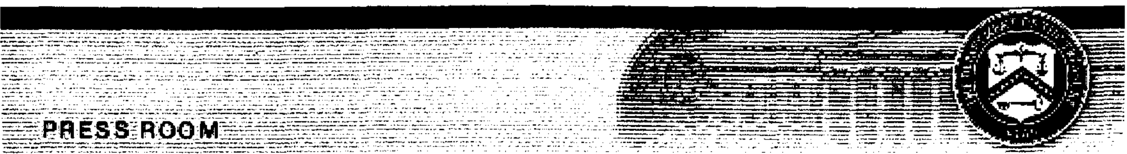


March 21, 2008
HP-882

Treasury Secretary Paulson to Host Press Briefing on the Social Security and Medicare Trustees Reports

Treasury Secretary and Managing Trustee Henry M. Paulson, Jr. will be joined by members of the Social Security and Medicare Boards of Trustees for a press briefing to discuss the release of the annual Trustees Reports on Tuesday.

Who
Secretary of Treasury and Managing Trustee Henry M. Paulson, Jr.
Secretary of Labor and Trustee Elaine L. Chao
Secretary of Health and Human Services and Trustee Michael Leavitt
Commissioner of Social Security and Trustee Michael J. Astrue

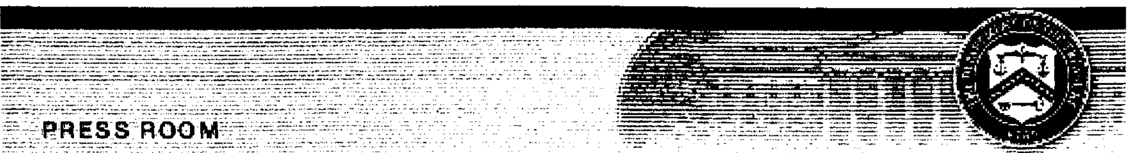
What
Press Conference to discuss Social Security and Medicare Trustees Reports

When
Tuesday, March 25, 2008, 2:00 p.m. EDT

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

Note
Copies of the Social Security and Medicare Trustees Reports will be available at the briefing. A pen and pad background briefing will follow the press conference at 2:30 p.m. in the same room.

Media without Treasury press credentials should submit full name, Social Security number, and date of birth to Frances Anderson at 202-622-2960 or Frances.Anderson@do.treas.gov.



March 21, 2008
HP-883

Treasury Broadens Savings Opportunities for More Investors
New $100 Minimums for Treasury Marketable Securities to Debut in April

Washington- The Treasury Department announced today that it would expand savings opportunities for investors. Beginning with the 13- and 26-week bill auctions of Monday, April 7, 2008, all Treasury marketable bills, notes, bonds and Treasury Inflation-Protected Securities (TIPS) will be available to the public in minimum and multiple amounts of $100. Marketable Treasury securities have been available in $1,000 minimums and multiples since August 1998.

"U.S. Treasury securities, the world's safest, most liquid investments, should be accessible to the broadest universe of investors- large and small. The new, lower minimum Treasury amount will put marketable securities within reach of more savers and investors in the United States and around the world," said Anthony Ryan, Assistant Secretary of the Treasury for Financial Markets. "In addition, being able to buy securities in $100 increments adds a new degree of flexibility for all market participants."

All Treasury bills, notes, bonds and TIPS may now be sold and transferred in multiples of $100. The new minimum and multiples will also apply to outstanding Treasury marketable securities effective April 7, 2008. Previously, the securities could only be transferred in increments of $1,000.

Treasury securities can be purchased non-competitively on original issue directly from the Treasury after opening either a TreasuryDirect account online at www.treasurydirect.gov or a Legacy Treasury Direct account. Securities can also be obtained on either a competitive or non-competitive basis through bond brokers and dealers. More information on how to purchase Treasury marketable securities can be found on www.treasurydirect.gov.

Additionally, the minimum and multiple par amount of Treasury securities that may be stripped in the Separate Trading of Registered Interest and Principal of Securities (STRIPS) program will be reduced to $100 beginning April 7, 2008.

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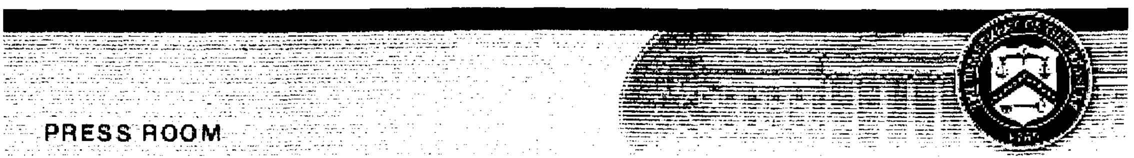

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March 21, 2008
HP-884

Report to Congress on Financial Implications of U.S. Participation in the International Monetary Fund

Q1 – Q4 FY2007

REPORTS

- (PDF) Report to Congress on Financial Implications of U.S. Participation in the International Monetary Fund

REPORT TO CONGRESS ON FINANCIAL IMPLICATIONS OF U.S. PARTICIPATION IN THE INTERNATIONAL MONETARY FUND

Q1 – Q4 FY2007

This report has been prepared in compliance with Section 504(b) of Appendix E, Title V of the Consolidated Appropriations Act for FY 2000. [1] The report focuses exclusively on the financial implications of U.S. participation in the International Monetary Fund (IMF) and does not attempt to quantify the broad and substantial economic benefits to the United States and the global economy resulting from U.S. participation in the IMF.

As required, the report provides financial information on the net interest income and valuation changes associated with U.S. participation in the IMF. The broader context for the financial implications of U.S. participation in the IMF and the methodology used in deriving these figures has been laid out in previous reports. The methodology is also summarized briefly in the footnotes attached to the tables. Reports under Section 504(b) are prepared quarterly and made available to the public on the Treasury website: http://www.treas.gov/press/reports.html.

This report provides quarterly data for the full fiscal year of 2007. It provides information on U.S. participation in the IMF's General Department as well as information related to U.S. holdings of Special Drawing Rights (SDRs) as part of its international reserves and the financial implications of U.S. participation in the SDR Department of the IMF.[2]

Data on the net interest income and valuation changes related to U.S. participation in the IMF's General Department during the first to fourth quarters of fiscal year 2007 are provided in Table 1. For comparison purposes, the previous three fiscal years of data are also provided.

Similarly, data for net interest income and valuation changes related to U.S. participation in the SDR Department of the IMF during the first to fourth quarters of fiscal year 2007 are provided in Table 2. For comparison purposes, previously-reported data for the last three fiscal years are also provided.

The table footnotes explain the columns shown and provide pertinent information and assumptions used in the calculations.

As shown in Table 1, for the first to fourth quarters of fiscal year 2007, the financial implications of U.S. participation in the General Department reflected a net interest income effect of $103

[1] Section 504(b) of Appendix E, Title V of the Consolidated Appropriations Act for FY 2000, Public Law 106-113, 113 Stat. 1501A-317, requires that the Secretary of the Treasury prepare and transmit to the appropriate committees of the Congress a quarterly report on United States participation in the International Monetary Fund (IMF), detailing the costs or benefits to the United States as well as valuation gains or losses on the United States' reserve position in the IMF.

[2] The SDR is an international reserve asset created by the IMF. The SDR is used as a unit of account by the IMF and other international organizations. Its value is determined as a weighted average of a basket of currencies -- the dollar, euro, pound sterling and yen. The SDR carries a market-based interest rate determined on the basis of a weighted average of interest rates on short-term instruments in the markets of the currencies included in the SDR valuation basket.

million. The valuation change in the U.S. Reserve Position for the first to fourth quarters of fiscal year 2007 was $259 million.[3]

As shown in Table 2, for the first to fourth quarters of fiscal year 2007, the net interest income effect of U.S. participation in the SDR Department was negative $14 million. The valuation change on U.S. SDR holdings for the first to fourth quarters of fiscal year 2007 was $81 million.[4]

Attachments

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[3] For an explanation of the methodology used in deriving these figures, see the section on "Calculating the Financial Implications of U.S. Participation in the General Department" in the report prepared for the fourth quarter of fiscal year 2000, submitted in December 2000 and available at http://www.treas.gov/press/releases/report3073.htm

[4] For an explanation of the methodology used in deriving these figures, see the section on "Calculating the Financial Implications of U.S. Participation in the SDR Department" in the report prepared for the fourth quarter of fiscal year 2000, submitted in December 2000 and available at http://www.treas.gov/press/releases/report3073.htm.

Table 1

Net Interest Income and Valuation Changes Related to U.S. Participation in the IMF

-- General Department --

U.S. Fiscal Year, Quarterly

(millions of U.S. Dollars)

	Transactions with the IMF			Interest Calculations				Valuation	Total
Fiscal Year Ended 9/30	Transactions under U.S. Quota (Letter of Credit &Transfers of Reserve Assets) Cumulative	U.S. Loans to IMF (Under SFF, GAB, NAB) Cumulative	Total U.S. Transactions with the IMF/1	Interest Expense Associated with Financing U.S. Transactions with the IMF	Remuneration Received by U.S. from IMF & Refund of Burden Sharing	Interest Received by U.S. from IMF under SFF, GAB, and NAB	Net Interest Income	Valuation Changes on U.S. Reserve Position	Total
			(Col 1+2)				(Col. 4+5+6)		(Col 7+8)
	Col. 1	Col. 2	Col. 3	Col. 4	Col.5	Col.6	Col. 7	Col. 8	Col. 9
2004									
Q1: Oct - Dec 03	-$16,702	$0	-$16,702	-$65	$78	$0	$13	$903	$916
Q2: Jan - Mar 04	-15,886	0	-15,886	-58	79	0	21	-78	-57
Q3: Apr -June 04	-14,530	0	-14,530	-60	69	0	9	-220	-211
Q4: July -Sept 04	-13,867	0	-13,867	-67	74	0	7	43	50
Total				**-$249**	**$300**	**$0**	**$50**	**$648**	**$698**
2005									
Q1: Oct - Dec 04	-$12,882	$0	-$12,882	-$73	$82	$0	$9	$1,026	$1,035
Q2: Jan - Mar 05	-9,119	0	-9,119	-$53	$88	$0	$35	-440	-405
Q3: Apr -June 05	-9,677	0	-9,677	-$59	$71	$0	$12	-565	-553
Q4: July -Sept 05	-7,772	0	-7,772	-$51	$75	$0	$24	-75	-51
Total				**-$237**	**$316**	**$0**	**$79**	**-$54**	**$25**
2006									
Q1: Oct - Dec 05	-2,660	0	-2,660	-$41	$69	$0	$29	-159	-130
Q2: Jan - Mar 06	-1,947	0	-1,947	-$18	$58	$0	$41	69	110
Q3: Apr -June 06	-2,296	0	-2,296	-$14	$40	$0	$26	179	205
Q4: July -Sept 06	-1,023	0	-1,023	-$12	$42	$0	$30	18	48
Total				**-$85**	**$210**	**$0**	**$125**	**$107**	**$232**
2007									
Q1: Oct - Dec 06	658	0	658	$0	$36	$0	$36	100	136
Q2: Jan - Mar 07	822	0	822	$0	$27	$0	$27	18	45
Q3: Apr -June 07	-548	0	-548	-$2	$23	$0	$21	21	42
Q4: July -Sept 07	1,395	0	1,395	-$2	$20	$0	$18	120	138
Total				**-$4**	**$107**	**$0**	**$103**	**$259**	**$362**

Note: Detail may not add to total due to rounding.

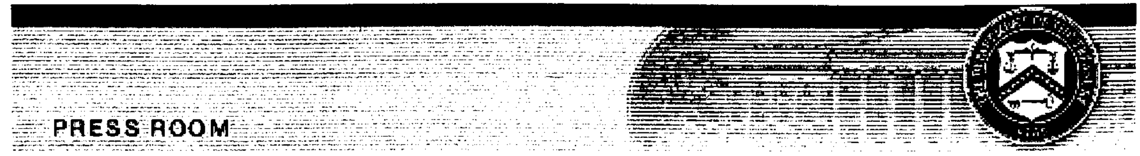
Table 2

Net Interest and Valuation Changes Related to U.S. Participation in the IMF

-- SDR Department --

U.S. Fiscal Year, Quarterly
(millions of U.S. Dollars)

	Net SDR Holdings			Interest Calculations			Valuation	Total
Fiscal Year Ended 9/30	Dollar Value of SDR Holdings	Dollar Value of Cumulative SDR Allocation	Net SDR Holdings	Interest Income on Net SDR Holdings	Interest Expense Associated with Financing Cumulative U.S. SDR Transactions	Net Interest Income	Valuation Changes	Total
			(Col. 1 - 2)			(Col. 4 + 5)		(Col. 6 + 7)
	Col. 1	Col. 2	Col. 3	Col. 4	Col. 5	Col. 6	Col. 7	Col. 8
2004								
Q1: Oct - Dec 03	$12,638	$7,281	$5,357	$20	-$17	$3	$199	$202
Q2: Jan - Mar 04	12,645	7,228	5,417	21	-17	5	-39	-34
Q3: Apr - June 04	12,659	7,184	5,475	21	-20	1	-33	-32
Q4: July - Sept 04	12,782	7,197	5,585	24	-25	-1	10	10
Total				**$87**	**-$79**	**$8**	**$137**	**$145**
2005								
Q1: Oct - Dec 04	$13,628	$7,609	$6,019	$29	-$34	-$5	$319	$315
Q2: Jan - Mar 05	11,565	7,402	4,162	33	-29	3	-163	-160
Q3: Apr - June 05	11,243	7,137	4,106	26	-32	-6	-149	-155
Q4: July - Sept 05	8,245	7,102	1,143	26	-10	16	-20	-4
Total				**$114**	**-$106**	**$8**	**-$14**	**-$5**
2006								
Q1: Oct - Dec 05	$8,210	$7,003	$1,207	$11	-$12	-$1	-$16	-$17
Q2: Jan - Mar 06	$8,344	$7,059	$1,284	$9	-$15	-$5	$10	$5
Q3: Apr - June 06	$8,618	$7,248	$1,369	$11	-$17	-$6	$34	$29
Q4: July - Sept 06	$8,655	$7,234	$1,421	$13	-$18	-$5	-$3	-$8
Total				**$44**	**-$62**	**-$17**	**$25**	**$8**
2007								
Q1: Oct - Dec 06	$8,870	$7,371	$1,499	$14	-$19	-$5	$27	$22
Q2: Jan - Mar 07	$8,948	$7,399	$1,548	$15	-$20	-$4	$6	$1
Q3: Apr - June 07	$9,018	$7,426	$1,592	$16	-$20	-$4	$6	$2
Q4: July - Sept 07	$9,301	$7,627	$1,674	$18	-$19	-$1	$43	$42
Total				**$63**	**-$77**	**-$14**	**$81**	**$68**



March 24, 2008
HP-885

Paulson Statement on Federal Housing Finance Board Action to Help Mortgage Market

Washington – Treasury Secretary Henry M. Paulson, Jr. made the following statement today regarding the Federal Housing Finance Board's decision to allow the Federal Home Loan Banks to bring temporary relief to the mortgage market.

"The targeted decision by the Federal Housing Finance Board to enable the Federal Home Loan Banks to assist temporarily in this period of stress, consistent with safe and sound operations, will bring more liquidity to the mortgage market."

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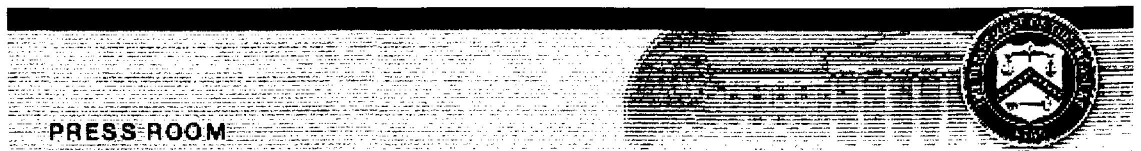

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March 25, 2008
hp-886

**Statement by Secretary Henry M. Paulson, Jr.
on the 2008 Social Security and Medicare Trust Fund Reports**

Washington--The Social Security and Medicare Boards of Trustees met this afternoon to complete their annual financial review of the programs and to transmit the Trustees Reports to Congress. I welcome my Cabinet colleagues.

For decades, Social Security and Medicare have provided vital support for millions of Americans. As the baby boom generation moves into retirement, these programs face progressively larger financial challenges. If we do not take action soon to reform Social Security and Medicare, the coming demographic bulge will jeopardize the ability of these programs to support people who depend on them. Without change, rising costs will drive government spending to unprecedented levels, consume nearly all projected federal revenues, and threaten America's future prosperity. Our Nation needs a bipartisan effort to strengthen both programs for future retirees.

This year's Social Security Report again demonstrates that the Social Security program is financially unsustainable and requires reform. In fewer than 10 years, cash flows are projected to turn negative--meaning that we will draw upon general revenues to support withdrawals from the Trust Funds in order to pay current benefits. The Trust Funds are projected to be exhausted in 2041, the same as projected in last year's Report. Reform is needed and time is of the essence. The longer we delay, the larger the required adjustments will be and the more heavily the burden of those adjustments will fall on future generations.

Social Security's unfunded obligation--the difference between the present values of Social Security inflows and outflows less the existing Trust Fund--equals $4.3 trillion over the next 75 years and $13.6 trillion on a permanent basis. To make the system whole on a permanent basis, the combined payroll tax rate would have to be raised immediately by 26 percent (from 12.4 percent to about 15.6 percent), or benefits reduced immediately by 20 percent.

This Report confirms the need for action; the sooner we take action to strengthen Social Security's financial footing, the less drastic the needed reforms will be, and the fairer reforms will be to future generations. President Bush has called for bipartisan solutions that generate a permanently sustainable Social Security system. The President has put forward a number of well-considered ideas. We now need serious and thoughtful engagement from all sides to make sure Social Security is strengthened and sustained for future generations.

The 2008 Medicare Trustees Report shows that the Medicare program poses a far greater financial challenge than Social Security. Medicare faces the same demographic trends as Social Security, and, in addition, the system must cope with expected large increases in health care costs. Medicare's annual costs were 3.2 percent of GDP in 2007, or nearly three-quarters of Social Security's, but are projected to surpass Social Security expenditures in 2028 and reach nearly 11 percent of GDP in 2082, compared to 5.8 percent for Social Security.

Cash flow for the Hospital Insurance (HI) Trust Fund is projected to be negative this year and for all subsequent years. The HI Trust Fund is projected to become insolvent in 2019, the same as projected in last year's Report.

The Supplementary Medical Insurance (SMI) Trust Fund, which includes Part B for outpatient services and the new Part D prescription drug benefit, is financed in large

part by general revenues as well as beneficiary premiums. SMI expenditures are projected to increase rapidly, resulting in growing pressures on future federal budgets and, in turn, the U.S. economy. General revenue financing for SMI is expected to increase from about 1.3 percent of GDP in 2007 to over 4 percent in 2082, with continued increases beyond 75 years.

Today, seniors all over America have guaranteed access to affordable prescription drug coverage. The market-based structure of the new prescription drug benefit appears to be working. Average premiums for Part D have come down again this year.

The facts are clear: the sooner Social Security and Medicare are reformed, the fairer reforms will be to future generations. The serious concerns raised by the Trustees Reports demand the attention of America's policymakers and the public. Americans who will depend on Social Security and Medicare expect us to address the long-term funding issues. Successful long-term reform of these programs is a shared responsibility and we all have to rise to the challenge.

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REPORTS

- Medicare Report
- Social Security Report
- Summary of Reports

A MESSAGE TO THE PUBLIC:

Each year the Trustees of the Social Security and Medicare trust funds report on the current and projected financial status of the two programs. This message summarizes our 2008 Annual Reports.

The financial condition of the Social Security and Medicare programs remains problematic. Projected long run program costs are not sustainable under current financing arrangements. Social Security's current annual surpluses of tax income over expenditures will begin to decline in 2011 and then turn into rapidly growing deficits as the baby boom generation retires. Medicare's financial status is even worse. This year Medicare's Hospital Insurance (HI) Trust Fund is expected to pay out more in hospital benefits and other expenditures than it receives in taxes and other dedicated revenues. The difference will be made up from general revenues which pay for interest credits to the Trust Fund. Growing annual deficits are projected to exhaust HI reserves in 2019 and Social Security reserves in 2041. In addition, the Medicare Supplementary Medical Insurance (SMI) Trust Fund that pays for physician services and the prescription drug benefit will continue to require general revenue financing and charges on beneficiaries that grow substantially faster than the economy and beneficiary incomes over time.

The drawdown of Social Security and HI Trust Fund reserves and the general revenue transfers into SMI will result in mounting pressure on the Federal budget. In fact, pressure is already evident. For the second consecutive year, a "Medicare funding warning" is being triggered, signaling that non-dedicated sources of revenues—primarily general revenues—will soon account for more than 45 percent of Medicare's outlays. The President recently proposed remedial action pursuant to the warning in last year's report and, in accordance with Medicare statute, a Presidential proposal will be needed in response to the latest warning.

We are increasingly concerned about inaction on the financial challenges facing the Social Security and Medicare programs. The longer action is delayed, the greater will be the required adjustments, the larger the burden on future generations, and the more severe the detrimental economic impact on our nation.

Medicare

As we reported last year, Medicare's financial difficulties come sooner–and are much more severe—than those confronting Social Security. While

both programs face demographic challenges, rapidly growing health care costs also affect Medicare. Underlying health care costs per enrollee are projected to rise faster than the wages per worker on which payroll taxes and Social Security benefits are based. As a result, while Medicare's annual costs were 3.2 percent of GDP in 2007, or nearly three quarters of Social Security's, they are projected to surpass Social Security expenditures in 2028 and reach 10.8 percent of GDP in 2082.

Moreover, this is the second consecutive year that the Medicare Report triggers a Medicare funding warning. Under the Medicare Prescription Drug, Improvement, and Modernization Act of 2003 the Medicare Report must include a determination of whether the difference between total Medicare outlays and dedicated financing (such as premiums and payroll taxes) exceeds 45 percent of total outlays within the first 7 years of the projection period (2008-2014 for the 2008 Report). The Act provides that an affirmative determination in two consecutive reports be treated as a "funding warning" for Medicare that would, in turn, prompt a Presidential proposal to respond to the warning and expedited Congressional consideration of such proposal. The 2008 Report projects that the difference will surpass 45 percent in 2014 and therefore again makes a determination of excess general revenue funding (as prior Reports did in 2006 and 2007). This determination triggers the second consecutive Medicare funding warning. Under the provisions of the 2003 Act, this calls for a Presidential proposal to respond to the warning within 15 days of the submission of the Fiscal Year 2010 budget and for Congress to consider the proposal on an expedited basis. This provision is expected to bring additional attention to Medicare's impact on the Federal budget.

The projected 75-year actuarial deficit in the Hospital Insurance (HI) Trust Fund is now 3.54 percent of taxable payroll, down slightly from 3.55 percent projected in last year's report. Were it not for new methods for projecting immigration that were implemented this year, the HI actuarial deficit would have increased rather than decreased. Despite the slight improvement, the fund again fails our test of short-range financial adequacy, as projected annual assets drop below projected annual expenditures within 10 years—by 2013. The fund also continues to fail our long-range test of close actuarial balance by a wide margin. The projected date of HI Trust Fund exhaustion is 2019, the same as in last year's report, when dedicated revenues would be sufficient to pay only 78 percent of HI costs. Projected HI dedicated revenues fall short of outlays in this and all future years. The Medicare Report shows that the program could be brought into actuarial balance over the next 75 years by an immediate

122 percent increase in the payroll tax (from 2.9 percent to 6.44 percent), or an immediate 51 percent reduction in program outlays or some combination of the two. As with Social Security, adjustments of greater magnitude would be necessary if changes are delayed or phased in gradually. Larger changes would also be required to make the program solvent on a sustainable basis beyond the 75-year horizon.

Part B of the Supplementary Medical Insurance (SMI) Trust Fund, which pays doctors' bills and other outpatient expenses, and Part D, which pays for access to prescription drug coverage, are both projected to remain adequately financed into the indefinite future because current law automatically provides financing each year to meet next year's expected costs. However, expected steep cost increases will result in rapidly growing general revenue financing needs—projected to rise from 1.3 percent of GDP in 2007 to 4.5 percent in 2082—as well as substantial increases over time in beneficiary premium charges.

Social Security

The annual cost of Social Security benefits represented 4.3 percent of Gross Domestic Product (GDP) in 2007 and is projected to increase to 6.1 percent of GDP in 2035, and then decline to 5.8 percent of GDP by 2048 and remain at that level. The projected 75-year actuarial deficit in the combined Old-Age and Survivors and Disability Insurance (OASDI) Trust Fund is 1.70 percent of taxable payroll ($4.3 trillion in present value terms), down from 1.95 percent projected in last year's report. This decrease is due primarily to changes in projection methods. Although the combined OASDI program passes our short-range test of financial adequacy, the Disability Insurance Trust Fund does not; in addition, OASDI continues to fail our long-range test of close actuarial balance by a wide margin. Projected OASDI tax income will begin to fall short of outlays in 2017, and will be sufficient to finance only 78 percent of scheduled annual benefits in 2041, after the combined OASDI Trust Fund is projected to be exhausted.

Social Security could be brought into actuarial balance over the next 75 years in various ways, including an immediate increase of 14 percent in payroll tax revenues (from 12.4 percent to 14.1 percent) or an immediate reduction in benefits of 12 percent or some combination of the two. Ensuring that the system is solvent on a sustainable basis beyond the next 75 years would require larger changes, because an aging population and increasing longevity cause the projected current-law OASDI cash-flow

deficits to be substantially larger after the 75-year projection period than they are on average during the period.

The projected actuarial deficit in the OASDI Trust Fund over the infinite future is 3.2 percent of taxable payroll (1.1 percent of GDP), or $13.6 trillion in present value terms. The system could be brought into actuarial balance over this time horizon with an immediate increase in payroll tax revenues of 26 percent (from 12.4 percent to 15.6 percent) or an immediate reduction in benefits of 20 percent, or some combination of the two.

Conclusion

The financial difficulties facing Social Security and Medicare pose enormous challenges. The sooner these challenges are addressed, the more varied and less disruptive their solutions can be. We urge the public to engage in informed discussion and policymakers to think creatively about the changing needs and preferences of working and retired Americans. A national conversation and timely political action are essential to ensure that Social Security and Medicare continue to play a critical role in the lives of all Americans.

By the Trustees:

Henry M. Paulson, Jr.,
Secretary of the Treasury,
and Managing Trustee

Elaine L. Chao,
Secretary of Labor,
and Trustee

Michael O. Leavitt,
Secretary of Health
and Human Services,
and Trustee

Michael J. Astrue,
Commissioner of
Social Security,
and Trustee

A SUMMARY OF THE 2008 ANNUAL SOCIAL SECURITY AND MEDICARE TRUST FUND REPORTS

Who Are the Trustees? There are six Trustees, four of whom serve by virtue of their positions in the Federal Government: the Secretary of the Treasury, the Secretary of Labor, the Secretary of Health and Human Services, and the Commissioner of Social Security. The other two Trustees are public representatives appointed by the President, subject to confirmation by the Senate. The two Public Trustee positions are currently vacant.

What Are the Trust Funds? Congress established the trust funds in the U.S. Treasury to account for all program income and disbursements. Social Security and Medicare taxes, premiums, and other income are credited to the funds. Disbursements from the funds can be made only to pay benefits and program administrative costs.

The Department of the Treasury invests program revenues not needed in the current year to pay benefits and administrative costs in special non-marketable securities of the U.S. Government on which a market rate of interest is credited. Thus, the trust funds represent the accumulated value, including interest, of all prior program annual surpluses and deficits, and provide automatic authority to pay benefits.

There are four separate trust funds. For Social Security, the Old-Age and Survivors Insurance (OASI) Trust Fund pays retirement and survivors benefits, and the Disability Insurance (DI) Trust Fund pays disability benefits. (The two trust funds are often considered on a combined basis designated OASDI.) For Medicare, the Hospital Insurance (HI) Trust Fund pays for inpatient hospital and related care. The Supplementary Medical Insurance (SMI) Trust Fund comprises two separate accounts: Part B, which pays for physician and outpatient services, and Part D, which covers the prescription drug benefit.

What Were the Trust Fund Results in 2007? In December 2007, 40.9 million people received OASI benefits, 8.9 million received DI benefits, and 44.1 million were covered under Medicare. Trust fund operations, in billions of dollars, are shown below (totals may not add due to rounding). All four trust funds showed net increases in assets in 2007.

	OASI	DI	HI	SMI
Assets (end of 2006)	$1,844.3	$203.8	$305.4	$33.1
Income during 2007	675.0	109.9	223.7	238.2
Outgo during 2007	495.7	98.8	203.1	228.5
Net increase in assets	179.3	11.1	20.7	9.7
Assets (end of 2007)	2,023.6	214.9	326.0	42.9

How Has the Financial Outlook for Social Security and Medicare Changed Since Last Year? Under the intermediate assumptions, the combined OASDI Trust Funds show a 75-year actuarial deficit equal to 1.70 percent of taxable payroll, 0.26 percentage point smaller than last

year's estimate. The difference is due mainly to changes in methods used to project immigration. The revised methods result in persistently lower projected costs as a percentage of payroll. Over the infinite horizon, the actuarial deficit is 3.2 percent of projected payroll, 0.3 percentage point smaller than last year. The OASI Trust Fund and the combined OASI and DI Trust Funds are adequately financed over the next 10 years. The DI Trust Fund is expected to remain solvent over the next 10 years, but does not meet the short-range test for financial adequacy because its assets are projected to fall short of 100 percent of annual expenditures, reaching 95 percent at the end of 2017.

Medicare's HI Trust Fund has a projected 75-year actuarial deficit equal to 3.54 percent of payroll under the intermediate assumptions, nearly the same as reported last year (3.55 percent). The HI Trust Fund is expected to remain solvent over the next 10 years, but does not meet the short-range test of financial adequacy; its assets are projected to fall short of 100 percent of annual expenditures by 2013. If the annual growth in HI expenditures averages 7.4 percent during 2008-17 as expected, HI Trust Fund assets would fall to 39 percent of annual HI expenditures in 2017.

The SMI Trust Fund is adequately financed under current law because of the automatic financing established for Medicare Parts B and D. Nonetheless, projected SMI cost growth over the long term will require increases in enrollee premiums and general revenue funding that will average about 6.5 percent annually, placing an ever-increasing burden on beneficiaries and Federal revenues.

This year's Medicare Trustees Report is the third consecutive report in which the annual general revenue funding contribution to total Medicare expenditures is projected to exceed 45 percent within the first 7 years of the 75-year projection period. This result triggers another "Medicare funding warning."

How Are Social Security and Medicare Financed? For OASDI and HI, the major source of financing is payroll taxes on earnings that are paid by employees and their employers. The self-employed are charged the equivalent of the combined employer and employee tax rates. During 2007, an estimated 163 million people had earnings covered by Social Security and paid payroll taxes; for Medicare the corresponding figure was 168 million people. The payroll tax rates are set by law and for OASDI apply to earnings up to an annual maximum ($102,000 in 2008) that increases with the growth in the nationwide average wage. HI taxes are paid on total earnings. The payroll tax rates (in percent) for 2008 and later are:

	OASI	DI	OASDI	HI	Total
Employees	5.30	0.90	6.20	1.45	7.65
Employers	5.30	0.90	6.20	1.45	7.65
Combined total	10.60	1.80	12.40	2.90	15.30

About 75 percent of SMI Part B and Part D expenditures are paid from Federal general fund revenues, with most of the remaining costs covered by monthly premiums charged to enrollees. Part B and Part D premium amounts are based on methods defined in law and increase as the estimated costs of those programs rise.

In 2008, the Part B standard monthly premium paid by most enrollees is $96.40. During 2007-09, an income-related premium surcharge is being phased in for Part B beneficiaries whose modified adjusted gross income exceeds inflation-indexed thresholds (in 2008, $82,000 for individual tax returns, $164,000 for joint returns).

In 2008, the Part D "base monthly premium" is $27.93. (Actual premium amounts charged to Part D beneficiaries depend on the specific plan in which they are enrolled and average $25 for standard coverage in 2008.) Part D also receives payments from States for the Federal assumption of Medicaid responsibilities for prescription drug costs for individuals eligible for both Medicare and Medicaid. In 2008, State payments are estimated to cover 14 percent of Part D costs, but that percentage is projected to decline to 10 percent by 2014 as the State requirement decreases.

Income to each trust fund, by source, in 2007 is shown in the table below (totals may not add due to rounding).

Source *(in billions)*	OASI	DI	HI	SMI
Payroll taxes	$560.9	$95.2	$191.9	—
General fund revenue	—	—	0.6	$178.4
Interest earnings	97.0	13.2	16.5	2.2
Beneficiary premiums	—	—	2.8	50.6
Taxes on benefits	17.2	1.4	10.6	—
Other	*	*	1.3	7.0
Total	675.0	109.9	223.7	238.2

* Less than $50 million.

What Were the Administrative Expenses in 2007? Administrative expenses, as a percentage of total expenditures, were:

	OASI	DI	HI	SMI
Administrative expenses 2007	0.6	2.5	1.4	1.5

How Are Estimates of the Trust Funds' Future Status Made? Short-range (10-year) and long-range (75-year) projections are reported for all funds. Estimates are based on current law and assumptions about factors that affect the income and outgo of each trust fund. Assumptions include economic growth, wage growth, inflation, unemployment, fertility,

immigration, and mortality, as well as factors relating to disability incidence and the cost of hospital, medical, and prescription drug services.

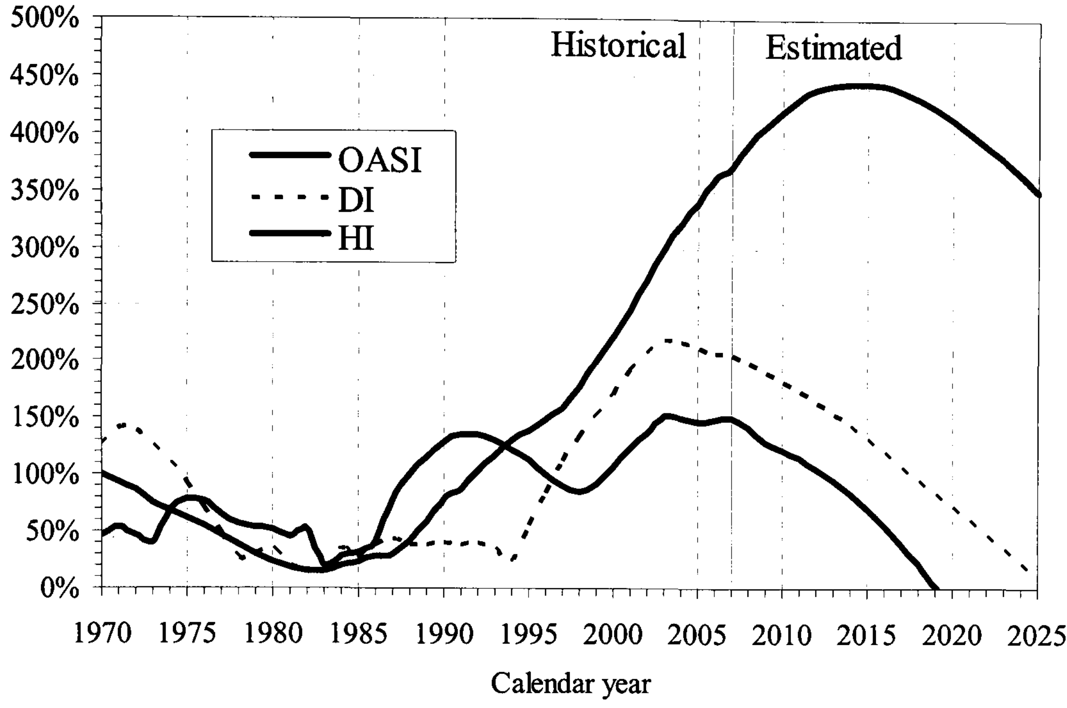
Because the future is inherently uncertain, three alternative sets of economic, demographic, and programmatic assumptions are used to show a range of possibilities. The intermediate assumptions (alternative II) reflect the Trustees' best estimate of future experience. The low-cost alternative I is more optimistic for trust fund financing, and the high-cost alternative III is more pessimistic; they show trust fund projections for more and less favorable conditions for trust fund financing than the best estimate. The assumptions are reexamined each year in light of recent experience and new information about future trends, and are revised as warranted. In general, greater confidence can be placed in the assumptions and estimates for earlier projection years than for later years. The statistics and analysis presented in this Summary are based on the intermediate assumptions.

What is the Short-Range Outlook (2008-2017) for the Trust Funds?
For the short range, the adequacy of the OASI, DI, and HI Trust Funds is measured by comparing their assets at the beginning of a year to projected costs for that year (the "trust fund ratio"). A trust fund ratio of 100 percent or more—that is, assets at least equal to projected benefit payments for a year—is considered a good indicator of a fund's short-term adequacy. That level of projected assets for any year means that even if expenditures exceed income, the trust fund reserves, combined with annual tax revenues, would be sufficient to pay full benefits for several years, allowing time for legislative action to restore financial adequacy.

By this measure, the OASI Trust Fund is financially adequate throughout the 2008-2017 period, but the DI Trust Fund fails the short-range test because its trust fund ratio falls below 100 percent by the end of 2017. The HI Trust Fund also does not meet the short-range test of financial adequacy, with assets projected to fall below 100 percent of one year's outgo by 2013. Chart A shows these trust fund ratios under the intermediate assumptions through 2025.

For SMI Part B, a less stringent annual "contingency reserve" asset test applies because the major portion of the financing for that account is provided by beneficiary premiums and Federal general fund revenue payments automatically adjusted each year to meet expected costs. Part D is similarly financed on an annual basis. Moreover, the operation of Part D through private insurance plans, together with a flexible appropriation for Federal costs, eliminates the need for a contingency reserve in that account. Note, however, that the cost estimates for Part B are very likely to be too low for 2008 and ensuing years (perhaps by 10 to 20 percent in the long range) because they assume that current law governing the structure of physician payment updates will persist. That would lead to substantial reductions in physician payments per service during 2008-17 and slow the growth of projected Part B costs.

Chart A–OASI, DI, and HI Trust Fund Ratios
[Assets as a percentage of annual expenditures]



For each year since 2001, Congress has passed legislation to maintain or increase physician payments rather than allow the current law reductions. Thus, experience indicates that the scheduled reductions are unlikely to occur before legislative intervention. The understated physician payments affect projected costs for Part B, total SMI, and total Medicare.

The following table shows the projected income and outgo, and the change in the balance of each trust fund (except for SMI) over the next 10 years. SMI income and expenditures are shown in separate columns for Parts B and D. Changes in the SMI Trust Funds are not shown because of the automatic annual adjustments in program income to meet the following year's projected expenditures.

ESTIMATED OPERATIONS OF TRUST FUNDS
(In billions—totals may not add due to rounding)

	Income					Expenditures					Change in fund		
				SMI					SMI				
Year	OASI	DI	HI	B	D	OASI	DI	HI	B	D	OASI	DI	HI
2008	$708	$112	$221	$213	$52	$516	$108	$230	$187	$52	$192	$4	$-8
2009	755	118	247	220	62	545	115	246	194	62	210	3	1
2010	801	124	259	192	68	578	122	260	205	68	223	2	-2
2011	848	129	271	218	75	615	129	276	216	75	233	1	-5
2012	897	135	283	232	84	657	137	295	229	84	240	-2	-11
2013	947	141	296	255	92	704	145	316	251	92	243	-4	-19
2014	998	147	309	264	102	755	153	338	261	102	242	-6	-28
2015	1,050	152	322	307	114	810	161	361	278	114	239	-9	-40
2016	1,103	158	335	277	127	869	170	387	298	127	235	-12	-52
2017	1,159	164	348	330	142	931	179	415	325	142	228	-15	-67

What is the Long-Range (2008-2082) Outlook for Social Security and Medicare Costs? An instructive way to view the projected cost of Social Security and Medicare is to compare the financing required to pay all scheduled benefits for the two programs with the gross domestic product (GDP), the most frequently used measure of the total output of the U.S. economy. Costs for both programs rise steeply between 2010 and 2030 because the number of people receiving benefits will increase rapidly as the large baby-boom generation retires (Chart B). During those years, cost growth for Medicare is higher than for Social Security because of the rising cost of health services, increasing utilization rates, and anticipated increases in the complexity of services. Beyond 2030, Social Security costs increase slowly for about 5 years, reaching a peak of 6.1 percent of GDP in the middle of the decade. Costs then decline slightly over the following decade to about 5.8 percent of GDP where they remain for the last 35 years of the projection period. In contrast, Medicare costs continue to grow rapidly after 2030 due to expected increases in the cost of health care.

Chart B–Social Security and Medicare Cost as a Percentage of GDP

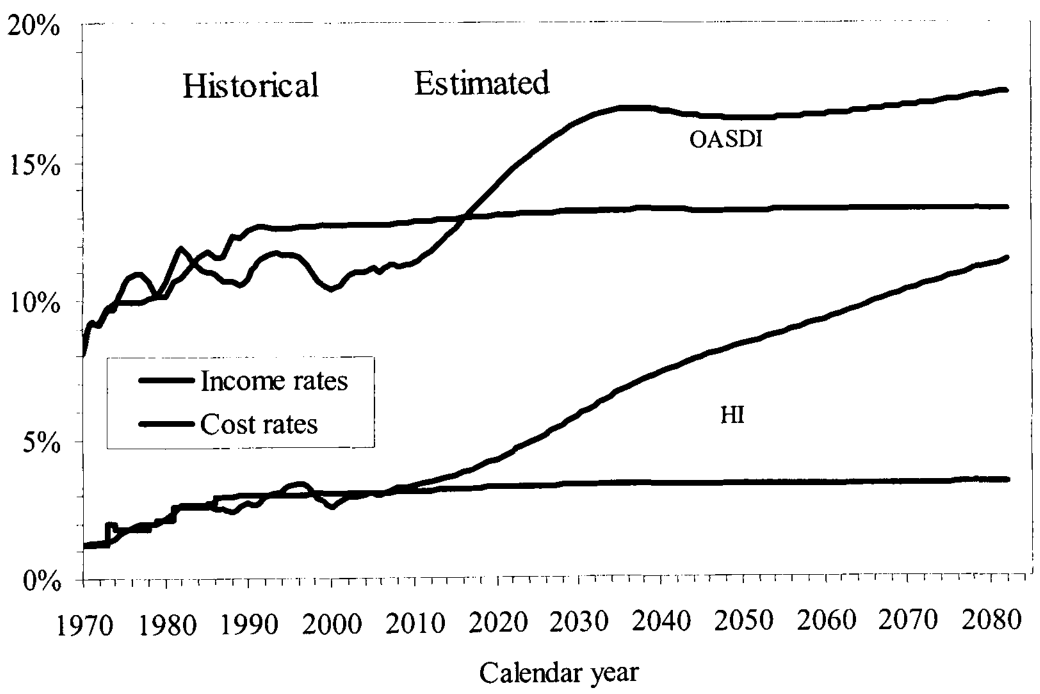
12%
10%
8%
6%
4%
2%
0%
Historical
Estimated
HI + SMI
(including Part D)
OASI + DI
1970 1980 1990 2000 2010 2020 2030 2040 2050 2060 2070 2080
Calendar year

The projected cost outlook for Social Security and Medicare has improved relative to that described in last year's report. In 2007, the combined cost of the Social Security and Medicare programs represented about 7.5 percent of GDP. Social Security outgo amounted to 4.3 percent of GDP in 2007 and is projected to increase to 5.8 percent of GDP in 2082 (compared to 6.3 percent in 2081 last year). Medicare's cost was smaller in 2007—3.2 percent of GDP— but is projected to surpass the cost of Social Security in 2028, growing to 10.8 percent of GDP in 2082 (compared to 11.3 percent in 2081 last year) when it will be 85 percent larger

than Social Security's cost. In 2082, the combined cost of the programs would represent 16.6 percent of GDP. As a point of comparison, in 2007 all Federal receipts amounted to 19.6 percent of GDP.

What is the Outlook for OASDI and HI Costs Relative to Tax Income? Both Medicare and Social Security costs are projected to grow substantially faster than the economy over the next several decades, but tax income to the HI and OASDI Trust Funds will not. Because the primary source of income for HI and OASDI is the payroll tax, it is customary to compare the programs' income and costs expressed as percentages of taxable payroll. These income and cost rates are shown in Chart C. Although both the HI and OASDI annual cost rates increase markedly from their 2007 levels (3.11 and 11.26 percent), income rates increase very little over the long run. The reason is that payroll tax rates are not scheduled to change and income from the other tax source, taxation of OASDI benefits, will increase only gradually as a greater proportion of beneficiaries is subject to taxation in future years.

Chart C–Income and Cost Rates
[Percentage of taxable payroll]



What is the Long-Range Actuarial Balance of the OASI, DI, and HI Trust Funds? The traditional way to view the outlook of the payroll tax financed trust funds is in terms of their actuarial balances for the 75-year valuation period. The actuarial balance of a fund is essentially the difference between annual income and costs, expressed as a percentage of taxable payroll, summarized over the 75-year projection period. Because SMI is brought into balance annually through premium increases and general revenue transfers, actuarial balance is not an informative concept for that program.

The OASI, DI, and HI Trust Funds all have actuarial deficits under the intermediate assumptions, as shown in the following table. The actuarial deficit can be interpreted as the percentage points that could be either added to the current law income rate or subtracted from the cost rate for each of the next 75 years to bring the funds into actuarial balance. Actuarial balance is achieved if trust fund assets at the end of the period are equal to the following year's expenditures. Because large and growing annual deficits are projected at the end of the long-range period, adequate financing beyond 2082 would require even larger changes than are needed for solvency in 2008-82. Projections show that over the infinite horizon the actuarial deficit for OASDI is 3.2 percent, 1.5 percentage points higher than the 75-year deficit. For HI, the actuarial deficit over the very long run is 6.1 percent of taxable payroll, 2.6 percentage points higher than the 75-year imbalance.

LONG-RANGE ACTUARIAL DEFICIT OF THE OASI, DI, AND HI TRUST FUNDS

(As a percentage of taxable payroll; total may not add due to rounding)

	OASI	DI	OASDI	HI
Actuarial Deficit	1.46	0.24	1.70	3.54

What Are Key Dates in Long-Range OASI, DI, and HI Financing? When cost exceeds income excluding interest (Chart C), use of trust fund assets occurs in stages. For HI, the process begins in 2008 when HI income excluding interest falls short of expenditures, and interest earnings (which are paid from Federal general revenues) must be used to cover the difference. Beginning in 2010, costs are projected to exceed income including interest, and assets must be redeemed each year until the trust fund is exhausted in 2019. The onset of the use of trust fund assets to help finance HI benefits is now expected to start a year earlier than indicated in last year's report. The change is due to a combination of slightly lower payroll tax income and higher short-range HI expenditures than projected in the 2007 Report. In 2019, tax income is estimated to be sufficient to pay 78 percent of HI costs—and by 2082 only 30 percent.

For OASDI, interest income will first be needed to pay a portion of benefits in 2017, although the trust funds will continue to accumulate assets. In 2027, trust fund assets will begin to be depleted and are projected to be exhausted in 2041, after which continuing tax income would be sufficient to cover 78 percent of scheduled benefits. Tax income would cover 75 percent of scheduled benefits in the final year (2082) of the 75-year projection period. Although the projected exhaustion date for the DI Trust Fund is 2025, the value of the OASI Trust Fund would be sufficient at that point to make assets available to pay full DI benefits, but only with authorizing legislation.

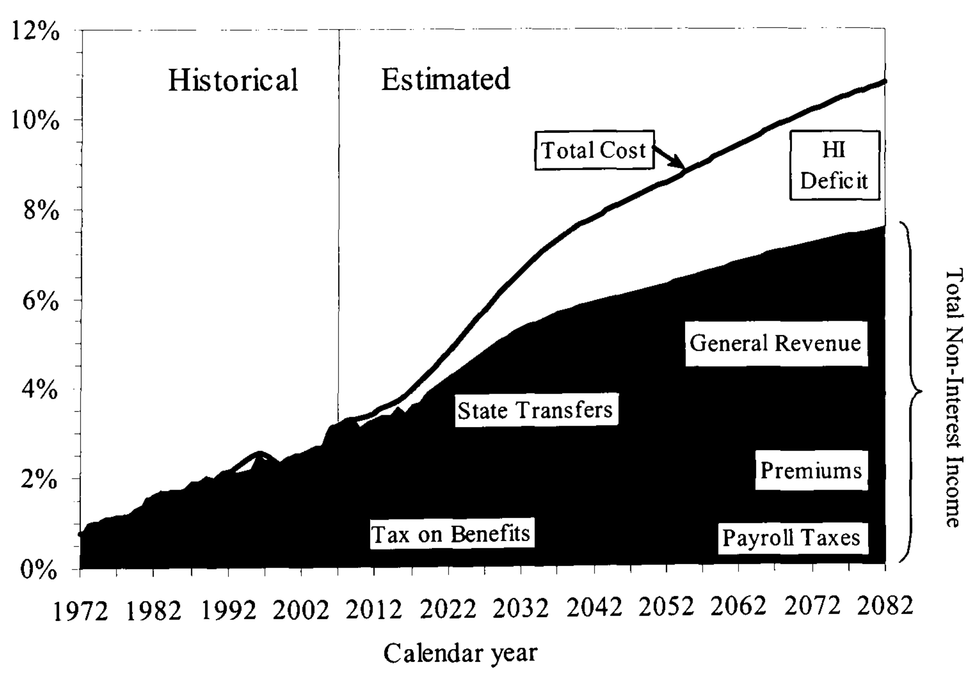
The key dates regarding cash flows are shown in the following table.

KEY DATES FOR THE TRUST FUNDS

	OASI	DI	OASDI	HI
First year outgo exceeds income excluding interest	2018	2005	2017	2008
First year outgo exceeds income including interest	2028	2012	2027	2010
Year trust fund assets are exhausted	2042	2025	2041	2019

How Do the Sources of Medicare Financing Change? As Medicare costs grow over time, general revenues and beneficiary premiums will play a larger role in financing the program. Chart D shows expenditures and current law non-interest revenue sources for HI and SMI combined as a percentage of GDP. The total expenditure line is the same as displayed in Chart B and shows Medicare cost rising to 10.8 percent of GDP by 2082. Revenue from taxes would remain at roughly 1.5 percent of GDP under current law, while general fund revenue contributions are projected to increase from 1.3 percent in 2008 to 4.5 percent in 2082, and beneficiary premiums from 0.5 to 1.4 percent of GDP. Thus, revenue from taxes would fall substantially as a share of total non-interest Medicare income (from 45 percent to 19 percent) while general fund revenue would rise (from 39 to 60 percent), as would premiums (from 15 percent to 19 percent). These current-law relationships could change as a result of the need to address the future HI Trust Fund deficits. The gap between total non-interest income and expenditures steadily widens due to growing annual HI deficits, reaching 3.4 percent of GDP by 2082. All told, by 2082 the

Chart D–Medicare Cost and Non-Interest Income by Source as a Percent of GDP



Medicare program is projected to require general revenue transfers equal to 4.5 percent of GDP. Moreover, the HI deficit represents a further 3.4 percent of GDP in 2082, and there is no provision to finance this deficit under current law through general fund transfers or any other revenue source.

The Medicare Modernization Act (2003) requires that the Board of Trustees determine each year whether the annual difference between program outlays and dedicated revenues (the bottom four layers of Chart D) exceeds 45 percent of total Medicare outlays within the first 7 years of the 75-year projection period. In effect, the law sets a threshold condition that signals that a trust fund's dedicated financing is inadequate and/or that general revenue financing of Medicare is becoming excessive. In that case, the annual report includes a determination of "excess general revenue Medicare funding." When that determination is made in two consecutive reports, a "Medicare funding warning" is triggered. The warning requires the President to respond by submitting proposed legislation within 15 days of the next budget submission to address the problem, and for Congress to consider the proposal on an expedited basis.

This year's report projects the difference between outlays and dedicated financing revenues to exceed 45 percent in 2014, prompting a determination of "excess general revenue Medicare funding" for the third consecutive report. In response to the "Medicare funding warning" triggered by the 2007 Medicare Trustees Report, President Bush submitted legislation in February 2008. No further action has been taken as of the date of this report and another "Medicare funding warning" is triggered.

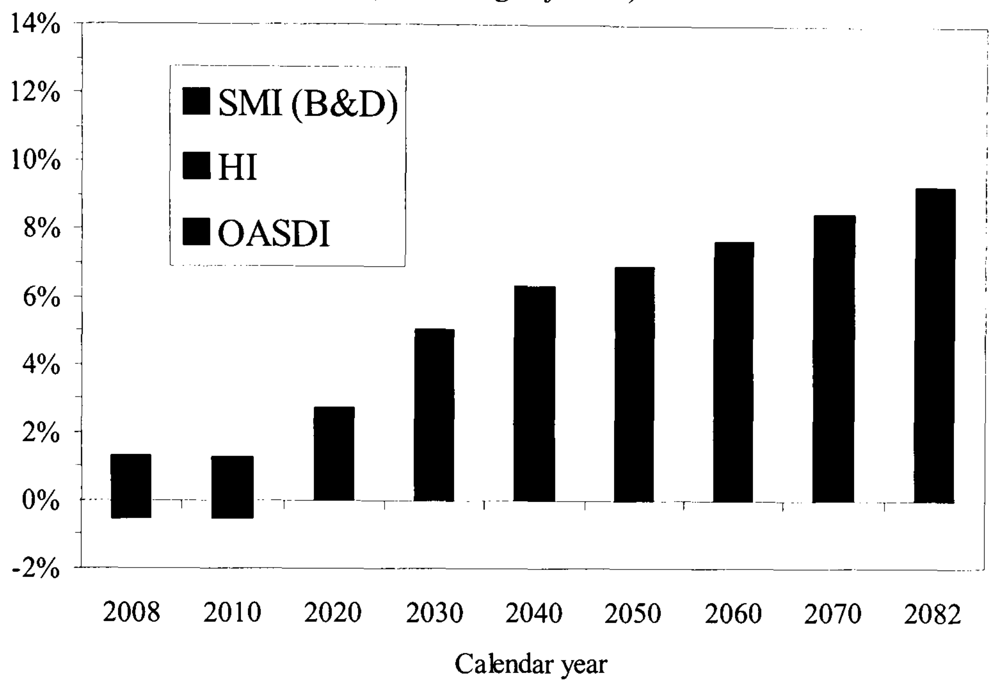
Why is Reform to Improve the Social Security and Medicare Financial Imbalances Needed? Concern about the long-range financial outlook for Medicare and Social Security often focuses on the exhaustion dates for the HI and OASDI Trust Funds—the time when projected finances under current law would be insufficient to pay the full amount of scheduled benefits. A more immediate issue is the growing burden that the programs will place on the Federal budget well before the trust funds are exhausted.

The difference between the cost of scheduled benefits and tax income for the HI and OASDI Trust Funds is shown in Chart E, together with the Federal general fund revenues provided under current law for SMI. During 2008-18 for HI, general revenues (the red bars in the chart) must be used to cover the interest earnings and asset redemptions required to offset the shortfall of HI tax revenues. Similarly, general revenues cover these offsets for the OASDI deficits during 2017-40 (blue bars). In addition, general revenues pay for roughly 75 percent of all SMI costs under current law (green bars).

In 2019 and later for HI, and in 2041 and later for OASDI, there is no provision in current law that would enable full payment of benefits, once the

trust funds are exhausted. If asset exhaustion actually occurred, benefits could be paid only up to the amount of ongoing dedicated revenues. Further general fund transfers could not be made to finance the deficits.

Chart E– Projected OASDI and HI Tax Income Shortfall *plus* the 75-Percent General Fund Revenue Contribution to SMI
(Percentage of GDP)



The initial negative amounts shown for OASDI indicate that tax income exceeds cost (which occurs during 2008-16) and represent net cash flow to the Treasury that results in the issuance of special Treasury bonds to the trust funds. Those OASDI net revenues are more than offset by the Medicare general revenue requirements under current law. For instance, in 2008 the Social Security tax income surplus ($79 billion) is estimated to be significantly smaller than the statutory Medicare Part B and Part D general revenue transfers, resulting in an overall cash requirement of $117 billion (0.8 percent of GDP) from the general fund of the Treasury.

The combined difference grows each year, so that by 2017, net revenue flows from the general fund will total $449 billion (2.0 percent of GDP). The positive amounts that begin in 2017 for OASDI, and in 2008 for HI, initially represent payments the Treasury must make to the trust funds when assets are redeemed to help pay benefits in years prior to exhaustion of the funds. Note that neither the redemption of trust fund bonds, nor interest paid on those bonds, provides any new net income to the Treasury, which must finance redemptions and interest payments through some combination of increased taxation, reductions in other government spending, or additional borrowing from the public.

Chart E shows that the difference between outgo and dedicated payroll tax and premium income will grow rapidly in the 2010-30 period as the

baby-boom generation reaches retirement age. Beyond 2030, the difference continues to increase nearly as rapidly due primarily to health care costs that grow faster than GDP. After the trust fund exhaustion dates (2041 for OASDI, 2019 for HI), the increasing positive amounts for OASDI and HI depict the excess of scheduled benefits over projected program income. When the statutory SMI general fund revenue requirements are added in, the projected combined Social Security and Medicare deficits and statutory general fund revenues in 2082 equal 9.3 percent of GDP, indicating the magnitude of the potential effect on the Federal budget if general revenues were used to ensure payment of all scheduled program benefits. A similar burden today would require nearly 80 percent of all Federal income tax revenues, which amounted to 11.7 percent of GDP in 2007.

To put these magnitudes into historical perspective, in 2007 the combined annual cost of HI, SMI, and OASDI amounted to 38 percent of total Federal revenues, or about 7 percent of GDP. That cost (as a percentage of GDP) is projected to double by 2060, and then to increase further to nearly 17 percent of GDP in 2082. It is noteworthy that over the past four decades, the average amount of total Federal revenue as a percentage of GDP has been 18 percent, and has not exceeded 21 percent in a given year. Assuming the continued need to fund a wide range of other government functions, the projected growth in Social Security and Medicare costs would require that the total Federal revenue share of GDP increase to wholly unprecedented levels.

This year's Trustees Reports describe large long-term financial imbalances for Social Security and Medicare, and demonstrate the need for timely and effective action. The sooner that solutions are adopted, the more varied and gradual they can be.

Because the two Public Trustee positions are currently vacant, there is no Message from the Public Trustees for inclusion in the Summary of the 2008 Annual Reports.

March 26, 2008
HP-887

Remarks by Secretary Henry M. Paulson, Jr on Current Financial and Housing Markets at the US Chamber of Commerce

Washington -- Thank you for inviting me to address your Capital Markets Competitiveness Conference. We share a commitment to competitive markets, and Treasury will soon release a Blueprint for Regulatory Reform that proposes a financial regulatory framework which we believe will more effectively promote orderly markets and foster financial sector innovation and competitiveness.

As you know, financial market stress began last August and has led to significant de-leveraging and repricing of risk, and sentiment has swung hard to risk aversion. There have been, as there always are during periods like this, bumps in the road and unpleasant surprises along the way.

I am constantly asked how much longer will this take to play out and if this is the worst period of market stress I have experienced. I respond that every period of prolonged turbulence seems to be the worst until it is resolved. And it always is resolved. Our economy and our capital markets are flexible and resilient and I have great confidence in them. I am certain we will work through this situation and go on to new heights as we always do.

As we work our way through this turbulence, our highest priority is limiting its impact on the real economy. We must maintain stable, orderly and liquid financial markets and our banks must continue to play their vital role of supporting the economy by making credit available to consumers and businesses. And we must of course focus on housing, which precipitated the turmoil in the capital markets, and is today the biggest downside risk to our economy. We must work to limit the impact of the housing downturn on the real economy without impeding the completion of the necessary housing correction. I will address each of these in turn. Regulators and policy makers are vigilant; we are not taking anything for granted.

Orderly Financial Markets

For some months now, reduced access to short term funding and liquidity issues have created turmoil in our capital markets. In the midst of these conditions, Bear Stearns found itself facing bankruptcy. The Federal Reserve acted promptly to resolve the Bear Stearns situation and avoid a disorderly wind-down. It is the job of regulators to come together to address times such as this; and we did so. Our focus was the stability and orderliness of our financial markets.

Discount Window Access

As the Federal Reserve resolved the Bear Stearns situation, it subsequently took a very important and consequential action of instituting a temporary program for providing liquidity to primary dealers. I fully support that action. Taking this step in a period of stress recognizes the changed nature of our financial system and the role played by investment banks in the post Glass-Steagall world.

Such direct lending from the central bank to non-depository institutions has not occurred since the 1930s. Recent market turmoil has required the Federal Reserve to adjust some of the mechanisms by which it provides liquidity to the financial system. Their creativity in the face of new challenges deserves praise, but the circumstances that led the Fed to modify its lending facilities raises significant policy

considerations that need to be addressed.

Insured depository institutions remain important participants in financial markets, but this latest episode has highlighted that the world has changed as has the role of other non-bank financial institutions, and the interconnectedness among all financial institutions. These changes require us all to think more broadly about the regulatory and supervisory framework that is consistent with the promotion and maintenance of financial stability. Now that the Fed is granting primary dealers temporary access to liquidity facilities, we must consider the policy implications associated with such access.

Historically, commercial banks have had regular access to the discount window. Access to the Federal Reserve's liquidity facilities traditionally has been accompanied by strong prudential oversight of depository institutions, which also has included consolidated supervision where appropriate. Certainly any regular access to the discount window should involve the same type of regulation and supervision.

While there has been extraordinary convergence in financial services, one distinction between banks and investment banks remains particularly important - banks have the advantage that they issue deposits that are insured by the Federal government. A properly designed program of deposit insurance greatly reduces the likelihood of liquidity pressures on depository institutions and as a corollary, makes the funding base of these institutions more stable. The trade-off for this subsidized funding is regulation tailored to protect the taxpayers from moral hazard this insurance creates.

For the non-depository institutions that now have temporary access to the discount window, I believe a few constructive steps would enable the Federal Reserve to protect its balance sheet, and ultimately protect U.S. taxpayers.

First, the process for obtaining funds by non-banks must continue to be as transparent as possible. The Fed should describe eligible institutions, articulate the situations in which funds will be made available, and the magnitude and pricing structure for the funds. The TAF process is a good model for a structure that would provide relevant information to the marketplace.

Second, and perhaps most importantly, the Federal Reserve should have the information about these institutions it deems necessary for making informed lending decisions. The Federal Reserve is currently working to ensure the adequacy of such information. We suggest that the Federal Reserve, the SEC, and the CFTC continue their work of building a robust cooperative framework. Already, at the invitation of the SEC, the Federal Reserve is working alongside their teams within these institutions. These regulators should consider whether a more formalized working agreement should be entered into to reflect these events.

With this added information flow, the Federal Reserve will be better positioned to consider market stability issues like liquidity provisioning and the interconnectedness of financial institutions. The Federal Reserve's participation could also allow for broader consideration of market stability issues by the SEC and the CFTC. This collaborative process will necessarily have a strong focus on liquidity and funding issues.

The combination of these steps should provide the Federal Reserve with a structure and the information that it would need to make liquidity backstop loans during periods of market instability to non-banks. They address the current situation, in which investment banks have temporary access to the discount window. Clearly, many difficult policy questions must also be addressed on a going-forward basis.

Despite the fundamental changes in our financial system, it would be premature to jump to the conclusion that all broker-dealers or other potentially important financial firms in our system today should have permanent access to the Fed's liquidity facility. Recent market conditions are an exception from the norm. At this time, the Federal Reserve's recent action should be viewed as a precedent only for unusual periods of turmoil.

As we work through this period, we will learn through this experience. And the

Federal Reserve will learn as it works with financial institutions as they come to the window. It is appropriate that we evaluate that experience in the coming months, and use the lessons of that experience to inform a path forward. Very relevant to this issue is the fact that bank regulation, which applies to institutions with an explicit taxpayer-funded backstop, is fundamentally different from non-bank regulation, which applies to institutions that are not supported by federal deposit insurance. The President's Working Group on Financial Markets will evaluate these issues and their implications for regulation of bank and non-bank financial institutions.

Housing and Mortgage Markets

The housing downturn and the surrounding uncertainty are significantly impacting our financial institutions and capital markets. However, we should not lose sight of the fact that this downturn was precipitated by unsustainable home price appreciation which was particularly pronounced in a relatively few regions. A correction was inevitable and the sooner we work through it, with a minimum of disorder, the sooner we will see home values stabilize, more buyers return to the housing market, and housing will again contribute to economic growth. Having stability in housing markets will in turn contribute to better conditions in credit markets for mortgage-backed securities.

Data releases every month create headlines about declining housing sales, starts and prices. Yet, declines are exactly what we should expect during a correction. It takes time to work through the excess inventory – and we are. The question many are asking is how deep the correction will be and how long it will last. The Case-Shiller index of home prices in 10 major metropolitan areas showed an 11.4 percent decline in home prices over the 12 months ending in January, and the futures market is predicting that the index will decline another 13 percent in 2008. But we do not have a national housing market; housing markets are regional – and there is considerable variation in adjustment, with prices changing the most in areas that had the greatest overbuilding.

Amid this correction, there are many calls to "do something about housing." When people say this, they are urging any number of possible things – minimize foreclosures, make affordable mortgages more available, improve the secondary market and liquidity for mortgages, improve the mortgage origination process, prosecute fraud, reduce the inventory of homes for sale, or help communities hardest hit by foreclosures.

The `to do' list tends to get conflated. We must sort through each of these shared and desired outcomes, carefully choosing policies that minimize the impact of – but do not slow – the housing correction.

Availability of Mortgage Finance

Turbulence in the financial markets has disrupted and reduced the availability and increased the cost of mortgage financing. The secondary mortgage market is still facing liquidity and pricing issues. We are taking steps to increase the availability of affordable mortgage financing. The Federal Reserve's temporary lending facility for non-banks will help in this area, as will the Federal Housing Finance Board's decision to authorize the Federal Home Loan Banks to increase purchases of agency mortgage backed securities, which could provide over $100 billion in new MBS market liquidity.

Another helpful step is the agreement reached last week among Fannie Mae, Freddie Mac and OFHEO, their independent regulator, to inject more capital into the mortgage market.

Fannie and Freddie, two of the nation's housing Government Sponsored Entities or GSEs, have been playing an important, countercyclical role in supporting the secondary market for mortgage finance. The GSEs' market share has grown substantially from 46 percent of all new mortgages in the second quarter of 2007 to 76 percent in the fourth quarter. It is very important that the GSEs remain positioned to play this critical role. That is why I was pleased that the GSEs committed to raise significant capital. A stronger capital base will better enable them to support more home purchases and refinancings through their securitization

activities. Additional capital not only increases the availability of mortgage financing, but also strengthens mortgage market fundamentals.

The Economic Stimulus Act of 2008 also temporarily raised the conforming loan limit, which should reduce costs for homebuyers seeking a jumbo mortgage.

The subprime mortgage market accounted for a large portion of housing purchase growth before the downturn, and the market for subprime mortgage financing is now largely closed. Last August, President Bush launched the FHASecure initiative, an important new solution for subprime homeowners. To date, FHASecure has helped more than 130,000 families refinance their mortgages and stay in their homes. That number is expected to reach 300,000 by year end. More can be done. Secretary Jackson continues to examine administrative tools to make FHA mortgages more widely available. And it is essential that Congress pass FHA modernization that would provide FHA the authority to help as many as 250,000 more homeowners at this critical time.

We will continue to look for solutions that expand mortgage access and availability for all borrowers, including financially-able subprime borrowers.

Foreclosures

Home foreclosures are also a significant issue today. Foreclosures are painful and costly to homeowners and, neighborhoods. They also prolong the housing correction by adding to the inventory of unsold homes. Before quickly reviewing our initiatives to prevent avoidable foreclosures, let me observe that some current headlines make it difficult to put foreclosure rates in perspective. So let me try to do so.

First, 92 percent of all homeowners with mortgages pay that mortgage every month right on time. Roughly 2 percent of mortgages are in foreclosure. Even from 2001 to 2005, a time of solid U.S. economic growth and high home price appreciation, foreclosure starts averaged more than 650,000 per year.

Last year there were about 1.5 million foreclosures started and estimates are that foreclosure starts might be as high as 2 million in 2008. These foreclosures are highly concentrated – subprime mortgages account for 50 percent of foreclosure starts, even though they are only 13 percent of all mortgages outstanding. Adjustable rate subprime mortgages account for only 6 percent of all mortgages but 40 percent of the foreclosures. So we are right to focus many of our policies on subprime borrowers.

There are approximately 7 million outstanding subprime mortgage loans. Available data suggests that 10 percent of subprime borrowers were investors or speculators. This figure is likely higher, as some investors misrepresented themselves to take advantage of a cheaper rate, and others speculated on a primary residence, expecting prices to continue going up.

Other subprime loans were very poorly underwritten and borrowers simply can not afford the home they bought. Almost 18 percent of adjustable rate subprime mortgages underwritten in 2006 were in foreclosure six months before the initial rate was scheduled to reset. Subtracting the speculators and those who took on more than they could handle leaves us with our target population of subprime borrowers for whom we are seeking a solution – those who want to keep their homes, have the financial wherewithal, but are facing challenges making their monthly payments.

We are focused on private sector and government efforts to help these borrowers avoid foreclosure.

The HOPE NOW alliance has announced that, since July, more than 1 million struggling homeowners received a work out, either a loan modification or repayment plan that helped them avoid foreclosure. HOPE NOW's work-out efforts are accelerating more quickly than the foreclosure rate. In the month of January foreclosure starts were up 5 percent while the number of mortgage workouts grew 19 percent.

HOPE NOW and the American Securitization Forum together have implemented a protocol targeted specifically at subprime borrowers facing mortgage resets. Through the protocol, those who made their initial payments and want to keep their home should be fast-tracked into a sustainable refinancing or loan modification.

We are closely monitoring the implementation and results of HOPE NOW and the ASF efforts. Responsible homeowners who have been making their payments and want to find a way to stay in their home should not go into foreclosure merely because the volume of people seeking help overwhelms the system.

Homeowners with Negative Equity

Much attention has been given to the fact that an estimated 8.8 million households may currently have negative home equity. We can expect that number to rise as the housing correction plays out, and to begin to reverse once the correction has run its course. The best outcome for these homeowners is to work through this correction as quickly as possible.

Homeowners with negative equity are more common in this housing downturn because lending practices changed dramatically in recent years. In 2007, 29 percent of mortgages were originated with no down payment. Some of those mortgages went to speculators; others to responsible borrowers who were able to buy a home because of expanded access to credit.

But let me emphasize that we do not need a system-wide solution for the vast majority of loans where a homeowner temporarily has negative equity. Negative equity does not affect borrowers' ability to pay their loans. Homeowners who can afford their mortgage payment should honor their obligations --- and most do. They know that there are housing cycles, and they bought more than houses. They bought homes to become part of a community, and they bought them as places to live, not as investments. And if they live in them for the long term, they are likely to become good investments.

Let me also emphasize that any homeowner who can afford his mortgage payment but chooses to walk away from an underwater property is simply a speculator. Washington can not create any new mortgage program to induce these speculators to continue to own these homes, unless someone else foots the bill.

The people we seek to help are those who want to keep their homes but can't afford the monthly payment because of an ARM reset. If they also have negative equity in their homes, refinancing becomes almost impossible and so workouts become even more important. Secretary Jackson is examining the potential for FHA to be a solution for these borrowers.

Conclusion

In summary, there is bipartisan interest in bolstering our economy, maintaining stable and orderly capital markets, and helping struggling homeowners. New ideas and solutions can come from either side of the aisle. The Administration and Congress demonstrated how well bipartisanship can work when we quickly passed and enacted an economic stimulus package earlier this year. I am hopeful we can demonstrate this again by quickly concluding the FHA Modernization bill, and I am working hard to make progress on comprehensive GSE reform legislation because stronger oversight is essential for these large, critically important financial institutions.

I know Members of Congress have outlined other ideas, but most are not yet ready for the starting gate. FHA Modernization and GSE reform are well on their way to the finish line – let's complete this important legislation now, so we can implement them and help homeowners and our economy.

Timeliness is critical for adding confidence in today's markets. I continue to focus on additional steps that the Administration can take without delay – things that don't require congressional action and will immediately impact the availability of affordable mortgage finance.

We are obviously well aware that the housing market correction was not only a precipitating cause but continues to be an underlying factor in our capital markets' stress. Both are disrupting our economy right now. We will continue to pursue policies that strike the right balance: that do not slow the housing correction, yet also help avoid preventable foreclosures and unnecessary capital market turmoil.

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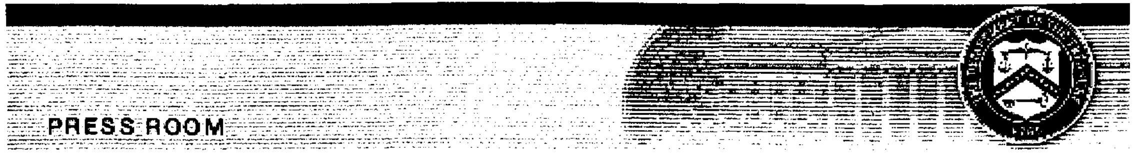

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March 26, 2008
hp-888

Implementation of Certain Legislative Provisions Relating to the International Monetary Fund

Implementation of Certain Legislative Provisions Relating to the International Monetary Fund

REPORTS

- Legislative Mandates Report

IMPLEMENTATION OF CERTAIN LEGISLATIVE PROVISIONS RELATING TO THE INTERNATIONAL MONETARY FUND

A Report to Congress

in accordance with

Sections 1503 and 1705(a) of the
International Financial Institutions Act,

Section 801(c)(1)(B) of the
Foreign Operations, Export Financing, and Related Programs
Appropriations Act, 2001

and

Section 605(d) of the
Foreign Operations, Export Financing, and Related Programs
Appropriations Act, 1999

United States Department of the Treasury
January 2008

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Introduction

This is the ninth report prepared in accordance with Sections 1503 and 1705(a) of the International Financial Institutions Act (the IFI Act – codified at 22 United States Code sections 262o-2 and 262r-4(a)).[1] This report also covers policies set forth in Section 801(c)(1)(B) of the Foreign Operations, Export Financing, and Related Programs Appropriations Act, 2001, [2] as required by Section 1705(a) of the IFI Act. The report reviews actions taken by the United States to promote these legislative provisions in International Monetary Fund ("IMF" or the "Fund") country programs. Annex 1 covers new IMF lending arrangements per section 605(d) of the Foreign Operations, Export Financing, and Related Programs Appropriations Act, 1999. Earlier reports under these provisions are available on the Department of the Treasury's website (www.treas.gov/press/reports.html).

Treasury and the Office of the United States Executive Director ("USED") at the IMF consistently endeavor to build support in the IMF's Executive Board for the objectives set out in this legislation. These endeavors include meetings with IMF staff and other Board members on country programs and IMF policies, formal statements by the USED in the IMF Board, and USED votes in the Board. Treasury's objective is to support strengthened commitments in IMF programs, policy actions by program countries, and policy decisions at the IMF itself.

Treasury's IMF task force is charged with increasing awareness among Treasury staff about legislative mandates and identifying opportunities to influence IMF decisions in line with broader U.S. international economic policy objectives. Assessments of the overall effectiveness of the Treasury and USED's office in promoting the legislative provisions are published annually by the GAO and are available online.[3] The most recent report states that the "Treasury continues to promote the [IMF] task force as a tool for monitoring and promoting legislative mandates and other policy priorities."

Report on specific provisions

I. Section 1503(a)

(1) Exchange rate stability

Article I of the IMF's Articles of Agreement states that one of the purposes of the IMF is "to promote exchange stability, to maintain orderly exchange arrangements among members, and to avoid competitive exchange depreciation." In June, 2007, as a result of U.S. leadership, the IMF adopted a new framework for exchange rate surveillance. A key feature of this framework is the concept of fundamental misalignment. A country's exchange rate can be found fundamentally misaligned if it substantially deviates from its long run equilibrium level and if it is coupled with

[1] These provisions were enacted in Sections 610 and 613 of the Foreign Operations, Export Financing, and Related Programs Appropriations Act, 1999 (Public Law 105-277, division A, § 101(d), title VI, §§ 610 & 613). Section 1705(a) was amended by Section 803 of the Foreign Operations, Export Financing, and Related Programs Appropriations Act, 2001 (Public Law 106-429, title VIII, § 803).
[2] Public Law 106-429, title VIII, § 801(c)(1)(B).
[3] *Treasury Has Sustained Its Formal Process to Promote U.S. Policies at the International Monetary Fund*, Government Accountability Office (GAO), June 2006.

a persistent misalignment in the current account. A finding of fundamental misalignment does not, in itself, imply a sanction by the Fund. However, it would sharpen the discussion on whether the country's exchange rate policy has a detrimental impact on the rest of the world. If a country were found to be fundamentally misaligned with the intent of increasing net exports, the Fund could find the country to be manipulating its currency in violation of its obligations under the IMF's articles of agreement.

This new framework is in the process of being implemented. Some Article IV's have been delayed, included China's, in order to incorporate the new framework into the Article IV reviews.

Treasury has urged the Fund to exercise firm surveillance over exchange rates throughout the year, as the new framework was being formulated.

- In its Board statement at the September 2007 Article IV discussions on the Republic of Korea, the USED underscored Korea's strong growth in a flexible exchange rate regime and the role of exchange rate appreciation in mitigating inflationary pressures.

- In its July 2007 statement on the Article IV review of Brazil, the USED noted that heavy intervention resulted in substantial reserve accumulation. It stated that given the Central Bank of Brazil's high level of reserves, intervention is more costly than the alternative options for preventing the development of an overvalued real exchange rate and that concerns about exchange rate overshooting could be better addressed through countercyclical fiscal policy.

- In its December 2006 board statement on the Article IV review of India, the USED noted that India's flexible exchange rate regime will support the economy's adjustment as well as encourage the recognition and hedging of foreign exchange risk. It also emphasized that there is scope for additional flexibility in the application of the exchange rate policy which is particularly important as India moves toward greater integration with the global economy.

- In its Board statement at the October 2006 Article IV discussions on Russia, the USED noted that heavy intervention in the foreign exchange market has led to significant money supply growth and that negative real interest rates have helped fuel an asset price boom. The USED highlighted that given that Russia now has the world's third largest foreign exchange reserves and a current account surplus of 11 percent of GDP, the authorities should cease intervening in the foreign exchange market and rather focus monetary policy directly on steadily reducing inflation.

(2) Policies to increase the effectiveness of the IMF in promoting market-oriented reform, trade liberalization, economic growth, democratic governance, and social stability through:

(A) Establishment of an independent monetary authority

With the support of the United States, the IMF has been a consistent advocate of greater independence of monetary authorities across a range of countries. IMF conditionality frequently includes measures to strengthen central bank autonomy and accountability. The IMF also provides technical assistance to help countries achieve these goals. In addition, the Fund promotes these objectives through assessments of compliance with internationally-agreed upon standards and codes, as well as rules for safeguarding the use of IMF resources. Examples of United States activities in the last year with regard to these issues include the following:

- In its Board statement at the July 2007 Article IV discussions, the USED urged that the Brazilian Central Bank be granted full autonomy, especially given Brazil's recent success in anchoring the market's inflation expectations.

- In its statement on Pakistan's November 2006 Article IV review, the USED noted that a strong and independent central bank will continue to be a key to macroeconomic stability.

(B) Fair and open internal competition among domestic enterprises

Though the World Bank has the lead mandate on these issues, with United States support the IMF encourages member countries to pursue policies that improve internal economic efficiency. These measures may include ending directed lending (or other relationships between government and businesses based on favoritism), improving anti-trust enforcement, and establishing a sound and transparent legal system. For example,

- In a January 2007 Board Statement on Swaziland's Article IV review, the USED urged authorities to remove legal, regulatory, and administrative barriers to business establishment and operation in an effort to promote private sector-led economic development.

(C) Privatization

The IMF has made privatization a component of country programs where significant distortions and government ownership of business enterprises have created substantial inefficiencies in the allocation of resources and the production of goods. Collaborating with the World Bank, the Fund has supported the use of competitive and transparent means of privatization so that borrowing countries might achieve gains in economic efficiency and improve their fiscal positions. Examples of IMF programs and surveillance discussions in which the USED has advocated privatization include the following:

- In an August 2007 board statement for the Iraq Article IV, the USED commended the liberalization of fuel imports and encouraged Iraqi authorities to push for quick passage and implementation of a suite of hydrocarbons laws to encourage private investment in oil production.

- In a December 2006 Board statement on the second review of Cameroon's Poverty Reduction and Growth Facility, the USED urged the government to move forward with the privatization

of the government-owned airline, telecom company and water parastatal, noting that further delay would require additional government subsidization.

- In an April 2007 Board statement on a Poverty Reduction and Growth Facility for Burkina Faso, the USED encouraged Burkina Faso authorities to continue efforts for the government to reduce the government's ownership stake in SOFITEX, the country's largest cotton company and a central player in the critical cotton sector.

(D) Economic deregulation and strong legal frameworks

Markets are distorted and entrepreneurship is stifled without strong property rights, enforcement of contracts, and fair and open competition. While these issues are often addressed as part of the World Bank's mandate, the IMF periodically includes such policy advice in its programs or surveillance on measures considered critical to the member country's macroeconomic performance. Examples of United States' efforts to encourage these reforms include the following:

- In the August, 2007 Article IV review for Uruguay, the USED urged Uruguayan authorities to support increased financial intermediation through promoting banking sector competition, reforming state-owned banks, and strengthening bank supervision and regulation.

- In the December, 2006 Article IV review for India, the USED emphasized that an inefficient dispute resolution system, the lack of binding international arbitration and the backlogged domestic court system remain major deterrents to foreign investment in critical infrastructure projects.

(E) Social safety nets

While growth is an essential ingredient for poverty reduction, investment in human development and basic social services is also critical. Cost effective social safety nets can play an important role in building domestic support for economic reform, and in alleviating the direct impact of poverty.

The IMF does not lend directly for budget support to build social safety nets. However, the Fund's policy advice and its focus on macroeconomic stability encourage domestic policy makers to develop fiscal strategies that address the needs of the poor. Reducing generalized subsidies while protecting pro-poor spending, for example, is a common theme. In the poorest countries, IMF advice is developed within a country-specific poverty reduction strategy (PRS) that encourages accountability between donors and recipients.

- In the June 29, 2007 Board review of Paraguay's Stand-by Arrangement, the USED advocated increased expenditure on poverty reduction in Paraguay, financed by increased revenues from reforms to broaden the tax base.

(F) Opening of markets for agricultural goods through reductions in trade barriers

The IMF encourages a multilateral, rules-based approach to trade liberalization across all sectors of the global economy, including, but not limited to, the agricultural sector. The IMF has played a supportive role in promoting trade liberalization, particularly in the context of the WTO trade negotiations under the Doha Development Agenda (DDA). In April 2004, the Fund approved the Trade Integration Mechanism (TIM) to provide financial support to countries facing balance of payments problems resulting from trade adjustment. The proposal represents a concrete response to developing country concerns about the potential negative impacts from multilateral trade liberalization. The IMF is prepared, along with the World Bank, to provide transitional assistance to member countries experiencing payment imbalances arising from the passage of trade reform.

(3) *Strengthened financial systems and adoption of sound banking principles and practices*

The joint IMF-World Bank *Financial Sector Assessment Program* ("FSAP") has emerged as a critical instrument for financial sector surveillance and advice. As of end-September 2007, 116 countries have completed FSAP assessments and 24 countries have completed FSAP update assessments. Twenty-eight reviews are underway or planned.

Results from the FSAP are used to generate assessments of compliance with key financial sector standards such as the Basel Committee's *Core Principles for Effective Banking Supervision,* the International Organization of Securities Commission's *Objectives and Principles of Securities Regulation,* and the IMF's own *Code of Good Practices on Transparency in Monetary and Financial Policies.* The FSAP assessment results are summarized in *Financial System Stability Assessments* ("FSSA") which are often provided to the public. Some key examples of where the USED has supported the strengthening of financial systems are:

- In its May, 2007 Board statement on Turkey's 6th review of its Stand-by Arrangement the USED noted that Government of Turkey supervisory capacity has improved substantially, while the legislative framework is being modernized with the new Banking Law, the Mortgage Law, and prospective legislation on insurance and capital markets.

- In its statement on Japan's Article IV review in July 2007, the USED called for greater focus on consumer and investor protection, based on information disclosure, and risk management measures. The USED emphasized the need for such efforts to respond to Japanese investors' increased appetite for risk and investment abroad, and the need to increase the return on savings for retirement.

- During the IMF Board discussion on Brazil's Article IV review in July 2007, the USED supported policies that would foster financial intermediation, further reductions in directed lending, gradual phase out of the financial transactions tax, phase-out of credit quotas to specific sectors, and reorientation of the state-owned development bank toward market-oriented lending.

(4) *Internationally acceptable domestic bankruptcy laws and regulations*

The IFIs have continued to build upon work started after the Asian financial crisis to promote more effective insolvency and debtor-creditor regimes. While the World Bank normally leads reviews of domestic insolvency laws, the IMF actively supports this agenda. Both the UN Commission on International Trade Law (UNCITRAL) and the World Bank have worked to compile recommendations in this area covering, respectively, insolvency law and sound insolvency/creditor rights regimes. At the urging of the United States, staff from the World Bank, IMF and UNCITRAL worked together to develop a standardized, unified assessment methodology to assess implementation of those recommendations. The Financial Stability Forum, also with strong U.S. support, has called on World Bank and UNCITRAL staff to continue this cooperation and complete a concise, unified international standard for insolvency and creditor rights.

The IFIs also provide technical assistance to help emerging market economies develop efficient insolvency regimes. The IMF and the World Bank have supported adoption of the Model Law on Cross-Border Insolvency developed by the UN (the UNCITRAL Model Law) to facilitate the resolution of increasingly complex cases of insolvency where companies have assets in several jurisdictions. With the support of the United States, the IMF has worked with the World Bank to promote improved insolvency regimes in a number of countries.

(5) *Private sector involvement*

The United States continues to work to ensure that the private sector plays an appropriate role in the resolution of financial crises. Over the past several years, the IMF, with the support of the United States, has taken important steps towards strengthening crisis prevention and resolution. The IMF has strengthened its surveillance of member countries and instilled more discipline in the use of official sector financing, especially through the establishment of rules and procedures governing exceptional access to Fund resources. Additionally, the use of collective action clauses (see Section C, below), supported by the IMF as an accepted contractual, market-based approach to sovereign debt restructurings, should help a sovereign restructure its debt when under financial distress. The IMF recognizes the need to preserve the fundamental principles that (a) creditors should bear the consequences of the risks they assume, and (b) debtors should honor their obligations.

In particular, the United States has advocated policies that include:

(A) Increased crisis prevention through improved surveillance and debt and reserve management

The United States has urged the IMF to strengthen further its surveillance function and crisis prevention capabilities. In May 2007, the Board discussed an IMF staff paper on strengthening debt management which provided a stocktaking of the IMF and World Bank's experience in helping middle- and low-income countries in strengthening debt management practices. The Board noted that the development of clear operational frameworks to identify, monitor, and manage balance sheet and market risks would be helpful for middle- and low-income countries and the USED supported a four-year pilot project for providing technical assistance to three to

four low-income countries per year to help them build the capacity to develop and implement an effective medium-term debt management strategy.

The USED has also supported the balance sheet approach to measure vulnerabilities in emerging markets and has called for greater focus on debt sustainability in both low-income and emerging market countries.

- In its October, 2006 Article IV Board statement, the USED commended Colombia's performance in reducing its debt ratio to a predicted 40% or less of GDP by 2010, and encouraged continued debt reduction and prudent fiscal policies.

- In its January 26, 2007 review of the Peru Stand-By Arrangement, the USED welcomed authorities' efforts to re-balance the currency denomination of debt towards domestic currency, reducing the government's vulnerability to exchange rate volatility.

- In its July 18, 2007 Article IV response, the USED supported Indonesia's fiscal stance which aims to reduce public debt, and noted that this goal remains appropriate.

The IMF continues to encourage, with strong United States support, member countries to make their economic and financial conditions more transparent. Countries are urged to provide additional information to private market participants by publishing Article IV assessments and program documentation as well as by regularly releasing data consistent with the IMF's Special Data Dissemination Standard (SDDS).

- Fund members subscribing to either the General or Special Data Dissemination Standards (SDDS) increased from 75% of all members in 2005 to 82% in 2006, and 83% in 2007.

- In its October 2006 statement on Burma's September 2006 Article IV review, the USED noted that economic data continues to not be transparent to outside observers and the Burmese public and found that IMF surveillance and formulation of policy recommendations are hindered by questionable transparency and data shortcomings.

- In its November 2006 statement on India's Article IV review, the USED encouraged the Indian authorities to adopt the methods outlined by SDDS and to publicize current statistics.

- In its Board statement at the September 2007 Article IV discussions on the Republic of Korea, the USED emphasized that that it would welcome welcome a greater degree of transparency from Korean authorities regarding the timing and magnitude of their foreign exchange interventions.

(B) Strengthening of emerging markets' financial systems

The IMF continues to work with other IFIs to promote stronger financial systems in emerging market economies (see Section 3). The IMF and the World Bank reviewed coordination of their assistance efforts and the results of this review were set forth in the Malan Report which was published in February 2007. This report notes that the IMF and the World

Bank are the only IFIs with near universal membership, and that both of these institutions play an important role in helping emerging economies address the challenges of globalization, and obtain its benefits. The report recommended that future cooperation be based on the comparative expertise of the two institutions, with the IMF taking the lead in instances where there are significant issues of domestic or global economic stability, and the World Bank leading in instances where financial sector development issues are paramount.

The IMF is also actively involved with the World Bank in monitoring the implementation of the Basel Core Principles for Effective Banking Supervision. The IMF, with United States support, has increased its cooperation with the World Bank in this area, through the joint Financial Sector Assessment Program (FSAP) and in assessing countries' observance of other standards and codes.

Some key examples of where the USED has supported a strengthening of emerging market financial systems are:

- In its statement during the December 2006 IMF Executive Board discussion on India's Article IV consultations, the USED urged the removal of restrictions on banking sector assets, divestiture of government ownership of financial institutions, elimination of the obstacles to development of securitization markets, and improving reporting standards.

- The IMF Board discussed Turkey's Article IV review in May 2007. Welcoming Turkey's recent participation in the FSAP, the USED called for bolstering the bank resolution framework, supported authorities' commitment to bank privatization. The USED's statement encouraged ongoing human capital investment so that bank supervisors can respond effectively to still high levels of deposit dollarization, the large stock of foreign currency loans, and the thin inter-bank markets.

- In its Board statement at the February 2007 Article IV discussions, the USED noted that although Guatemalan authorities made progress in upgrading the bank supervisory framework and implementing the Basel Core Principles, the supervisors still lack sufficient legal authority to conduct effective consolidated supervision, and need to take immediate steps to bolster the crisis management framework, initiate comprehensive special inspection of banks, and recapitalize the deposit insurance fund with public money.

- In its December, 2006 review of the Uruguay Stand-By Arrangement, the USED urged the passage of a financial sector law, along with capitalization of the central bank, as a means of reducing financial sector vulnerabilities.

(C) Strengthened crisis resolution mechanisms

The United States, in cooperation with the IMF and the broader international financial community, has promoted a strengthened framework for crisis resolution through use of collective action clauses (CACs), application of the lending into arrears policy, and clear limits on the use of official finance.

(i) Collective Action Clauses

Sovereign bonds governed by New York law conventionally had not included provisions which would permit modification of key payment terms by less than unanimous consent. This restriction made these bonds harder to restructure when a sovereign experienced financial distress. The United States has worked actively with the IMF and the private sector to promote the market's adoption of CACs in order to improve debt restructuring processes. CACs have now become the market standard for sovereign bonds issued under New York law.

As of August 2007, CACs are included in 66 percent of the stock of external sovereign bonds issued by emerging markets. The IMF, encouraged by the United States, has made CACs an important element of its crisis resolution agenda. The IMF has indicated it will continue to encourage future issuers to follow this trend.

(ii) Lending into Arrears

The IMF lending into arrears policy permits the Fund to provide financial support for policy adjustments, despite the presence of actual or impending arrears on a country's obligations to private creditors, where: (i) prompt IMF support is considered essential for the successful implementation of the member's adjustment program; and (ii) the member is pursuing appropriate policies and is making a good faith effort to reach a collaborative agreement with creditors. IMF efforts in recent years have focused on applying the "good faith" criterion to specific cases, including Argentina, the Dominican Republic, Iraq, and Dominica.

(iii) Clear Limits on Official Finance

The United States continues to press the IMF to improve its lending selectivity. In 2002 explicit criteria were developed for extending loans to countries seeking to borrow beyond normal limits ("exceptional access"). These include: (i) the member must be experiencing "exceptional balance of payments pressures on the capital account" which cannot be addressed with normal resources, (ii) an analysis of sustainable debt levels, (iii) reasonable prospects exist that the member will regain access to private capital markets during the program term, and (iv) the member's policy program can reasonably be expected to succeed. In addition, procedures were introduced to require: (i) a "higher burden of proof in program documentation", (ii) early consultation with the Board on sovereign creditor negotiations, (iii) the issuance of a staff note specifically outlining all of the relevant considerations, and (iv) an ex-post evaluation of such a program within twelve months of its completion.

(6) *Good governance*

The IMF's commitment to promoting good governance is outlined in its 1996 *Declaration on Partnership for Sustainable Global Growth* and its 1997 *Guidelines on Good Governance*. The IMF also supports good governance through its emphasis on transparency, strong fiduciary diagnostics, and its promotion of market-based reforms.[4] Recently, the IMF has been

[4] IMF financing is provided to central banks to address balance of payments difficulties. The IMF does not lend to fund specific projects in member countries aimed at procurement and financial management controls.

particularly active in promoting good governance through its efforts to protect against abuse of the financial system and to fight corruption.

The Fund's involvement has focused on those governance aspects that are generally considered part of the IMF's core expertise, such as improving public administration, increasing government transparency, enhancing data dissemination, and implementing effective financial sector supervision. The IMF promotes best practice principles through its codes and standards, such as the *Code of Good Practices on Fiscal Transparency,* and is collaborating with the World Bank on strengthening the capacity of HIPC countries to track public sector spending. The Fund has worked with the World Bank and other donors to develop 28 Public Expenditure and Financial Accountability (PEFA) indicators, building on the 16 HIPC indicators, to measure and track countries' PMF performance over time. Supplementing this is the Fund's 2005 resource revenue guide, updated in 2007, a complement to the FISC ROSC for use in resource (oil-gas-mining) rich countries. The guide is being used increasingly in diagnostic work in extractive industry intense economies.

Examples of U.S. efforts to encourage good governance include the following:

- In its October 2006 statement on Burma's September 2006 Article IV, the USED observed that ongoing pervasive government control of the Burmese economy continues to generate serious macroeconomic imbalances, resulting in low investment, high and volatile inflation and entrenched poverty.

- In an August 2007 Board Statement on Angola's Article IV review, the USED urged authorities to increase oil and diamond sector transparency to ensure that the country's improved macroeconomic performance translates into lower poverty, a more diversified economy, and increased opportunities for all Angolans.

- During the July 2007 Third Review of Liberia's performance under the staff-monitored program, the USED urged timely passage of anti-corruption legislation to allow the government to continue its pursuit of good governance and greater transparency.

- In meetings with IMF staff, OUSED and Treasury staff encouraged the Fund to accelerate the use of the resource revenue guide in Fiscal ROSCs and to apply it more systematically in relevant Article IV reports.

(7) *Channeling public funds away from unproductive purposes, including large "show case" projects and excessive military spending, and toward investment in human and physical capital to protect the neediest and promote social equity*

The Fund published a *Code of Good Practices on Fiscal Transparency* in 1998 that aims to enhance fiscal policy transparency, promote quality audit and accounting standards, and reduce or eliminate off-budget transactions, which are often the source of unproductive government spending. The IMF also encourages countries to conduct "public expenditure reviews" with the World Bank.

- In its July, 2007 Article IV review of Bolivia, the USED encouraged Bolivian authorities to enact a new budget framework to strengthen the budget process and control subnational spending.

- In its Board statement at the most recent Brazil Article IV discussions, the USED questioned the value of Brazil's use of fiscal adjustors to the primary surplus, noting that such adjustments tend to cloud fiscal transparency.

(8) ***Economic prescriptions appropriate to the economic circumstances of each country***

The United States has supported flexibility in Fund programs, while emphasizing the need to focus conditionality on issues critical to growth and macroeconomic stability using measurable results. Partly as a result of U.S. efforts, program conditions have focused increasingly on debt and financial vulnerability in middle-income countries and macroeconomic management in low-income countries. In low-income countries, the U.S. has supported the use of Poverty Reduction Strategy Papers ("PRSP"), which are developed by local authorities and civil society and help ensure that IMF programs meet specific needs of the country.

(9) ***Core labor standards (CLS)***

Core labor standards provide a useful benchmark for assessing countries' treatment of workers against internationally agreed-upon standards. The State Department monitors labor standards in all IFI borrower countries and Treasury is mandated to submit a separate report to Congress assessing progress made with respect to internationally recognized worker rights.

(10) ***Discouraging practices that may promote ethnic or social strife***

By helping to create the conditions for a sound economy, IMF assistance facilitates the reduction of ethnic and social strife, to the extent such strife is driven in part by economic deprivation. For example, with United States support, the IMF has increasingly encouraged the strengthening of social safety nets. The IMF also encourages consultation with various segments of society in the development of programs so that these segments have an opportunity to participate in the implementation of national priorities. IMF assistance has helped to free up resources for more productive public investment by contributing to a reduction in country military expenditures.

(11) ***Link between environmental and macroeconomic conditions and policies***

With respect to its individual lending operations, the IMF does not itself evaluate positive or negative linkages between conditions and environmental sustainability. Rather, the IMF coordinates with the World Bank which, unlike the IMF, possesses the internal expertise to address such linkages. The United States has encouraged the inclusion of conditions on environmental issues in cases where such issues have significant macroeconomic consequences.

- In the August 2007 statement on Laos' July Article IV review, the USED noted that a transparent and predictable resource revenue management framework would help maximize the benefits of Lao's vast natural resources and strongly recommended that the authorities participate in the Extractive Industries Transparency Initiative and adhere to the Fund's guidelines on resource revenue management.

(12) *Greater transparency*

Over the last several years, the IMF has increased significantly the amount of information on its programs that it has made available to the public. The United States has stressed the need to build on this progress and expand the number of publications and IMF practices open to public scrutiny. As of July 2004, publication of all Article IV and Use of Fund Resources staff reports is presumed unless a country objects. In addition, all exceptional access reports will generally be published as a pre-condition for the Board's approval of such an arrangement.[5] The USED consistently encourages countries to publish the full Article IV staff report on the IMF's public website. The percentage of staff reports published increased from 78 percent in 2004 to 84 percent in 2006.

(13) *Greater IMF accountability and enhanced self-evaluation*

In April 2000, with the strong urging of the USED, the Executive Board agreed to establish an Independent Evaluation Office ("IEO") to supplement existing internal and external evaluation activities. The IEO provides objective and independent evaluation on issues related to the IMF and operates independently of Fund management and at arm's length from the IMF Board. Since its inception, the IEO has published thirteen comprehensive reviews, including recent assessments of the IMF's structural conditionality, exchange rate policy advice, and aid to Sub-Saharan Africa. All reports are publicly available on the IEO's website at (http://www.imf.org/external/np/ieo/index.htm).

In response to recommendations of a 2002 IEO study on prolonged use of IMF resources, the IMF now requires "Ex Post Assessments" (EPAs) of IMF engagement in countries where the IMF has had a program in place for at least 7 out of the past 10 years. The EPAs are intended to provide a long-term, arms-length perspective and are led by someone other than the country mission chief, ideally someone outside of the area department. EPAs provide valuable insights to guide future engagement with "prolonged use" countries.

(14) *Structural reforms which facilitate the provision of credit to small businesses, including microenterprise lending*

The lack of financial services available to the poor is a significant obstacle to growth for many developing countries. The IMF does not have the lead role in microeconomic reforms to benefit small businesses; however, the Treasury Department engages with the IFIs to promote structural reforms that encourage the provision of credit to small and micro enterprises. The microfinance sector is frequently reviewed in the context of the Financial Sector Assessment Program (FSAP) in developing countries.

[5] "Exceptional access" refers to financing arrangements in amounts that exceed the Fund's normal limits.

- In its July, 2007 Article IV response, the USED voiced concerns about the impact of a state-run development bank, BDP, on the Bolivian micro-credit industry, doubting its potential to complement the private sector without competition.

(15) *Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT)*

Comprehensive integration of the efforts of the IMF and the other IFI efforts as part of the global war on terrorism has been a consistent policy priority for the United States and its partners. We have encouraged collaboration between the IFIs and the Financial Action Task Force (FATF) to assess global compliance with the anti-money laundering (AML) and counter-terrorist financing (CFT) standards based on the FATF 40 Recommendations on Money Laundering and the 9 Special Recommendations on Terrorist Financing.

In April 2007, largely as a result of US and G7 leadership, the Executive Board of the IMF reiterated the importance of AML/CFT standards to strengthening the integrity of financial systems and deterring financial abuse, and affirmed the collaborative arrangements presently in place with the FATF and FATF-style regional bodies (FSRBs) for assessing AML/CFT regimes in the context of the IMF's financial sector work. The Board also encouraged greater transparency by calling for the publication of comprehensive country evaluations.

Collaboration by the IMF, FATF and FSRBs, with the assessors, using the same common methodology, institutionalizes the global fight against terrorist financing and money laundering, and helps countries identify shortfalls in their AML and CFT regimes and implement reforms. As of September 2007, the IMF had conducted 50 assessments of country compliance with AML/CFT, four of which were conducted jointly with the World Bank.

The IMF is also a substantial source of funding for countries' efforts to strengthen their own AML/CFT regimes – an activity that Treasury has supported and has joined in to leverage Treasury's own bilateral AML/CFT assistance. The IMF has provided substantial technical assistance (TA) on a bilateral and regional basis, delivering 88 missions and events from May 2006 to April 2007.

In the latest Communiqué of the International Monetary and Financial Committee of the Board of Governors of the International Monetary Fund (IMFC) - the Secretary of the Treasury is the Governor for the United States - the IMFC reiterated the importance of these issues and called for closer cooperation between the IMF and FATF in promoting stronger implementation of AML/CFT standards and encouraged publication of comprehensive country evaluations.

The USED/IMF office played a crucial role in mobilizing the IMF Board support for this initiative, as well as making sure note is taken of AML/CFT issues in Article IV reviews and reports, IMF programs, and other regular reviews of country progress. Examples include:

- In its September 2007 statement on the United Arab Emirates' Article IV report, the USED concurred with IMF staff in calling upon the government of the United Arab Emirates to strengthen its legal framework for combating terrorist financing and money laundering.

- In the USED July 2007 Board Statement, the USED noted that MENA FATF (the regional FSRB for the Middle East and North Africa) had completed its AML/CFT assessment of Syria. The USED asked IMF staff to review the MENA FATF assessment and provide the Board with comment on its main findings.

- In its December 2006 statement on Hong Kong's Article IV review, the USED noted that Hong Kong authorities are taking steps to improve their AML/CFT legislative framework. The USED called for improved enforcement of AML/CFT measures, and highlighted the need for greater regulatory oversight.

- In its November 2006 statement on Pakistan's Article IV review, the USED congratulated Pakistani authorities on measures taken to date to build robust controls against illicit finance and emphasized that passage of the long-delayed legislation on money laundering would be an important step.

II. <u>Section 801(c)(1)(B)</u>

(I) Suspension of IMF financing if funds are being diverted for purposes other than the purposes for which the financing was intended

With strong United States support, the IMF has taken steps in the past several years to ensure that IMF resources are used solely for the purposes for which they are intended. These steps constitute a serious and far-reaching initiative to strengthen the system for safeguarding the use of Fund resources and for deterring the misreporting of data to the IMF.

The IMF's safeguards framework requires countries receiving funds to submit to external financial audits of their central bank's data. This process is designed to ensure that central banks have adequate control, accounting, reporting and auditing systems in place to protect central bank resources, including IMF disbursements. Any critical gaps identified during the assessment process must be remedied before additional IMF resources can be disbursed.

(II) IMF financing as a catalyst for private sector financing

The IMF recognizes that, if structured effectively, official financing can complement and attract private sector flows. The Fund promotes policy reforms that catalyze private financing and, in cases of financial crisis, allow countries to regain access to international private capital markets as quickly as possible. (See Section 5 above for a more in-depth discussion of private sector involvement.)

(III) Financing must be disbursed (i) on the basis of specific prior reforms; or (ii) incrementally upon implementation of specific reforms after initial disbursement

IMF disbursements are tranched based on a country's performance against specified policy actions, both prior to and during the program.

- In its Board statement at the February 2007 discussions on the Ex-post Assessment of the 2002-2006 PRGF program for Nicaragua, the USED noted that using an IMF disbursement of funds as a signal to other donors of compliance put pressure on the IMF to disburse funds despite countries not meeting program standards, limiting the IMF's ability to be an effective gatekeeper of funds.

(IV) ***Open markets and liberalization of trade in goods and services***

The IMF has been a consistent advocate of open markets and trade liberalization. The Fund also recognizes that trade adjustments can cause temporary balance of payments problems and has developed the Trade Integration Mechanism to provide transitional financial assistance to countries if needed.

- In its Board statement at the December 2006 Article IV discussion for India, the USED agreed with IMF staff that India can play a proactive role in restarting multilateral trade talks and noted that in the Doha Round, key developing countries such as India also need to reduce tariffs and other trade barriers in order to promote new trade flows in agriculture, manufactured goods and services.

- In its Board statement at the February 2007 Article IV discussions, the USED encouraged Panama that implementation of the US-Panama FTA would provide additional impetus for reforms and help sustain growth.

(V) ***IMF financing to concentrate chiefly on short-term balance of payments financing***

In September 2000, with strong United States support, the IMF agreed to reorient IMF lending to discourage continued or prolonged use of IMF funds, and provide incentives for quick repayment. In particular, the IMF shortened the expected repayment periods for both Stand-By and Extended Arrangements and established surcharges for higher levels of access.

In early 2006 the IMF activated an Exogenous Shocks Facility (ESF) for low-income countries, which the U.S. supported to bolster the IMF's focus on addressing short-term balance of payments needs. The U.S. also successfully pressed for the adoption of the non-borrowing Policy Support Instrument (PSI), to provide a framework for IMF policy advice and donor signaling without the need for IMF lending. The U.S. has discouraged low-income countries from pursuing serial PRGF programs. The U.S. urges those countries without a clear balance of payments financing need to opt for a PSI, in which case they would retain the option of seeking ESF financing in the event of sudden adverse developments in their balance of payments.

(VI) ***Graduation from receiving financing on concessionary terms***

The United States supports comprehensive growth strategies to move countries from concessional to market-based lending. The United States works closely with the IMF and World Bank to promote a growth-oriented agenda in developing countries based on strong monetary and fiscal policies, trade liberalization, and reduction of impediments to private sector job creation. The IMF extends concessional credit through the PRGF. Eligibility is based

principally on a country's per capita income and eligibility under the International Development Association ("IDA"), the World Bank's concessional window (the current operational cutoff point for IDA eligibility is a 2004 per capita GNI level of $965). Factors that would contribute to reduced reliance on concessional resources include a country's growth performance and prospects, capacity to borrow on non-concessional terms, vulnerability to adverse external developments such as swings in commodity prices, and balance of payments dynamics.

ANNEX 1
Report to Congress on International Monetary Fund Lending
October 1, 2006 – September 30, 2007

11/20/2006	Haiti	SDR 73.7 million (US $110 million)	PRGF	Support	
12/15/2006	Moldova	SDR 30.8 million (US $46 million)	PRGF Augmentation	Support	
12/18/2006	Mauritania	SDR 16.1 million (US $24 million)	PRGF	Support	
12/22/2006	Central African Republic	SDR 36.2 million (US $54 million)	PRGF	Support	
01/26/2007	Peru	SDR 172.4 million ($258 million)	SBA	Support	
02/21/2007	The Gambia	SDR 14 million ($21 million)	PRGF	Support	
04/23/2007	Burkina Faso	SDR 6 million ($9 million)	PRGF	Support	
05/07/2007	Gabon	SDR 77.2 million ($116 million)	SBA	Support	
08/03/2007	Côte d'Ivoire	SDR 40.6 million (US$62 million)	EPCA	Support	

Legislative Provisions
Section 1503 of the International Financial Institutions Act, as amended
(originally passed as Section 610 of the
Foreign Operations, Export Financing, and
Related Programs Appropriations Act, 1999, and amended in 2004)

The Secretary of the Treasury shall instruct the United States Executive Director of the International Monetary Fund to use aggressively the voice and vote of the Executive Director to do the following:

(1) Vigorously promote policies to increase the effectiveness of the International Monetary Fund in structuring programs and assistance so as to promote policies and actions that will contribute to exchange rate stability and avoid competitive devaluations that will further destabilize the international financial and trade systems.

(2) Vigorously promote policies to increase the effectiveness of the International Monetary Fund in promoting market-oriented reform, trade liberalization, economic growth, democratic governance, and social stability through –
(A) Establishing an independent monetary authority, with full power to conduct monetary policy, that provides for a non-inflationary domestic currency that is fully convertible in foreign exchange markets;
(B) Opening domestic markets to fair and open internal competition among domestic enterprises by eliminating inappropriate favoritism for small or large businesses, eliminating elite monopolies, creating and effectively implementing anti-trust and anti-monopoly laws to protect free competition, and establishing fair and accessible legal procedures for dispute settlement among domestic enterprises;
(C) Privatizing industry in a fair and equitable manner that provides economic opportunities to a broad spectrum of the population, eliminating government and elite monopolies, closing loss-making enterprises, and reducing government control over the factors of production;
(D) Economic deregulation by eliminating inefficient and overly burdensome regulations and strengthening the legal framework supporting private contract and intellectual property rights;
(E) Establishing or strengthening key elements of a social safety net to cushion the effects on workers of unemployment and dislocation; and
(F) Encouraging the opening of markets for agricultural commodities and products by requiring recipient countries to make efforts to reduce trade barriers.

(3) Vigorously promote policies to increase the effectiveness of the International Monetary Fund, in concert with appropriate international authorities and other international financial institutions (as defined in Section 1701(c)(2)), in strengthening financial systems in developing countries, and encouraging the adoption of sound banking principles and practices, including the development of laws and regulations that will help to ensure that domestic financial institutions meet strong standards regarding capital reserves, regulatory oversight, and transparency.

(4) Vigorously promote policies to increase the effectiveness of the International Monetary Fund, in concert with appropriate international authorities and other international financial institutions (as defined in Section 1701(c)(2)), in facilitating the development and implementation of internationally acceptable domestic bankruptcy laws and regulations in developing countries, including the provision of technical assistance as appropriate.

(5) Vigorously promote policies that aim at appropriate burden-sharing by the private sector so that investors and creditors bear more fully the consequences of their decisions, and accordingly advocate policies which include –

(A) Strengthening crisis prevention and early warning signals through improved and more effective surveillance of the national economic policies and financial market development of countries (including monitoring of the structure and volume of capital flows to identify problematic imbalances in the inflow of short and medium term investment capital, potentially destabilizing inflows of offshore lending and foreign investment, or problems with the maturity profiles of capital to provide warnings of imminent economic instability), and fuller disclosure of such information to market participants;

(B) Accelerating work on strengthening financial systems in emerging market economies so as to reduce the risk of financial crises;

(C) Consideration of provisions in debt contracts that would foster dialogue and consultation between a sovereign debtor and its private creditors, and among those creditors;

(D) Consideration of extending the scope of the International Monetary Fund's policy on lending to members in arrears and of other policies so as to foster the dialogue and consultation referred to in subparagraph (C);

(E) Intensified consideration of mechanisms to facilitate orderly workout mechanisms for countries experiencing debt or liquidity crises;

(F) Consideration of establishing ad hoc or formal linkages between the provision of official financing to countries experiencing a financial crisis and the willingness of market participants to meaningfully participate in any stabilization effort led by the International Monetary Fund;

(G) Using the International Monetary Fund to facilitate discussions between debtors and private creditors to help ensure that financial difficulties are resolved without inappropriate resort to public resources; and

(H) The International Monetary Fund accompanying the provision of funding to countries experiencing a financial crisis resulting from imprudent borrowing with efforts to achieve a significant contribution by the private creditors, investors, and banks which had extended such credits.

(6) Vigorously promote policies that would make the International Monetary Fund a more effective mechanism, in concert with appropriate international authorities and other international financial institutions (as defined in Section 1701(c)(2)), for promoting good governance principles within recipient countries by fostering structural reforms, including procurement reform, that reduce opportunities for corruption and bribery, and drug-related money laundering.

(7) Vigorously promote the design of International Monetary Fund programs and assistance so that governments that draw on the International Monetary Fund channel public funds away

from unproductive purposes, including large "show case" projects and excessive military spending, and toward investment in human and physical capital as well as social programs to protect the neediest and promote social equity.

(8) Work with the International Monetary Fund to foster economic prescriptions that are appropriate to the individual economic circumstances of each recipient country, recognizing that inappropriate stabilization programs may only serve to further destabilize the economy and create unnecessary economic, social, and political dislocation.

(9) Structure International Monetary Fund programs and assistance so that the maintenance and improvement of core labor standards are routinely incorporated as an integral goal in the policy dialogue with recipient countries, so that –

(A) Recipient governments commit to affording workers the right to exercise internationally recognized core worker rights, including the right of free association and collective bargaining through unions of their own choosing;

(B) Measures designed to facilitate labor market flexibility are consistent with such core worker rights; and

(C) The staff of the International Monetary Fund surveys the labor market policies and practices of recipient countries and recommends policy initiatives that will help to ensure the maintenance or improvement of core labor standards.

(10) Vigorously promote International Monetary Fund programs and assistance that are structured to the maximum extent feasible to discourage practices which may promote ethnic or social strife in a recipient country.

(11) Vigorously promote recognition by the International Monetary Fund that macroeconomic developments and policies can affect and be affected by environmental conditions and policies, and urge the International Monetary Fund to encourage member countries to pursue macroeconomic stability while promoting environmental protection.

(12) Facilitate greater International Monetary Fund transparency, including by enhancing accessibility of the International Monetary Fund and its staff, foster a more open release policy toward working papers, past evaluations, and other International Monetary Fund documents, seeking to publish all Letters of Intent to the International Monetary Fund and Policy Framework Papers, and establishing a more open release policy regarding Article IV consultations.

(13) Facilitate greater International Monetary Fund accountability and enhance International Monetary Fund self-evaluation by vigorously promoting review of the effectiveness of the Office of Internal Audit and Inspection and the Executive Board's external evaluation pilot program and, if necessary, the establishment of an operations evaluation department modeled on the experience of the International Bank for Reconstruction and Development, guided by such key principles as usefulness, credibility, transparency, and independence.

(14) Vigorously promote coordination with the International Bank for Reconstruction and Development and other international financial institutions (as defined in Section 1701 (c)(2)) in promoting structural reforms which facilitate the provision of credit to small businesses, including microenterprise lending, especially in the world's poorest, heavily indebted countries.

(15) Work with the International Monetary Fund to

- *(A) foster strong global anti-money laundering (AML) and combat the financing of terrorism (CFT) regimes;*
- *(B) ensure that country performance under the Financial Action Task Force anti-money laundering and counterterrorist financing standards is effectively and comprehensively monitored;*
- *(C) ensure note is taken of AML and CFT issues in Article IV reports, International Monetary Fund programs, and other regular reviews of country progress;*
- *(D) ensure that effective AML and CFT regimes are considered to be indispensable elements of sound financial systems; and*
- *(E) emphasize the importance of sound AML and CFT regimes to global growth and development.*

Legislative Provisions
Section 801 (c) (1) (B)
Foreign Operations, Export Financing, and
Related Programs Appropriations Act, 2001

Treasury should report on the extent to which the IMF is implementing –

I. *Policies providing for the suspension of financing if funds are being diverted for purposes other than the purpose for which the financing was intended;*

II. *Policies seeking to ensure that financing by the Fund normally serves as a catalyst for private sector financing and does not displace such financing;*

III. *Policies requiring that financing must be disbursed (i) on the basis of specific prior reforms; or (ii) incrementally upon implementation of specific reforms after initial disbursement;*

IV. *Policies vigorously promoting open markets and liberalization of trade in goods and services;*

V. *Policies providing that financing by the Fund concentrates chiefly on short-term balance of payments financing;*

VI. *Policies providing for the use, in conjunction with the Bank, of appropriate qualitative and quantitative indicators to measure progress toward graduation from receiving financing on concessionary terms, including an estimated timetable by which countries may graduate over the next 15 years.*

Legislative Provisions
Section 605(d) of the Foreign Operations, Export Financing, and Related Programs Appropriations Act, 1999

On a quarterly basis, the Secretary of the Treasury shall report to the appropriate committees on the standby or other arrangements of the Fund made during the preceding quarter, identifying separately the arrangements to which the policies described in section 601(4) of this title apply and the arrangements to which such policies do not apply.

March 26, 2008
2008-3-26-14-49-55-13417

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 $75,146 million as of the end of that week, compared to $75,366 million as of the end of the prior week.

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

	March 21, 2008		
A. Official reserve assets (in US millions unless otherwise specified)	Euro	Yen	Total
(1) Foreign currency reserves (in convertible foreign currencies)			75,146
(a) Securities	15,446	12,324	27,770
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	15,301	6,902	22,203
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	4,330		
(3) SDRs	9,802		
(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 !!				
(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	

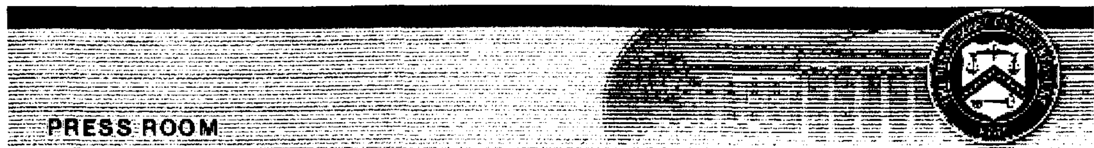
(d) securities lent and on repo	
--lent or repoed and included in Section I	
--lent or repoed but not included in Section I	
--borrowed or acquired and included in Section I	
--borrowed or acquired but not included in Section I	
(e) financial derivative assets (net, marked to market)	
--forwards	
--futures	
--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)	75,146
--currencies in SDR basket	75,146
--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.



March 27, 2008
HP-889

Secretary Paulson to Visit China Next Week

Secretary Henry M. Paulson, Jr. will travel to China next week to meet with the newly appointed leadership and discuss a broad range of economic issues. Paulson will be in Beijing April 2 and 3.

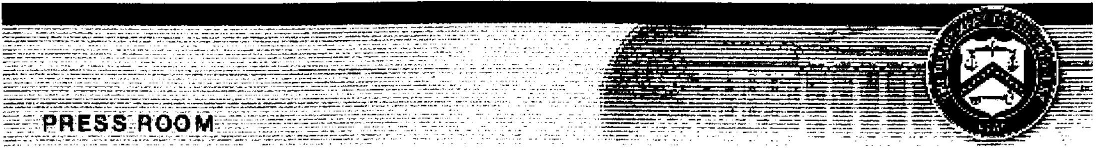
While there he will also deliver remarks on U.S. and Chinese cooperation on issues surrounding energy and the environment.

Presidents Bush and Hu established the U.S.-China Strategic Economic Dialogue (SED) in 2006 to provide a focused and effective framework for addressing economic issues of mutual concern. By prioritizing issues in the broader context of our bilateral economic relationship, the SED gives direction and creates momentum for the many existing bilateral mechanisms we use to foster cooperation and resolve concerns across the spectrum of economic issues. The SED focuses on a range of issues including financial sector reform and increased currency flexibility, the integrity of trade and product safety, and investment.

Paulson's remarks will focus on an agreement reached at the last meeting of the SED, in which the United States and China agreed to conduct extensive cooperation over a ten-year period to address the challenges of environmental sustainability, climate change and energy security. This ten year collaboration will advance technological innovation, further the adoption of highly-efficient, clean energy technology, promote the development of technology to address climate change, and promote the sustainability of natural resources. Both sides agreed to take additional steps to promote energy efficiency and security and address climate change.

Protecting the environment and promoting clean energy represent a shared priority for the United States and China. The two countries are the two largest consumers of natural resources, and recognize that meaningful results require cooperation on a wide range of sustainable resource and environment initiatives.

Who
Secretary Henry M. Paulson, Jr.
What
Remarks
When
9:00 a.m. (Local Time), Thursday, April 3
Where
Chinese Academy of Sciences
Research Center for Eco-Environmental Sciences
18 Shuangqing Road
Haidian District, Beijing, China



March 27, 2008
HP-890

Treasury To Hold Briefing on China Trip

Ambassador Alan F. Holmer, Special Envoy for China and the Strategic Economic Dialogue, will hold a pen-and-pad briefing on Secretary Paulson's April 2-3 trip to China.

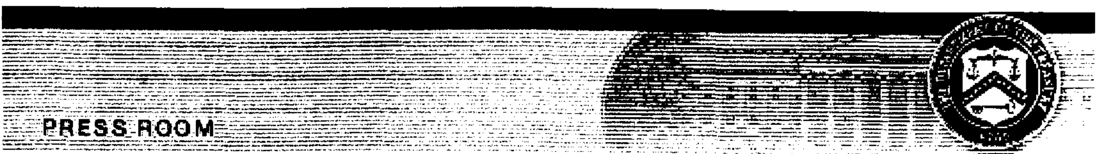
Who
Ambassador Alan F. Holmer

What
Pen-and-Pad Briefing on Secretary Paulson's China Trip

When
Friday, March 28, 2:00 p.m. EDT

Where
U.S. 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. No cameras will be permitted into the briefing.



March 27, 2008
HP-891

Remarks By Treasurer Anna Escobedo Cabral on Housing Before the National Association of Hispanic Real Estate Professionals

Washington – Thank you, Chairman DeHerrera, for the kind introduction and strong leadership. I am pleased to be here with all of you today for the 2008 Legislative Conference.

I send my most sincere thanks to NAHREP President and CEO Timothy Sandos, incoming Chair Rebecca Gallardo-Serrano, Legislative Conference Committee Chair Alex Chaparro, the panelists representing many distinguished organizations in the housing sector and last, but certainly not least, those representatives from NAHREP's 60 local affiliate chapters for making the trip to DC today.

Together, you create a resounding, powerful voice on issues that affect Hispanic homeownership throughout our nation.

As we gather today, during the opening days of spring, we have much work to do. Despite the homeownership challenges we face, the majority of homeowners in the country are not experiencing serious housing problems. For the 92 percent of homeowners who pay their mortgages on time, the sun is shining. But for those remaining families who are at risk of foreclosure, are struggling to make payments, or have lost their homes, their spring has yet to come.

Many struggling to stay in their homes face constant worry, causing some to declare that "Home is where the *mortgage* is."

Minority homeownership in this country has risen to historic levels -- above 50 percent -- since the President took office. But, the housing crisis hit the Hispanic community especially hard and too many families in this country face a time when they are watching their dreams fade into a not-so-distant past.

Solutions to complex housing and economic problems do not come easily, nor swiftly, but there are ways we can help people keep their homes. The Administration is taking many steps to ensure that our nation works through this difficult period.

First, as many of you know, the President signed into law an economic growth package that will provide rebates payments to more than 130 million Americans and tax incentives to businesses. These funds will create a temporary, meaningful boost to our economy as we weather the housing correction. (And, it will put extra spending money in your pockets!)

The President is also working closely with Secretary Jackson at HUD to assist those homeowners in danger of foreclosure and to make necessary changes to the home buying process including:

- Promoting FHASecure, which has helped more than 130,000 current and delinquent homeowners nationwide to refinance into a safer, more secure FHA loan;
- Reforming RESPA, which will ensure that the process of signing a mortgage is clear and understandable; and
- Pushing Congress to act on important issues like GSE reform and FHA Modernization.

I know your luncheon speaker today, Secretary Jackson, is going to delve much deeper into those issues.

At Treasury, we are equally committed to an ownership society and to helping homeowners. We know that government works best when it joins together with the private sector to solve problems. This is why Secretary Paulson and Secretary Jackson, at the behest of the President, have partnered with the private sector in an evolving voluntary industry effort to build back the housing market.

The HOPE NOW Alliance – made up of our nation's leading counselors, servicers, and investors – has been critical in bolstering our efforts to vulnerable homeowners. Representing more than 70 percent of the mortgage industry and 90 percent of the subprime mortgage industry, HOPE NOW has implemented a variety of outreach services, including a direct mail campaign and a centralized hotline. We know that half of borrowers who foreclosed on a home never reached out to their lender or housing counselor to ask for the crucial help they need. We must work to encourage those families who fall behind that they can't avoid the letters. They can't avoid the phone calls. They can't avoid the problem.

We need your help in spreading the word. If you know a homeowner who needs assistance, and they are not comfortable calling their mortgage lender directly, please encourage them to call the HOPE NOW hotline at: 1-888-995-HOPE. That's 1-888-995-4673, or HOPE. At the other end of that line will be a housing counselor – people who have the training, tools, and know-how to help keep people in their homes.

As Treasurer, I have made it a priority to help educate the public about how to make important decisions about their finances, from understanding the importance of having a bank account to knowing how to use credit to your advantage to knowing the terms of your mortgage.

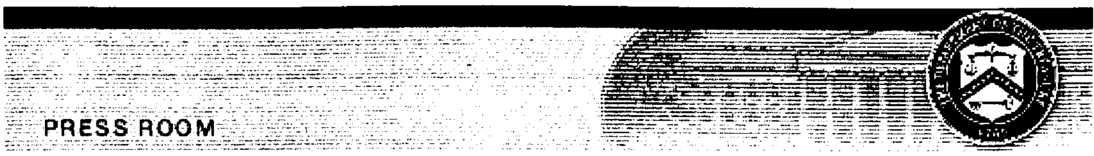
Sometimes it is easier to see the value of financial education when it is not there. In the past few years, too many individuals entered into mortgages that they didn't understand or couldn't manage. For most Americans, buying a home is the biggest, most important purchase of a lifetime. In the Hispanic community, where home equity accounts for the majority of household wealth, this is especially true. I would encourage all Americans to use the financial education resources available to their advantage and to use housing counselors.

I know that the members of NAHREP are lending a hand during this challenging time. Your members are vital to this effort, because you work closely with communities. You build trust. And, you assist those with language barriers to become, and remain, homeowners. The organization's historic growth in membership in the past six years is sure to further enhance its ability to make an even greater impact in the Hispanic community.

Let me close with this: President Bush has worked hard to break down barriers to homeownership and expand the dream of owning a home to more Americans. It is all of our responsibilities to help protect and preserve this dream. At the end of the day, the more families we place and keep in homes improves lives and strengthens our nation's economy. Working together, I'm confident we can move forward to brighter days ahead and preserve the American Dream of homeownership for all Americans.

Thank you.

-30-



March 27, 2008
HP-892

Under Secretary McCormick Remarks to the Japan Society

U.S.-Japan Relations: An Essential Bond in a Changing World

New York – I'd like to thank the Japan Society for inviting me to speak here today. The Japan Society recently celebrated its 100th anniversary, and over the past century the Society's efforts have contributed greatly to making the U.S.-Japan relationship one of the strongest – and most important – bilateral relationships we have.

As this group knows well, the U.S.-Japan alliance is the bedrock of economic stability and prosperity in Asia. The economic success of the Asia Pacific region owes much to the open trading regime promoted by the United States and Japan. There is no doubt that this relationship has had its moments of tension over the past 60 years, but through the strength of our mutual interests and our shared values, it has grown, flourished and matured.

While this economic relationship is exceptionally strong and successful, it also is clear that it has not achieved its full potential in many ways. Given the size of our two economies, for example, we have failed to achieve the full benefits of economic integration through bilateral trade and investment. Likewise, despite our many mutual interests around the world, we have not fully leveraged the strength of our alliance to confront common challenges and opportunities on crucial issues such as global trade, energy and the environment, or investment liberalization.

With this context, my argument today is a simple one: in this time of dramatic global economic change – a period marked by factors including the rapid growth of emerging economies, the rise of protectionism, and global financial market turmoil and uncertainty – U.S.-Japan cooperation on the international stage is more important than ever. Japan and the United States must work together on a focused agenda for addressing these common challenges and opportunities. Today, I'd like to suggest some critical components of the common U.S.-Japan agenda.

The U.S.-Japan Relationship in Perspective

To get a sense of how much the challenges confronting Japan and the United States have changed – one needs only to go back a single generation. In the early 1980s, the U.S. and Japanese economies overwhelmingly dominated the Asia-Pacific region, accounting for 84% of the area's GDP. Economic issues were synonymous with trade issues – steel, autos, and semiconductors dominated U.S.-Japan economic discussion. The Asian tigers – Korea, Taiwan, Hong Kong, and Singapore – were growing rapidly but still relatively small. China was just beginning its turn towards a market economy.

Today, the emerging markets of Asia – China in particular – are far larger in the region and the world. The U.S. and Japan share of Asia-Pacific GDP has fallen to 75 percent. We should be absolutely clear: the rapid growth of Asian economies is a validation of the open global economic system that the United States and Japan fostered. Their growth has enhanced our prosperity. But it has also altered the world that we operate in and the many challenges that we face.

The US-Japan economic relationship has also changed over this period. A quarter-century ago, Japan was America's top economic challenger and the face of the globalization threat for U.S. workers. Ironically, just as American fear of the Japanese challenge became most intense, the bursting of an equity and property market bubble launched Japan into a period of sluggish growth, financial crisis, and deflation. The Japanese now refer to this as the "lost decade." U.S. worry about

Japanese economic weakness and its effect on the global economy after the Asian financial crisis displaced worry about Japan's strength. And lectures about macroeconomic policy supplemented U.S. demands for market opening.

This Administration has recognized Japan as an indispensible ally in Asia and introduced a quiet, less strident and more respectful dialogue across all dimensions of the relationship. We understood that solving financial sector problems and deflation were key to restoring the vibrancy of Japan's economy. And, restoring a vibrant economy was essential if Japan was to play a confident, leading role on the world stage.

Economic and financial sector reforms have restored health to Japan's banking sector and Japan is now in its longest postwar economic recovery. But deflation remains surprisingly stubborn and domestic demand – particularly consumer spending – has been weak. Despite years of structural reform, Japan still relies heavily on foreign demand and lacks the domestic vibrancy to stimulate growth. For these reasons, Japan should continue with comprehensive reforms to spur competition and raise Japan's long-term growth. There are some encouraging signs, including the government's financial sector reform plans and its recent creation of a blue-ribbon panel to consider how the Japanese economy should evolve over the next quarter century. But it is fair to say - as many of my friends in Japan would acknowledge – that beyond discussion, more action must be taken faster.

Our joint focus on the bilateral relationship has sometimes come at the expense of our two countries presenting a common and forceful front on issues of international significance. Yet, in many areas of international policy, a strong US-Japan partnership is critical and necessary for success. There are several particularly important and timely areas for cooperation.

Common Challenges and Opportunities

Maintaining open trade and investment is perhaps the most important common global challenge we face. Although trade liberalization and increasing openness to capital flows and investment have been fundamental to our two countries' growth and prosperity, they are now under increasing challenge. The Doha Round of trade negotiations presents a significant opportunity to create new trade in agriculture, industrial goods, and services. It is important that Japan play a leading role, along with the United States, in bringing Doha to a successful conclusion. In addition, Japanese leadership is critical to achieving ambitious trade liberalization in the Asia-Pacific region through a Free Trade Area of the Asia-Pacific.

Open Investment

Openness to investment is as important as openness to trade. The United States has benefited greatly from the free flow of capital. Cumulative foreign direct investment in the United States now exceeds 28 percent of GDP. International investment in the United States fuels U.S. economic prosperity by creating well-paid jobs, importing new technology, and providing healthy competition that fosters innovation, productivity gains, lower prices, and greater variety for consumers. Over 10 million Americans – 9.2 percent of the U.S. private sector – are employed, directly or indirectly, by the U.S. operations of foreign-owned firms.

Like the United States, Japan has been the beneficiary of inward foreign portfolio investment and the ability of its firms to invest overseas. In contrast, however, foreign direct investment flows into Japan have averaged just 0.1 percent of GDP over the past ten years, and the Ministry of Finance estimates the stock of foreign direct investment at just 3.0 percent of GDP, among the lowest in the OECD. The Fukuda government has ambitiously pledged to double incoming foreign direct investment by 2010. This would spur an increase in productivity and domestic demand growth.

The most immediate challenge to maintaining open investment regimes comes from the rapid growth and increasing importance of state-owned sovereign wealth funds as international investors. Sovereign wealth funds can bring many benefits, by boosting funds available for investment, and by being patient, long run investors. Sovereign wealth funds, as public sector entities, should have both an interest in

and a responsibility for financial market stability.

At the same time, rising investment by state-owned wealth funds could provoke a new wave of investment protectionism, which would be very harmful to the global economy. Protectionist sentiment could be partially based on a lack of information and understanding of the objectives of sovereign wealth funds. It could be done in part due to limited transparency and spotty communication on the part of the funds themselves. Better information and understanding on both sides of the investment relationship are needed.

To maintain open investment regimes and ensure that the world continues to benefit from investment by sovereign wealth funds, we have proposed the development of a multilateral framework for best practices. The International Monetary Fund should develop best practices for sovereign wealth funds, building on existing best practices for foreign exchange reserve management. These would provide guidance to new funds on how to structure themselves, reduce any potential systemic risk, and demonstrate they are responsible, constructive market participants.

We have also proposed that the Organization for Economic Co-operation and Development (OECD) identify best practices for countries that receive foreign government-controlled investment. These should have a focus on avoiding protectionism and should be guided by the well-established principles embraced by the OECD and its members for the treatment of foreign investment. Japan has been, and should continue to be, an important ally in the development and adoption of best practices for sovereign wealth funds and for the recipients of sovereign wealth fund investment.

Exchange Rates

A more obvious cause of protectionist backlash against open trade and globalization is rigid exchange rate policies in surplus countries, particularly China. The U.S. and Japan both recognize the value of maintaining floating exchange rates. We have found common ground with Japan in the G7, which in February 2008 welcomed China's decision to increase the flexibility of its currency, but also encouraged accelerated appreciation of China's effective exchange rate.

RMB exchange rate policy is a multilateral issue, and Japan and others in the G7 have highlighted the importance of RMB appreciation for the global economy. Japanese Finance Minister Nukaga has also called publicly for China to accelerate the appreciation of the RMB. And, Japan has established a ministerial "High Level Economic Dialogue" with China, which covers pressing economic issues, including the protection of intellectual property, food and product safety, and currency flexibility.

Japan's engagement with China on currency is particularly useful. Chinese academics and government officials frequently suggest that China won't move faster on currency because they do not want to repeat Japan's experience with deflation and sluggish growth following the appreciation of the yen in the mid-1980s. For this reason, Japan's willingness to engage in a full and frank discussion has helped encourage China's progress on currency reform. In addition, Japan's full support for vigorous implementation of the IMF's new exchange rate surveillance mechanism would encourage China's progress toward a fully market-determined currency.

Energy and the Environment

An additional prerequisite to achieving sustainable global growth is facing the high costs of energy demand and the associated environmental challenges. Climate change is a global challenge that requires global solutions. Our and Japan's strategies reflect this reality. In this area, we share common commitment and capabilities for developing and promoting cutting edge clean technology. We also share a common commitment to play leading roles in the Major Economies process launched by President Bush in September of last year and in working towards a successful conclusion to the Bali roadmap that was agreed to last December. Japan's leadership in the upcoming G8 will be crucial to pushing this important agenda forward.

In addition, the U.S. and Japan, together with the UK, have agreed on one part of the solution for addressing climate change through the creation of a fund to accelerate deployment of clean technologies in the developing world. Our three countries are working with the World Bank to launch a multibillion-dollar multilateral trust fund, to help fund deployment of clean technology to reduce greenhouse gas emissions in major emerging economies.

The fund would support national policies that use market forces to encourage the adoption of clean technologies, and help finance the cost difference between clean and dirty technologies. President Bush will be seeking authorization for a U.S. contribution of $2 billion over three years to this "Clean Technology Fund". Japan announced its support for the Fund in January. This, too, will be a crucial part of the agenda at the upcoming G8.

Conclusion

Ladies and Gentlemen, as I hope my remarks have made clear, the U.S.-Japan bilateral relationship is robust. It is important. And, it offers enormous unrealized potential. A vibrant, confident Japan on the world stage is critical for addressing global challenges. Given our leading economic positions, the U.S. and Japan share a unique responsibility for maintaining and strengthening the global trade and financial system. Our committed, comprehensive, and energetic cooperation is critical for making this goal a reality.

Thank you for your attention today, and I welcome your questions.

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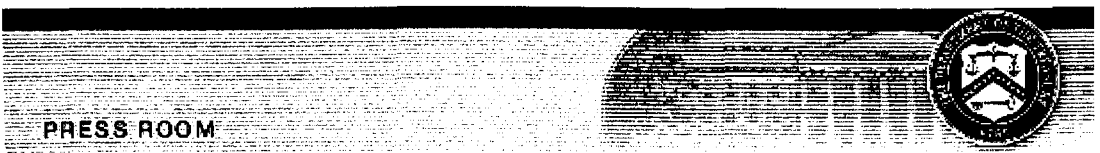

March 27, 2008
HP-893

Paulson to Meet with Australian Prime Minister Rudd

Washington - Treasury Secretary Henry M. Paulson, Jr. will welcome Australian Prime Minister Kevin Rudd to the U.S. Department of the Treasury on Friday, March 28. They will discuss a range of economic and financial issues including Australia's leadership in the fight against illicit finance in the Asia-Pacific region.

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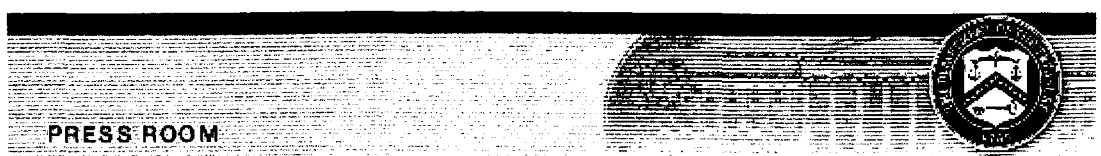
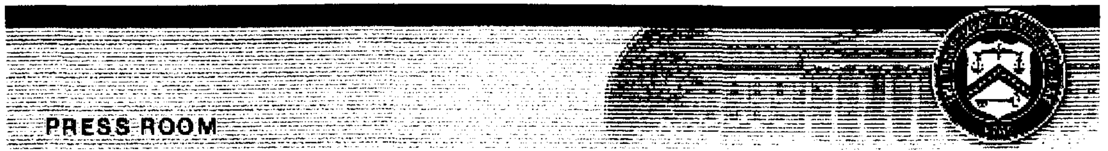


March 28, 2008
HP-894

Paulson to Deliver Remarks on Financial Market Issues

U.S. Treasury Secretary Henry M. Paulson, Jr. will deliver remarks at the Treasury Department Monday, March 31. The Secretary will discuss issues relating to financial institutions and financial markets. The event will be available for viewing via webcast at www.treas.gov. The following event is open to press:

Who
U.S. Treasury Secretary Henry M. Paulson, Jr.
What
Remarks on Financial Market Issues
When
Monday, March 31, 10 a.m. (EDT)
Where
U.S. Treasury Department
Cash Room
1500 Pennsylvania Ave.
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.



March 31, 2008
hp-895

MEDIA ADVISORY:
Treasury To Host Background Briefing on Regulatory Blueprint

U.S. Treasury department officials will host a pen-and-pad background briefing following remarks by Secretary Henry M. Paulson, Jr. to discuss Treasury's *Blueprint for a Modernized Financial Regulatory Structure*. No cameras will be admitted to the briefing. The following event is open to the press:

What Background Briefing on Regulatory Blueprint

When Monday, March 31, 2008, 11 a.m. (EDT)

Where U.S. Treasury Department
West Gables Room (Room 5432)
1500 Pennsylvania Ave.
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.

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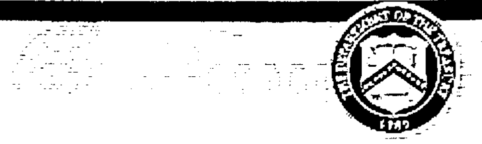

PRESS ROOM

To view or print the PDF content on this page, download the free Adobe® Acrobat® Reader®.

March 31, 2008
hp-896

Treasury Releases Blueprint for Stronger Regulatory Structure

Washington- The U.S. Treasury Department today released its Blueprint for an improved financial regulatory structure, one that strengthens consumer protections, improves tools for market stability and enhances financial innovation. Treasury's *Blueprint for a Modernized Financial Regulatory Structure* presents a series of short-, intermediate- and long-term recommendations for reform of the U.S. regulatory structure. The Blueprint, announced in June 2007, is a key part of Treasury Secretary Henry M. Paulson Jr.'s efforts to improve the competitiveness of the U.S. capital markets in the increasingly global marketplace.

"We should and can have a structure that is designed for the world we live in, one that is more flexible, one that can better adapt to change, one that will allow us to more effectively deal with inevitable market disruptions and one that will better protect investors and consumers," said Secretary Paulson in remarks at the Treasury Department. "The challenge is to evolve to a more flexible, efficient and effective regulatory framework – and that is the purpose of this Blueprint."

The short-term recommendations include improvements to regulatory coordination and oversight that regulators can make quickly. The Blueprint recommends creating a new federal commission for mortgage origination to protect consumers better. The report also recommends modernizing the President's Working Group on Financial Markets and clarifying the Federal Reserve's liquidity provisioning, as Secretary Paulson discussed last week.

> Intermediate-term recommendations focus on eliminating some of the duplication in our existing regulatory system, but more importantly they offer ways to modernize the regulatory structure for certain financial services sectors, within the current framework. Recommendations include eliminating the thrift charter, creating an optional federal charter for insurance and unifying oversight for futures and securities
>
> The long-term recommendation is to create an entirely new regulatory structure using an objectives-based approach for optimal regulation. The structure will consist of a market stability regulator, a prudential regulator and a business conduct regulator with a focus on consumer protection.

The United States is the world leader in financial services, so it is from this position of strength that we must constantly work to improve our system. Secretary Paulson convened a blue-ribbon panel to discuss this issue at his March 2007 U.S. Capital Markets Competitiveness Conference. Industry leaders and policymakers alike agreed that the competitiveness of our financial services sector – and its ability to support U.S. economic growth – are constrained by an outdated financial regulatory framework.

The U.S. regulatory structure does not serve American as well as it could, and modernization is inevitable. It has been largely knit together over the last 75 years, put into place for particular reasons at different times and in response to circumstances that may no longer exist. The current U.S. regulatory framework for financial services providers includes:

- Five federal depository institution regulators in addition to state-based supervision.

- One federal securities regulator, additional state based supervision of securities firms, and self-regulatory organizations with broad regulatory powers.
- One federal futures regulator
- Insurance regulation that is almost wholly state-based, with 50+ regulators. This structure also has an international dimension that can be inefficient, costly and harmful to U.S. competitiveness.

But capital markets and the financial services industry have evolved significantly over the past decade. Globalization and financial innovation, such as securitization, have provided benefits to domestic and global economic growth; while highlighting new risks to financial markets.

These developments are pressuring the U.S. regulatory structure, exposing regulatory gaps and redundancies, and often encouraging market participants to do business in other jurisdictions with more effective regulation. As a result, the U.S. regulatory structure reflects an antiquated system struggling to keep pace with market developments, while facing increasing challenges to anticipate and prevent today's financial crises.

Although Treasury began this effort a year ago, market conditions today provide a pertinent backdrop for this study's release and highlight the need to examine the U.S. regulatory structure. Recent events have also reinforced the need to balance strong consumer protection and market stability on one hand, with capital markets competitiveness on the other.

Public input has been important to our work. In addition to the range of views present at the Capital Markets Conference in March 2007, Treasury published a request for public comment in the Federal Register in October. Response to the Federal Register notice was strong, with hundreds of letters from investor advocates, state regulators, financial institutions and many others. All public comments are posted on the internet at www.regulations.gov.

For more information, visit http://www.treas.gov/offices/domestic-finance/regulatory-blueprint/.

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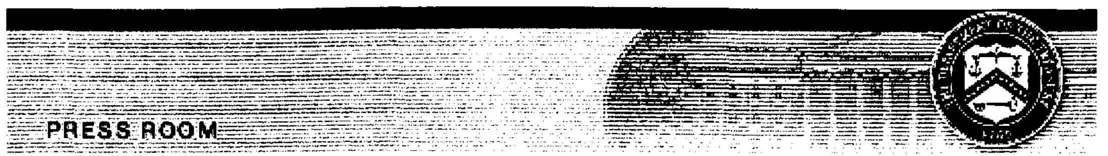
REPORTS

- Blueprint for a Modernized Financial Regulatory Structure
- Fact Sheet



March 9, 2007
HP-304

Schedule for Treasury Conference on US Capital Markets Competitiveness

Treasury Secretary Henry M. Paulson, Jr. will host a conference to examine issues affecting U.S. capital markets competitiveness on Tuesday, March 13 in Washington, D.C. Following is a schedule of events:

8:45 a.m.
Secretary Paulson
Opening Remarks
Healy Hall Auditorium
Georgetown University
37th and O Streets, NW
Washington, DC
NOTE: Broadcast media should arrive starting at 6:30 a.m. and must arrive no later than 7:30 a.m. All media must RSVP with Andrea Sarubbi at 202-687-4328 or aes54@georgetown.edu prior to the event for credentials.

8:55 a.m.
Panel I
Framing the Issues: Markets Perspectives
Moderators: Secretary Paulson
SEC Chairman Christopher Cox
Panelists: Warren E. Buffett, Chairman and CEO, Berkshire Hathaway Inc.
James Dimon, Chairman and CEO, JPMorgan Chase & Co
Jeffrey R. Immelt, Chairman and CEO, General Electric Company
Charles R. Schwab, Founder, Chairman, and CEO, Charles Schwab Corporation
John A. Thain, CEO, NYSE Group
Ann Yerger, Executive Director, Council of Institutional Investors

Gaston Hall
3rd Floor, Healy Hall
Georgetown University
37th and O Streets, NW
Washington, DC
NOTE: Broadcast media must arrive no later than 7:30 a.m. All media must RSVP with Andrea Sarubbi at 202-687-4328 or aes54@georgetown.edu prior to the event for credentials.

Panel II
Framing the Issues: Public Policy Perspectives
Moderators: Secretary Paulson
Chairman Cox
Panelists: The Honorable Michael R. Bloomberg, Mayor, New York City
The Honorable Dr. Alan Greenspan, Greenspan Associates, and Former Chairman of the Board of Governors, Federal Reserve System
The Honorable Arthur Levitt, Jr., Senior Advisor, The Carlyle Group, and Former Chairman, Securities and Exchange Commission
The Honorable Robert E. Rubin, Director and Chairman of the Executive Committee, Citigroup Inc., and Former Secretary of the Treasury
The Honorable Paul A. Volcker, Former Chairman of the Board of Governors, Federal Reserve System

Gaston Hall
3rd Floor, Healy Hall
Georgetown University

37th and O Streets, NW
Washington, DC
NOTE: Broadcast media must arrive no later than 7:30 a.m. All media must RSVP with Andrea Sarubbi at 202-687-4328 or aes54@georgetown.edu prior to the event for credentials.

5:15 p.m.
Under Secretary Robert K. Steel
Pen and Pad Briefing
Philodemic Room
2nd Floor, Healy Hall
Georgetown University
37th and O Streets, NW
Washington, DC
NOTE: No cameras will be admitted to the briefing. All media must RSVP with Andrea Sarubbi at 202-687-4328 or aes54@georgetown.edu prior to the event for credentials.

March 26, 2008
HP-887

Remarks by Secretary Henry M. Paulson, Jr
on Current Financial and Housing Markets
at the US Chamber of Commerce

Washington -- Thank you for inviting me to address your Capital Markets Competitiveness Conference. We share a commitment to competitive markets, and Treasury will soon release a Blueprint for Regulatory Reform that proposes a financial regulatory framework which we believe will more effectively promote orderly markets and foster financial sector innovation and competitiveness.

As you know, financial market stress began last August and has led to significant de-leveraging and repricing of risk, and sentiment has swung hard to risk aversion. There have been, as there always are during periods like this, bumps in the road and unpleasant surprises along the way.

I am constantly asked how much longer will this take to play out and if this is the worst period of market stress I have experienced. I respond that every period of prolonged turbulence seems to be the worst until it is resolved. And it always is resolved. Our economy and our capital markets are flexible and resilient and I have great confidence in them. I am certain we will work through this situation and go on to new heights as we always do.

As we work our way through this turbulence, our highest priority is limiting its impact on the real economy. We must maintain stable, orderly and liquid financial markets and our banks must continue to play their vital role of supporting the economy by making credit available to consumers and businesses. And we must of course focus on housing, which precipitated the turmoil in the capital markets, and is today the biggest downside risk to our economy. We must work to limit the impact of the housing downturn on the real economy without impeding the completion of the necessary housing correction. I will address each of these in turn. Regulators and policy makers are vigilant; we are not taking anything for granted.

Orderly Financial Markets

For some months now, reduced access to short term funding and liquidity issues have created turmoil in our capital markets. In the midst of these conditions, Bear Stearns found itself facing bankruptcy. The Federal Reserve acted promptly to resolve the Bear Stearns situation and avoid a disorderly wind-down. It is the job of regulators to come together to address times such as this; and we did so. Our focus was the stability and orderliness of our financial markets.

Discount Window Access

As the Federal Reserve resolved the Bear Stearns situation, it subsequently took a very important and consequential action of instituting a temporary program for providing liquidity to primary dealers. I fully support that action. Taking this step in a period of stress recognizes the changed nature of our financial system and the role played by investment banks in the post Glass-Steagall world.

Such direct lending from the central bank to non-depository institutions has not occurred since the 1930s. Recent market turmoil has required the Federal Reserve to adjust some of the mechanisms by which it provides liquidity to the financial system. Their creativity in the face of new challenges deserves praise, but the circumstances that led the Fed to modify its lending facilities raises significant policy

considerations that need to be addressed.

Insured depository institutions remain important participants in financial markets, but this latest episode has highlighted that the world has changed as has the role of other non-bank financial institutions, and the interconnectedness among all financial institutions. These changes require us all to think more broadly about the regulatory and supervisory framework that is consistent with the promotion and maintenance of financial stability. Now that the Fed is granting primary dealers temporary access to liquidity facilities, we must consider the policy implications associated with such access.

Historically, commercial banks have had regular access to the discount window. Access to the Federal Reserve's liquidity facilities traditionally has been accompanied by strong prudential oversight of depository institutions, which also has included consolidated supervision where appropriate. Certainly any regular access to the discount window should involve the same type of regulation and supervision.

While there has been extraordinary convergence in financial services, one distinction between banks and investment banks remains particularly important - banks have the advantage that they issue deposits that are insured by the Federal government. A properly designed program of deposit insurance greatly reduces the likelihood of liquidity pressures on depository institutions and as a corollary, makes the funding base of these institutions more stable. The trade-off for this subsidized funding is regulation tailored to protect the taxpayers from moral hazard this insurance creates.

For the non-depository institutions that now have temporary access to the discount window, I believe a few constructive steps would enable the Federal Reserve to protect its balance sheet, and ultimately protect U.S. taxpayers.

First, the process for obtaining funds by non-banks must continue to be as transparent as possible. The Fed should describe eligible institutions, articulate the situations in which funds will be made available, and the magnitude and pricing structure for the funds. The TAF process is a good model for a structure that would provide relevant information to the marketplace.

Second, and perhaps most importantly, the Federal Reserve should have the information about these institutions it deems necessary for making informed lending decisions. The Federal Reserve is currently working to ensure the adequacy of such information. We suggest that the Federal Reserve, the SEC, and the CFTC continue their work of building a robust cooperative framework. Already, at the invitation of the SEC, the Federal Reserve is working alongside their teams within these institutions. These regulators should consider whether a more formalized working agreement should be entered into to reflect these events.

With this added information flow, the Federal Reserve will be better positioned to consider market stability issues like liquidity provisioning and the interconnectedness of financial institutions. The Federal Reserve's participation could also allow for broader consideration of market stability issues by the SEC and the CFTC. This collaborative process will necessarily have a strong focus on liquidity and funding issues.

The combination of these steps should provide the Federal Reserve with a structure and the information that it would need to make liquidity backstop loans during periods of market instability to non-banks. They address the current situation, in which investment banks have temporary access to the discount window. Clearly, many difficult policy questions must also be addressed on a going-forward basis.

Despite the fundamental changes in our financial system, it would be premature to jump to the conclusion that all broker-dealers or other potentially important financial firms in our system today should have permanent access to the Fed's liquidity facility. Recent market conditions are an exception from the norm. At this time, the Federal Reserve's recent action should be viewed as a precedent only for unusual periods of turmoil.

As we work through this period, we will learn through this experience. And the

Federal Reserve will learn as it works with financial institutions as they come to the window. It is appropriate that we evaluate that experience in the coming months, and use the lessons of that experience to inform a path forward. Very relevant to this issue is the fact that bank regulation, which applies to institutions with an explicit taxpayer-funded backstop, is fundamentally different from non-bank regulation, which applies to institutions that are not supported by federal deposit insurance. The President's Working Group on Financial Markets will evaluate these issues and their implications for regulation of bank and non-bank financial institutions.

Housing and Mortgage Markets

The housing downturn and the surrounding uncertainty are significantly impacting our financial institutions and capital markets. However, we should not lose sight of the fact that this downturn was precipitated by unsustainable home price appreciation which was particularly pronounced in a relatively few regions. A correction was inevitable and the sooner we work through it, with a minimum of disorder, the sooner we will see home values stabilize, more buyers return to the housing market, and housing will again contribute to economic growth. Having stability in housing markets will in turn contribute to better conditions in credit markets for mortgage-backed securities.

Data releases every month create headlines about declining housing sales, starts and prices. Yet, declines are exactly what we should expect during a correction. It takes time to work through the excess inventory – and we are. The question many are asking is how deep the correction will be and how long it will last. The Case-Shiller index of home prices in 10 major metropolitan areas showed an 11.4 percent decline in home prices over the 12 months ending in January, and the futures market is predicting that the index will decline another 13 percent in 2008. But we do not have a national housing market; housing markets are regional – and there is considerable variation in adjustment, with prices changing the most in areas that had the greatest overbuilding.

Amid this correction, there are many calls to "do something about housing." When people say this, they are urging any number of possible things – minimize foreclosures, make affordable mortgages more available, improve the secondary market and liquidity for mortgages, improve the mortgage origination process, prosecute fraud, reduce the inventory of homes for sale, or help communities hardest hit by foreclosures.

The `to do' list tends to get conflated. We must sort through each of these shared and desired outcomes, carefully choosing policies that minimize the impact of – but do not slow – the housing correction.

Availability of Mortgage Finance

Turbulence in the financial markets has disrupted and reduced the availability and increased the cost of mortgage financing. The secondary mortgage market is still facing liquidity and pricing issues. We are taking steps to increase the availability of affordable mortgage financing. The Federal Reserve's temporary lending facility for non-banks will help in this area, as will the Federal Housing Finance Board's decision to authorize the Federal Home Loan Banks to increase purchases of agency mortgage backed securities, which could provide over $100 billion in new MBS market liquidity.

Another helpful step is the agreement reached last week among Fannie Mae, Freddie Mac and OFHEO, their independent regulator, to inject more capital into the mortgage market.

Fannie and Freddie, two of the nation's housing Government Sponsored Entities or GSEs, have been playing an important, countercyclical role in supporting the secondary market for mortgage finance. The GSEs' market share has grown substantially from 46 percent of all new mortgages in the second quarter of 2007 to 76 percent in the fourth quarter. It is very important that the GSEs remain positioned to play this critical role. That is why I was pleased that the GSEs committed to raise significant capital. A stronger capital base will better enable them to support more home purchases and refinancings through their securitization

activities. Additional capital not only increases the availability of mortgage financing, but also strengthens mortgage market fundamentals.

The Economic Stimulus Act of 2008 also temporarily raised the conforming loan limit, which should reduce costs for homebuyers seeking a jumbo mortgage.

The subprime mortgage market accounted for a large portion of housing purchase growth before the downturn, and the market for subprime mortgage financing is now largely closed. Last August, President Bush launched the FHASecure initiative, an important new solution for subprime homeowners. To date, FHASecure has helped more than 130,000 families refinance their mortgages and stay in their homes. That number is expected to reach 300,000 by year end. More can be done. Secretary Jackson continues to examine administrative tools to make FHA mortgages more widely available. And it is essential that Congress pass FHA modernization that would provide FHA the authority to help as many as 250,000 more homeowners at this critical time.

We will continue to look for solutions that expand mortgage access and availability for all borrowers, including financially-able subprime borrowers.

Foreclosures

Home foreclosures are also a significant issue today. Foreclosures are painful and costly to homeowners and, neighborhoods. They also prolong the housing correction by adding to the inventory of unsold homes. Before quickly reviewing our initiatives to prevent avoidable foreclosures, let me observe that some current headlines make it difficult to put foreclosure rates in perspective. So let me try to do so.

First, 92 percent of all homeowners with mortgages pay that mortgage every month right on time. Roughly 2 percent of mortgages are in foreclosure. Even from 2001 to 2005, a time of solid U.S. economic growth and high home price appreciation, foreclosure starts averaged more than 650,000 per year.

Last year there were about 1.5 million foreclosures started and estimates are that foreclosure starts might be as high as 2 million in 2008. These foreclosures are highly concentrated – subprime mortgages account for 50 percent of foreclosure starts, even though they are only 13 percent of all mortgages outstanding. Adjustable rate subprime mortgages account for only 6 percent of all mortgages but 40 percent of the foreclosures. So we are right to focus many of our policies on subprime borrowers.

There are approximately 7 million outstanding subprime mortgage loans. Available data suggests that 10 percent of subprime borrowers were investors or speculators. This figure is likely higher, as some investors misrepresented themselves to take advantage of a cheaper rate, and others speculated on a primary residence, expecting prices to continue going up.

Other subprime loans were very poorly underwritten and borrowers simply can not afford the home they bought. Almost 18 percent of adjustable rate subprime mortgages underwritten in 2006 were in foreclosure six months before the initial rate was scheduled to reset. Subtracting the speculators and those who took on more than they could handle leaves us with our target population of subprime borrowers for whom we are seeking a solution – those who want to keep their homes, have the financial wherewithal, but are facing challenges making their monthly payments.

We are focused on private sector and government efforts to help these borrowers avoid foreclosure.

The HOPE NOW alliance has announced that, since July, more than 1 million struggling homeowners received a work out, either a loan modification or repayment plan that helped them avoid foreclosure. HOPE NOW's work-out efforts are accelerating more quickly than the foreclosure rate. In the month of January foreclosure starts were up 5 percent while the number of mortgage workouts grew 19 percent.

HOPE NOW and the American Securitization Forum together have implemented a protocol targeted specifically at subprime borrowers facing mortgage resets. Through the protocol, those who made their initial payments and want to keep their home should be fast-tracked into a sustainable refinancing or loan modification.

We are closely monitoring the implementation and results of HOPE NOW and the ASF efforts. Responsible homeowners who have been making their payments and want to find a way to stay in their home should not go into foreclosure merely because the volume of people seeking help overwhelms the system.

Homeowners with Negative Equity

Much attention has been given to the fact that an estimated 8.8 million households may currently have negative home equity. We can expect that number to rise as the housing correction plays out, and to begin to reverse once the correction has run its course. The best outcome for these homeowners is to work through this correction as quickly as possible.

Homeowners with negative equity are more common in this housing downturn because lending practices changed dramatically in recent years. In 2007, 29 percent of mortgages were originated with no down payment. Some of those mortgages went to speculators; others to responsible borrowers who were able to buy a home because of expanded access to credit.

But let me emphasize that we do not need a system-wide solution for the vast majority of loans where a homeowner temporarily has negative equity. Negative equity does not affect borrowers' ability to pay their loans. Homeowners who can afford their mortgage payment should honor their obligations --- and most do. They know that there are housing cycles, and they bought more than houses. They bought homes to become part of a community, and they bought them as places to live, not as investments. And if they live in them for the long term, they are likely to become good investments.

Let me also emphasize that any homeowner who can afford his mortgage payment but chooses to walk away from an underwater property is simply a speculator. Washington can not create any new mortgage program to induce these speculators to continue to own these homes, unless someone else foots the bill.

The people we seek to help are those who want to keep their homes but can't afford the monthly payment because of an ARM reset. If they also have negative equity in their homes, refinancing becomes almost impossible and so workouts become even more important. Secretary Jackson is examining the potential for FHA to be a solution for these borrowers.

Conclusion

In summary, there is bipartisan interest in bolstering our economy, maintaining stable and orderly capital markets, and helping struggling homeowners. New ideas and solutions can come from either side of the aisle. The Administration and Congress demonstrated how well bipartisanship can work when we quickly passed and enacted an economic stimulus package earlier this year. I am hopeful we can demonstrate this again by quickly concluding the FHA Modernization bill, and I am working hard to make progress on comprehensive GSE reform legislation because stronger oversight is essential for these large, critically important financial institutions.

I know Members of Congress have outlined other ideas, but most are not yet ready for the starting gate. FHA Modernization and GSE reform are well on their way to the finish line – let's complete this important legislation now, so we can implement them and help homeowners and our economy.

Timeliness is critical for adding confidence in today's markets. I continue to focus on additional steps that the Administration can take without delay – things that don't require congressional action and will immediately impact the availability of affordable mortgage finance.

We are obviously well aware that the housing market correction was not only a precipitating cause but continues to be an underlying factor in our capital markets' stress. Both are disrupting our economy right now. We will continue to pursue policies that strike the right balance: that do not slow the housing correction, yet also help avoid preventable foreclosures and unnecessary capital market turmoil.

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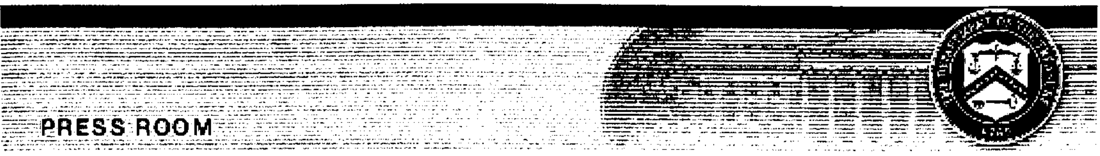


March 13, 2007
HP-306

**Opening Remarks by Treasury Secretary Henry M. Paulson, Jr.
at Treasury's Capital Markets Competitiveness Conference
Georgetown University**

Washington, DC -- Thank you very much, President DeGioia. We are pleased to be here at Georgetown University. Georgetown is a world-class institution that trains leaders in a number of areas, and we are especially pleased to be joined in our discussions by faculty and students from Georgetown's McDonough School of Business.

The participants in today's Conference are a distinguished group of leaders in U.S. capital markets, and I welcome you and thank you all for being here. You have many areas of expertise and you bring a variety of perspectives: years of valuable experience in academia, government, the business world, Wall Street, or as investor advocates. All of your views are welcome and appreciated. This is a very knowledgeable group of people and I am looking forward to an engaging discussion.

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. They help entrepreneurs implement new ideas and businesses expand operations, creating new jobs. They give our citizens the confidence to invest, earn higher returns on their savings, and reduce the cost of borrowing.

U.S. capital markets are the deepest, most efficient, and most transparent in the world. We are the world's leader and innovator in mergers and acquisitions advice, venture capital, private equity, hedge funds, derivatives, securitization skills, and Exchange Traded Funds. With this expertise, our major financial institutions have contributed greatly to economic success throughout the world.

One of the great strengths of our markets is their dynamism. They change with the times to serve the needs of investors and businesses. Yet, our markets are not immune to challenges. After years of economic expansion and the excesses and exuberance of the late 1990s, the technology and telecom bubble burst and a wave of corporate scandals undermined investor confidence. We weathered the storm. The President, both parties in Congress, and regulators moved quickly to address the business scandals, which helped to restore investor confidence.

We responded to the corporate scandals with the Sarbanes-Oxley Act of 2002, new listing rules for public companies, and regulatory and enforcement actions to alter certain business practices. These changes have been extensive and significant, so it is quite naturally taking time for companies to understand, process, and implement the new rules and requirements. But the principles behind them have been positive, as have many of the results.

As U.S.-listed companies are adapting to these rules, global capital markets around the world are evolving and developing, introducing new competition for our markets. At the same time, we have witnessed extraordinary growth in private pools of capital, including hedge funds. Each of these changes presents its own set of benefits and challenges. The question we have to consider is the individual and cumulative impact of these changes on U.S. public companies.

Our markets are, indeed, the best in the world. Yet we must be vigilant, and we must do everything we can to ensure they stay that way. We at Treasury have some ideas and our fellow regulators are working on these issues as well. There are some obvious adjustments, such as the recent administrative actions regarding

Section 404 which should mitigate a major problem related to Sarbanes-Oxley implementation. But these are complex, interrelated issues and I am confident that we can benefit greatly from the views of the people in this room.

In particular, we will focus on three issues: our regulatory structure; the accounting industry; and our legal and corporate governance environment.

Our regulatory system has served us very well over the course of our history. It is part of the foundation for our prosperity and growth. And, robust and balanced regulation is critical to ensuring that we continue to have the strongest capital markets in the future. Yet, the addition of new regulators over many years, and the tendency of these regulators to adapt to the changing market by expanding, as opposed to focusing on the broader objective of regulatory efficiency, is a trend we should examine. We should assess how the current system works and where it can be improved, with a particular eye toward more rigorous cost-benefit analysis of new regulation. And we should also consider whether it would be practically possible and beneficial to move toward a more principles-based regulatory system, as we see working in other parts of the world.

Because many of the corporate scandals of the late 90s were, for the most part, accounting scandals, it is not surprising that much of the reform focused on the accounting profession. This reform has helped to restore investor confidence. This is key because capital markets rely on trust, which is based on financial information presumed to be accurate and to reflect economic reality. But the cumulative impact of all the change has significantly affected the accounting industry, fundamentally altering the interactions between auditors and corporate management and boards in a number of ways, some of which might not be constructive. Also, we have seen great concentration among the major accounting firms and there are legitimate questions about the sustainability of the accounting profession's business model.

We should also consider whether our system is producing the high-quality audits and attracting the talented auditors we need, whether there is currently enough competition in the accounting profession, and the desirability of moving toward more principles-based accounting standards.

The basic principles that underpin a robust corporate governance system are accountability, transparency, and the need to identify and manage conflicts of interest. As a result of Sarbanes-Oxley and other regulatory changes, corporate directors are more independent, more aware of real and perceived conflicts, more diligent about their fiduciary responsibilities. Of course, directors must now spend much more time engaged in compliance processes and finding the right balance on the use of director time is critically important. But good corporate governance is a means to an end, not an end in itself. Our goal should be better managed, more competitive corporations that earn investor confidence through sound leadership, thoughtful governance, and outstanding performance. In my judgment, we must rise above a rules-based mindset that asks, "Is this legal?" and adopt a more principles-based approach that asks, "Is this right?" And we should consider whether our legal system appropriately protects investors or gives too much latitude to unscrupulous lawyers.

Throughout the day, the fundamental question we must ask is: Have we struck the right balance between investor protection and market competitiveness – a balance that assures investors the system is sound and trustworthy, and also gives companies the flexibility to compete, innovate, and respond to changes in the global economy?

At today's conference there are no pre-determined answers. We are looking for a real discussion, with rigorous questioning and candid and collegial debate.

At the end of the day, I hope each of us will have had one of our opinions challenged, or been given the opportunity to view an issue from a new perspective. Given the cumulative wisdom and experience in this room, I am confident the day will be thought-provoking and productive.

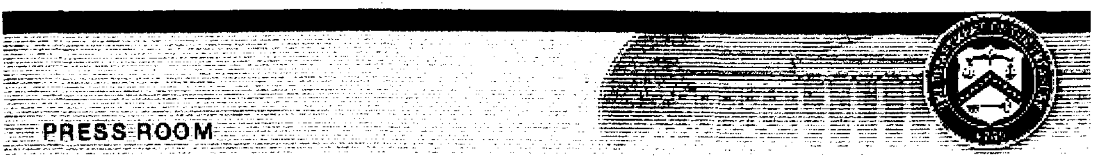
At Treasury, we will carefully consider the views we have heard today along with the recommendations of a number of other groups which have studied this subject. Together they will inform us as we develop specific follow up steps in the coming

months to keep US capital markets the strongest and most innovative in the world. There will be things we at Treasury, working with the regulatory agencies, will do in the near term and some other actions over a longer time frame to address these challenges to our competitiveness. This is a high priority for me.

My great thanks again to the students, faculty, and administrators of Georgetown for hosting us. And thank you to all of our conference participants for taking the time to lend your voices to this process. Given the importance of our capital markets to our long-term economic growth and competitiveness, it is essential to have our best minds engaged on this matter.

Now, let's get started. Please welcome to the stage our first panel participants.

-30-



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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:

____
Taiya Smith
Executive Secretary of the Treasury

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March 31, 2008
hp-897

Remarks by Secretary Henry M. Paulson, Jr. on Blueprint for Regulatory Reform

Washington, DC--Good morning, everyone. A strong financial system is vitally important - not for Wall Street, not for bankers, but for working Americans. When our markets work, people throughout our economy benefit – Americans seeking to buy a car or buy a home, families borrowing to pay for college, innovators borrowing on the strength of a good idea for a new product or technology, and businesses financing investments that create new jobs. And when our financial system is under stress, millions of working Americans bear the consequences. Government has a responsibility to make sure our financial system is regulated effectively. And in this area, we can do a better job. In sum, the ultimate beneficiaries from improved financial regulation are America's workers, families and businesses – both large and small.

Today I am pleased to release Treasury's Blueprint for Financial Regulatory Reform. Or, perhaps I should say – given the last few days' news coverage --- that I am pleased to provide additional details to accompany the release of this Blueprint for Regulatory Reform. It's been a long road, as we began the process leading to this final report a year ago, in March of 2007, after convening industry leaders and policymakers for a conference on capital markets competitiveness.

The conference participants concluded that our current financial regulatory system could more effectively promote stable and resilient markets and a more competitive financial services industry. So, in addition to our other capital markets initiatives, last June we began work on a Blueprint for a financial regulatory structure that would be more effective and more appropriate for modern financial markets.

When we announced that we would work on such a Blueprint, other than some enthusiastic academics, few noticed. Today, of course, capital markets and financial regulation are on everybody's mind. As recent events have demonstrated, investor protection and market stability are critical elements of competitiveness. Far from being at odds with one another, they are mutually reinforcing.

We have been undergoing a period of financial market stress since last August. Markets are pricing and reassessing risk and as we should expect, there are always difficulties during periods such as this. We know that a housing correction has precipitated this turmoil, and housing remains by far the biggest downside risk to our economy. As we work through this period, our highest priority is limiting its impact on the real economy.

I have the greatest confidence in the resiliency, flexibility and strength of our economy and our capital markets. We are focused on maintaining stable, orderly and liquid financial markets and ensuring that our banks continue to support the economy by making credit available to consumers and businesses.

Our regulatory community is working cooperatively through some very challenging times. Last week I reiterated my support for the important and consequential recent actions taken by the Federal Reserve. The Fed must have the necessary information to perform its role as it temporarily provides liquidity to non-banks. But it would be premature to assume these institutions should have permanent access to the Fed's discount window and permanent supervision by the Fed. We will learn lessons from the experience of this temporary facility, and those lessons will inform a path forward.

Our first and most urgent priority is working through this capital market turmoil and housing downturn, and that will be our priority until this situation is resolved. With few exceptions, the recommendations in this Blueprint should not and will not be implemented until after the present market difficulties are past.

Some may view these recommendations as a response to the circumstances of the day; yet, that is not how they are intended. This Blueprint addresses complex, long-term issues that should not be decided in the midst of stressful situations and should not be implemented to add greater burden to a market already under strain. These long-term ideas require thoughtful discussion and will not be resolved this month or even this year.

Let me also remind you that two weeks ago, the President's Working Group on Financial Markets released a series of recommendations addressing issues including ratings agencies, securitization, mortgage origination, and OTC derivatives. They are a policy response to the current market turmoil, designed to reduce the likelihood that we will repeat our current problems. We are focused on seeing these recommendations implemented, to improve the workings of our financial markets. But we will not seek to implement them on a pace or in a manner that interferes with our first priority of working through this current period of market difficulty.

Before I describe our Regulatory Blueprint, I will briefly outline why updating our financial regulatory structure is essential.

Evolution of our Financial Regulatory System

Our current regulatory structure was not built to address the modern financial system with its diversity of market participants, innovation, complexity of financial instruments, convergence of financial intermediaries and trading platforms, global integration and interconnectedness among financial institutions, investors and markets. Moreover, our financial services companies are becoming larger, more complex and more difficult to manage. Much of our current regulatory system was developed after the Great Depression and it has developed through reaction --- a pattern of creating regulators as a response to market innovations or to market stress.

We have five federal deposit institution regulators in addition to state-based supervision. We bifurcate securities and futures regulation. And regulation of one of our largest financial services industries, insurance, is almost entirely at the state level. The bulk of these regulatory responses made sense at the time they were created, but as we look at today's financial markets, the lack of a comprehensive design is clear.

The 1991 Bush Administration study, known as the "Green Book," made the case for many of the changes adopted in the last comprehensive financial regulatory overhaul, the Gramm-Leach-Bliley Act of 1999. That Act made important changes to our financial regulatory structure by allowing broader affiliations of financial services firms through a Financial Holding Company structure. But, it also maintained separate regulatory agencies across the traditional securities, futures, insurance and banking industry segments. This functional division is at odds with the increasing convergence of financial service providers and products. It creates jurisdictional disputes among regulators, and it is a likely result that some financial services and products are exported to more adaptive foreign markets.

This complex structure can invite regulatory arbitrage, where business models are chosen based on regulatory structure, or even worse, based on the regulator itself. Regulators have adapted to keep pace with innovation, but they do so within a rigid structure that can not readily adapt as the financial services industry evolves. The current system fosters duplicative requirements and can allow important regulatory matters to fall through the cracks.

That said, I do not believe it is fair or accurate to blame our regulatory structure for the current market turmoil. As we work through this period, our regulators are cooperating to the extent appropriate, recognizing their different roles, responsibilities and authorities. They are also working cooperatively with their global counterparts. They share information when appropriate, minimize duplication

and try to avoid jurisdictional conflict. We are very fortunate to have experienced professionals acting out of a shared sense of responsibility for the public good.

I am not suggesting that more regulation is the answer, or even that more effective regulation can prevent the periods of financial market stress that seem to occur every five to ten years. I am suggesting that we should and can have a structure that is designed for the world we live in, one that is more flexible, one that can better adapt to change, one that will allow us to more effectively deal with the inevitable market disruptions, one that will better protect investors and consumers, and one that will enable US capital markets to remain the most competitive in the world.

This is a complex subject deserving serious attention. Those who want to quickly label the Blueprint as advocating "more" or "less" regulation are over-simplifying this critical and inevitable debate. The Blueprint is about structure and responsibilities – not the regulations each entity would write. The benefit of the structure we outline is the accountability that stems from having one agency responsible for each regulatory objective. Few, if any, will defend our current balkanized system as optimal.

I also want to make clear that today's recommendations will not alter how we continue to set policy and coordinate the implementation of rules designed to protect the financial system from money laundering, terrorist finance and other illicit activities. Our challenge is to thoughtfully evolve to a more flexible, efficient and effective safety and soundness regulatory framework – and that is the purpose of this Blueprint.

The Optimal Financial Regulatory Model

We concluded we could only do justice to this topic by asking a rather theoretical question: If we could start over, which of course we can't, what regulatory model would we build? The idea here was to put forward an aspirational model, which could only be achieved after many years. But the model would serve as a beacon guiding us as we take necessary steps to modernize our financial regulatory structure to reflect today's market realities. Several difficult but unavoidable issues must be confronted, and we have put forward specific intermediate term recommendations to address these transitional issues over a two to eight year period. And we have a few recommendations for the near-term. But let's begin with the optimal or aspirational model.

We took a deliberative approach to developing this Blueprint. We met extensively with US and international financial regulators. We considered several models currently used in other global financial centers. We requested public comment on a broad range of issues and received hundreds of thoughtful and constructive comments. We interviewed thought leaders, industry, academics, and advocates of all political persuasion, including former Treasury leaders from both sides of the aisle. To a person, everyone agreed with two things: first, it was a difficult task and second, we must do this to retain our competitive advantage.

Our work led us to recommend a regulatory model based on objectives, to more closely link the regulatory structure to the reasons why we regulate. This model would have three regulators: a regulator focused on market stability across the entire financial sector, a regulator focused on safety and soundness of those institutions supported by a federal guarantee, and a regulator focused on protecting consumers and investors. A major advantage of this structure is its timelessness and its flexibility. It can more easily respond and adapt to the ever-changing marketplace because it is organized by regulatory objective rather than by financial institution category.

Market Stability Regulator

Given its traditional central bank role of promoting overall macroeconomic stability, the Federal Reserve is the natural choice for the important task of market stability regulator. In our model, the Federal Reserve's market stability role would continue through traditional channels of implementing monetary policy and providing liquidity to the financial system. In addition, the Federal Reserve would be provided with a different, yet critically important regulatory role with broad powers focusing on the

overall financial system.

This role would replace the Fed's more limited role of bank holding company supervision because we recognize the need for enhanced regulatory authority to complement market discipline to deal with systemic risk. To do its job as the market stability regulator, the Fed would have to be able to evaluate the capital, liquidity, and margin practices across the entire financial system and their potential impact on overall financial stability. The Fed would have the authority to go wherever in the system it thinks it needs to go for a deeper look to preserve stability.

To do this effectively, the Fed will collect information from commercial banks, investment banks, insurance companies, hedge funds, commodity pool operators, but rather than focus on the health of a particular organization, it will focus on whether a firm's or industry's practices threaten overall financial stability. It will have broad powers and the necessary corrective authorities to deal with deficiencies that pose threats to our financial stability.

To illustrate, consider that our current regulatory system is almost solely focused above the ground at the tree level. But, the real threat to market stability is below the ground, at the root level where the health of financial firms is intertwined. Obvious root systems requiring the attention of our market stability regulator would include the interconnected OTC derivatives markets with their lack of a cohesive design for clearing, settlement, and novation protocols. Similarly, a market stability regulator would have the authority to review certain private pools of capital, such as hedge funds and private equity, which have the potential to contribute to a systemic event.

This market stability regulator's job sounds difficult and I assure you, it is. No regulator can prevent all instability and market turmoil, and this one won't either. I would expect that we will continue to go through periods of market stress every five to ten years. But hopefully with the proper tools and authorities, greater transparency and better information flow, we will be better able to avoid some problems and more effectively work through others. As a nation we have placed great faith in the powers of market discipline and this regulator is designed to better harness those forces.

Prudential Financial Regulator

Our second regulator combines all federal bank charters into one charter and consolidates all federal bank regulators into a single prudential regulator. For further regulatory efficiency, we recommend a federal insurance charter and put oversight of these guaranteed products within the jurisdiction of our federal prudential regulator. By its singular focus on prudential regulation that ensures the safety and soundness of institutions with federal guarantees, this regulator would serve a role similar to the current Office of the Comptroller of the Currency, the OCC.

Conduct of Business Regulator

Third, we propose a dedicated business conduct regulator with the responsibility to vigorously protect consumers and investors, one which will focus on achieving greater consistency across product lines. This regulator would monitor business conduct regulation across all types of financial institutions and entities. Business conduct regulation in this context includes key aspects of consumer protection such as disclosures, business practices, chartering and licensing of certain types of financial institutions, and rigorous enforcement programs. This agency would assume many of the roles of the CFTC, the SEC, and the consumer protection and enforcement roles of our insurance and banking regulators. Having one agency responsible for these critically important issues for all financial products should bring greater consistency to regulation where overlapping requirements currently exist. Mortgages are an example of a consumer financial product that has suffered from uneven and inadequate treatment in our current regulatory and enforcement regime.

The premise of our optimal structure is that clarity of mission and objective will lead to strengthened regulation and improved capital markets efficiency.

We chose an objectives-based structure because we believe it provides a flexible

framework that fosters and embraces innovation, helps ensure competitiveness and better manages risk. Such a structure would be better able to adjust to market and institutional changes. It would allow for clearer focus on particular goals – how do we prevent market failures – and provide a clear view across the financial landscape of functions, products, practices and institutions to meet those goals. Establishing regulatory lines by objective also has the potential for establishing and enforcing the greatest levels of market discipline by aiming regulation at the most vulnerable points.

An objectives-based model is substantially different from our current system and, realistically, will not and could not be implemented any time soon. However, we are anchoring our recommendations in a tangible, aspirational Blueprint even though it will take many years to evolve to this model. In the interim, the model can guide us as we consider and then take steps along the way.

Near Term Recommendations

I will now turn to our near term recommendations.

PWG Executive Order

I have a particularly high regard for the talented and dedicated professionals who today lead our regulatory agencies and, while recognizing their different roles, responsibilities and authorities, also collaborate to deal with current challenges. The President's Working Group on Financial Markets, the PWG, is a forum that is designed to help do just that. It was developed to coordinate across the current US structure, just as the Financial Stability Forum, the FSF, has developed as the means of facilitating international cooperation. We should formalize the current informal coordinating practice among the US regulatory community by amending and enhancing the Executive Order which created the PWG.

The new executive order will emphasize the importance of coordination and communication. It will clarify the PWG's mission of attempting to mitigate systemic financial risk, enhancing financial market integrity, promoting consumer and investor protection, and supporting capital markets efficiency and competitiveness. It will also increase the PGW membership to include all federal financial regulators so that information is shared in an appropriate, timely and efficient manner.

One thing that the PWG will work on immediately is determining whether the government has all the tools and powers it needs to deal with a financial crisis. As part of this, as I mentioned in my remarks last week, the PWG should examine the lessons of the current temporary liquidity facility the Fed has established for investment banks, and examine a number of issues regarding the proper level of oversight that should apply.

Mortgage Origination Process

Another issue that needs attention is the mortgage origination process. Simply put, that process was broken. We are aggressively addressing the immediate problem, working to increase the availability of affordable mortgage financing, prevent avoidable foreclosures and to minimize the economic disruption of the housing downturn. We concluded that it was also appropriate to put forward a proposal to address the policy issues arising from the current turmoil, to avoid a recurrence of recent events and to respond to the fact that a very large percentage of the problematic subprime mortgages originated in the last four years were originated by state-regulated entities.

Mortgage origination is one of the best case studies for the importance of regulatory structure. It raises the question of proper balance between federal and state oversight, and requires a balancing of innovation, consumer choice and expanded access to credit with protecting consumers from predatory lending and deceptive or incomplete disclosure practices. I have reviewed and analyzed a number of ideas to deal with this process. We thought quite seriously about federal preemption of enforcement authority but concluded in this case it was best to focus on the immediately achievable.

We are recommending retaining state-level regulation of mortgage origination

practices, but we are also recommending creating a new federal-level commission, the Mortgage Origination Commission. This commission, the MOC, would be led by a director appointed by the President. The Commission membership would include federal banking regulators and appropriate state representation. Legislation should set forth or task this Commission to establish minimum standards which should include personal conduct and disciplinary history, minimum educational requirements, testing criteria and procedures, and appropriate licensing revocation standards.

In addition to the standards, the MOC would provide important information to the marketplace about the strength of each state's mortgage compliance standards. The MOC would evaluate, rate, and report on each state's adequacy for licensing and regulation of participants in the mortgage origination process. These evaluations would grade the overall adequacy of a state system by descriptive categories, indicating a system's strength or weakness. These evaluations could provide further information regarding whether mortgages originated in a state should be viewed cautiously before being securitized. This powerful Commission, coupled with the Federal Reserve's strong regulatory proposal regarding the HOEPA rules, should go a long way in preventing recent issues from recurring.

Intermediate Term Recommendations

Now, as these near term steps are taken, we also recommend action on a number of intermediate steps after the current market stress has passed. We should focus on a critical part of our economy: payment and settlement systems. Also, there are two areas where our regulatory structure severely inhibits our competitiveness – futures and securities, and insurance. Our recommendations in each area also call for fundamental change that move us toward the longer-term, objectives-based structure and, consequently, will take a number of years to complete.

Payment and Settlement Systems

Payment systems are critically important for overall market stability. On a typical business day, US payment and settlement systems settle transactions valued at over $13 trillion. Every American relies on a payment system in one way or another, everyday. Yet, our government is behind the curve in payment system oversight. I am not intending to raise an alarm here. There is no crisis, but we should be proactive and address this issue. In our Blueprint, we recommend the creation of a federal charter for systemically important payment and settlement systems and that these systems should be overseen by the Federal Reserve. This will allow the Federal Reserve to guard the integrity of this vital part of our nation's economy.

Merge SEC and CFTC

When the topic of regulatory structure comes up, people often rush to the assumption that the SEC and the CFTC should be merged. We agree that the realities of the current marketplace for securities and futures products make it increasingly difficult to rationalize a separate regulatory regime. And, we believe that we should pursue moving our regulation in the direction that the markets are taking us.

As you will see in the Blueprint, in this case process is just as important as substance. The market benefits achieved in the futures area should be preserved and we do not want to lose the CFTC's principle-based process for market exchange oversight. Accordingly, instead of simply recommending merging the SEC and CFTC with the expectation that all will work out, we recommend a number of steps and an evolutionary approach to shape the merger process so as to preserve the best aspects of each regulator. In fact, the SEC and the CFTC have recently signed a mutual cooperation agreement that embodies the spirit of what the Blueprint is trying to achieve.

Optional Federal Charter for Insurance

Insurance presents a clear need for regulatory modernization. States have been the primary regulator for insurance for over 135 years. While a completely state-based regulatory system for insurance may have been appropriate at one time, insurance market changes have put increasing strains on the system.

A state-based regulatory system is quite burdensome. It allows price controls to create market distortions. It can hinder development of national products and can directly impact the competitiveness of US insurers. There have been numerous attempts to modernize the regulatory structure for insurance. At this time, it seems clear that the way forward is to give insurers the ability to elect for federal regulation. Therefore, in the Blueprint we recommend the establishment of a federal insurance regulatory structure to provide for the creation of an Optional Federal Charter for insurance companies, similar to the current dual-chartering system for banking. This system would be built on a proven model and we recommend, as in the banking sector, that this federal agency be housed within the Treasury Department. This is the most effective way to address these issues and we outline the critical elements to this legislation.

Revocation of the Federal Thrift Charter

In some cases, the market develops so quickly as to render parts of our regulatory structure relatively obsolete. This is the case with the federal thrift charter and the Office of Thrift Supervision, the OTS. The thrift charter is no longer necessary to ensure sufficient residential mortgage loans availability for US consumers. In the Blueprint, we have concluded that the thrift charter has run its course and should be phased out. With the elimination of the federal thrift charter, the OTS would be closed and its operations would be assumed by the OCC.

Conclusion

We recognize that these ideas will generate some controversy and healthy debate. This is not unlike the circumstances surrounding the 1991 "Green Book," which after a period of constructive discussion resulted in the passage of the Gramm-Leach-Bliley Act, modernizing our financial services industry some eight years later.

One of the most constant aspects of American life is change – and nowhere is it more evident than in our financial markets. If private sector institutions don't change, they become obsolete. Our regulatory structure also needs to change and evolve to one which will stand the test of time. Once we are through this period of market stress we need to begin the serious work of modernizing and reforming the structure, which will require a great deal of discussion and many years to complete.

This will not be a small or easy effort -- transformative efforts rarely are. But this is a subject we must debate, and ultimately address, for our long-term economic growth and prosperity. Thank you.

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LINKS

- Press Release
- Report
- Fact Sheet

March 31, 2008
2008-3-31-15-53-2-23651

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 $75,840 million as of the end of that week, compared to $75,146 million as of the end of the prior week.

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

	March 28, 2008		
A. Official reserve assets (in US millions unless otherwise specified)	Euro	Yen	Total
(1) Foreign currency reserves (in convertible foreign currencies)			75,840
(a) Securities	15,732	12,289	28,021
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	15,622	6,881	22,503
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	4,374		
(3) SDRs	9,901		
(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 [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	

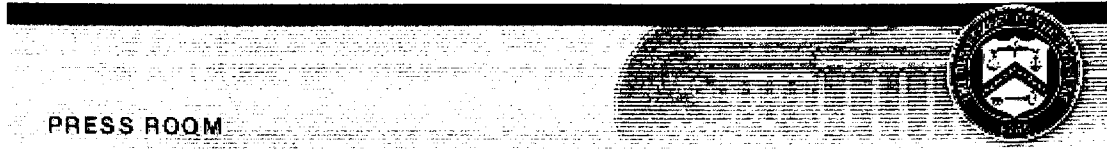
(d) securities lent and on repo	
--lent or repoed and included in Section I	
--lent or repoed but not included in Section I	
--borrowed or acquired and included in Section I	
--borrowed or acquired but not included in Section I	
(e) financial derivative assets (net, marked to market)	
--forwards	
--futures	
--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)	75,840
--currencies in SDR basket	75,840
--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.



April 1, 2008
HP-898

Under Secretary for Terrorism and
Financial Intelligence Stuart Levey
Testimony Before the Senate Committee on Finance

Washington – Chairman Baucus, Ranking Member Grassley, and distinguished members of the Committee, thank you for the opportunity to speak with you today about the work of the Treasury Department's Office of Terrorism and Financial Intelligence (TFI). I want to thank this Committee and the others that oversee TFI for the continued support and guidance we have received. Today, I want to brief you on the progress we have made over the past four years and also talk about some of the challenges we face moving forward.

THE OFFICE OF TERRORISM AND FINANCIAL INTELLIGENCE AND THE TREASURY DEPARTMENT'S ROLE IN PROTECTING NATIONAL SECURITY

Nearly four years have passed since I first testified before this committee as the nominee for my current position. At the time, I think it is fair to say that the extent of the Treasury Department's future role in protecting U.S. national security was uncertain at best. Most of the Treasury's law enforcement functions had been moved to the Departments of Justice and Homeland Security in 2003, the Treasury was not integrated into the Intelligence Community, and the office that I was being asked to lead was only in the process of being established.

But there were some who recognized that the Treasury Department's efforts to protect the safety and soundness of the international financial system were indispensable to our national security, especially given the types of threats we face in a post -9/11 world. Globalization is a positive trend; open finance and free trade enhance the economic security and prosperity of people in this country and around the world. But illicit actors seek to abuse the global financial system to support their dangerous activities. The financing of terrorism and weapons proliferation often occurs within the same system that spreads prosperity at home and abroad. It was therefore important to adapt our national security strategy to confront this challenge. This was the genesis of the Office of Terrorism and Financial Intelligence, or TFI.

Fast-forward to today, and we have a Treasury Department that is playing a greater role in national security than ever before. The guiding principle of TFI's approach is that many of the threats we face – from terrorism to the proliferation of weapons of mass destruction (WMD) to narcotics trafficking – all have one thing in common: they rely on financial support networks. These threats are not neatly confined within the borders of another country. They are asymmetric and borderless and thus not necessarily susceptible to being solved exclusively by traditional means of deterrence. The Treasury is well-situated to address them because of the authorities we command, the relationships we possess with governments and private sector actors around the world, and the financial information we can draw upon.

Transactions by those engaged in threatening conduct typically leave a trail of detailed information that we can follow to identify key actors and map their networks. Opening an account or initiating a funds transfer requires a name, an address, a phone number. This information tends to be very accurate and durable. In 2004, with the creation of TFI's Office of Intelligence and Analysis, the Treasury became the first finance ministry in the world to develop in-house intelligence and analytic expertise to use this information. We now work with the broader Intelligence Community to communicate the Department's requirements and evaluate information that threatens our national security. The Treasury then considers this information with an eye toward potential action – be it a designation, an advisory to the private sector, or a conversation to alert the private sector and government officials in another country to a particular threat. The financial networks of these illicit actors are not only a rich source of intelligence, but also they are a

vulnerability we can exploit. As I will explain, we have seen in various contexts that targeting these financial networks, when we do it right, can place an enormous amount of pressure on these networks and the actors they support.

A. COMBATING THREATS WITH TARGETED FINANCIAL MEASURES

As we have applied our authorities to different threats over the past several years, we have adopted a new strategy of using targeted, conduct-based financial measures aimed at particular bad actors. I intentionally refer to these targeted actions as "financial measures" rather than "sanctions" because the word "sanctions" often evokes such a negative reaction. These targeted financial measures are proving to be quite effective, flying in the face of a widely-held historical view that dismisses sanctions as ineffective, harmful to innocents, or both.

In the case of broad, country-wide sanctions that are often perceived as political statements, it can be difficult to persuade other governments and private businesses to join us in taking action. Even when other governments agree with us politically, they generally tend to be unwilling to force their businesses to forgo opportunities that remain open to others. When the private sector views such broad sanctions as unwelcome barriers to business, companies are unmotivated to do more than what is minimally necessary to comply. Indeed, history is replete with examples of participants in the global economy working to evade such sanctions while their governments turn a blind eye.

The dynamic is different when we instead impose financial measures specifically targeted against individuals or entities engaging in illicit conduct. When we use reliable financial intelligence to build conduct-based cases, it is much easier to achieve a multilateral alignment of interests. It is difficult for another government, even one that is not a close political ally, to oppose isolating actors who are demonstrably engaged in conduct that threatens global security or humanitarian interests. Also, whatever their political views, all countries want their financial sectors to prosper and to have good reputations. They therefore share a common interest with us in keeping their financial sectors untainted by illicit conduct.

The key difference when we use targeted financial measures is the reaction of the private sector. Rather than grudgingly complying with, or even trying to evade these measures, we have seen many members of the banking industry, in particular, voluntarily go beyond their legal requirements because they do not want to handle illicit business. This is a product of good corporate citizenship and a desire to protect their institutions' reputations. The end result is that private sector voluntary actions amplify the effectiveness of government-imposed measures.

Once some in the private sector decide to cut off companies or individuals we have targeted, it becomes an even greater reputational risk for others not to follow, and so they often do. Such voluntary implementation in turn makes it even more palatable for foreign governments to impose similar measures because their financial institutions have already given up the business, thus creating a mutually-reinforcing cycle of public and private action.

Armed with the critical intelligence capability I have described, as well as our experience building and maintaining multilateral government and private sector support for our actions, TFI draws on any one or a combination of authorities to respond to a particular threat. In many circumstances, we have found that our most effective tool is simply sharing information about illicit actors with other governments and members of the international private sector.

I would now like to describe some of the results of this marriage of intelligence and strong financial authorities, and the role it plays across various elements of our national security strategy.

1. Disrupting and Dismantling Terrorist Support Networks

Our efforts to track and combat terrorist financing are critical pillars of the U.S. government's efforts to protect U.S. citizens and other innocents around the world from terrorist attacks. These efforts span across U.S. departments and agencies and range from intelligence collection and analysis to public actions aimed at holding terrorist financiers accountable for their conduct and deterring other would-be donors. Activities to combat terrorist financing are more integrated than ever

before into the U.S. government's strategic approach to counterterrorism by virtue of the National Implementation Plan, which synchronizes the U.S. government's overall counterterrorism efforts.

Over the last four years, we have become more adept at pursuing that strategy and at pursuing the most appropriate course of action to combat the particular terrorism threat presented. In December of 2005, the 9/11 Commission's Public Discourse Project awarded its highest grade, an A-, to the U.S. government's efforts to combat terrorist financing. Since then, we have continued to develop and improve our strategy and there are signs that we are making important progress.

To start, we have made significant progress in mapping terrorist networks. "Following the money" yields some of the most valuable sources of information we have in this effort. As 9/11 Commission Chairman Lee Hamilton has stated: "Use of this tool almost always remains invisible to the general public, but it is a critical part of the overall campaign against al Qaida." That is because financial intelligence is extremely reliable; money trails don't lie. At times, our best course is not to take public action, but to continue to trace the network both upstream to the ultimate donors and downstream to the operational cells.

On some occasions, we decide that the best approach is to share intelligence with other countries and urge them to take action against the relevant actors. We have found that almost all countries will take such requests very seriously, especially when the information concerns al Qaida.

At other times, we have determined that the best course is for the Treasury to take public action. We have a powerful Executive Order that allows us to designate terrorists and their supporters, freezing any assets they have under U.S. jurisdiction and preventing U.S. persons from doing business with them. We have used this authority against key terrorist entities, facilitators, donors, and terrorist-supporting charities, ranging from Bayt al-Mal and Yousser Company, which are financial institutions that functioned as Hizballah's unofficial treasury in Lebanon, to Adel Abdul Jalil Batterjee, a Saudi-based donor to al Qaida.

When it comes to al Qaida and the Taliban, there is a UN Security Council resolution, UNSCR 1267, which provides for designations similar to our Executive Order designations. There are other Security Council resolutions dealing with terrorist financing more generally, but for Hamas, Hizballah and other terrorist organizations we have designated, there is no comparable UN list. We are still grappling with this challenge. We nevertheless have found that our unilateral designations are followed voluntarily by many banks around the world that have decided they simply do not want to do business with these actors.

The disruptive impact of these actions is significant. Beyond the direct effect on the designated individual or entity, designations can also deter other would-be financiers. The terrorist operative who is willing to strap on a suicide belt may not be susceptible to deterrence, but the individual donor who wants to support violent jihad may well be. Terrorist financiers typically live public lives with all that entails: property, occupation, family, and social position. Being publicly identified as a financier of terror threatens an end to that "normal" life.

Designations have also been an effective tool in combating terrorist abuse of charities. Historically, al Qaida and other terrorist groups have set up or exploited some charities, preying on unwitting donors trying to fulfill their religious obligation of charitable giving or seemingly engaging in humanitarian activity to garner support from communities in need. Indeed, many terrorist-supporting charities have gone to great lengths in attempting to obscure their support for violence.

Through a combination of public designations and law enforcement and regulatory actions against corrupt charities, both at home and abroad, we have exposed and taken out key organizations and deterred or disrupted others. We have thus far designated approximately 50 charities worldwide as supporters of terrorism, including several in the United States, putting a strain on al Qaida's financing efforts.

There is also increased awareness among charities around the world of the danger of terrorist abuse. In that regard, our active engagement with the charitable sector has been just as important as our actions against specific charities that have

supported terrorism. This is particularly important because we want humanitarian assistance to reach those who are truly in need through channels safe from terrorist exploitation.

We have issued guidance to assist charities in mitigating the risk of exploitation by terrorist groups. We have engaged in a comprehensive outreach campaign to the charitable sector and the Arab/Muslim-American communities to explain the threat, provide guidance, and address questions regarding Treasury enforcement actions. Internationally, we have worked through organizations like the Financial Action Task Force – or the "FATF," the world's premier standard-setting body on combating terrorist financing and money laundering – to develop and implement standards and best practices on preventing terrorist financing through charitable organizations. This effort has made it much more difficult for al Qaida and other terrorist groups to raise money through ostensibly mainstream charities while also helping well-intentioned donors support worthy causes.

The real value of all of our counter-terrorist financing efforts is that they provide us with another means of maintaining persistent pressure on terrorist networks. Terrorist networks and organizations require real financing to survive. The support they require goes far beyond funding attacks. They need money to pay operatives, support their families, indoctrinate and recruit new members, train, travel, and bribe officials. When we restrict the flow of funds to terrorist groups or disrupt a link in their financing chain, we can have an impact.

With respect to the terrorist group that poses the greatest threat to the United States, al Qaida, we have made real progress. We have disrupted or deterred many of the donors on which al Qaida used to rely. At the very least, these donors are finding it far more difficult to fund al Qaida with the ease and efficiency provided by the international financial system. The same applies to many of the charities that al Qaida previously depended upon as a source of funds. To the extent we can force terrorists and their supporters out of the formal financial system, we force them into more cumbersome and riskier methods of raising and moving money, subjecting them to a greater likelihood of detection and disruption. In this regard, we are also pursuing important efforts to facilitate the interdiction of cash couriers, for example by working with DHS to identify and interdict them. The Department of Homeland Security's Customs and Border Protection is playing a leading role in this global effort.

Along with our allies around the world, we have disrupted many of al Qaida's most important facilitation networks. Consider this relatively recent quote from an interview by a high-ranking al Qaida official, Mustafa Abu-al-Yazid, also known as Shaykh Sa'id:

> "As for the needs of the Jihad in Afghanistan, the first of them is financial. The Mujahideen of the Taliban number in the thousands, but they lack funds. And there are hundreds wishing to carry out martyrdom-seeking operations, but they can't find the funds to equip themselves. So funding is the mainstay of Jihad. . . . And here we would like to point out that those who perform Jihad with their wealth should be certain to only send the funds to those responsible for finances and no other party, as to do otherwise leads to disunity and differences in the ranks of the Mujahideen."

Al Qaida's expression of concern about its financial difficulties is not limited to this one comment; this concern has recently been echoed elsewhere in al Qaida's upper ranks. This, in part, is the impact of being forced out of the formal financial system. Al Qaida has had no choice but to turn to less reliable methods of raising, storing, and moving money, giving rise to opportunities for fraud and distrust within its ranks.

The overall impact of all of our efforts has been substantial: as DNI McConnell recently testified, over the last year to 18 months we have seen that the core leadership of al Qaida has had difficulty raising funds and sustaining itself.

That does not mean that I am satisfied; there are still tough issues that need to be tackled. One of our greatest challenges will be to foster the political will required to deter terrorist financiers more consistently and effectively. It has proven difficult to persuade officials in some countries to identify and to hold terrorist financiers publicly accountable for their actions. This lack of public accountability undermines

our ability to deter other donors. Those who reach for their wallets to fund terrorism must be pursued and punished in the same way as those who reach for a bomb or a gun. We have made some progress in this area, but we have a long way to go. So long as that is the case, even when we are successful in disrupting terrorist facilitators and financial conduits, our successes may well be short-lived.

Stemming the violence in Iraq continues to be a significant challenge, but TFI is contributing to the effort. Our intelligence work has been particularly useful in helping to restrict the flow of funds fueling the Iraqi insurgency. The Treasury and Defense Departments established in late 2005 a Baghdad-based interagency intelligence unit, known as the Iraq Threat Finance Cell (ITFC), to enhance the collection, analysis, and dissemination of timely and relevant financial intelligence to combat the insurgency. The ITFC has made significant contributions to our war fighters. Senior U.S and Coalition military commanders have come to rely on the cell's strategic and tactical analysis to help combat the Iraqi insurgency and disrupt terrorist, insurgent, and militia financial networks.

The presence of al Qaida in Iraq is representative of another trend that poses a significant challenge for us. In the years since September 11, al Qaida has continued to merge with regionally-based terrorist groups to support its cause. Although these partners, which include groups based in Africa, the Middle East and elsewhere, may have had long-standing objectives of using terrorist tactics against governments and regimes, their affiliation with al Qaida brings with it the potential that their personnel and resources could be used to engage in attacks globally including against the United States. Our challenge is to stay in front of this trend by working to understand these groups' operations, organizational structure and, of course, their financial networks, as quickly as they are evolving. By focusing on the financing of these nodes, we can better understand the relationship among them and identify potential vulnerabilities.

We are also not yet where we need to be with respect to State Sponsors of Terrorism, particularly Iran and Syria. These states not only provide support and safe haven to terrorists, but also a financial infrastructure that terrorists can use to move, store, and launder their funds. Iran poses the biggest problem in this area, using its Qods Force to provide weapons and financial support to the Taliban and terrorist organizations. We have designated individuals or entities in both Iran and Syria for supporting terrorism-related activities, and, as in other areas, we find that responsible financial institutions take these actions into account and adjust their business accordingly.

Finally, there is only so much that the United States can do alone. We have good cooperation from many other governments and the private sector on counter-terrorist financing. The work of the UN Security Council in implementing Security Council Resolution 1267 and the FATF in setting international standards has been instrumental. But there are still challenges. Legal authorities and operational capacity to combat terrorist financing on a national level remain uneven. Some countries still have not criminalized terrorist financing; others have taken this step, but have yet to use the authority. Most importantly, countries need to develop and apply intelligence as a basis of disrupting terrorist financing networks through law enforcement as well as through the use of targeted financial measures. Even some of our best partners still lack the political will or national authorities to consistently and aggressively disrupt terrorist financing networks. This is particularly true when it comes to terrorist groups beyond al Qaida or when there is need to rely on intelligence as a basis for financial action.

2. Targeting Proliferators and their Supporters

We are applying the lessons we have learned in combating terrorist financing to respond to the threat of WMD and missile proliferation. Targeted financial action against proliferation networks has the potential to be particularly effective for two reasons. First, while terrorist organizations are likely to use informal networks or cash couriers, proliferation networks often engage in ostensibly legitimate commercial transactions and therefore tend to depend upon access to the formal financial system, where transparency and our controls are greatest. Second, many in the proliferation chain are motivated by profit, rather than ideology, making them more susceptible to deterrence if we can credibly threaten to publicly expose or isolate them.

Recognizing this, President Bush issued Executive Order 13382 in June of 2005,

adding targeted financial measures to the array of options previously available to the U.S. government to combat proliferation. This order authorizes the Treasury and State Departments to target key nodes of WMD and missile proliferation networks, including their suppliers and financiers, in the same way we do with terrorists. We have used it to designate a number of banks, entities, and individuals supporting proliferation activities in Iran, North Korea, and Syria.

In the Iran context, UN Member States are implementing targeted financial measures against entities and individuals identified by the Security Council in a series of Chapter VII UN Security Council resolutions for their involvement in Iran's nuclear and missile programs. Beyond that, most governments do not yet have a national-level designation authority similar to ours as a tool to stem proliferation. Nonetheless, U.S. designations in this area gain worldwide recognition, particularly among financial institutions. My colleagues and I have traveled worldwide explaining our actions to, and sharing information with, foreign government officials and private sector representatives to help them understand the nature of the threat. The result is that our actions jeopardize designated proliferators' access to the international financial system and put their commercial partners on notice of the threat they pose. Those who continue to do business with them do so at the risk of tainting their reputations or even being designated themselves.

We also continue to work bilaterally and multilaterally to raise awareness of the problem of WMD proliferation finance and to encourage the creation of authorities like those we have under our Executive Order. We have been working closely with our G-7 Finance Ministry counterparts, in particular, to determine what steps can be taken to isolate proliferators from the international financial system through multilateral action. One of the most promising avenues is the recent and ongoing work of the FATF to study the threat of proliferation finance and assess the types of actions countries can take to prevent and disrupt proliferators' financial activities. This work has been strongly and unanimously endorsed by the G7, and we hope it will lead to international standards and best practices on proliferation finance, much like we already have on terrorist financing and money laundering. The Treasury and State Departments are also working to encourage the more than 85 countries that participate in the Proliferation Security Initiative (PSI) – aimed at stopping shipments of weapons of mass destruction, their delivery systems, and related materials to state and non-state actors of proliferation concern – to use financial measures to combat proliferation support networks.

3. Combating the Illicit Financial Conduct of Rogue Regimes

States engaged in illicit conduct pose a particular challenge. They hide behind a veil of legitimacy, disguising their activities, such as weapons sales or procurement, through the use of front companies and intermediaries. In some cases, they intentionally obscure the nature of their financial activities to evade detection and avoid suspicion. We have had important successes countering the illicit financial activity of both North Korea and Iran by using a combination of financial measures, fueled by financial intelligence, to target their conduct in a way that is persuasive both for other governments and the private sector.

North Korea

Confronted with North Korean conduct ranging from WMD and missile proliferation-related activities to the counterfeiting of U.S currency and other illicit financial behavior, the Treasury Department took two important public actions. First, we targeted a number of North Korean proliferation firms under E.O. 13382. Second, we acted under Section 311 of the *USA PATRIOT Act* to protect our financial system from abuse by Banco Delta Asia, a Macau-based bank that, among other things, knowingly allowed its North Korean clients to use the bank to facilitate illicit conduct and engage in deceptive financial practices.

Much of the real impact of these actions came from the information we made public in conjunction with the actions and the information we shared with governments and banks around the world. The private sector's reaction was dramatic. Since the information pointed to the North Korean regime's involvement in the illicit conduct, many of the world's private financial institutions terminated their business relationships not only with designated entities, but also with North Korean clients altogether. Banks in China, Japan, Vietnam, Mongolia, Singapore and across Europe decided that the risks associated with this business far outweighed any benefit. The result has been North Korea's virtual isolation from the global financial

system. That, in turn, put enormous pressure on the regime – even the most reclusive government depends on access to the international financial system. This effort was valuable both in securing the integrity of the international financial system and in providing the State Department with leverage in its diplomacy with North Korea.

In addition to these public actions, we have continued to work with the U.S. Secret Service to counteract North Korea's counterfeiting of U.S. currency. The Secret Service is continuing to investigate North Korea's counterfeiting activities and the high-quality counterfeit bills produced by North Korea, known as the "Supernote," continue to surface.

Iran

Dealing with Iran – a country that is much more deeply integrated into the international financial system than North Korea – has presented an even more complex challenge. Iran poses a number of threats. Among them are the regime's continued pursuit of nuclear capabilities in defiance of UN Security Council resolutions and its provision of financial and material support to terrorist groups. The combination of these dangerous activities has an extraordinarily lethal potential. Iran uses its global financial ties to pursue both policies, and it engages in an array of deceptive financial conduct specifically designed to avoid suspicion and evade detection by regulators and law-abiding financial institutions. By combating Iran's illicit financial activities with a strategy that combines targeted financial measures with an unprecedented level of outreach around the world, the Treasury is playing an integral role in the U.S. and multilateral strategy for dealing with Iran.

Iran's financial conduct underlies its proliferation and terrorism activities. Iran uses its state-owned banks for its nuclear and missile programs and for financing terrorism. It also uses front companies and intermediaries to engage in ostensibly innocent commercial transactions that are actually related to its nuclear and missile programs. These front companies and intermediaries enable the regime to obtain dual-use technology and materials from countries that would typically prohibit such exports to Iran.

We have also seen how Iranian banks request that other financial institutions take their names off of transactions when processing them in the international financial system. This practice is intended to evade the controls put in place by responsible financial institutions and has the effect of threatening to involve them in transactions they would never engage in if they knew who, or what, was really involved. This practice is even used by the Central Bank of Iran.

Over the past year and a half, I and other senior Treasury officials have met with our finance ministry and central bank counterparts from around the world to discuss the importance of ensuring that the international financial system is not tainted by Iran's abuse. We have also met with scores of banks to share this information and to discuss the risks of doing business with Iran.

We have taken targeted financial action under our proliferation and terrorism Executive Orders against key Iranian banks, entities and individuals facilitating the regime's dangerous conduct. Among these designations, we have acted against state-owned Bank Saderat, which has been used by the regime to funnel money to terrorist organizations. We have also designated three other Iranian state-owned banks – Bank Sepah, Bank Melli, and Bank Mellat – for facilitating the regime's proliferation activities and designated the Qods Force under our terrorism Executive Order for providing material support to the Taliban and terrorist organizations. The State Department has designated other key entities of proliferation concern, including the Islamic Revolutionary Guard Corps (also known as the Iranian Revolutionary Guard Corps) and the Ministry of Defense and Armed Forces Logistics.

These U.S. efforts have been accompanied by international action. The State Department's intensive diplomatic efforts have resulted in three UN Security Council resolutions imposing sanctions on Iran for its pursuit of nuclear capabilities and ballistic missiles. The most recent resolution, UNSCR 1803, calls upon UN member states to exercise vigilance over their own financial institutions' activities with all financial institutions domiciled in Iran, and their branches and subsidiaries abroad. This provision makes special mention of the risks posed by Bank Melli and Bank Saderat. And, in February, the FATF issued its second statement on Iran,

sending a clear message to governments and financial institutions worldwide about the threat Iran poses to the international financial system.

In response to Resolution 1803 and the FATF's warning, Treasury's Financial Crimes Enforcement Network (FinCEN) issued an advisory on March 20 to U.S. banks warning them of the risks of doing business with Iran and identifying Iranian state-owned and private banks and their branches and subsidiaries abroad. We also warned financial institutions about the conduct of the Central Bank of Iran, both in obscuring the true parties to transactions and in helping Iranian proliferation and terrorist-supporting entities avoid sanctions.

The overall result has been just the type of mutually-reinforcing cycle of governmental and private sector action that I previously described. In reaction to U.S. and multilateral actions, the world's leading financial institutions have largely stopped dealing with Iran, and especially Iranian banks, in any currency. Foreign-based branches and subsidiaries of Iran's state-owned banks are becoming financial pariahs – threatening their viability – as banks and companies around the world resist dealing with them. This represents a substantial success in protecting the integrity of the financial system from Iranian illicit conduct while simultaneously providing leverage to support the multilateral effort to reach a negotiated solution on Iran's nuclear program.

Combating other Threats

Our use of targeted financial measures is not limited to combating terrorism, proliferation, and the illicit financial conduct of Iran and North Korea. We are also using these tools in a variety of other contexts, including against corruption, narcotics trafficking, and abusive and oppressive regimes. In all of these situations, we can help put pressure on specific bad actors and try to rally the private sector to isolate them from the international financial system. Of course, these financial measures cannot alone solve these types of intractable problems. They are just one component of broader U.S. and, in some cases international, strategies to address them.

Combating Corruption

Corruption is one of the newer areas where we are increasingly relying on targeted financial measures. Corruption erodes democracy, the rule of law and economic well-being around the world. It taxes the poor, deprives legitimate businesses of opportunity and breeds criminality and mistrust. To address this threat, the President announced a strategy in August 2006 to combat high-level corruption, or "kleptocracy." The Treasury's charge in this strategy is to ensure that the international financial system is not misused by kleptocrats seeking to hide or move their ill-gotten gains. We also have targeted financial authorities aimed at exposing and disrupting corrupt officials' financial networks in countries such as Belarus, Burma and Syria.

In addition to the use of targeted financial measures to combat corruption, we are also working to increase transparency in the U.S. domestic and international financial systems, ensuring that an appropriate level of due diligence is applied to the financial dealings of foreign officials in positions of public trust, otherwise know as "Politically Exposed Persons," or PEPs.

Addressing Human Rights Abuses and Oppressive Regimes

In the past several years, we have learned that targeted financial measures can play a helpful role in reinforcing broader strategies to address human rights abuses and the conduct of brutal and oppressive regimes. Our efforts span across the crisis in Darfur to human rights violations and other oppressive activities in Zimbabwe, Burma, and Belarus. In the context of Darfur, for example, we have used the precision of targeted financial measures to focus on those who foment violence and human rights abuses. Our designations have included Sudanese individuals, including government and rebel leaders, elements of the logistical support network that arm those committing atrocities, and companies tied to the regime. These actions supplement an already comprehensive country sanctions program and have played an important role in exposing ongoing atrocities and bringing a new element – the financial sector – into the fight to bring them to an end. In the context of Burma, we have designated key financial operatives of the Burmese regime and

their business networks.

Combating Narcotics Trafficking

No discussion of the success of targeted financial measures would be complete without mention of the Treasury Department's counternarcotics sanctions program. This program has been in place since 1995, when President Clinton issued an Executive Order targeting the activities of significant foreign narcotics traffickers in Colombia, with the objective of isolating and incapacitating the businesses and agents of the Colombian drug cartels. Designations under this order continue today and span multiple industries, including such enterprises as drugstore chains, construction firms, agricultural businesses, and department stores. This program was the model in 1999 for the *Foreign Narcotics Kingpin Designation Act* ("*Kingpin Act*"), which provides a statutory framework for the President to impose sanctions against foreign drug kingpins and their organizations on a worldwide scale. Targets under the Kingpin Act have been identified in Mexico, the Caribbean, Middle East, and Southeast Asia.

This program has achieved many successes. Among them is the historic September 2006 plea agreement between the U.S. government and Miguel and Gilberto Rodriguez-Orejuela, the brothers who ran the infamous Cali Cartel in Colombia, which was responsible for importing tons of cocaine into the United States during the past two decades. According to the plea agreement, the Rodriguez-Orejuela brothers admitted smuggling over 30 metric tons of cocaine into the United States, generating an illicit fortune in excess of one billion dollars. Treasury, Justice, and other law enforcement agencies had for years worked to uncover and immobilize the hidden assets of the Cali Cartel, with the Office of Foreign Assets Control (OFAC) designating hundreds of front companies and individuals in Colombia and 10 other countries. In the end, the Rodriguez-Orejuela brothers were willing to plead guilty and spend the rest of their lives in jail just to make their family members eligible to be removed from OFAC's list.

B. SAFEGUARDING THE INTEGRITY OF THE FINANCIAL SYSTEM

Our efforts to combat threats to our national security using our financial authorities are most effective when they build on a foundation of strong systemic safeguards in the financial sector. Indeed, one of the Treasury's core missions is to ensure that these safeguards are part of our own domestic financial system and to encourage the adoption of similar safeguards worldwide. The common thread that runs throughout these initiatives is the goal of bringing greater transparency to the international financial system.

Transparency is, in and of itself, a powerful safeguard against the kinds of abuse of the financial system that I have described today. It is critical to enabling financial institutions and law enforcement, regulatory and other authorities to identify sources and conduits of illicit finance so that they can take steps to protect themselves, contributing to the overall safety, soundness, and security of the international financial system. Their efforts, in turn, deny terrorist organizations, proliferators and other criminals access to the financial system, forcing them to adopt costlier and riskier alternative financing mechanisms. We work to promote security by:

- Understanding how illicit actors abuse the financial system and ensuring that the U.S. financial system is protected by a comprehensive, efficient, and rigorously enforced anti-money laundering/counterterrorist financing (AML/CFT) regime;
- Strengthening and expanding international AML/CFT standards;
- Taking protective actions against threats and systemic vulnerabilities; and
- Partnering with the private sector.

I would like to share with you some of the actions we are taking to meet each of these objectives.

1. Understanding How Illicit Actors Abuse the Financial System and Ensuring the Protection of that System

The first step in safeguarding the financial system is to understand where it is vulnerable and the threats it faces. The Treasury Department has worked for many years to improve its understanding of illicit finance, and, in 2006, we coordinated

the first U.S. government-wide Money Laundering Threat Assessment. The assessment brought together the expertise of regulatory, law enforcement and investigative officials from across the government to investigate the current and emerging trends and techniques used to raise, move and launder illicit proceeds. Following the assessment, the Treasury joined with the Departments of Justice and Homeland Security to craft the 2007 National Money Laundering Strategy, which is mapped explicitly to the vulnerabilities identified in the threat assessment.

The Treasury is working with other agencies to ensure that we are appropriately addressing these threats. Highlights of this effort include FinCEN's ongoing efforts to analyze *Bank Secrecy Act* (BSA) filings to provide geographic threat assessments, such as the 43 State-specific reports provided to State regulators last year, analysis of Suspicious Activity Report (SAR) filings related to the districts of individual U.S. Attorney offices, and the ongoing analytical work in the area of mortgage fraud following FinCEN's first published report on that topic in November 2006. FinCEN also continues its coordination with the IRS and law enforcement agencies to identify potentially unregistered money services businesses and to target those businesses with outreach, education, and, where appropriate, enforcement efforts.

In addition to taking these specific steps, we are constantly examining our regulatory system to ensure it is as efficient and effective as possible. In that regard, on June 22, 2007, Secretary Paulson announced the first in a series of ongoing initiatives to promote the efficiency and effectiveness of the AML/CFT regulatory framework. FinCEN has been working with the Federal Banking Agencies and other government authorities, and in the coming months will be taking public steps in the areas previewed by the Secretary, including discussing the results of our efforts with the banking regulators to enhance risk-scoping in the bank examination process; proposing a clearer and more tailored regulatory definition of money services businesses; and proposing a restructured set of regulations to enable covered industries to focus more quickly on rules that apply specifically to them. Moreover, FinCEN continues to provide feedback to the financial industry on the usefulness to law enforcement of reported information and through analytical studies, guidance, and advisories to help financial institutions better target their risk control activities.

Strong enforcement of our money laundering and sanctions laws also plays an important role in protecting the financial system from abuse. The Department of the Treasury works with its other financial regulatory colleagues to administer and promote understanding of, and compliance with, these laws. Most enforcement in this area is civil, involving the banking regulators, OFAC, or FinCEN. In cases of serious violations, however, criminal enforcement may be warranted.

In the summer of 2005, the Department of Justice amended the United States Attorneys' Manual to require that all money laundering prosecutions of financial institutions be coordinated with, and approved by, the Criminal Division in Washington. The Manual contains a similar provision for cases under the International Emergency Economics Power Act – or IEEPA – which is one of the principal statutory authorities for OFAC's sanctions programs. These provisions promote consistency and uniformity in the use of these statutes and help ensure that unintended consequences from relevant cases are minimized. In that regard, they were specifically designed to enable Justice to consult with other agencies, including the Treasury Department. In enforcement actions involving violations of the BSA, Justice and the Treasury attempt to act concurrently whenever possible to promote consistency and avoid multiple actions against the same financial institution at different times for similar and related conduct.

The continued consultation between the Justice and Treasury Departments is vitally important given the complexities surrounding potential criminal charges against banks and other financial institutions, including the potential impact of such cases on the U.S. financial system. Under Assistant Attorney General Alice Fisher's leadership, the right atmosphere has been created for that consultation. In the end, the U.S. government must strike a delicate balance. We need to ensure the proper respect for the laws that safeguard the integrity of our financial system, but do so in a way that (1) allows our civil regulatory system to function effectively and (2) ensures that we maintain our position of leadership in the global financial system. This requires the exercise of well-informed and wise prosecutorial discretion. Consultation between the Treasury and Justice is an important part of that process.

2. Strengthening and Expanding International AML/CFT Standards

Given the global nature of the financial system, focusing only on the U.S. financial system and its AML/CFT regime is not sufficient. Safeguarding the U.S. financial system requires global solutions and effective action by financial centers throughout the world. We work toward this objective through multilateral bodies that set and seek to ensure global compliance with strong international standards.

The Treasury Department primarily advances this strategic objective through FATF, which articulates standards in the form of recommendations, guidelines, and best practices. The FATF standards have been recognized by more than 175 jurisdictions and have been integrated into the work of international organizations such as the United Nations, the World Bank and the International Monetary Fund. The FATF seeks global implementation of its standards through a number of mechanisms. Partnership with the IMF, World Bank and FATF-Style Regional Bodies ensures that every country in the world is assessed against the same standards using the same methodology. AML/CFT is one of twelve core standards used by the IMF to evaluate financial sector stability and is the sole required standard for all countries. As of September 2007, the IMF had conducted 50 assessments -- four of which were done jointly with the World Bank -- of country compliance with AML/CFT standards. These assessments highlight the key deficiencies for countries seeking to improve their AML/CFT standards. We have seen steady progress in legislation by countries to address their deficiencies identified in their assessments. Assessments also highlight deficiencies in a way that is useful to the private sector in assessing risk.

In some cases, implementation of AML/CFT standards is a question of political will. In other cases, however, countries need help to comply with the standards. In such cases, the Treasury has worked through its Office of Technical Assistance and other agencies to provide technical assistance to support the development of legal authorities and operational capacity that will enable countries to meet these standards.

While we work to ensure the current standards are being implemented, we also have consistently engaged the FATF to expand and strengthen these international standards to address the systemic vulnerabilities that terrorists and other criminals exploit. Most recently, we have successfully engaged the FATF to adopt a new international standard to combat the illicit use of cash couriers, and we have enhanced the international standard for combating terrorist abuse of charities.

Not only does this investment in foreign capacity building make it more difficult for illicit actors to hide and thrive, it also opens up new avenues to share information across borders. For this purpose FinCEN is the designated financial intelligence unit (FIU) for the United States and has played a leading role in fostering the sharing of financial intelligence among the FIUs of 106 countries that are members of the Egmont Group.

One new and promising initiative that touches on these important issues is the Merida Initiative – a U.S.-proposed multi-year cooperation initiative with the governments in Mexico and the countries of Central America. For Fiscal Year 2008, the Administration has requested $500 million for Mexico and $50 million for Central America to fulfill U.S. obligations under the initiative. This would be the first tranche of a potential $1.4 billion multi-year package. The assistance proposed falls into three broad areas: counternarcotics, counterterrorism, and border security; public security and law enforcement; and institution-building and the rule of law. A key part of the effort will be to modernize the Mexican financial intelligence unit's ability to respond more effectively to the evolving nature of money laundering. Overall, this initiative would complement existing U.S.-Mexico and Central America cooperation in countering the cross-border movement of billions of dollars in drug proceeds and in restricting the placement of these illicit proceeds into the U.S. financial system.

3. Taking Protective Action against Systemic Vulnerabilities

Although it is important to focus on improving transparency and ensuring adequate AML/CFT controls are in place on a global level, there are also times when specific, discrete vulnerabilities are not adequately addressed in the international financial system. In those cases, we need to take action to warn the financial industry of the risks and to protect ourselves from the threat those vulnerabilities pose to our financial system.

In that regard, Section 311 of the *USA PATRIOT Act* – which I mentioned briefly in the context of our efforts on North Korea – is an important and extraordinarily powerful tool. Section 311 authorizes the Treasury to designate a foreign jurisdiction, foreign financial institution, type of account or class of transactions to be of "primary money laundering concern," thereby enabling the Treasury to impose any one or combination of a range of special measures that U.S. financial institutions must take to protect against illicit financing risks associated with the designated target. We are the only country in the world that has an authority to take such protective action.

The Treasury has utilized Section 311 against both jurisdictions and financial institutions that posed a serious money laundering concern. When we have designated an entire jurisdiction – such as the Ukraine or Nauru – we have done so as part of, or in response to, a multilateral action, such as a FATF determination that these countries were "non-cooperative" on AML/CFT issues. One of the things that makes the Section 311 authority unique, however, is that it also allows us to finely target our actions so that we can protect ourselves from the threat that an individual financial institutions poses. This gives us enormous flexibility in determining how best to apply this authority to achieve the desired impact.

Our use of Section 311 has been extremely effective. Not only have our Section 311 designations had a significant effect in protecting the U.S. financial system, but they also have spurred actions by other countries that have the result of protecting the broader international financial system. In some instances, designation under Section 311 has facilitated the development of rehabilitative measures by a financial institution or jurisdiction that effectively addressed the underlying systemic vulnerability to the extent that withdrawal of the 311 designation was warranted.

4. Partnership with the Private Sector

Finally, we know that it is not sufficient to work only in partnership with governments on strengthening AML/CFT standards and identifying and closing specific vulnerabilities to the financial sector. The private sector brings a unique and invaluable insight into how the international financial system works and how we can be effective in achieving our objectives. We have forged important partnerships with both the domestic and international private sector to tap into and better utilize their expertise.

On the domestic side, Congress established the Bank Secrecy Act Advisory Group (BSAAG) in 1992 to enable the financial services industry and law enforcement to advise the Secretary of the Treasury on ways to enhance the utility of BSA records and reports. Since 1994, the BSAAG has served as a forum for industry, regulators, and law enforcement to communicate about how SARs and other BSA reports are used by law enforcement and how recordkeeping and reporting requirements can be improved. Under the chairmanship of the Director of FinCEN, the BSAAG meets twice a year in plenary and through multiple subcommittees over the course of the year. It has become an increasingly active group in suggesting priorities and to promote the efficiency and effectiveness of BSA rules and regulations.

On an international scale, we collaborated effectively with the private sector on the issue of "cover payments." Cover payment transactions occur typically with respect to foreign correspondent banking, where the actual movement of funds is made through one or more intermediary banks that "cover" the payment amount, but the intermediaries do not know on whose behalf they are settling a given transaction. It became increasingly clear to many banks that this practice, which developed over time for a variety of commercial reasons, is inconsistent with international AML/CFT standards, in particular with the purpose behind FATF Special Recommendation VII requiring that originator information remain with the funds transfer throughout the payment chain.

Industry representatives raised with the Treasury Department the issue of vulnerabilities of cover payments – together with a proposal on how to rectify the situation in the most efficient way. In April 2007, the Clearing House Association – a provider of payment services owned by the U.S. affiliates of almost two dozen major banks – and the Wolfsberg Group – an association of 12 global banks – proposed an amendment to the global bank messaging standards to incorporate all relevant transaction information. That proposal was refined and endorsed by national bank groups in January 2008, and SWIFT, the Society for Worldwide Interbank Financial Telecommunication, will introduce the new message standards

in November 2009. In addition to the technical changes, these groups of leading global banks announced payment message standards that they would follow to further enhance transparency in international payments, and thereby help avoid abuse by individuals and organizations that these banks would not accept as their own customers, such as money launderers and terrorist financiers. The Treasury Department, together with the Federal Banking Agencies, has engaged with their counterparts through the Basel Committee on Banking Supervision, FATF and the Egmont Group to promote a consistent global approach to ensuring compliance with these emerging global best practices.

The Treasury has also spearheaded an important initiative, the Private Sector Dialogue (PSD), to facilitate a dialogue between U.S. financial institutions and their counterparts in key regions on AML/CFT issues. Our goal for these dialogues, which focus on the Middle Eastern and North African and Latin American banking and regulatory communities, is to raise awareness of domestic and regional money laundering and terrorist financing risks, international AML/CFT standards and regional developments, and U.S. government policies and private sector measures to combat terrorist financing and money laundering. These dialogues are also helping us to assess the impact of these international standards and U.S. laws and regulations and to strengthen development and implementation of effective AML/CFT measures, particularly in regions of strategic importance and jurisdictions that lack fully-functional AML/CFT regimes.

CONCLUSION

Over the past four years, I believe that, with your active support, we have transformed the Treasury Department into an important part of our country's national security architecture. We have greatly improved our ability to analyze and use financial intelligence. We have further developed and implemented strategies for combating terrorist financing and other pressing threats to our national security, including through the innovative use of targeted financial measures against specific bad actors. These strategies, particularly in the cases of North Korea and Iran, have provided valuable leverage in difficult diplomatic negotiations. We have also made important strides in strengthening the systemic safeguards in the financial system both here in the United States and around the world. But our work is not nearly complete. We continue to face significant challenges as we move forward with these efforts, including fostering and maintaining the political will among other governments to take effective and consistent action.

I look forward to continuing to work with this Committee as we tackle these challenges.

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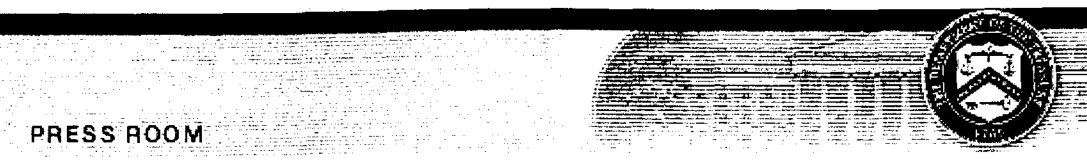

April 2, 2008
HP-900

Deputy Assistant Secretary Valerie Abend
Testimony on Implementation of Regulations Required
by the Unlawful Internet Gambling Enforcement Act of 2006

Washington – Mr. Chairman, Ranking Member Paul, and Members of the Subcommittee, it is my privilege to appear before you today to discuss the Unlawful Internet Gambling Enforcement Act of 2006 (the "Act").

Proposed Rulemaking

The Act was fashioned to require payment systems to interdict the flow of funds from gamblers to businesses providing unlawful internet gambling services. To accomplish this, the Act requires the Treasury Department and the Federal Reserve Board, in consultation with the Justice Department, to jointly prescribe regulations requiring participants in designated payment systems to establish policies and procedures that are reasonably designed to prevent or prohibit such funding flows. It also requires that payment systems, or portions of payment systems, be exempted in situations in which it would not be reasonably practical for payment systems to prevent or prohibit unlawful internet gambling transactions.

On October 4, 2007 the Treasury Department and the Federal Reserve Board, after consultation with the Justice Department, published a Notice of Proposed Rulemaking seeking public comment. Our goal when writing this proposed rule was to faithfully adhere to the mandates set forth by Congress in the Act. The comment period ended on December 12, 2007.

We received more than 200 comments from a diverse group of interests, including entities potentially subject to the proposed regulations, individuals and groups supportive of internet gambling, individuals and groups opposed to internet gambling, as well as others.

We are currently reviewing each comment closely, and analyzing the issues presented. Many comments present more than a single issue, and certain issues require additional research into operations of various parts of payment systems, or into existing law relevant to the comment provided.

Some of the comments address the meaning of statutory definitions provided by Congress, the applicability of requirements to specific portions of designated payment systems, and the impacts this proposed regulation could have in the event it were to be finalized as proposed.

Crafting such a joint rulemaking requires extensive coordination. We are working jointly with the Federal Reserve Board in consultation with the Justice Department. We have been impressed with the quality of the comments provided, and with the effort and expertise employed in the development of many of these comments.

An over-arching goal for our efforts has been to closely adhere to the statutory instructions provided to us by the Congress. The Act requires designation of payment systems that could be used in connection with unlawful internet gambling. Such a designation makes the payment system, and financial providers participating in the system, subject to the requirements of the regulations. The proposed rule designated the following 5 payment systems:

- Automated Clearing House Systems
- Card Systems (e.g., credit cards, debit cards, as well as stored value products)
- Check Collection Systems

- Money Transmitting Businesses
- Wire Transfer Systems (i.e., CHIPS)

The Act requires us to exempt certain restricted transactions or designated payment systems from any requirement imposed by the regulations if the Treasury Department and the Federal Reserve Board jointly determine that it is not reasonably practical for participants to prevent or prohibit unlawful internet gambling transactions. However, the proposed rule does propose to partially exempt certain participants within some of the designated payment systems from having to establish reasonably designed policies and procedures. The Treasury and the Federal Reserve Board determined that this was the most appropriate way to implement the Act while retaining fidelity to the intent of Congress.

Under the proposed rule, the gambling *business's* bank (or, if abroad, the first U.S. bank dealing with that bank) would not be exempted because it could, through reasonable due diligence, ascertain the nature of its customer's business and ensure that the customer relationship is not used to receive unlawful internet gambling transactions. The proposed exemptions generally extend to the gambler's bank. For example, in the case of checks, the check collection system is highly automated and it is not reasonably practical for the gambler's bank to know whether a check presented to it for payment involves unlawful internet gambling. However, the proposed rule provides that the gambling business's bank (or, if abroad, the first U.S. bank to receive the check) would need to have reasonably designed policies and procedures to prevent or prohibit unlawful internet gambling transactions involving these checks. In the situation where the bank of the gambling business is located abroad, the proposed requirements focus on the bank in the United States that has a corresponding relationship with the gambling business's bank.

The Act further requires us to provide nonexclusive examples of policies and procedures, which would be deemed "reasonably designed" to prevent or prohibit unlawful internet gambling transactions. As a result, this proposed rule contains a "safe harbor" provision, as mandated by the Act, that includes for each designated payment system nonexclusive examples of reasonably designed policies and procedures.

Conclusion

The Treasury, working closely and collaboratively with our colleagues at the Federal Reserve Board, is making progress in reaching our statutory mandate to promulgate a final rule that strictly adheres to the Act. No final decisions have been made regarding any aspect of the final rule or the comments provided, and we are still considering all aspects of the proposed rule. W hen we publish the final rule we will, of course, provide an analysis of the comments received, and the reasons for any decisions. We are committed to giving fair consideration to all relevant comments as we are working toward promulgation of a final rule. We have benefited from the knowledge and efforts of our colleagues at the Federal Reserve Board and the Justice Department, as we have proceeded in our consideration and analysis. Thank you, I would be happy to answer your questions.

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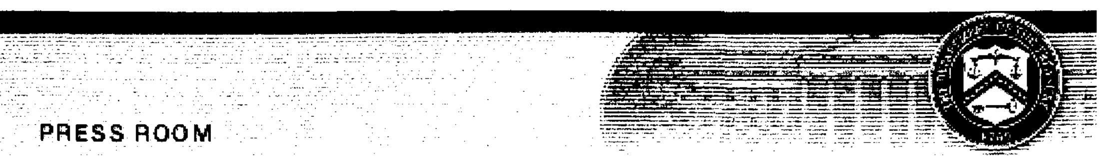


April 2, 2008
HP-901

**Secretary Paulson to Attend
Annual Inter-American Development Bank
Meeting in Miami**

Secretary Henry M. Paulson, Jr. will attend the 2008 Inter-American Development Bank (IDB) annual meeting in Miami next week. The United States is hosting this year's annual meeting which is an important opportunity for high-level government and private sector representatives from Latin America and the Caribbean to discuss the work of the IDB and other financial issues facing the region. Paulson attended last year's meeting in Guatemala.

As the representative of the host country, Paulson will accept the nomination of Chairman of the Board of Governors for 2008-09. In addition to delivering opening remarks at the inaugural session, Paulson will meet with several of his counterparts from the region while in Miami.

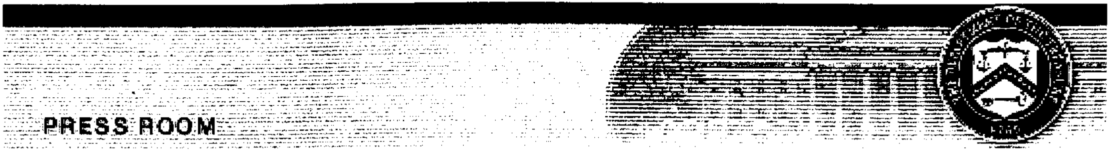
"I look forward to attending this year's meeting in Miami and thank President Moreno and the IDB for the hard work and positive impact the Bank has had in the region," said Paulson. "The U.S. looks forward to continuing to work with the Bank to increase growth and reduce poverty in Latin America and the Caribbean."

The following events are open to the media:

Who
Secretary Henry M. Paulson, Jr.
IDB President Luis Alberto Moreno
Guatemala Finance Minister Juan A. Fuentes (outgoing IDB Board of Governors Chairman)
Miami Mayor Manuel Diaz
What
Inaugural Session
When
Monday, April 7, 9:30 a.m. EDT
Where
Jackie Gleason Theater
1700 Washington Avenue
Miami Beach, Fla.

Who
Treasury Secretary Paulson and Commerce Secretary Gutierrez
What
Joint Press Conference
When
Monday, April 7, 4:00 p.m. EDT
Where
Miami Beach Convention Center
1901 Convention Center Drive
Miami Beach, Fla.

For more information on the IDB's annual meeting in Miami go to:
http://www.iadb.org/.



April 2, 2008
HP-902

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 the media:

- **Who** Treasury Assistant Secretary Phillip Swagel
- **What** Monthly Economic Press Briefing
- **When** Friday, April 4, 2008, 11:00 a.m. EDT
- **Where** Treasury Department
  Media Room (Room 4121)
  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.

- 30 -

April 2, 2008
HP-903

Remarks by Secretary Henry M. Paulson, Jr.
Meeting the Challenge: A Partnership on Energy and the Environment

Beijing, CHINA-- Thank you. It is my pleasure to join you here at the Chinese Academy of Sciences. I understand my visit is timely – many of you are also participating in the Chinese Ministry of Science and Technology and the U.S. Environmental Protection Agency discussions on new technology for environmental challenges. Thank you for your work. I believe that workshops like these will help our two countries overcome the energy and environmental challenges of the future.

China has just completed a significant change in its leadership, something that happens every five years. I am here to meet those new leaders so that we can immediately begin work and achieve progress on the critically-important U.S.–China economic relationship. The United States welcomes a stable and prosperous China and wants to continue our efforts and dialogues to meet our shared responsibilities to advance a robust and sustainable world economy.

Benefits of the Strategic Economic Dialogue

The Strategic Economic Dialogue, created by President Bush and President Hu in September of 2006, has allowed both countries to develop long-term, strategic solutions and to address immediate issues of pressing concern in our economic relationship. Through the SED, we make progress on those long-term issues by defining our strategic objectives and laying a course of concrete actions. We solve immediate problems through cooperative engagement. We reduce misunderstandings through dialogue. And perhaps most importantly, at each session of the SED, we review our previous agreements and make sure that progress is being made.

Long-term, structural challenges confront both of our economies. For the United States, the challenge is to save more and spend less. For China, the challenge is to save less and consume more. A deep and more efficient financial sector will help Chinese households earn a higher return on their investments and thus achieve their financial goals without having to save so much of their income. It will give them greater financial security by allowing them to insure against life's many risks, while also reducing their need to save. A more flexible exchange rate is also a powerful tool in redirecting growth to domestic consumption. Although the process of adjustment is not complete, the accelerated pace of appreciation is significant and welcome, and should continue.

The SED also provides a mechanism to address immediate issues. When serious concerns about food and product safety arose last year, our governments quickly initiated consultations to enhance the safety of Chinese food, feed, drug, and medical device exports to the United States. These consultations, in conjunction with the Chinese government's domestic efforts, resulted in two bilateral accords at our last SED meeting, which will enhance cooperation and improve the safety of Chinese exports to the United States. Although these issues are not fully resolved, we now have a process for developing timely solutions to similar problems as they arise. And the U.S. Department of Health and Human Services is establishing a Food and Drug Administration office in China to strengthen collaboration with Chinese regulators.

Ten Years of Cooperation: Achieving Economic Growth, Energy Security and Environmental Sustainability

Energy and environmental challenges are also part of our overall economic relationship. The United States and China, individually and together, continue to find ways to maintain economic growth while also developing sustainable and

secure energy supplies, and protecting and conserving the environment.

At last December's SED meeting, the United States and China announced that we would embark on ten years of cooperation on energy and environmental issues. The cooperation will not replace ongoing United Nations' multilateral climate change negotiations, supported by the Major Economies Process, which includes China and the United States. Through the Major Economies process, we will continue our efforts and will urge every country to reach an agreed outcome by the end of next year that is both environmentally effective and economically sustainable. Successfully confronting the challenge of global climate change will require commitment and leadership by all major economies. Our ten year energy and environment cooperative framework is part of that commitment, as we will focus on shared objectives, including energy security, lower greenhouse gas emissions, clean water, clean air and preservation of wild and beautiful places.

Working together on this ten year framework will challenge our governments, industries, universities, research institutions, academics, thought leaders, and non-governmental organizations to find answers to these and many other questions: How do we reduce dependency on oil and increase energy security? How do we better preserve the natural environment, and prevent greenhouse gas release due to deforestation? How do we meet our energy goals? How do we ensure that our water is clean and safe?

These questions may be answered differently in the United States than in China. Yet, our approaches to finding answers may be similar – to implement proven, effective policies, to educate individuals to make environmentally sound decisions, to ensure that companies follow regulations designed to protect human health. Other solutions will require technological breakthroughs and making existing or new technology affordable by reducing market access barriers.

Our two countries share the challenge of achieving balanced economic growth along with energy security and environmental sustainability. It will take resourcefulness, creativity, determination and a long-term commitment to achieve the results we seek.

Since December, we have been hard at work creating and adding details to this framework, which will require cooperation at the highest levels on climate change, energy security and efficiency, pollution abatement, and natural resource conservation. Only through greater cooperation will we be able to better organize our efforts and target some of the most pressing issues that the United States and China will face in the coming decade.

We are selecting shared goals, such as reducing dependency on oil. We are defining specific energy targets, such as increasing vehicle fleet fuel efficiency and creating incentives for the development and use of alternative fuels. We are developing action plans for joint projects that will build upon and accelerate existing efforts. These action plans will help each country identify policy solutions to improve implementation of existing regulations and incentives, and challenge us to develop even more innovative approaches and answers.

For example, I was pleased by the announcement by the X Prize Foundation that there will be an X prize for whoever can develop a car that goes 100 miles on a gallon of gas. I want to see American and Chinese scientists and engineers actively engaged in developing that car. I want to see us establish national laboratory systems that will communicate, conduct joint research and share expertise.

This cooperation will likely bring innovations that we cannot even imagine and create new ways to expand our relationship. I often hear from U.S. companies that have Chinese clients ready to buy their technology, but do not sell it for fear that their designs and technology will be stolen. In China, I hear from government officials about the need for U.S. technology to help clean up China's rivers and control pollution from China's many smoke stacks, but that technology can be expensive in part due to tariffs and non-tariff barriers. We have a shared interest in resolving these dilemmas, and we can solve them. Making the air and water clean, improving the health of our people and creating sustainable economic growth, are strong motivations.

Environmental Challenges

The United States knows well that economic development increases opportunity and prosperity, but also that rapid industrial growth often brings serious environmental side effects.

During the late nineteenth and early twentieth centuries, as the United States industrialized, factories and manufacturing plants were built throughout America. As these plants and factories produced goods, they also released chemicals and waste into our environment.

In one example, Ohio's Cuyahoga River – a major tributary into Lake Erie – was so polluted in the 1930's that the river often burst into flames. Pollution was so severe that descriptions from the time declared that the Cuyahoga had "no visible life, not even low forms such as leeches and sludge worms." On June 23, 1969, the Cuyahoga again caught fire, with flames leaping as high as five stories.

China today faces similar and daunting environmental challenges. According to the World Bank, 16 of the world's 20 most polluted cities are in China. Water quality also has deteriorated. Ninety percent of all rivers show signs of significant pollution, and 62 percent of water is unsuitable for fish. We have followed with great interest the ways you have sought to address the pollution issues surrounding Lake Tai in Jiangsu Province.

In the United States, we address our problems by combining strict laws and regulations with the will and capacity to enforce them. The hazards created by the Cuyahoga River led to the 1972 Federal Water Pollution Control Act. Subsequent efforts to clean the Cuyahoga have been so successful that Lake Erie now has a thriving $600 million dollar annual fishing industry.

Energy Challenges

Economic activity in China and the United States requires energy; and the energy challenges are as daunting as the environmental challenges.

China's economy is one-sixth the size of the U.S. economy, yet China is in the process of overtaking the United States as the world's largest source of greenhouse gas emissions. China is now the world's largest coal producer and consumer. In 2006, it became the second largest global market for new vehicles, which is one of the key reasons why China is now the world's second largest consumer of oil.

I am not here to tell you what you already know – that achieving economic growth along with energy security and environmental protection is a formidable task. The United States also knows this struggle, and we also continue to search for solutions.

Promoting Energy Security and Protecting the Environment

U.S. economic growth brought substantial environmental impacts, and our government has taken enormous steps to protect our water, land and air. Economic incentives for new cleaner technologies, in addition to strong regulations and enforcement, have been at the core of our success.

The U.S. recognizes the importance of safeguarding the environment through conservation. Through a variety of federal, state and local agencies we conserve, protect and manage natural resources. We also expect private industry and a vibrant non-profit sector to further support these efforts.

I am pleased that China has also recognized the importance of conservation efforts, and applaud China's steps to develop legislation that would more effectively protect natural habitat. It is important that this legislation move forward quickly. I am also encouraged to know that China is adding 2 million hectares of forest per year to increase forest coverage by 6 percent to combat desertification. According to official Chinese projections, by 2010, 16 percent of China's total territory will be natural reserve areas, and 90 percent of typical forest ecosystems and key national wildlife will effectively be protected.

China has established numerous plans and ambitious goals to tackle the energy and environment challenge. With the Tenth Five Year Plan, for 2001 to 2005, China

recognized that energy would drive its future economic growth. And in the Eleventh Five Year Plan, for 2006 to 2010, China recognizes that energy and environmental issues must be integrated to promote sustainable economic growth. Aggressive goals have been established to reduce energy consumption per unit of GDP by 20 percent, to reduce total discharge of major pollutants by 10 percent, and to increase overall forest coverage in China from 18.2 to 20 percent.

China has moved towards meeting some of these goals in 2007. China reduced energy consumption over 3 percent per unit of GDP output, and has made progress in reducing water pollution and sulfur dioxide emissions. While I applaud this continued focus and am encouraged by China's progress to date, further results cannot come fast enough.

The Role of Markets

Harnessing market forces can also improve governments' ability to resolve these issues. The 1990 Clean Air Act has demonstrated clearly how market-driven measures can cost-effectively reduce pollution.

The goal of the Clean Air Act was to reduce acid rain by reducing sulfur dioxide, SO2, and nitrogen oxides, NOX. Traditional source-by-source limits were set for NOx. A system of tradable credits – allowing those who could reduce emissions most cheaply to sell excess credits to those whose reductions were more expensive – were set for SO2.

Studies estimate that the SO2 market-based trading system will reduce SO2 emissions by about 50 percent, and that it has reduced the cost of controlling acid rain by up to 80 percent compared to traditional source-by-source regulations. Further, the annual benefits of this market-based trading system are estimated to exceed the program's operating costs by over 40 times.

After a very costly experiment with oil price restrictions, the United States has also learned the lessons of attempting to defy market forces. We learned that markets and consumers are best served when prices are allowed to fluctuate.

In the 1970s, the U.S. attempted various price control regimes. Rather than achieving our intended result, we experienced winter heating oil shortages, supply problems, rationing, and a reduction in domestic oil and gas investment and exploration. In some cases we attempted to control output prices without being able to control input prices, forcing operating losses and large cuts in supply.

China, by setting price controls on fuel, is facing similar consequences today – as can be seen by persistent gasoline and diesel shortages throughout the country. The consequences of these policies also extend to the power sector, where price caps on electricity and fuel contributed to nationwide power outages during snowstorms this past January and February.

The United States has learned that price controls interfere with the natural equilibrium of markets to match supply and demand, and lead to shortages. And because market forces can never be completely eliminated, price controls often lead to smuggling and corruption.

U.S. Energy and Environment Policy Today

Experience has also taught us that rising energy prices are a strong incentive for consumers to buy more efficient cars and appliances, to insulate homes and buildings and to employ technological advances to reduce energy consumption. This demand for greater efficiency unleashes a wave of market-based innovations.

In the United States, we encourage these innovations and couple them with policies and regulations that encourage and require higher energy efficiency standards. As a result, the consumer benefits, markets continue to evolve and grow, and we come closer to realizing the national good of a cleaner environment.

And these efforts are producing positive results. According to the International Energy Agency, from 2000-2004, as our population increased and our economy grew by nearly 10 percent, U.S. carbon dioxide emissions increased by only 1.7

percent. During the same period, European Union carbon dioxide emissions grew by 5 percent, with lower economic growth. Over the past 35 years, the U.S. has dramatically reduced its energy use per unit of output. Between 1973 and 2006, U.S. total economic production grew from $4.3 to $11.4 trillion, a 265 percent increase. Yet the energy used for that production grew by only 32 percent.

U.S. energy and environmental policies continue to evolve, and our efforts are on-going. Since the beginning of the Bush Administration, the United States has spent nearly $18 billion to research, develop, promote and bring clean and efficient technologies to market. We continue to develop new strategies – President Bush's "Twenty in Ten" initiative aims to reduce U.S. gasoline consumption by at least 20 percent in ten years through new mandatory fuel economy standards and alternative fuel sources. With the recent signing of the energy bill into law, the President established a mandate for 36 billion gallons of renewable fuel to be provided as transportation fuel, which is five times the amount of renewable fuel consumed in the U.S. transportation sector in 2007.

U.S. – China Cooperation

United States – China energy and environmental cooperation will build on a solid foundation. We already have an agreement to increase industrial energy efficiency, and a joint five-year commitment to promote large scale deployment of alternative fuel technologies for vehicles. We have a memorandum of understanding to combat illegal logging and promote sustainable forest management. In conjunction with the International Energy Agency, we have also strengthened cooperation on strategic oil reserves. And we have launched efforts to help China develop a nationwide program on sulfur dioxide emissions trading.

In both the United States and China, the private sector is also helping to create the "green" economy. Whether it is the public sector or the private sector, this work is aspirational. We are rethinking transportation systems. We are constructing "green" buildings and "green communities." And we are developing new methods and technology to power our economies.

Our next steps will be important. Technology must be developed and adopted at a faster pace. Policies and regulations must be developed and refined to create the proper incentives and price signals. U.S. and Chinese institutions need to manage the new demands of energy and environmental issues in innovative ways.

U.S. and Chinese governments and industries have a role to play in reducing greenhouse gases and pollution, increasing energy security and natural resource conservation, and can do a better job of increasing public awareness of the environmental impacts of energy choices.

What can be done right now?

As we establish our ten year energy and environment cooperative framework, my friends in China often ask what can be done about China's immediate energy and environmental challenges. My answer is that China, given its current economic growth and prosperity, can leapfrog the United States and the rest of the world in deploying and using advanced energy and environmental technology.

Adopting advanced technology will increase China's energy efficiency and reduce the emissions of greenhouse gases and harmful pollutants. But bringing this technology to China is hindered by the high tariff and non-tariff barriers that China places on environmental goods and services.

For example, there is a water membrane technology available right now. If installed properly, it could help local communities take significant steps towards reducing the pollution entering rivers from power plants. That means that within months, some Chinese citizens could have cleaner water. Yet a tariff of 22 percent on water membranes makes this technology too expensive for many communities.

A high priority should be given to eliminating tariffs and non-tariff barriers on products, goods and services that can improve the health and welfare of the Chinese people.

Advancing a Bilateral Agenda for Sustainable Growth

U.S. and Chinese policy makers will meet for our fourth Strategic Economic Dialogue in June. We will focus on defining a vision for sustainable economic growth. This theme invokes a transcendent challenge: to sustain economic development while also enhancing energy security and environmental quality – a vision which relies on a strategy of economic openness, especially free trade and open investment policies.

While progress on these issues may be difficult, both our countries gain when we share our capabilities and experiences. We share a commitment to allow our people to prosper and our natural environment to thrive. Our cooperation here is just one powerful step in managing these issues for the future. Thank you.

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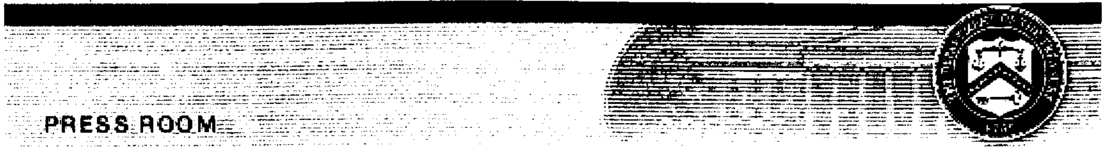

April 3, 2008
HP-904

Under Secretary for Domestic Finance Robert K. Steel Testimony Before the Senate Committee on Banking, Housing and Urban Affairs

Washington – Chairman Dodd, Ranking Member Shelby, Members of the Committee, good morning. I very much appreciate the opportunity to appear before you today to represent Secretary Paulson and the U.S. Treasury Department, and to join the independent regulators leading the Board of Governors of the Federal Reserve System, the Securities and Exchange Commission, and the Federal Reserve Bank of New York. As you know Secretary Paulson is on a long-scheduled trip to China.

You have invited Treasury here today to discuss the ongoing challenges in our credit markets, and specifically the agreement between JPMorgan Chase & Co. and the Bear Stearns Companies Inc. The Treasury Department continues to closely monitor the global capital markets, and the past several months have presented to us many important issues and situations to evaluate and address.

As Secretary Paulson stated earlier this week, a strong financial system is vitally important – not only for Wall Street, not only for bankers, but for all Americans. When our markets work, people throughout our economy benefit – Americans seeking to buy a car or buy a home, families borrowing to pay for college, innovators borrowing on the strength of a good idea for a new product or technology, and businesses financing investments that create new jobs. And when our financial system is under stress, all Americans bear the consequences.

Mr. Chairman, as you appropriately noted in your letter to Secretary Paulson, "it is important to maintain liquidity, stability, and investor confidence in the markets." The recent events in the credit and mortgage markets are of considerable interest to this Committee, other Members of Congress, and most importantly, the citizens of this country.

For several months, our financial markets have gone through periods of turbulence, followed by periods of improvement. A great deal of de-leveraging is occurring, which has created liquidity challenges for financial institutions and thereby compromised our credit markets' ability to help be an engine of economic growth.

It took a long time to build up the excesses in our markets, and we are now working through the consequences. Market participants are adjusting, making disclosures, raising capital, and re-pricing assets.

We have continued to engage with our fellow regulators and market participants, so that collectively, we work through these challenges to limit the spillover effects to our economy and make our markets even stronger.

During times of market stress, certain issues may hold the potential to spill over to the broader markets and cause harm to the American economy. This was the case with the events surrounding the funding capability of Bear Stearns between March 13, 2008 and March 24, 2008.

The funding condition of Bear Stearns had deteriorated rapidly, and by March 13, 2008 had reached such a critical stage that the company would have faced a bankruptcy filing on March 14, 2008 absent an extraordinary infusion of liquidity. During this period, regulators were continuously communicating with one another, working collaboratively, and keeping each other apprised of the changing circumstances.

Our focus was not on this specific institution, but on the more strategic concern of

the implications of a bankruptcy. The failure of a firm that was connected to so many corners of our markets would have caused financial disruptions beyond Wall Street. We weighed the multiple risks, such as the potential disruption to counterparties, other financial institutions, the markets, and the market infrastructure. These risks warranted a very careful review and thorough consideration of potential implications and responses.

Our role at the Treasury Department was to support the independent regulators and their efforts with private parties as credit markets were operating under considerable stress, and we believed that certain prudent actions would help to mitigate systemic risk, enhance liquidity, facilitate more orderly markets, and minimize risks to the taxpayers.

The Treasury Department supports the actions taken by the Federal Reserve Bank of New York and the Federal Reserve. We believe the agreements reached were necessary and appropriate to maintain stability in our financial system during this critical time.

Obviously, each independent regulator had to make its own individual assessment and determination as to what actions it would or would not take. While the Treasury Department was not a party to any agreements, we have a great deal of respect for the leadership of each regulator and appreciate their efforts during this extraordinary time.

Upon assessing the Bear Stearns' situation, the Federal Reserve decided to take the very important and consequential action of authorizing the Federal Reserve Bank of New York to institute a temporary program for providing liquidity to primary dealers. Recent market turmoil has required the Federal Reserve to adjust some of the mechanisms by which it provides liquidity to the financial system. Its response in the face of new challenges deserves praise.

At the Treasury Department, we will continue to monitor market developments. We remain focused on the issues surrounding the recent developments, including the important responsibility of safeguarding government funds.

Recent events underscore the need for strong market discipline, prudent regulatory policies, and robust risk management. The Treasury Department and our colleagues comprising the President's Working Group on Financial Markets are addressing the current and strategic challenges, and are doing all we can to ensure high quality, competitive, and orderly capital markets. We seek to strengthen market discipline, mitigate systemic risk, enhance investor confidence and market stability, as well as facilitate stable economic growth.

Thank you and I am pleased to take your questions.

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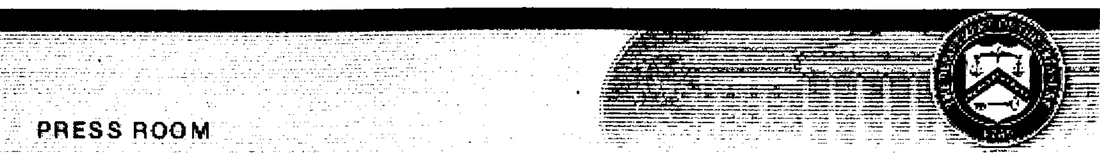

April 4, 2008
HP-905

Treasury Economic Update 4.4.08

"The rebate checks and investment incentives in the stimulus package will provide important support to family and business spending at a time when a broad range of indicators, including today's employment report, point to a slowing economy."
Assistant Secretary Phillip Swagel, April 4, 2008

Employment Fell in March:
Job Growth: Payroll employment fell by 80,000 in March, following a decrease of 76,000 jobs in February. The United States has added 8.0 million jobs since August 2003. Employment increased in 43 states and the District of Columbia over the year ending in February. (Last updated: April 4, 2008)
Low Unemployment: The unemployment rate rose to 5.1 percent in March from 4.8 percent in February. Unemployment rates declined or remained steady in 24 states over the year ending in February. (Last updated: April 4, 2008)

Signs of Economic Strength Include Exports and Low Inflation:
Exports: Strong global growth is boosting U.S. exports, which grew by 8.4 percent over the past 4 quarters. (Last updated: March 27, 2008)
Inflation: Core inflation remains contained. The consumer price index excluding food and energy rose 2.3 percent over the 12 months ending in February. (Last updated: March 14, 2008)

The Economic Stimulus Package Will Provide a Temporary Boost to Our Economy:
The package will help our economy weather the housing correction and other challenges. The Economic Stimulus Act of 2008, signed into law by President Bush has two main elements--temporary individual tax relief so that working Americans have more money to spend and temporary tax incentives for businesses to invest and grow. Together, the legislation will provide about $150 billion of tax relief for the economy in 2008, leading to the creation of over half a million additional jobs by the end of this year. (Last updated: February 29, 2008)

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 strong economic growth. Looking ahead, higher spending on entitlement programs dominates the future fiscal situation; we must squarely face up to the challenge of reforming these programs.
www.treas.gov/economic-plan

PRESS ROOM

April 4, 2008
HP-906

**Treasurer Anna Escobedo Cabral Remarks
as Prepared for Delivery
at the Inter-American Development Bank Board of Governors Meeting**

Miami Beach, Fla.– Thank you, President Mosbacher, for the kind introduction and for your tremendous leadership. OPIC, IDB, and the Department of the Treasury are strong partners. I look forward to our continued efforts in the future.

President Moreno, Don Terry, Sandra Darville, and the entire team at IDB: thank you for organizing this terrific annual meeting in beautiful Miami. I know we are all pleased to join you in your efforts to improve quality of life for those in Latin America, the Caribbean, and across the globe. I am honored to conclude today's seminar.

I would like to thank the distinguished panelists –Elizabeth Littlefield, Rafael Llosa Barrios, Arnaud Ventura, Kurt Koenigsfest, Paul DiLeo, Martin Redrado, Helen Alexander and Fernando Pozo – for joining in today's discussion. I know everyone here today has benefited from your insightful words and ideas. I admire your commitment to IDB and to helping small businesses throughout the Americas gain access to financial services that will help them grow and flourish.

Financial inclusion is a very important issue to me. In February, I hosted a workshop on financial inclusion in the Americas, which was the first of its kind at the Department of the Treasury. I was very pleased that Sandra and Don could attend, as well as representatives from many financial institutions and government agencies in Mexico, Honduras, El Salvador, and the U.S. Out of this workshop came some great discussion – and even greater action. Currently, we have a team in Guatemala on a World Bank Mission working with the government to assess and develop priorities for action. This is the first of many initiatives which will come from the conference.

As you know, inclusion in the financial mainstream is essential for a country's long-term economic growth and financial stability. In many Latin American countries, where up to 70 percent of the population functions entirely outside of the financial system, this is especially important. By providing families with the opportunity to safely save, borrow, and invest, we can empower individuals with the ability to take advantage of economic opportunities and build financial security.

As we wrap up today's activities, I want to leave you with a few broad, final thoughts on the importance on financial inclusion, its challenges, and what the Department of the Treasury is doing to help.

We must have a financial system that works for everyone. Growth and development depend critically on the ability of *all* residents to use the financial system. Banks cannot simply serve the wealthy. They must also serve those in the middle class – the up and coming, the entrepreneurs, and the innovators – and those at the low end of the spectrum – those struggling to make ends meet. These are the people for whom a dry season could spell destitution, or for whom schooling for their children is out of reach.

We must ensure that a robust financial infrastructure is in place. Secure, effective, and accessible payment systems play a critical role in expanding financial inclusion. Also important is getting people access not just to loans, but to savings, pension funds, and other services. Some studies indicate that one of the greatest, if not the greatest, financial need of the underserved is insurance. The more people active in the mainstream financial sector, the bigger the investment we make in our communities.

Barriers that financially exclude people vary by country. We must address barriers throughout Latin America– improving on physical access, language issues, financial literacy, and lack of trust.

Financial education is a critical part of financial inclusion. Here in the U.S., we struggle with financial education issues. The President has formed a Council to address these issues for students, workers, and families in our country. It is vital that people not only need access to services, but must understand how to use those services. Without this knowledge, these folks can become the victims of financial abuse and predatory practices. We unfortunately saw this play out in some cases in the U.S. housing industry. We need to develop and launch effective financial education programs that can reach even our most isolated communities.

Micro, small, and medium enterprises have the potential to be the powerhouses of our economies, but many entrepreneurs are intimidated by formal bank settings and requirements for opening accounts. Instead these entrepreneurs turn to informal lenders who increase their cost of doing business. Opening the formal system to these business owners will make them more competitive and increase their opportunities for growth.

As many of you are aware, Treasury has been deeply involved in financial inclusion and remittance issues for years both at home and abroad. These are very important issues to President Bush and to Secretary Paulson. Over the past year, the Secretary has launched several initiatives with our Latin American counterparts to strengthen the region's economic infrastructure, enhance access to finance and markets, and advance the benefits from trade. He has traveled to Columbia, Guatemala, Peru, Mexico, Brazil, Chile, Uruguay, and Canada to support Treasury's initiatives in these countries.

We know that small business creation is important to decreasing poverty, expanding social mobility, and creating a strong middle class. Last June, to facilitate greater access to finance, Secretary Paulson announced a small business finance initiative. This initiative encourages market-based bank lending to small businesses in Latin America by combining the capabilities of the IDB, OPIC, and the U.S. Treasury. With this initiative, small businesses will get the financial support they need to flourish. I know many Treasury officials will be joining you in the days to come to continue these important discussions, including Secretary Paulson.

At the end of the day, our success in fostering a dynamic and stable economy will depend on our ability to establish an environment in which a competitive, flexible, inclusive, efficient, and resilient financial system can flourish. I hope the meaningful exchange of ideas between the international group of panelists and guests here today will provide a springboard toward those efforts throughout the world. By creating a financial system that works for everyone, and that everyone knows how to use, we can ensure that *all* people benefit from the Americas growing prosperity.

Thank you.

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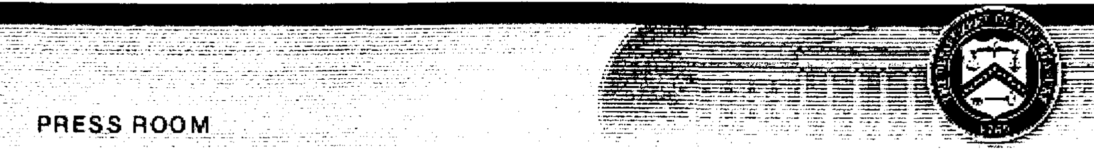

April 7, 2008
HP-907

**Remarks by Secretary Henry M. Paulson, Jr.
at the Inaugural Session of the Inter-American
Development Bank Annual Meeting**

It is an honor to receive the Chairman's gavel on behalf of the United States of America. It is most appropriate that we are here in Miami, a city which is rightly known as the U.S. gateway to Latin America. Thank you, Minister Fuentes and the government of Guatemala, for your leadership of the Inter-American Development Bank this past year. And thank you President Moreno for making the Bank more nimble and effective in creating economic opportunity and reducing poverty throughout the Western Hemisphere. We believe that we should measure success by demonstrable results that show the IDB's operations are building and strengthening foundations for sustainable and widespread economic growth in the region.

A number of you have asked about the current challenges facing the U.S. economy. We are going through a difficult housing correction that is also impacting our capital markets. We are taking a number of aggressive measures to minimize the downturn's effect – including helping homeowners avoid preventable foreclosures, and enacting a stimulus package to provide a boost to our economy and create jobs this year. U.S. long-run economic fundamentals remain sound, and the good news is that Latin American economies and financial markets have proven more resilient to the recent global financial turmoil than many might have expected. I believe we will work through this period as we have worked through past periods. And we will, as we always do, return to robust growth that benefits the American people and our neighbors in the Americas.

We share aspirations for a Western Hemisphere growing in liberty and prosperity and, as President Bush has stated, we have witnessed great achievements. Most recently, this includes the work by many of your countries to shore up public finances, reduce debt and open markets. This has resulted in real incomes increasing by 26 percent over the past five years. The region, as the IMF has recently noted, is now "reaping the rewards from a decade of investment in reducing vulnerabilities."

World Trade and Economic Integration Drive Growth

President Bush also knows well that stronger neighbors, who collaborate and work together, build a stronger neighborhood for us all. I share his view, and all of us in the Administration work hard to make sure the American people understand that we benefit from healthy, prosperous neighbors. If we are to achieve our goal of reducing poverty and creating opportunity, economic integration and trade are dynamic vehicles for growth and job creation. Certainly, history has shown that those countries that open themselves to trade and investment prosper, while those that don't are left behind. One of the most disturbing trends I see in the United States is an inclination against openness, a desire to retreat from world markets.

I have great confidence in America's workers and in the workers of all the Americas to compete and succeed in global markets. Yet, there is no doubt that we are in a time of rapid economic change. In some instances and in some industries this creates hardships and job losses, in your countries as in mine. What we need to do is figure out how to deal with the job losses that come from trade and make sure that we do not turn isolationist. Isolation limits prospects, limits prosperity, and dampens hope. This Administration is committed to pushing back on the rising tide of protectionism.

The United States welcomes the opportunity to work with countries in the region in building the financial, physical and market infrastructures that will help all of our

people prosper. We share the goal of inclusive economic prosperity that spreads your impressive top-line economic growth more broadly through your societies, reaching those who traditionally have been left behind.

The United States remains firmly committed to expanded world and regional trade as a powerful path to inclusive prosperity. This means that international development efforts need to link many more people to the opportunities that are created by trade. Resources and policies need to empower small businesses and farmers, particularly historically excluded groups.

Promoting Economic Integration

Our efforts, therefore, must focus on financing infrastructure to build and strengthen the connections between national and regional markets, and on reducing or eliminating barriers that hinder regional industrial, agriculture and services trade. The World Bank finds that it takes on average over 22 days for a Latin American exporter to move product from warehouse to port; in the United States this takes six days. To be viable suppliers to world markets, our region's companies need to move goods quickly and efficiently. Efficient customs procedures and harmonization of rules across borders would further reduce trading costs and delivery times --- helping both buyers and sellers of goods. We must also extend these efforts to developing and exchanging best practices within the region.

Finally, we must re-commit to building the capacity for trade, which helps small and remote businesses gain access to world markets and become exporters. The IDB has been a leader and set the standard for other donors in emphasizing trade capacity, as has the United States. Trade capacity building has been an integral part of U.S. free trade agreements in the region. Enhancing regional cooperation and involving the private sector and civil society will also deepen understanding and trust, which can lead to greater gains.

Economic integration makes industries throughout the region more dynamic, more innovative and more competitive. Companies will have greater access to capital and to larger regional and global markets, giving consumers more choices. Global competition reduces the prices of goods and services, which is particularly beneficial to those with lower incomes.

IDB and U.S. Efforts

Since IDB governors gathered in Guatemala City a year ago, both the IDB and the U.S. government have launched positive new initiatives in the region, often in close collaboration. The IDB's renewed emphasis on private sector activity through the Integrated Business Plan is most welcome and we urge its continued expansion. We applaud the Bank's renewed efforts to reach the poorest segments of the region's society through the Opportunities for the Majority Initiative. The Sustainable Energy and Climate Change Initiative rightly focuses on the region's need to address the challenges of renewable and efficient energy and climate change.

In these and all activities, we urge the Bank to continue to focus on concrete results that demonstrate achievements towards its core mission of economic growth and poverty reduction. We should measure the quality of the assistance, not just the quantity.

Let me also take this opportunity to acknowledge the tremendous achievements of the Multilateral Investment Fund (MIF) over its first fifteen years and to thank Don Terry for his great leadership during that time. We will miss Don but know that the MIF's important work promoting private-sector jobs and growth will continue, with our strong support.

The U.S. Treasury Department has launched several initiatives to promote economic integration within and between nations in our hemisphere. We are focused on specific areas where we can support the region's efforts to spread opportunity through all levels of society, to reduce poverty and help the poor move into the middle class. Specifically, we are working to help build the physical and financial infrastructure that facilitates economic mobility and integration.

Financial services are the backbone of any modern economy, and access to capital

can mean the difference between a people who thrive rather than merely survive. The Small Business Finance Initiative was launched last summer for just that reason. Treasury, the Overseas Private Investment Corporation, the Multilateral Investment Fund, and the Inter-American Investment Corporation are encouraging market-based bank lending to small and medium sized enterprises in the region. This initiative has introduced new lending models to fit smaller firms. It offers risk-sharing guarantees and loans to eligible banks so that they will broaden their lending base, and identifies regulatory changes that can increase credit available to small businesses. The initiative also finances technical assistance so local banks can develop the "know-how" needed for small business lending.

In just nine months, over $50 million has been committed to Latin American banks to expand their operations in the small business sector. An additional $165 million is in the pipeline, a portion of which will be dedicated to small business lending. Think about this vision --- new businesses all across the land and entrepreneurs closer to achieving their dreams.

We also know that financial inclusion is vital. Effective access to financial services can enable even the poorest households to manage their financial resources. This impacts small businesses, too, because often the money to start a business comes from personal savings or personal loans. . Treasury, especially through the good work of our Treasurer Anna Cabral, is actively working with several countries in the region to lower barriers to financial inclusion.

Once a business has the capital base to build and grow, it must have a means to get its goods and services to markets. In partnership with the International Finance Corporation (IFC), Treasury also began the Infrastructure Development Program of the Americas (IDPA) last year. The IDPA assists in identifying, structuring and launching sustainable infrastructure projects based on private sector partnerships. Together, the United States, Brazil, the IFC, the IDB and other partners have contributed $12 million, with an additional $8 million expected in the next one to two years.

To date, twelve IDPA projects, committing $1.3 million, are signed or in advance negotiations. These projects are in Brazil, Colombia, Haiti, Jamaica, Mexico and St. Lucia. They include airport and telecom projects in Haiti, and a major road project in Colombia. Overall, this $1.3 million will be leveraged for an additional, estimated $2.6 billion in private investment; $450 million of that will be greenfield investment. Estimates are that these transactions will bring improved basic services to 500,000 people and save local governments a minimum of $200 million. Savings by these local governments should mean they can use that money to build schools, roads and offer other services.

Latin American Free Trade Agreements

The United States welcomes two-way trade with the Americas, and we have a record of success. Our two-way trade flows, including Canada, topped $1 trillion in 2007 and two-way investment was also more than $1 trillion. Workers employed in the United States sent an estimated $45 billion home to their families in 2006.

Free Trade Agreements with nine Latin American countries have been approved by Congress and agreements with Colombia and Panama are pending. Two-way trade with existing regional FTA-partner countries was more than $400 billion in 2007, or 75 percent of our trade with Latin America.

Over the last few decades positive change has swept throughout the Western Hemisphere, expanding democracy, the rule of law and economic reforms. While some would turn back the clock to an undemocratic past of restricted freedoms and stunted economies, the vast majority of people in the Americas live in democracy, peace and increasing opportunity. Not surprisingly, they like it this way.

We see this in Colombia, where President Uribe has succeeded in transforming his country into one of the most stable and strong democracies in the region. Dramatic economic improvements have followed increased safety and security --- Colombia has one of the highest growth rates in the region, and poverty and unemployment are at ten-year lows. Congressional approval of the Colombian free trade agreement will reinforce democracy in Latin America by showing support for a key ally, an ally who has made significant advancements to combat violence and

instability.

In December, Congress approved the trade promotion agreement with Peru, which is basically the same agreement we have reached with Colombia. I call on the U.S. Congress to show support for the Colombian people and provide greater hope for their future by passing the Colombian trade agreement without further delay. Immediately after approving the Colombia FTA, Congress should turn to the pending agreement with Panama to further build the existing trade relationship with another U.S. ally.

One of the many things I have learned since moving to Washington is that no trade bill is an easy bill. You are all aware of how hard-fought these agreements are, and also aware of their positive long term economic gains that benefit your people. The Bush Administration remains committed to fight for these gains and welcomes your support as we do so.

Conclusion

Closer economic ties between nations create common interests and common goals that tend to lead to solutions rather than conflicts. We have made great progress within our hemisphere. While we gather here, let's share this good news and know that our work is far from done. While millions have been lifted from poverty, millions more still look for a hand up and a way out. The United States looks ahead to the future with you, at the same time we stand beside you to help ensure we achieve all that we plan, and all that we can.

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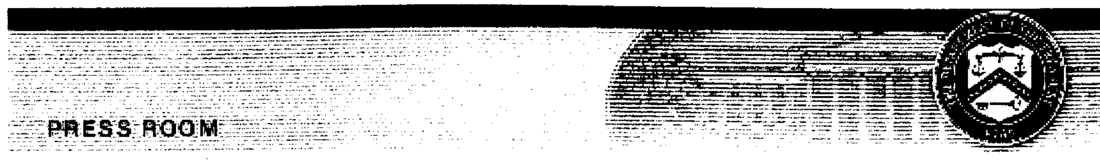

April 7, 2008
HP-908

Fact Sheet: Latin America Infrastructure Development Program Update

In July 2007, Secretary Paulson announced the creation of an infrastructure development program to increase investment in infrastructure projects in Latin America and the Caribbean (http://www.ustreas.gov/press/releases/hp482.htm). The United States, in partnership with the International Finance Corporation (IFC), a member of the World Bank Group, is working to catalyze private investment in infrastructure in Latin America.

The goal of the program is to partner with the private sector to identify, structure and launch sustainable infrastructure projects. The United States, Brazil, the IFC and the Inter-American Development Bank and other partners have contributed a combined $12 million (the U.S. contributed $4.6 million) to date, with additional contributions of at least $8 million envisaged in the next 1-2 years. The contributions will be used to:

- Help governments and private sector sponsors conduct market, technical, legal, and financial analyses in order to prioritize and design projects for development;
- Help governments manage transparent and competitive bidding processes.

Results To Date:

- Twelve projects are signed or under advanced negotiations, with $1.3 million committed from the initiative. The projects are located in Mexico, Brazil, Haiti, Colombia, Jamaica, and St. Lucia.
- $2.6 billion (estimated) in additional investment will be leveraged across all twelve projects, $450 million of which is greenfield investment.
- Fiscal savings to local governments from these transactions are estimated at a minimum of $200 million.
- Number of people expected to receive improved basic services from these transaction are estimated at 500,000.
- Eight advisory transactions are under execution; additional investment to be leveraged is estimated at $2.3 billion.

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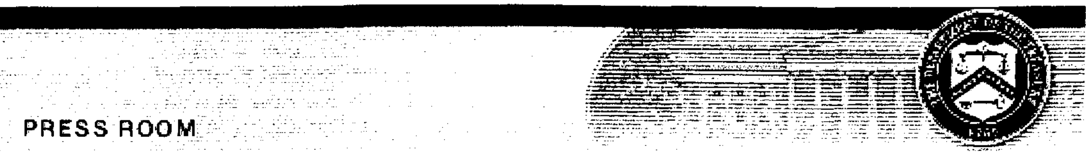

April 7, 2008
HP-909

Fact Sheet: Status of Latin America Small Business Lending Initiative

In June of 2007 the Treasury Department launched an initiative to expand and improve access for small businesses in Latin America to commercial financing (http://www.treas.gov/press/releases/hp452.htm). The three-part initiative is jointly supported by the U.S. Treasury Department, the Inter-American Development Bank (IDB), and the Overseas Private Investment Corporation (OPIC) as follows:

1. Through its Multilateral Investment Fund (MIF) and its Inter-American Investment Corporation (IIC), the IDB provides technical cooperation grants and loans to local banks to strengthen their capacity in lending to the small business sector;
2. OPIC offers guarantees and loans to banks that commit to initiating or expanding their small business lending; and
3. The Treasury Department's Office of Technical Assistance assists targeted Latin American countries in the design and implementation of regulations and oversight of credit providers to small businesses.

Progress to Date – Since its launch, the initiative has been very active in advancing the three goals originally established by Secretary Paulson:

(1) Introduce new lending models that fit the unique characteristics of smaller firms.

- In September 2007, the MIF committed $10 million to the Initiative and has since been actively promoting the Initiative among financial institutions in Latin America and the Caribbean.
- In November 2007, the MIF signed the first Technical Cooperation agreement with BanCentro in Nicaragua, approving a $500,000 grant for a $1 million capacity building project to develop new financial products for small businesses, expand its small business loan portfolio, strengthen capacity of its human resources in the analysis and management of risks specific to the small business sector and adopt international best practices in implementing and expanding its small business program.
- In the first quarter of 2008, the MIF started to receive applications from financial institutions throughout the region, and is currently analyzing requests from banks in Mexico, Central America and the Caribbean.

(2) Assume a portion of the risk associated with small business lending.

- In September 2007, OPIC committed $150 million to the Initiative to provide financing and guarantees for small business loans in Latin America and the Caribbean.
- Already, OPIC has approved over $52 million in loans to banks in Honduras, Costa Rica, Ecuador, Paraguay, and Peru to expand their operations in the small business sector.
- Typically, OPIC assumes between 50-80% of the commercial risk attached to each loan and in some cases provides additional inconvertibility of currency coverage as well.

(3) Ensure that small business lending is not unnecessarily constrained by burdensome regulations or bureaucracy.

- In Peru, OPIC and Treasury department officials have discussed ways to reduce the regulatory burden on banks operating in the small and medium-sized business sectors.
- Treasury's Office of Technical Assistance (OTA) met with Salvadoran

officials in February 2008 to discuss technical assistance in designing and implementing regulations, and oversight of credit providers to small business borrowers.
- MIF met with Latin American bank regulators in early 2008 to identify the critical challenges that they confront in setting up prudential frameworks for an evolving financing landscape. Specific areas of collaboration were identified, with proposals for follow-up action forthcoming.

Plans for 2008 - Over the coming months, follow-on activities will include:

- Pending approval, four to six new technical assistance projects could begin operations in mid-late 2008. MIF grants will be used to help banks strengthen their capacity to lend to the small business sector.
- It is estimated that about $3 million in MIF grants will be approved in 2008, with matching funds from the recipient banks.
- OTA plans to visit El Salvador, Guatemala, and Honduras in the coming months to further discussions on legal and regulatory roadblocks to small business lending and on implementing appropriate regulations and oversight of credit providers to deepen credit access to small businesses.
- OTA also plans to reach out to countries that have banks with MIF technical cooperation programs under the Initiative.
- OPIC has $165 million in loans in the pipeline to banks in Paraguay, Peru and Central America. A portion, to be determined, of each loan will be dedicated to small business lending.

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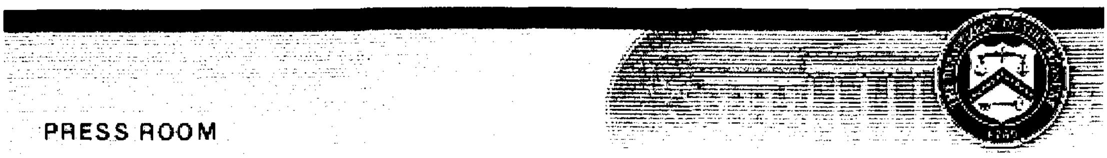


April 7, 2008
HP-910

Treasury Secretary Paulson To Hold Press Availability With Colombian Finance Minister Zuluaga

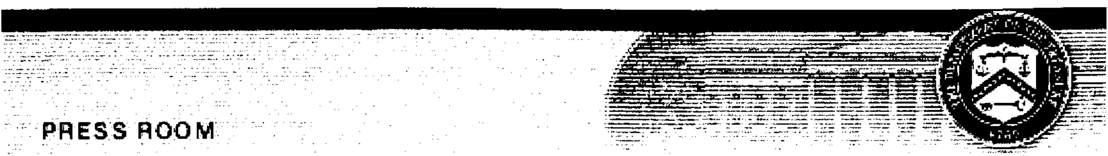
U.S. Treasury Secretary Henry M. Paulson, Jr. and Colombian Finance Minister Oscar Zuluaga will hold a brief press availability following their bilateral meeting Monday during the annual meeting of the Inter-American Development Bank.

Who
U.S. Treasury Secretary Henry M. Paulson, Jr.
Colombian Finance Minister Oscar Zuluaga

What
Joint Press Availability

When
Monday, April 7, 2:00-2:15 p.m. EST

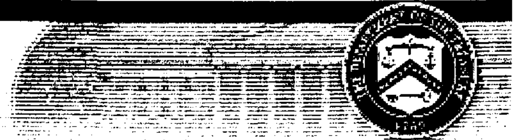
Where
Miami Beach Convention Center
1901 Convention Center Drive
Room C228
Miami Beach, Fla.



April 7, 2008
HP-911

Paulson Statement on Colombian Free Trade Agreement

"I urge the U.S. Congress to show support for the Colombian people and provide greater hope for their future by passing the Colombian free trade agreement without further delay. Congressional approval of the Colombian free trade agreement will reinforce democracy in Latin America by showing support for a key ally who has made significant advancements to combat violence and instability. Leveling the playing field for American farmers, ranchers, and the more than 9,000 U.S. companies exporting to Colombia will also help strengthen our nation's economy."



April 4, 2008
HP-912

Treasury Releases Schedule for Spring G-7 Meeting

U.S. Treasury Secretary Henry M. Paulson, Jr. will host a meeting of the G-7 Finance Ministers and Central Bank Governors at the Treasury Department on Friday, April 11, in Washington, D.C.

At the conclusion of the meeting, the Treasury Department will host a dinner that will include the G-7 Finance Ministers, Central Bank Governors, and representatives from several financial services companies. Secretary Paulson will lead a discussion of the causes and consequences of the recent financial market turmoil and how leaders in the private and public sectors are responding to this challenge.

Following is a schedule of events:

Who
Under Secretary for International Affairs David McCormick
What
Pre-G-7 Press Conference
When
Wednesday, April 9, 3 p.m. EDT
Where
Treasury Department
Media Room (Room 4121)
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 full name, Social Security number, and date of birth.

***

Who
G-7 Finance Ministers and Central Bank Governors
What
Ministerial Meeting-Photos at the Top
When
Friday, April 11, 2 p.m. EDT
Where
Treasury Department
Cash Room
1500 Pennsylvania Ave., NW
Washington, D.C.
Note
This is a pooled photo event – photographers wishing to participate should contact Courtney Forsell at (202) 622-2591 or Courtney.Forsell@do.treas.gov for more information.

***

Who
G-7 Finance Ministers and Central Bank Governors
What
Family Photo
When
Friday, April 11, 5 p.m. EDT
Where

Treasury Department
Bell Entrance Steps (West Side of Building)
1500 Pennsylvania Ave., NW
Washington, D.C.

Note

Photographers wishing to participate should contact Frances Anderson at (202) 622-2960 or Frances.Anderson@do.treas.gov with full name, Social Security number, and date of birth. Photographers may begin setting up at 3:45 p.m. Photographers must be in place no later than 4:30 p.m.

***

Who

Treasury Secretary Henry M. Paulson, Jr.

What

Press Conference

When

Friday, April 11, 6:45 p.m. EDT

Where

Office of Thrift Supervision
Auditorium, 2nd Floor
1700 G Street, NW
Washington, D.C.

Note

Media may begin setting up at 5:30 p.m. Treasury, White House, and IMF/World Bank Spring Meeting press credentials will be accepted – no other clearance is needed.

April 7, 2008
2008-4-7-16-56-50-1309

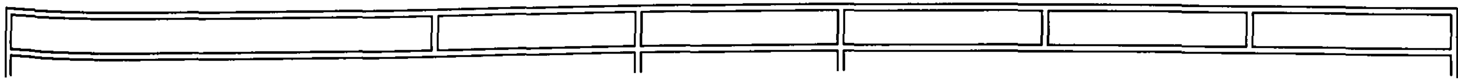
U.S. International Reserve Position

The Treasury Department today released U.S. reserve assets data for the latest week. As indicated in this table, U.S. reserve assets totaled $75,293 million as of the end of that week, compared to $75,840 million as of the end of the prior week.

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

	April 4, 2008		
A. Official reserve assets (in US millions unless otherwise specified)	Euro	Yen	Total
(1) Foreign currency reserves (in convertible foreign currencies)			75,293
(a) Securities	15,719	12,043	27,762
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	15,610	6,744	22,354
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	4,284		
(3) SDRs	9,852		
(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 [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	

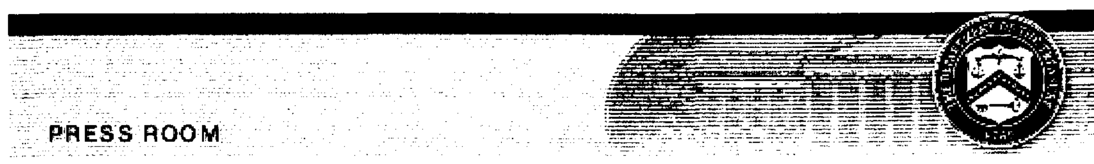
--lent or repoed but not included in Section I	
--borrowed or acquired and included in Section I	
--borrowed or acquired but not included in Section I	
(e) financial derivative assets (net, marked to market)	
--forwards	
--futures	
--swaps	
--options	
--other	
(f) derivatives (forward, futures, or options 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)	75,293
--currencies in SDR basket	75,293
--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.

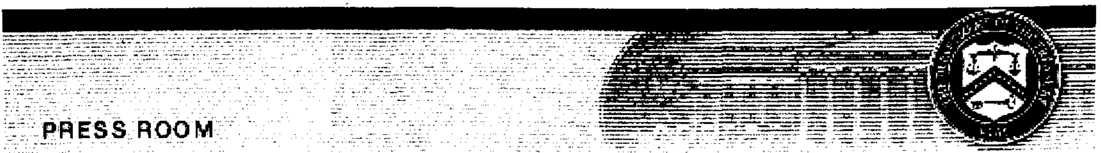


April 8, 2008
HP-913

Treasury To Host Briefing on Financial Restatement Study

U.S. Treasury officials will host a pen-and-pad briefing to discuss the Treasury-commissioned study The Changing Nature and Consequences of Public Company Financial Restatements. Secretary Paulson requested the study, conducted by University of Kansas professor Susan Scholz, as part of his capital markets competitiveness initiatives announced in May 2007. No cameras will be admitted to the briefing. The following event is open to the press:

Who
Assistant Secretary for Financial Institutions David G. Nason
University of Kansas Professor Sue Scholz
What
Briefing on Financial Restatement Study
When
Wednesday, April 9, 2008, 11:30 a.m. (EDT)
Where
U.S. Treasury Department
Grant Room (Room 2127)
1500 Pennsylvania Ave.
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. (No cameras will be permitted into the briefing.)



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April 9, 2008
HP-914

Treasury Releases Competitiveness Study on the Changing Nature and Consequences of Financial Restatements

Washington - Secretary Paulson announced today the completion of the Treasury-commissioned study, *The Changing Nature and Consequences of Public Company Financial Restatements*, as part of his efforts announced in May 2007 to encourage U.S. capital markets competitiveness.

"Many respected voices at Treasury's Capital Markets Competitiveness Conference last year noted the drastic increase in financial restatements over the last decade. It is important to take a hard look at the facts behind this rise," said Treasury Secretary Henry M. Paulson, Jr. "The information in this study should complement the work underway at the Securities and Exchange Commission and the Financial Accounting Standards Board to improve financial reporting for investors."

The study, conducted by University of Kansas Professor Susan Scholz, provides one of the most in-depth looks at the soaring number of financial restatements in the years before and after the Sarbanes-Oxley Act. Financial restatements grew nearly eighteen-fold in this time, from 90 in 1997 to 1,577 in 2006 with acceleration in restatement activity occurring in 2001 before the implementation of the Sarbanes-Oxley Act.

However, restatements associated with fraud and revenue declined after 2001. Fraud was a factor in 29 percent of all 1997 restatements, but only 2 percent of 2006 restatements. The proportion of revenue-related restatements also decreased from 41percent in 1997 to 11 percent in 2006.

Market reactions to the restatements dampened over the decade study period, while the number of restatements grew. Market reaction to financial restatements tended to be more negative when the restatement involved fraud or revenue errors.

Additionally, the study noted that restating companies are typically unprofitable even before the restatement. In the year prior to announcing a restatement, more than half of restating companies reported a net loss.

Treasury did not ask the study's author to develop policy recommendations. The study was intended to inform federal regulators and advisory committees, such as the SEC's Advisory Committee on Improvements to Financial Reporting. The goal was to take a clear look at figures often used when discussing U.S. companies' competitiveness and investor confidence in financial reporting.

\- 30 -

LINKS

- The Changing Nature and Consequences of Public Company Financial Restatements

THE CHANGING NATURE AND CONSEQUENCES OF PUBLIC COMPANY FINANCIAL RESTATEMENTS

1997-2006

by Susan Scholz

Associate Professor of Accounting
and Harper Faculty Fellow,
University of Kansas School of Business

The Department of the Treasury

April 2008

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VII. Acknowledgments **54**

I. EXECUTIVE SUMMARY

The U.S. Treasury Department commissioned this study to investigate the increase in public company restatement activity over the decade from 1997 to 2006. The purpose is to understand characteristics and consequences of financial statement restatements for violations of U.S. Generally Accepted Accounting Principles (GAAP) over this decade. The study analyzes 6,633 restatements of financial results announced over this period. These are the broad findings:

- It is well-known that restatements increased in recent years; over the decade, they grew nearly eighteen-fold, from 90 in 1997 to 1,577 in 2006. However, the increase is largely driven by companies that do not trade on the major stock exchanges.[1] Non-exchange-listed companies account for only 23% of all restatements in 1997, but increase to 62% by 2006. (See Figure 1.)
- Restatement frequencies begin to accelerate in 2001—well in advance of the passage of the Sarbanes-Oxley Act of 2002 (SOX). This acceleration is likely due in part to the economic downturn about this time.
- The average market reaction to restatement announcements is negative throughout the study period. However, beginning in 2001, the magnitude of market reactions declines notably. This decline coincides with an increase in the number of restatements between 2001 and 2006. (See Figure 2.)
- In particular years, restatement frequencies and market reactions are associated with several disparate factors. These include overall market returns and volatility, regulatory activities, and changes in the mix of underlying accounting issues. Regarding the shift in accounting issues:
  - Restatements attributed to fraud and those affecting revenues tend to have more negative market reactions. However, the percentages of both fraud and revenue restatements decline over the decade. Fraud is a factor in 29% of all 1997 restatements, but only 2% of 2006 restatements.[2] The proportion of revenue restatements also decreases, from 41% in 1997 to 11% in 2006.
  - On the other hand, restatements related to accounting for non-operating expenses, non-recurring events and reclassifications typically do not have discernibly negative market reactions. Together, these groups represent about 24% of all 1997 restatements, increasing to nearly half at the end of the study period.
- Across the decade, the average restating company increases in size, but remains similar to a comparison group of non-restating companies.[3] Companies of differing sizes tend to restate different accounting issues, and several of the distinctions are consistent with expected variations in the activities of larger versus smaller companies.
- Finally, restating companies are typically unprofitable even before the restatement. In the year prior to announcing a restatement, more than half of restating companies report a net loss.

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1 Major exchanges are the New York Stock Exchange (NYSE), American Stock Exchange (AMEX), or the NASDAQ National Market. Identification of major exchange (or exchange-listed) companies is based mainly on the availability of announcement date returns in the University of Chicago's *Center for Research in Security Prices* (CRSP) database, the market database most commonly used in academic studies (http://www.crsp.com/). It primarily tracks shares listed in those systems.

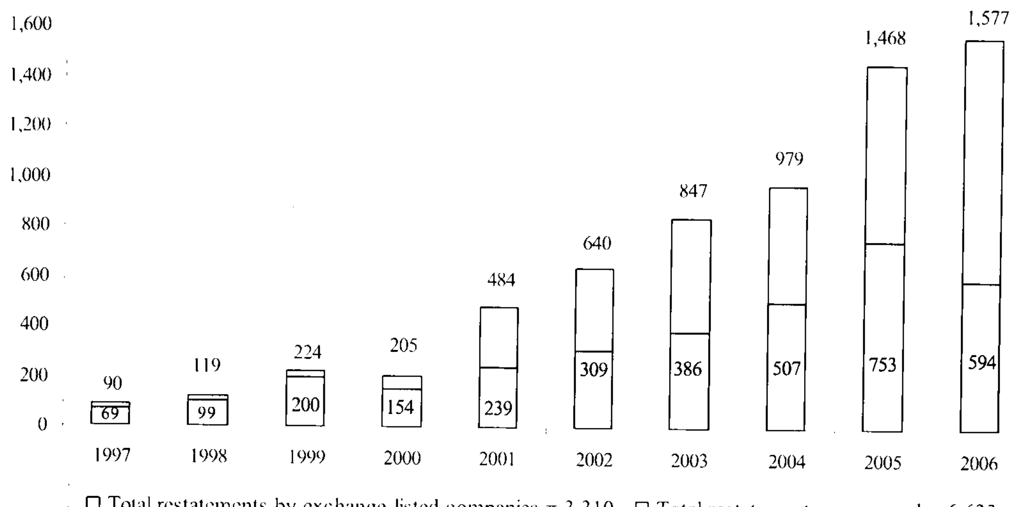
2 Identification of fraud relies in part on Securities and Exchange Commission (SEC) Accounting and Auditing Enforcement Releases (AAERs), so numbers may increase some for later years of the decade as the SEC's enforcement investigations conclude.

3 The comparison group is all U.S. companies included in Standard & Poor's Compustat database, the financial information database most commonly used in academic studies. On average, Compustat includes asset data for more than 9,000 companies each year.

A. Restatement Announcement Frequency

Over the decade, restatement frequency grew nearly eighteen-fold, from 90 in 1997 to 1,577 in 2006.[4] Figure 1 shows the total number of restatements reported each year, with the solid portion of each bar representing restatements by exchange-listed companies. Exchange-listed company restatements total 3,310, or slightly less than half of the 6,633 total restatements.

Figure 1 — **Number of Restatements: 1997 – 2006**



Restatements begin to accelerate in 2001—prior to the corporate accounting scandals and the passage of SOX.[5] The acceleration is particularly prevalent for companies that do not trade on major exchanges. For these firms, restatements increase 380% from 2000 to 2001, while exchange-listed company restatements increase only 55%.[6] Because the occurrence and/or disclosure of misstatements may be more likely for companies experiencing financial difficulties, increases in 2001 and 2002 are likely associated in part with the economic downturn beginning with the implosion of the technology bubble in March 2000.[7] Those resulting restatements would begin to appear in 2001.

Nonetheless, even as the overall market and economy improve in later years, restatement frequency continues to increase, due in part to regulatory changes. For example, the implementation of internal control reporting under SOX Section 404 appears to be associated with an increase in restatements beginning in 2003, particularly among large companies.[8] The size of restating companies appears to diminish in 2006, after larger companies implemented SOX Section 404.[9] Finally, two specific accounting issues, leases in 2005 and stock options backdating in 2006, contribute

4 Restatements in this study are defined as unique restatement events that correct accounting errors and irregularities made by companies reporting under U.S. GAAP. See Section II.A of the study for the definition of a restatement event and Section II.B for data sources.

5 See Section III.A for a timeline of restatement trends and related events.

6 From 1997 to 2006, restatement frequency for non-exchange-listed companies increases almost forty-five-fold. Restatements by major exchange-listed companies increase about eight-fold and actually decrease by 21% from 2005 to 2006.

7 See Mark L. Defond and Jere R. Francis, *Audit Research after Sarbanes-Oxley*, 24 AUDITING: A JOURNAL OF PRACTICE & THEORY 5 (2005) and Zoe-Vonna Palmrose, *Litigation and Independent Auditors: The Role of Business Failures and Management Fraud*, 6 AUDITING: A JOURNAL OF PRACTICE & THEORY 90 (1987).

8 See Appendix C for an analysis of the effects of SOX Section 404 reporting upon restatements.

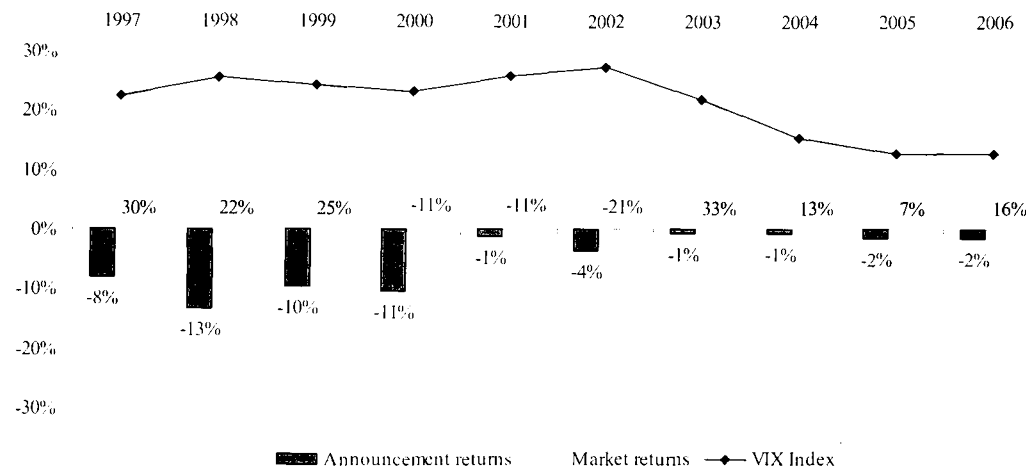
9 Median statistics for assets and revenues indicate statistically significant decreases to pre-2001 sizes. Average assets and revenues decline only slightly.

to higher numbers in later years. However, even after eliminating announcements for these two issues, the number of restatements is higher in 2005 and 2006 compared to 2004.

B. Market Reaction to Restatement Announcements

The market typically views restatements negatively, based on returns at the time of a restatement announcement.[10] However, there is a large difference in average reaction magnitudes between the years 1997-2000, when average announcement returns are -9.5%, and the years 2001-2006, when average announcement returns are -1.3%. This pattern is clear in Figure 2.[11] Thus, as the frequency of restatements increases beginning in 2001, the average reaction to restatement announcements lessens.[12]

Figure 2 — **Restatement Announcement Returns and Market Returns Over the Decade**



The generally down market beginning in March 2000 and continuing through 2002 coincides with this dampening.[13] However, returns continue to be muted even as the market recovers in later years. This appears to be associated with a reduction in market volatility, as shown by the VIX index in Figure 2, and a shift away from more severe restatements, such as restatements involving fraud and revenue accounts.

As shown in Figure 3, returns tend to be more negative when the restatement involves fraud or revenue accounting. Restatements involving fraud decrease as a proportion of all restatements from 29% in 1997 to 2% in 2006, while restatements affecting revenues decline from 41% in 1997 to 11% in 2006. This accounts for some of the reduction in the overall average market reaction. However, even reactions to fraud and revenue accounting are not as severe in the later part of the ten-year period under study.

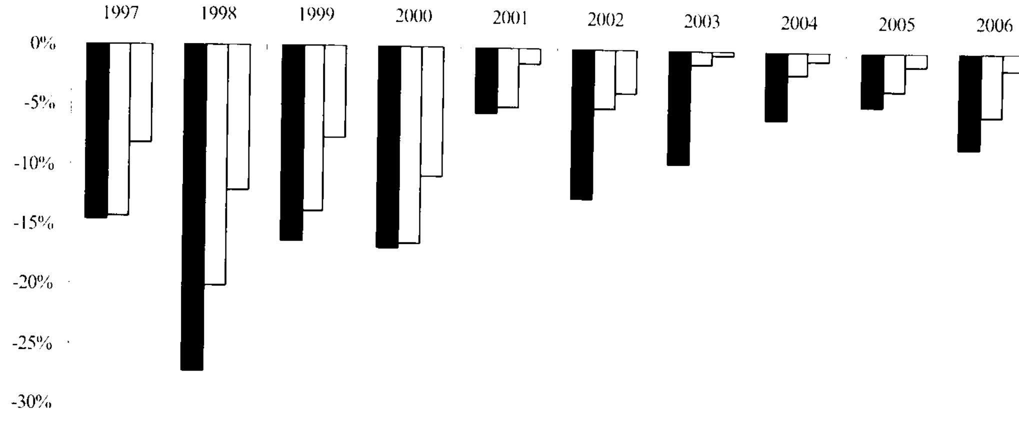
10 Following standard return analysis techniques, this study uses market-adjusted returns combined over a two-day return window beginning on the announcement date. These returns do not take into account any other news, good or bad, that accompanies the restatement announcement. A complete description of the calculation is in Section V.B.

11 The VIX index is the Chicago Board Options Exchange's volatility index. It is scaled to fit chart dimensions. Percentages on the axis do not apply to it.

12 The shift cannot be attributed to the increase in restatements by non-exchange-listed companies, because stock price data is available primarily for exchange-listed companies.

13 The overall return is similarly negative for 2000 and 2001, but in 2000 the downward trend does not begin until March. Restatements tend to be concentrated in the first three months of the year. In 2000, 37% of restatements are announced in the first quarter. Market returns are obtained from CRSP.

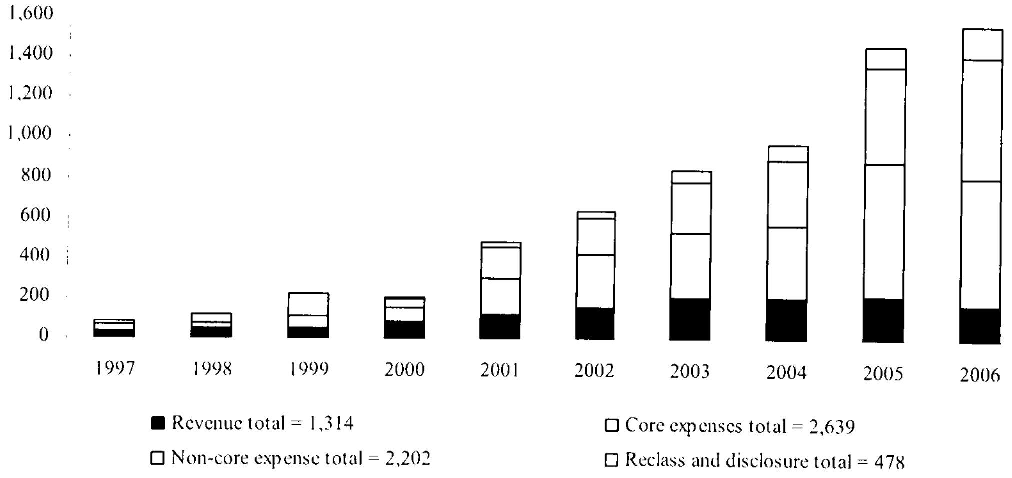
Figure 3 — **Average Returns for Fraud and Revenue Restatement Announcements**



C. Restatement Characteristics – Changes and Market Reactions

The percentages of restatements associated with other accounting issues increased as the proportion of revenue restatements decreased. Figure 4 shows the relative proportions of restatements related to four classifications of accounting issues across the decade. Definitions of the categories are in the following bullets.[14]

Figure 4 — **Accounting Issues Associated with Restatements**



In order of severity, based on market reactions, they are:

- Revenue – These are restatements involving revenue. The number of revenue restatements increases each year except 2006, but decreases as a proportion of overall restatements. The shift is most noticeable in

14 See Appendix A for complete descriptions and frequencies of accounting issues.

2001: the percentage of revenue restatements drops from 44% of all 2000 restatements to 25% of all 2001 restatements.[15] Revenue restatements are consistently associated with more negative market returns.

- Core Expenses – Restatements related to core expenses, i.e., on-going operating expenses, increase over twenty-fold across the decade: from about 30% of all restatements in early years to approximately 40% of all restatements in later years. Market reactions to core expense restatements are typically negative. However, there are two clusters of these restatements that do not elicit negative announcement returns:
  - Companies required to provide SOX Section 404 internal control reports (accelerated filers) and restating during the 2003-2005 SOX Section 404 implementation period.
  - Companies restating lease accounting in 2005.

  The lack of market response to these restatements may be due to anticipation of these restatements, or because they are viewed as arising from clarification of accounting principles or tightening of the financial reporting environment, rather than financial reporting lapses of individual companies.

- Non-Core Expenses – Restatements of non-core expenses, i.e., non-operating or non-recurring expenses, increase greatly in both number and proportion. Non-core expense restatements represent 20% of restatements in 1997 and nearly 40% at the end of the ten-year study period. Growth in this category is due to several accounting issues, including more misstatements of impairment charges, derivatives, taxes and convertible debt interest. There is not a significant market reaction to accounting issues in this category.

- Reclassifications and Disclosures – Restatements involving reclassification and disclosure issues also increase in number and proportion, but remain a relatively small percentage of all restatements, totaling 10% at the end of the study. Market reactions to these restatements tend to be less negative than the other types of restatements. These are particularly benign restatements since they typically do not affect previously reported income.

Other Restatement Characteristics and Consequences

The proportion of restatements that decrease reported income increases from about 80% to nearly 90% over the decade. Whether a restatement reduces income is generally not associated with negative announcement returns. Further, more than half of all restating companies report a net loss in the year prior to the restatement announcement.

The average number of fiscal years corrected by a restatement increases from about 1.25 years in 1997 to nearly 2.00 years in 2006. Concurrently, the proportion of restatements affecting annual, audited financial statements (rather than only quarterly, unaudited financial statements) increases from about 50% to 70%. The increase in restated periods is influenced by lease restatements, and larger company restatements during the SOX Section 404 implementation period. Both of these sets of restatements tend to correct relatively long time periods. Typically, returns are less negative when restatements correct longer time periods, even apart from these two groups. Perhaps, on average, misstatements of less recent financial statements are not as salient to current investors.

Subsequent to a restatement announcement, one-year market returns average -4%. (See Section V.C.) Average debt ratings also tend to be lower in the year following a restatement. Prior to a restatement, the median debt rating for a restating company is BB, slightly below the lowest investment grade of BBB. This median rating decreases to BB- in the year after an announcement. (See Appendix E.)

15 This is subsequent to the SEC's issuance of *Staff Accounting Bulletin: No. 101 – Revenue Recognition in Financial Statements* (Dec. 3, 1999), available at http://www.sec.gov/interps/account/sab101.htm.

D. Characteristics of Restating Companies

Restating companies' size increases steadily across the decade, except in 2006. However, it is typically similar to the average size of all companies in the Compustat database.[16]

Restatements by relatively larger companies tend to:[17]

- have a smaller market reaction;
- restate more years and decrease reported income;
- involve fraud and revenue recognition issues – although the latter is true only when size is measured using assets, not revenues;[18] and
- involve more complex accounting issues, such as derivatives, asset valuations, taxes, foreign subsidiaries and consolidations.

These last accounting issues are consistent with expected activities of larger companies. For example, larger companies are more likely to have complicated transactions involving foreign subsidiaries and consolidations.

On the other hand, restatements by relatively smaller firms are more likely to involve:

- on-going operating expenses;
- stock-based compensation; and
- debt-related problems—particularly imputed interest on convertible debt.

Again, these last two items are consistent with activities of smaller, growth-oriented organizations which are likely to rely heavily on stock-based compensation and convertible debt financing.

Industry representation among restating companies remains fairly consistent across the decade. The technology industry is an exception, as it announces fewer restatements in later years. The decline is most noticeable in 2001, following the end of the technology bubble.

16 Compustat is the main source of financial data used in this study. See note 3 for additional information.

17 "Larger companies" refers to an association with increasing company size, not companies of any particular size. There is no cut-off point or threshold for larger vs. smaller companies in the regression analyses from which these results are drawn. Recall, up to 50% of all restating companies are not available for some of these analyses because of unavailable data. These companies, without data, appear to be quite small. (See Section IV.A.).

18 Again, this association with fraud may be partly due to the way fraud is identified for this study.

II. PURPOSE AND SCOPE

The U.S. Treasury Department commissioned this study to analyze public company financial restatements from 1997 to 2006. The purpose is to understand characteristics and consequences of financial statement restatements for violations of U.S. GAAP over this decade. An important focus is the change in restatement activity over this time. To do this, the study analyzes restatement characteristics, including the underlying accounting issues associated with restatements, in each year and over the ten-year period. It also describes the companies making restatements. In terms of consequences, the study examines the impact of the restatements on short and longer-term market returns, as well as changes in debt ratings surrounding the announcement year. The study is intended to provide an analysis of restatements, not to provide recommendations derived from the analysis.

A. Definition of a Restatement Event

This study focuses on the correction of errors and irregularities in public company financial statements filed with the Securities and Exchange Commission (SEC) in accordance with U.S. GAAP. Every attempt is made to include only restatements to correct misstated financial statements and to exclude other financial statement changes. For example, some companies use the term restatement when reporting events such as a pooling-of-interest merger before the elimination of the pooling option in 2001. Also, companies adopting new accounting standards sometimes provide restated results to enhance the consistency of their financial information. All data sources used in this study attempt to eliminate such restatements.

The analysis focuses on misapplication of U.S. GAAP, so restatements by companies that do not report primarily under U.S. GAAP are excluded. These are mainly identified by the type of SEC form that is amended by the restatement. In particular, restatements amending SEC Form 6-K and Form 20-F are not included.[19]

For purposes of this study, a restatement event begins with the announcement of an accounting problem or potential accounting problem and concludes with the filing of the amended results. The initial revelation of the problem may be included in a press release or on a Form 8-K (Current Report), Form 10-K (Annual Report), or Form 10-Q (Quarterly Report) that amends the originally filed results. The amended results are typically filed on Form 10-K/A or Form 10-Q/A.[20] Although not necessarily intended under SEC rules in place during the time of this study, some companies did not file amended financial statements to correct past results, but rather presented revised results on a current Form 10-K or Form 10-Q.

When there is a time lag between the initial announcement and an amended filing, the sequence of events between these dates varies greatly. It may include a lengthy investigation and a series of updates by company management, or simply a speedy filing of the amended results. In some cases, investigations expand the scope of the initially reported problems and extend the time periods to be restated. In these cases, this study attempts to combine all periods finally restated and all accounting issues involved to create one restatement event. Companies rarely discover additional misstatements *after* their revised results are filed with the SEC. A restatement of a re-filed report is considered a separate restatement event. However, if a company provides expected revision amounts that differ from final amended results filed on the 10-K/A or 10-Q/A, the additional changes are not considered a separate event.

19 Form 6-K is the current report of foreign private issuers and Form 20-F is the annual or transition report of foreign private issuers.

20 Companies sometimes file amended results on Form 8-K, or if registration statements are involved, on amended S-series forms.

B. Data Sources and Limitations

The analysis focuses on restatements announced from January 1, 1997 through December 31, 2006. The information used for this study is drawn from several sources. In earlier years (1997-2003), restatements are mainly identified through Lexis-Nexis key-word searches of press releases and Form 8-K filings. Additional restatements during this period are found by comparing the search results to restatements listed in the Government Accountability Office (GAO) study and Audit Analytics (AA) restatement database for relevant years (GAO for 1997-2002 and AA for 2001-2003).[21] Comparison of data sources for overlapping periods indicates that AA includes nearly all restatements captured in the GAO lists and Lexis-Nexis searches, and some that are not identified through these methods. Therefore, restatements in later years (2004-2006) are obtained only from AA. As noted above, restatements by foreign filers and restatements that are not due to misapplications of U.S. GAAP are eliminated from all sources.[22]

C. Sample and Data Availability

The initial analysis focuses on 6,633 restatements. Based on an analysis of SEC Central Index Key (CIK) codes, these 6,633 restatements are made by 4,786 unique filers, with 1,660 filers reported to have multiple restatements. The number of restatements for filers with multiple restatements ranges from two restatements for 1,066 filers, to eight restatements for six filers.

These 6,633 restatements are identified from a set of 7,398 possible restatements drawn from all sources noted above. The difference arises mainly because AA defines a restatement somewhat differently than this study. If the accounting issues underlying a restatement change from the initial announcement to the filing of amended results, AA may count both the announcement and the amended filing as a restatement. That is, AA focuses on announcements of accounts restated, while this study focuses on overall restatement events. To address this definitional difference, it is assumed that restatements with announcement dates within ninety days of each other are duplicate announcements of the same event. Deleting likely duplicate announcements does not eliminate any restating company from the analysis, it only reduces the number of times a company appears.

Based on a comparison of announcement dates, about 10% (765) of the 7,398 possible events are likely not unique restatements. That is, the announcement dates are within ninety days of each other.[23] Thus, there are 6,633 restatements (7,398 – 765) likely to be corrections of unique misstatements. These 6,633 restatements are used to analyze restatement trends across the sample period. They are also used to analyze restatement characteristics such as the underlying accounting issues and the presence of fraud.

Many restating companies are quite small, or otherwise unusual, and so do not appear in the financial and market databases used in this study. These restatements are eliminated from later analysis due to unavailable data. The second stage of the analysis focuses on characteristics of restating companies, such as size, profitability, and exchange membership. For this analysis, necessary data are available for 4,923 (74%) of the initial 6,633 restatements. The third stage studies stock market returns at the time of the restatement. Announcement returns are mainly available for companies listed on major exchanges[24], or 3,310 companies, (67% of 4,923 and 50% of 6,633). Subsequent sections provide additional information about data availability and eliminated restatements.

21 The GAO list of restatements from 1997 to June 30, 2002 is available at http://www.gao.gov/new.items/d03395r.pdf. An updated GAO list is available at http://www.gao.gov/cgi-bin/getrpt?GAO-06-1079SP. AA is a commercial database. More information is available at http://www.auditanalytics.com.

22 In total, approximately 550 restatements provided by AA or the GAO are deleted in this initial step. Over half are eliminated because they are foreign filers; that is, they restated on Form 6-K or 20-F. The rest are eliminated because, upon closer examination, they do not appear to be restatements to correct U.S. GAAP misstatements.

23 If the window is expanded to 180 days, only another 135 possible duplicates are identified.

24 These major exchanges are the NYSE, the AMEX, and the NASDAQ National Market.

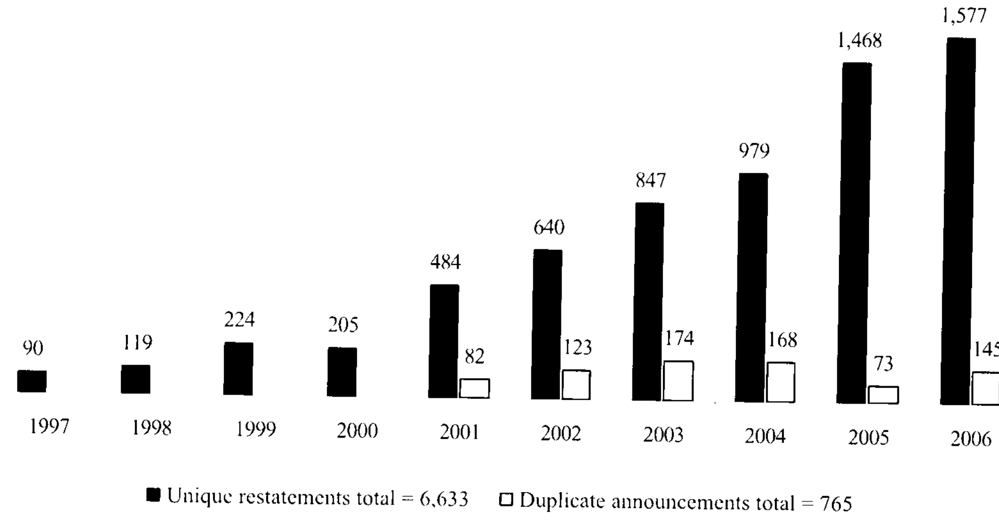
Three caveats apply to all analyses in this study. First, restatements deemed to be U.S. GAAP-compliant (e.g., a change from one acceptable method to another) are not included in this analysis. However, knowledgeable observers might disagree on a few of the distinctions between U.S. GAAP-compliant restatements and the correction of a misstatement. Second, it is possible that some restatement events with restatement dates outside the ninety-day window are also duplicates. Third, some restatements excluded by the ninety-day window may not be duplicates. All results should be considered with these possibilities in mind.

III. RESTATEMENT TRENDS AND CHARACTERISTICS

A. Restatement Trends and Related Events

The distributions of restatements and likely duplicates over the years of the study are shown in Figure 5 below:

Figure 5 — **Restatement Frequencies 1997-2006**



This figure clearly illustrates the oft-remarked increase in restatement activity, particularly in recent years. A brief history of financial reporting and market developments over this time provides context for understanding some of the trends.

- In August 1999, the SEC issued Staff Accounting Bulletin (SAB) 99. It emphasized that materiality considerations should include qualitative as well as quantitative factors.[25] To the degree SAB 99 expanded the number of misstatements deemed material, the number of restatements would have increased. Presumably, if these additional restatements were due to qualitative factors rather than the dollar amounts involved, there would have been an overall reduction in the impact of restatements on reported net income. However, the available data do not show income effects to be discernibly smaller in the year after SAB 99 was issued.[26]
- The SEC issued SAB 101 in December 1999. SAB 101 clarified a series of recurring revenue recognition issues, possibly reducing the number of revenue restatements in later years.[27]
- Much of the increase in restatements in 1999 is due to the SEC's identification of issues associated with determining amounts written off as acquired in-process research and development (IPR&D) costs.[28]

25 SEC, *Staff Accounting Bulletin: No. 99 – Materiality* (Aug. 12, 1999), available at http://www.sec.gov/interps/account/sab99.htm.

26 See Appendix F for further discussion and analysis of the limited data.

27 SEC, *Staff Accounting Bulletin: No. 101 – Revenue Recognition in Financial Statements* (Dec. 3, 1999), available at http://www.sec.gov/interps/account/sab101.htm.

28 The Chief Accountant of the SEC issued a letter on this topic to the American Institute of Certified Public Accountants SEC Regulations Committee. Discussion of SEC actions surrounding IPR&D are discussed in the *Letter from the Office of the Chief Accountant Regarding 1998-1999 Audit Risk Alerts* (Oct. 9, 1998), available at http://www.sec.gov/info/accountants/staffletters/aclr1009.htm.

This allocation and write-off is a typical step in accounting for acquisitions. Of the 224 restatements announced in 1999, 32% (71) were only to reduce the amount of purchased IPR&D written off, thereby increasing previously reported income. IPR&D also accounts for 9% of 1998 restatements. The total number of restatements decreased from 1999 to 2000, but excluding IPR&D-only restatements, they increased each year from 1997 to 2000 (20% from 1997 to 1998, 42% from 1998 to 1999, and 34% from 1999 to 2000).

- Restatements continue to increase after 2000. The following events occurred about this time.
  - There was a significant downturn in the American economy beginning in March 2000 with the end of the technology bubble. This was exacerbated in the third quarter of 2001 by 9/11. The major market indices did not begin to recover until early 2003. The occurrence and discovery of misstatements are associated with economic downturns.[29]
  - Enron announced its restatement in November 2001. This began a period of intense focus on accounting issues and turmoil in the accounting profession. Other well-known restatements around the time are Adelphia, in April 2002, and Worldcom, in June 2002.
  - The AA database commenced in 2001. AA's software crawls all Edgar filings, allowing more efficient identification of restatements filed without announcement on Form 8-K or in a press release, particularly restatements noted only on Form 10-K and Form 10-Q. While this would not lead to an increase in the number of restatements, it may lead to an increase in the number of restatements identified for analysis.
- The SOX was enacted July 30, 2002. This affected restatement activity in several ways.
  - SOX Section 302 required corporate officers to provide formal assurance that internal controls were adequate and financial statements were fairly presented. Combined with SOX Section 404 reporting, discussed below, the focus on internal control attestation and reporting appears to have increased restatements announced during 2003-2005.
  - Beginning with financial statements for fiscal years ending on or after November 15, 2004, SOX Section 404 regulations required U.S. accelerated filers to document, test and report on internal controls over financial reporting (ICFR). Auditors were also required to attest to management's ICFR assertions. Efforts to implement these requirements began as early as 2003, intensifying in 2004 and culminating in the first ICFR reports in early 2005.[30] Implementation of ICFR processes sometimes identified on-going misstatements. Additional detail regarding restatement activity and ICFR reporting is provided in Appendix C.
  - In addition to internal control provisions, other elements of SOX also increased the attention on financial reporting quality. This includes the establishment of the Public Company Accounting Oversight Board (PCAOB) as the public company auditor regulator with an inspection process and enforcement authority.
- The SEC's February 2, 2005 letter clarifying GAAP for lease accounting added to restatements announced in 2005. About 15% to 20% of restatements announced this year include lease issues.

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29 See Mark L. DeFond and Jere R. Francis, *Audit Research after Sarbanes-Oxley*, 24 AUDITING: A JOURNAL OF PRACTICE & THEORY 5 (2005), and Zoe-Vonna Palmrose, *Litigation and Independent Auditors: The Role of Business Failures and Management Fraud*, 6 AUDITING: A JOURNAL OF PRACTICE & THEORY 90 (1987).

30 For example, Gullapalli reports that in 2003-2004, PricewaterhouseCoopers increased its Section 404 compliance staff by 20% to 8,000. See Diya Gullapalli, *Grasping 'Internal Controls'*, WALL STREET JOURNAL, Nov. 3, 2004, at C1.

- Restatements to correct stock options backdating are reported beginning in 2006, and are a factor in about 6% of that year's restatements.

B. Restatement Severity

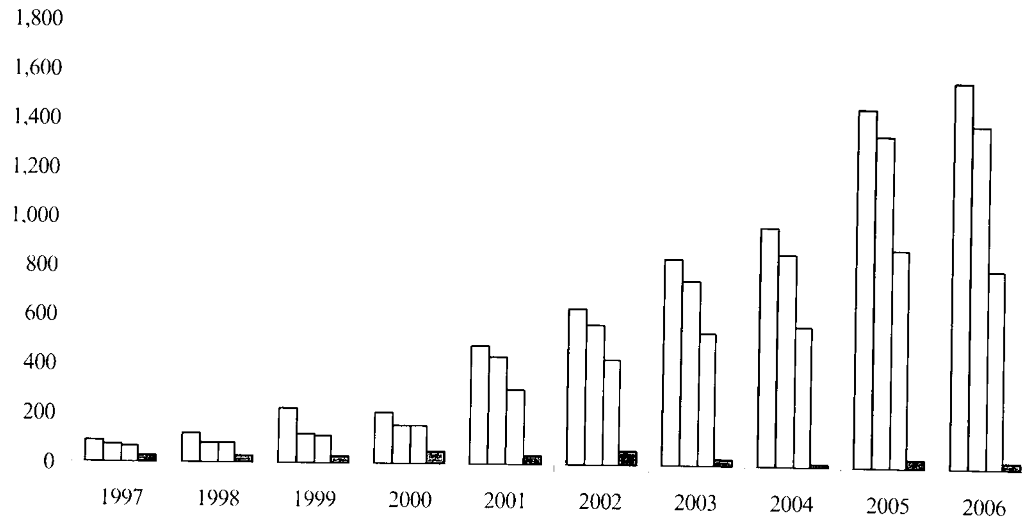
Past research suggests financial statement users react more negatively to restatements involving fraud, core earnings accounts (mainly revenue) and larger decreases in net income/increases in net losses.[31] Therefore, measures of these or similar characteristics are used in this study as indicators of restatement severity.

Fraudulent restatements are identified in three ways: 1) the SEC issues an Accounting and Auditing Enforcement Release (AAER), 2) the company admits to fraud or irregularities in its press releases or filings or 3) company officers are indicted.

Restatements of core earnings accounts include those that affect revenues or on-going operating expense items.[32] Measuring a restatement's dollar impact upon net income requires inspection of each restated report. If multiple periods are involved, it also requires calculation of the overall effect. Given the large number of restatements analyzed in this study, it is not feasible to obtain this information for analysis. Instead, an indicator for restatements that decrease previously reported income is used.[33]

Figure 6 and Table 1 compare the frequency of restatements with each of these severity measures to the overall number of restatements in each year.

Figure 6 — **Incidence of Restatements with Severe Characteristics**



□ All restatements = 6,633 □ Income decreasing total = 5,806 □ Core earnings total = 3,953 ▩ Fraud total = 350

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31 See Zoe-Vonna Palmrose and Susan Scholz, *The Circumstances and Legal Consequences of Non-GAAP Reporting: Evidence from Restatements*, 21 CONTEMPORARY ACCOUNTING RESEARCH 139 (Spring 2004), Zoe-Vonna Palmrose, Vernon J. Richardson and Susan Scholz, *Determinants of Market Reactions to Restatement Announcements*, 37 JOURNAL OF ACCOUNTING AND ECONOMICS 59 (Feb. 2004), and Cristi A. Gleason, Nicole Thorne Jenkins and W. Bruce Johnson, *The Contagion Effects of Accounting Restatements*, 83 ACCOUNTING REV. 83 (Jan. 2008).

32 See additional detail on accounting issue categories and classifications in Section III.C and in Appendix A.

33 AA is working to expand their database to include net income effects. Preliminary data for companies trading on major exchanges are recently available for the last two years of this study. However these data were not available at the time these analyses were performed.

Table 1 — **Incidence of Restatements with Severe Characteristics**

		1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	Total
All restatements:		90	119	224	205	484	640	847	979	1,468	1,577	6,633
Restatement characteristic:												
Income-decreasing	count	71	84	117	159	435	570	755	865	1,353	1,397	5,806
	percent	79%	71%	52%	78%	90%	89%	89%	88%	92%	89%	88%
Core earnings	count	68	79	110	158	304	426	540	570	889	809	3,953
	percent	76%	66%	49%	77%	63%	67%	64%	58%	61%	51%	60%
Fraud	count	26	30	33	50	39	59	28	18	36	31	350
	percent	29%	25%	15%	24%	8%	9%	3%	2%	2%	2%	5%
Any severe characteristic	count	78	95	139	185	465	614	818	922	1,405	1,491	6,212
	percent	87%	80%	62%	90%	96%	96%	97%	94%	96%	95%	94%
Core earnings or fraud	count	68	80	120	164	307	435	545	571	895	813	3,998
	percent	76%	67%	54%	80%	63%	68%	64%	58%	61%	52%	60%

Overall, 88% of restatements reduce income, the others either increase previously reported income or have no income effect. The latter includes reclassifications, footnote disclosures or EPS calculations. In early years of the study, more than 70% of restatements decrease income, except for a dip in 1999. Recall, restatements of improper IPR&D write-offs in this year increased reported income. Beginning in 2001, the percentage climbs to about 90% where it remains for the rest of the study period.[34]

Fraud restatements have an overall frequency of 5%. Although the number of frauds has remained fairly consistent across time, significant growth in the number of non-fraud restatements means that fraud restatements have declined as a percentage of all restatements across the study period. However, identification of fraudulent misstatements depends to some degree on SEC AAERs. So, it is likely that the number of known frauds will eventually increase for later years, as on-going enforcement actions are concluded. This is particularly true for restatements due to stock options backdating, which are mainly announced in 2006. Nonetheless, this may not have much effect on the overall percentage trend.[35]

Sixty percent of restatements affect core earnings accounts. The number of restatements involving core earnings has increased more than ten-fold over the decade; however, the percentage decreased in later years of the study, particularly in 2006. Accounting issues are addressed in greater detail in Section III.C and in Appendix A.

Since a high percentage of restatements decrease net income, the overall percentage of restatements with any one severe characteristic is 94%. This percentage is higher in later years of the study as the number of income-decreasing restatements increases. However, if only fraud and core earnings restatements are considered, the overall percentage with either one of

34 The frequency of income-decreasing restatements differs significantly across years, and is significantly lower from 1997-2000 than in later years, even excluding IPR&D restatements (Chi-square p-values < .001).

35 As of January 2008, the SEC web site lists less than twenty companies with AAERs related to stock options backdating. See http://www.sec.gov/spotlight/optionsbackdating.htm. A few of these do not appear to be related to restatements announced in 2006. In 2006, 100 restatements involved stock options backdating. Fraud frequency differs significantly across study years (Chi-square p-value < .001).

these items is 60%. Furthermore, this percentage has decreased significantly, although not consistently, over the years of the study. For example, in 1997, 76% of all restatements involved fraud or core earnings; by 2006, the percentage was only 52%.[36] This decrease in the relative number of restatements involving fraud and core earnings accounts suggests the frequency of severe restatements has declined even as the total number of restatements has increased.

C. Accounting Issues

Ascertaining the accounting issues underlying these restatements can be difficult. Some companies describe errors by account (e.g., revenue is overstated), others by the nature of the error (e.g., improper accounting for employee stock options). It is often unclear how the latter descriptions tie to specific financial statement elements, and thus it is not possible to consistently code by specific account. Also, most restatements correct multiple errors across several financial statement elements.[37] Finally, the 1997-2000 restatements are classified using a somewhat different scheme than that provided by AA. The following analysis should be considered with these caveats in mind.

Accounting Issue Classifications

Restatements are classified into four groups based on their relation to financial statement elements and expected significance to financial statement users. Appendix A provides greater detail on the categories and classifications used in the study. The groups, in order of expected significance to users, are:

- Revenue Recognition: These are restatements involving revenue. Revenue restatements are associated with more severe consequences in prior research, suggesting they are highly significant to financial statement users.[38]
- Core Expenses: Core expense restatements correct accounting related to companies' on-going operating expenses. These include restatements involving cost of sales, compensation (including stock-based), lease and depreciation costs, selling, general and administrative expenses, and research and development costs. Together, revenues and core expenses determine a company's core earnings, which are thought to be more relevant to users than non-core earnings.[39]
- Non-Core Expenses: Non-core expense restatements correct items that affect net income, but do not arise from on-going operating activities. They include accounting for interest, taxes and derivatives. This group also includes corrections of non-recurring transactions or special items. Examples are misstated impairments, contingencies, gains and losses. Restatements arising from consolidations, acquisitions, reorganizations and activities of foreign subsidiaries are also included here, if the specific accounts affected are not identified.[40]

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36 The frequency of restatements with any severe characteristic differs significantly across years, whether considering all three characteristics or just core earnings and fraud (Chi-square p-values < .001).

37 Often one issue triggers the restatement decision, and other misstatements are identified and corrected during the investigation. It may be that a portion of these subsequently identified corrections would not have individually warranted restatement. In fact, some companies explicitly state as much. However, it is often not possible to confidently identify the driving issue, and it certainly is not feasible for such a large number of restatements. For further analysis of underlying accounting issues during the later period of the study, see Marlene Plumlee and Teri Lombardi Yohn, *An Analysis of the Underlying Causes of Restatements*, (Working Paper Series, 2008), available at http://ssrn.com/abstract=1104189.

38 See Cristi A. Gleason, Nicole Thorne Jenkins and W. Bruce Johnson, *The Contagion Effects of Accounting Restatements*, 83 ACCOUNTING REV. 83 (Jan. 2008), Zoe-Vonna Palmrose and Susan Scholz, *The Circumstances and Legal Consequences of Non-GAAP Reporting: Evidence from Restatements*, 21 CONTEMPORARY ACCOUNTING RESEARCH 139 (Spring 2004), Zoe-Vonna Palmrose, Vernon J. Richardson and Susan Scholz, *Determinants of Market Reactions to Restatement Announcements*, 37 JOURNAL OF ACCOUNTING AND ECONOMICS 59 (Feb. 2004).

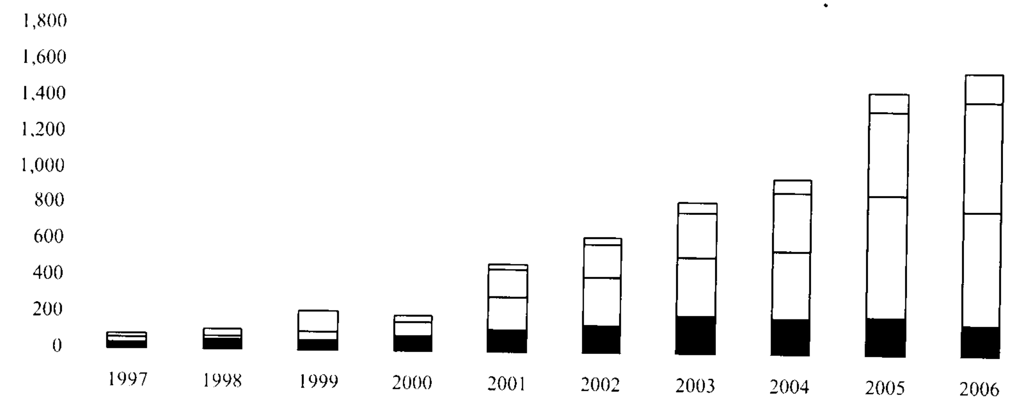
39 See Joseph H. Golec, Katsiaryna Salavei and John P. Harding, *Do Investors See Through Mistakes in Reported Earnings?* (Working Paper Series, 2008), available at http://ssrn.com/abstract=1092256.

40 Restating to correct the accounting for consolidations, acquisitions, reorganizations and activities of foreign subsidiaries may affect many accounts. However, no other accounting issue is identified for about 300 restatements attributed to one of these reasons.

- Reclassification and Disclosure Issues: Reclassification and disclosure restatements likely do not affect net income at all. They include restatements to reposition balance sheet, income or cash flow statement line items. This category includes reclassification of debt as long-term or current. Disclosure restatements typically revise footnote information. Corrections of earnings per share due to problems other than net income are also included here.

In Figure 7 and Table 2, each restatement is assigned to one of these four groups according to the most severe element of the misstatement. That is, any restatement involving revenue is classified as a revenue restatement whether or not any other accounts are affected. A restatement involving core expenses, but not revenue, is included with the core expense group, and so forth. Figure 7 shows the distribution of these four types of restatements across the study period.

Figure 7 — **Financial Statement Elements Affected by Restatements**



Numbers and percentages underlying Figure 7 are provided in Table 2, along with selected sub-groups. Sub-groups are restricted to restatements within each classification. That is, a lease restatement noted in this table may also affect other core expenses, but it cannot affect revenue. Percentages are based on total restatements reported in the bottom line of each column. Additional sub-groups are reported in Appendix A.

Table 2 — **Financial Statement Elements Affected by Restatements**

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	Total
Revenue	37	56	56	90	123	154	208	204	213	173	1,314
Percent of total	41%	47%	25%	44%	25%	24%	25%	21%	15%	11%	20%
Core expenses	31	23	54	68	181	272	332	366	676	636	2,639
Percent of total	34%	19%	24%	33%	37%	43%	39%	37%	46%	40%	40%
Leases	0	2	3	1	23	47	83	80	293	86	618
Percent of total	0%	2%	1%	0%	5%	7%	10%	8%	20%	5%	9%
Employee options	5	0	4	4	48	67	85	94	159	254	720
Percent of total	6%	0%	2%	2%	10%	10%	10%	10%	11%	16%	11%
Non-core expenses	18	38	112	40	155	181	246	326	474	612	2,202
Percent of total	20%	32%	50%	20%	32%	28%	29%	33%	32%	39%	33%
Debt and interest	9	9	6	9	48	55	64	91	179	262	732
Percent of total	10%	8%	3%	4%	10%	9%	8%	9%	12%	17%	11%
Asset valuation	1	4	11	6	24	32	53	60	81	84	356
Percent of total	1%	3%	5%	3%	5%	5%	6%	6%	6%	5%	5%
Taxes	1	1	2	3	19	17	53	66	99	89	350
Percent of total	1%	1%	1%	1%	4%	3%	6%	7%	7%	6%	5%
Derivatives	0	0	0	0	14	19	10	18	37	49	147
Percent of total	0%	0%	0%	0%	3%	3%	1%	2%	3%	3%	2%
Reclass & Disclosure	4	2	2	7	25	33	61	83	105	156	478
Percent of total	4%	2%	1%	3%	5%	5%	7%	8%	7%	10%	7%
Balance sheet	0	1	1	3	13	20	30	36	36	46	186
Percent of total	0%	1%	0%	1%	3%	3%	4%	4%	2%	3%	3%
Cash flows	0	0	0	0	2	1	8	25	45	86	167
Percent of total	0%	0%	0%	0%	0%	0%	1%	3%	3%	5%	3%
Total restatements	90	119	224	205	484	640	847	979	1,468	1,577	6,633

Revenue

Revenue recognition is a factor in 20% of all restatements over the study period. However, the relative frequency of revenue restatements has declined from about 40% in the early years of the study to 15% in 2005 and 11% in 2006. Other than 1999, with its high percentage of IPR&D restatements, the most noticeable shift is from 2000 to 2001, when the percentage of revenue restatements drops from 44% to 25%. This is after the technology bubble ended, and not long after SAB 101 was issued in December 1999. As technology companies tend to disproportionally restate revenue, and SAB 101 clarified acceptable revenue recognition practices, it is likely that both played a role in the reduction.

Core Expenses

On the other hand, the frequency of restatements affecting core expenses has remained more consistent over the study period. The latter years of the period are fairly close to the overall average of 40%. But in absolute numbers, these restatements have increased dramatically, from 31 in the first year of the study to the mid-600s in both 2005 and 2006. Thus, a significant portion of the increase in overall restatements is due to corrections of these accounts.

As noted previously, some of the increase in 2005 and 2006 is due to two specific issues: accounting for leases and employee stock options. In 2005, roughly 20% of the core expense restatements involve lease accounting.[41] In 2006, 16% involve stock-based compensation. Of these 254 stock-based compensation restatements, only 72 (28%) are attributed solely to stock options backdating.

Non-Core Earnings Issues

Non-core expense restatements have an average frequency of 33% for the study period. Again, the absolute number in this group has increased dramatically in the last few years of the study. The sum of such restatements in 2005 and 2006 (1,086) is nearly equal to the sum over all the other eight years (1,116). The increase is attributable to several issues. Debt-related restatements grew to 12% of all 2005 restatements and 17% of all 2006 restatements.[42] Restatements involving asset valuation issues, including misstatements of impairments of goodwill, intangible and other assets, have also increased in recent years, as have restatements related to taxes. Each of these represents about 5% of all restatements. Derivative restatements are a recent development, and appear to account for a relatively low percentage of restatements overall.[43] However, some of the interest-related restatements noted above may involve derivative instruments.

Reclassifications and Disclosure

The incidence of reclassification and disclosure restatements began to increase in 2003. There is an additional jump in 2006, which appears to be related to an uptick in cash flow statement reclassifications.

Underlying Circumstances

Data also indicate if misstatements arise from a few specific underlying events or circumstances, including consolidations, acquisitions, reorganizations or activities of foreign subsidiaries. These restatements can affect numerous accounts, and where possible are classified with the affected financial statement elements. Therefore, they are not broken out separately in Table 2.

Acquisitions/reorganizations are noted as a factor in 17% (1,127) of all restatements over the study period. These issues tend to be found in the earlier years, particularly the IPR&D year of 1999. It appears that about 39% of these restatements affect core earnings (revenues or core expenses).

Consolidation errors are noted as a factor in 8% (514) of all restatements. Consolidation issues are more likely to be found in 2003-2005. This concentration is likely associated with misstatements associated with accounting for variable interest entities. Financial Accounting Standards Board (FASB) guidelines related to these entities became effective in 2003.[44] Following adoption, some companies did not apply these guidelines correctly. About 32% of restatements arising from problems with consolidation affect core earnings.[45]

AA data indicate that accounting for foreign subsidiaries is an underlying factor in 8% (509) of all restatements from 2001-2006. These issues are more equally divided between core and non-core items: 54% affect core earnings. This category is not available for 1997-2000 restatements, but it appears to be fairly evenly distributed across other years of the study.

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41 The frequency for lease restatements depends on how depreciation restatements are classified. As noted in Appendix A, AA specifies that many of the restatements it classifies as depreciation related are due to the depreciation effects of correcting lease accounting. The lower end of the range (14% of all 2005 restatements) assumes none in the depreciation category are lease related; the higher end, used here, assumes all are.

42 This does not include reclassifications of debt between current and long-term. It does include interest issues associated with beneficial features of convertible stock.

43 FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*, finally became effective for fiscal quarters beginning after June 30, 2000, available at http://72.3.243.42/st/status/statpg133.shtml.

44 See FASB Interpretation No. 46, *Consolidation of Variable Interest Entities* (revised Dec. 2003), available at http://www.fasb.org/fin46r.pdf.

45 Frequencies differ significantly both across years and between core and non-core earnings items for consolidations and acquisition/reorganizations (Chi-square p-values < .001).

Accounting Issues Summary

The absolute number of all four financial statement elements (revenue, core expenses, non-core expenses and reclassification and disclosure issues) has increased over the study period. However, the increase is not evenly distributed. While the number of revenue restatements reported in 2006 is more than four times the number reported in 1997, the number of core expense restatements is more than twenty times higher, non-core expenses thirty-four times higher, and reclassification and disclosure issues are thirty-nine times higher, although only four such restatements were noted in 1997.

Thus, the proportion of accounting issues has shifted across the decade. Most noticeably, the proportion of revenue restatements decreased in recent years, while the proportion of non-core expense restatements has increased.[46] Again, these data are consistent with a shift to less severe restatements in later years of the study.

D. Number of Periods Restated

The period of time corrected by the restatements varies from one quarter to over sixteen years. The overall average is just under one year and three quarters, 1.71 years, where a quarter = .25. The median is one year. Table 3 shows the average number of years corrected in a restatement increased from less than 1.50 years through 2001 to more than 1.50 years from 2004 to 2006. The intervening years of 2002 and 2003 average approximately 1.50 misstated years.

The year with the longest average restated period is 2005, at 2.02 years. This is largely due to lease restatements, which tend to correct long-standing accounting practices, and so involve significantly more years than other accounting issues.[47]

Table 3 — **Years Restated per Restatement Event**

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	Total
Number of restatements	90	119	224	205	484	640	847	979	1,468	1,577	6,633
Years restated:											
Average	1.35	1.43	1.40	1.26	1.28	1.47	1.52	1.67	2.02	1.92	1.71
Median	1.00	1.25	0.75	0.75	1.00	1.00	1.00	1.00	1.75	1.00	1.00
Quarterly-only financials:	44	46	118	109	179	213	260	281	306	461	2,017
Percent of total	49%	39%	53%	53%	37%	33%	31%	29%	21%	29%	30%

Overall, 30% of restatements affect less than one year. That is, only quarterly (interim) financial statements are affected. This is important because auditors review interim financial statements but do not audit them. As might be expected from the increase in restated periods noted above, the proportion of quarterly-only restatements has declined. It is about half of all restatements through 2000, and drops to about 30% by 2003. The lowest percentage is found in 2005 (21%). Again, this is due to the lease restatements in that year.

46 Frequencies differ significantly across years for all four classifications (Chi-square p-values < .001).

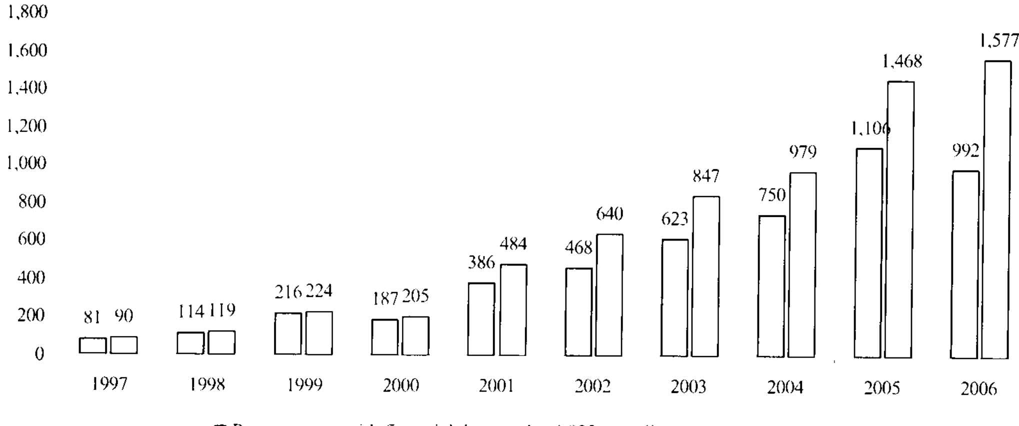
47 Mean differences across years are significant, and lease restatements affect significantly more periods than other types (t-test p-values < .001).

IV. CHARACTERISTICS OF RESTATING COMPANIES

The next stage of the analysis requires information about the restating company including exchange, industry, and basic financial data (assets, revenue and net income) around the year of the restatement announcement. These data are obtained mainly from the Compustat database. AA also provides this information for many companies in its database (AA obtains its data from Edgar On-Line). Basic financial data are available for 4,923 (74%) of the initial 6,633 restatements studied in the first stage of the analysis.[48]

The distribution of companies with and without available financial data is shown in Figure 8. Most restatements lacking basic financial information are found in later years of the sample. Financial data are available for over 90% of restatements from 1997-2000, decreasing to 63% in 2006. The 4,923 restatements remaining in the analysis are made by 3,464 unique companies. The number of restatements per company ranges from one (2,427 companies) to seven (two companies).

Figure 8 — **Distribution of Restatements with Basic Data Across Study Years**



A. Profile of Restatements Lacking Financial Data

Exchange membership is unknown for 90% of the 1,710 restatements lacking sufficient data for further analysis, suggesting these companies may not have been publicly traded at the time of the restatement. This may be partly due to the nature of the entities; they include a number of limited liability corporations, limited partnerships, private equity holding companies, funds and trusts. Some of these restatements amended pre-effective date, or S-Series, forms.[49]

Companies that exit the analysis tend to be very small. For the limited number with asset data available, the median asset balance is only $2.2 million. These restatements tend to correct shorter periods and involve fewer revenue restatements than those remaining in the analysis.[50]

48 Compustat is a product of Standard & Poor's. It is the primary source of financial information for most research in accounting and finance. It includes over 20,000 public companies – both currently active companies and those no longer extant. On average, Compustat has asset information for over 9,000 U.S. companies over the years of the study. Companies not included in the Compustat database tend to be very small or otherwise unusual.

49 These are the SEC forms filed by companies prior to their initial public offering.

50 The study uses data available from either Compustat or AA. The median asset balance is based on 694 companies that exit the analysis due to unavailable exchange data. The mean restated period for companies with financial data is significantly longer, 1.82 years, compared to 1.38 years for those without (t-statistic p-value < .001). The frequency of revenue restatements is significantly higher for companies with data, 22%, compared to 13% for companies without (Chi-square p-value < .001).

B. Industry Membership

Focusing on the 4,923 companies with basic financial data, Figure 9 shows the proportion of restatements reported by each industry across the decade.[51] Figure 10 shows the accounting issue classifications for the five industries with the most restatements, plus all others. In Figure 10, non-core expenses and reclassification and disclosures issues are combined due to relatively low frequencies in the latter group.

Figure 9 — **Industry Membership of Restating Companies Across Study Years**

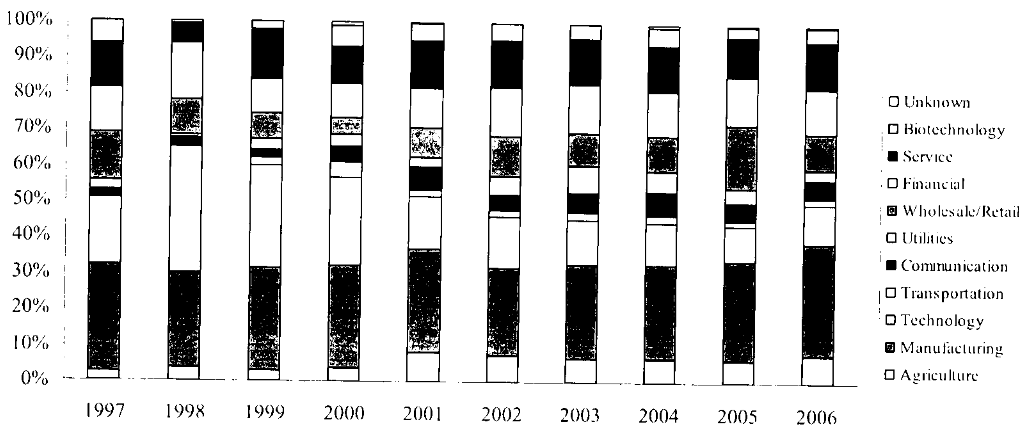


Figure 10 — **Accounting Issue Classification Frequency by Industry**

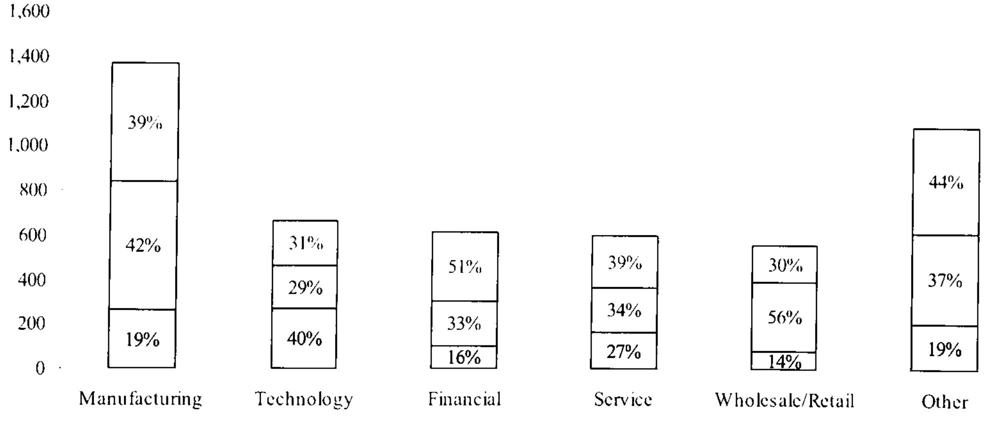


Figure 9 shows industry proportions tend to be fairly consistent across the study period. The technology industry is an exception, as it declines from 20%-30% of restatements in early years to around 10% in later years. As shown in Figure 10, the technology industry tends to have a higher proportion of revenue restatements, 40% compared to 22% overall. The decreases in both revenue and technology industry restatements in 2001 occur at the end of the technology bubble. This is also subsequent to the issuance of SAB 101, which was issued in December 1999 to clarify revenue reporting rules.

[51] Standard Industrial Classification (SIC) codes underlying these industry groups and tables reporting the counts and percentages underlying the figures are presented in Appendix B.

Another industry with inconsistent proportions is the wholesale/retail industry, whose restatements spiked in 2005 due to lease restatements. This is also reflected in the relatively high proportion of core expense restatements for wholesale/retail in Figure 10. Another distinction is found in the financial industry, which has a higher proportion of non-core expense/reclassification restatements. These are driven by derivative-related issues, most announced in the last two years of the study. Of course, it is possible that for financial industry companies, some of these derivatives pertain to core, rather than non-core, operations.

Considering other restatement characteristics, utilities, wholesale/retail and services tend to report more income-decreasing restatements, while technology companies report more income-increasing restatements than expected. IPR&D restatements are largely responsible for this association. Fraud also varies across industries. The technology industry tends to have more fraudulent restatements; the financial industry, fewer.[52]

C. Exchange, S&P 500 Membership and Accelerated Filer Status

Sixty percent of the restating companies with basic financial data trade on a major exchange, as shown in Table 4. This percentage is fairly consistent over the years. The years with highest percentages, 65% in 1999 and 66% in 2005, coincide with the IPR&D and lease restatement years. The higher percentage in 2005 is also associated with accelerated filers issuing initial ICFR reports.[53]

Table 4 — **Exchange and S&P 500 Membership of Restating Companies**

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	Overall
Total number of restatements	81	114	216	187	386	468	623	750	1,106	992	4,923
Exchange:											
NYSE	13	16	49	26	70	108	143	173	298	185	1,081
AMEX	5	4	4	5	20	21	45	56	79	77	316
NASDAQ Nat'l Mkt.	24	34	88	62	106	142	186	236	357	333	1,568
Total major exchange	42	54	141	93	196	271	374	465	734	595	2,965
% Major exchange	52%	47%	65%	50%	51%	58%	60%	62%	66%	60%	60%
OTC [54]	9	22	22	30	81	77	110	119	193	257	920
Other	30	38	53	64	109	120	139	166	179	140	1,038
Total non-major exchange	39	60	75	94	190	197	249	285	372	397	1,958
% Non-major exchange	48%	53%	35%	50%	49%	42%	40%	38%	34%	40%	40%
In S&P 500:	3	3	18	7	18	37	26	41	68	58	279
Percent of restating	4%	3%	8%	4%	5%	8%	4%	5%	6%	6%	6%
Percent of 500	1%	1%	4%	1%	4%	7%	5%	8%	14%	12%	n/a

52 Differences across industries between accounting issue categories, income increasing vs. income decreasing and fraud are all statistically significant (Chi-square p-values < .001).

53 Accelerated filers and companies restating lease accounting and correcting IPR&D write-offs are significantly more likely to trade on a major exchange than are other companies (all Chi-square p-values < .001).

54 Companies trading over the counter (OTC) include a total of 164 companies classified by AA as NASDAQ Small Cap. This category is not provided by Compustat. Regional exchanges are included in the "other" category.

As another indication of company size and influence, Table 4 indicates the number of restating companies that are members of the S&P 500. Overall, 6% are members. The highest percentages of restating S&P 500 companies are in 2005 (14%) and 2006 (12%). Higher numbers in 2005 appear to be partly due to restatements by accelerated filers implementing SOX Section 404 ICFR. The higher percentage in 2006 is related to companies restating for stock options backdating.[55]

Results for exchange and S&P membership suggests ICFR-accelerated filers alter the profile of restating companies during years they implement SOX Section 404 reporting. To assess the ICFR implementation effect, Table 5 compares the frequency of restatements announced by companies identified as accelerated filers during the ICFR era, 2003-2005, to the years before and after the ICFR implementation period. Fifty percent of all restatements in the analysis (2,479 of 4,923) are announced during the ICFR implementation period, and accelerated filers file nearly half of the restatements during the ICFR implementation period. By comparison, the companies that were later designated accelerated filers were responsible for only 33% of restatements prior to the ICFR implementation period, and 40% the year after the ICFR implementation period.[56] See Appendix C for additional analysis of the ICFR effects.

Table 5 — **Comparison of Accelerated Filer Restatement Rates**

	Pre-ICFR Implementation 1997-2002	ICFR Implementation 2003-2005	Post-ICFR Implementation 2006
All restatements announced	1,452	2,479	992
Accelerated filer in 2005	481	1,156	396
Percent of restatements by accelerated filers	33%	47%	40%

Overall, these data indicate that typically, very few of the companies that restate are members of the S&P 500, and about half do not trade on the major exchanges. The exceptions to these generalizations occur when there is a focus on a specific accounting issue (i.e., IPR&D and leases) or when larger companies are under particular scrutiny (i.e., ICFR implementation).

D. Size and Profitability

For restating companies, average assets are $5.25 billion. As shown in Figure 11, average assets for restating companies increase each year through 2005, leveling off in 2006. To provide context, average assets for all Compustat companies in each year of the study are also provided.[57] Restating companies are a little smaller than Compustat companies from 1996-2001; and a little larger than the average Compustat company each year thereafter. However, differences between restating and Compustat averages are not statistically significant in any year.[58]

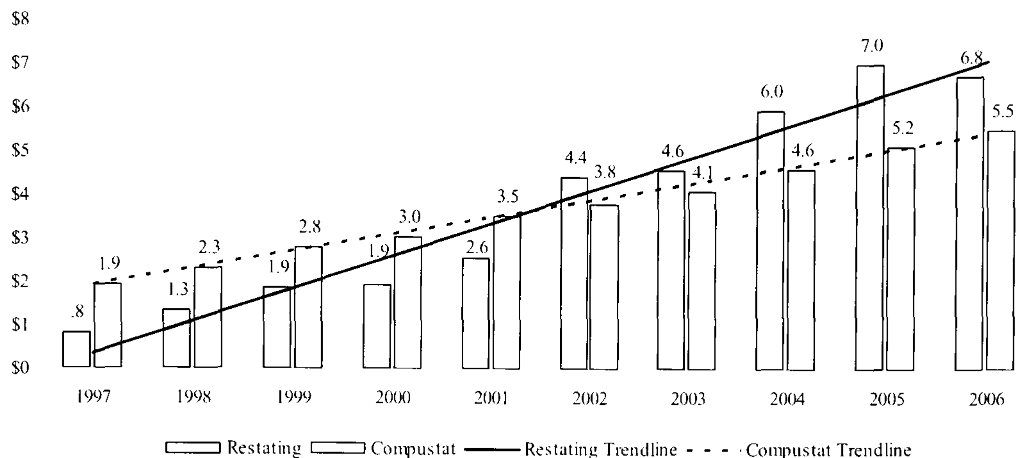
55 Accelerated filers and companies restating for stock options backdating are significantly more likely than other restating companies to be members of the S&P 500 (Chi-square p-values < .001). However, companies restating lease accounting are not.

56 Accelerated filer restatement rates during ICFR implementation are significantly higher than both before and after this period. (Chi-square p-values < .001.) See Appendix C for additional analysis of ICFR implementation effects.

57 When possible, assets are measured at the fiscal year end prior to the announcement, to provide the same perspective on the company that investors had at the time of the announcement. If this is not available, assets from the following year are substituted.

58 T-tests comparing average assets for Compustat and restating companies are not significant at the .10 p-value level. Slight changes in the composition of each group change the pattern in Figure 11. Compustat companies identified as American depositary receipts (ADRs) are not included in this comparison. If ADRs are added, average assets of restating companies are smaller than Compustat companies each year. Restating company averages are also smaller if the 694 restating companies for which assets are known, but other basic data are unavailable, are included.

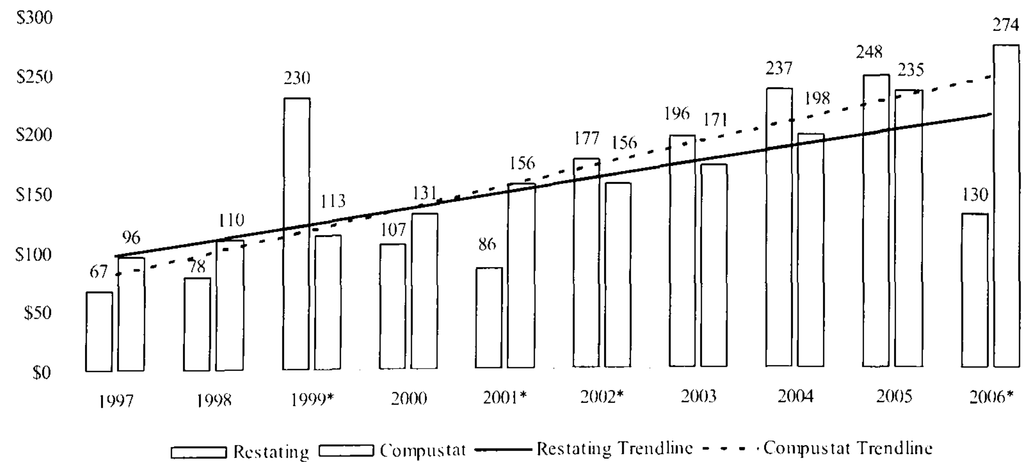
Figure 11 — **Average Assets for Restating and Compustat Companies ($B)**



Median assets for restating companies are $177 million. Trends across study years are shown in Figure 12. Years when the difference between the median restating and Compustat companies are statistically significant are indicated with an asterisk.[59]

Through 2001, restating companies are typically smaller than Compustat companies, except for the IPR&D year of 1999. Beginning with 2002, median assets of restating companies increase, and are similar to Compustat companies through 2005. This period of increasing restating company size begins the year of well-known accounting scandals, the enactment of SOX and intense focus on the accounting profession. It continues through the ICFR implementation period (2003-2005) and lease restatement year (2005), as companies involved in ICFR implementation and lease restatements tend to be relatively large. By 2006, restating companies' median assets drop to nearly pre-2002 levels, while Compustat assets continue to climb.

Figure 12 — **Median Assets for Restating and Compustat Companies ($M)**



59 Differences between restating and Compustat companies assets are statistically significant in 1999 and 2002, when restating companies are significantly larger, and in 2001 and 2006, when restating companies are significantly smaller. These results are based on non-parametric tests. Z-score p-values for significant years are < .001, except 2002 where the p-value is .06.

Average revenues for restating companies are $1.65 billion and median revenues for restating companies are $127 million. Patterns and inferences from revenue trends across the study period are similar to assets. (See Appendix D.) Like assets, median revenues for companies announcing restatements drop to pre-2002 levels in 2006.

Regression analyses are reported in Table 6. They test for significant associations between restating company assets (first column) or revenues (second column) and restatement characteristics.[60] Statistically significant restatement characteristics and their relation with restating company assets or revenues are noted in the "significant association" column with these symbols:

- As restating company size increases, the characteristic tends to increase or appear: +
- As restating company size decreases, the characteristic tends to decrease or disappear: -

If the restatement characteristic is not associated with differently sized companies, the cell is left blank. In considering these results, it is important to remember that nearly one-quarter of all restatements cannot be analyzed here because of unavailable data, and the companies lacking available data tend to be much smaller than those remaining in the analysis.

Table 6 — **Regression Analysis of Restating Company Size and Restatement Characteristics**

	Restating company assets				Restating company revenues			
	Significant association	Coef.	t-stat.	p-value	Significant association	Coef.	t-stat.	p-value
Fraud	+	.85	5.78	.00	+	.81	6.02	.00
Number of years restated	+	.38	16.71	.00	+	.35	16.94	.00
Income decreased	-	-.43	-4.13	.00	-	-.31	-3.30	.00
Revenue restated	+	.19	2.07	.04		.10	1.16	.24
Core expenses restated:								
Cost of sales		.04	.37	.71	+	.29	2.76	.01
Leases	+	.42	3.53	.00	+	.33	3.06	.00
Stock-based comp.	-	-.33	-2.90	.00	-	-.33	-3.28	.00
Other operating expenses	-	-.23	-3.06	.00	-	-.15	-2.21	.03
Non-core items restated								
Debt and interest	-	-1.70	-17.41	.00	-	-1.60	-18.02	.00
Derivatives	+	1.48	7.86	.00	+	1.16	6.78	.00
Asset valuation	+	.35	3.14	.00	+	.24	2.35	.02
Taxes	+	.63	5.35	.00	+	.57	5.34	.00
Reclass / disclosure	+	.36	4.13	.00	+	.27	3.47	.00
Underlying circumstances								
Acquisition / reorg.		-.12	-1.24	.22		-.13	-1.45	.15
Foreign subsidiaries	+	.36	2.76	.01	+	.40	3.43	.00
Consolidation	+	.35	2.58	.01	+	.28	2.33	.02

60 The natural log of assets and revenues measures is used in the regression, to better conform with data distribution assumptions of the OLS regression methodology. A constant and year and industry indicator variables are included in the model, but not reported in the table. Both models are significant: F-statistics > 50.0, p-values < .001. The adjusted-R^2 is .29 for assets and .21 for revenues. Statistical significance for regression coefficients is based on p-values < .10.

Whether company size is measured by assets or revenues, relatively larger restating companies are more likely to restate more years, and the restatement is less likely to reduce income. Larger restating companies also tend to have a higher incidence of fraud, at least as fraud is measured in this study.

Revenue restatements are associated with increasing size when size is measured by assets, but not when measured by revenues. On the other hand, cost of sales is associated with increasing size only when measured by revenues. Larger companies are also more likely to correct their accounting for:

- leases;
- derivatives;
- asset valuation;
- taxes; and
- reclassification and disclosure issues.

Finally, restatements by relatively large companies are more likely to arise from problems with foreign subsidiaries and consolidations. Several of these associations are consistent with expected activities of larger versus smaller companies. For example, larger companies are more likely to have complicated transactions involving derivatives, foreign subsidiaries and consolidations.

On the other hand, smaller companies are more likely to have problems involving other operating expenses, stock-based compensation and debt/interest. Again, this is consistent with the expected activities of smaller firms, as growth-oriented organizations are more likely to rely heavily on stock-based compensation and convertible debt financing.

Restating Company Profitability

Restating companies typically are not profitable, even prior to the restatement. Table 7 shows that more than half of all restating companies report net losses, rather than income in the year prior to the restatement announcement. This effect is particularly pronounced during 2001 and 2002, the years of economic downturn.

Table 7 — **Restating Companies Reporting Losses for the Year Prior to a Restatement Announcement**

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	Total
All restating companies	81	114	216	187	386	468	623	750	1,106	992	4,923
Net loss prior to restating	34	60	118	106	243	291	341	393	486	500	2,572
Percent reporting net loss	42%	53%	55%	57%	63%	62%	55%	52%	44%	50%	52%

As shown in Figures 13 and 14, restating companies typically report lower return on assets (ROA) than the average or median Compustat company. There is a steep decrease in ROA for restating companies beginning with the economic downturn in 2001. The average ROA is particularly low for companies restating in 2006. In Figure 14, the median Compustat company is profitable each year, but only companies restating in 1997 and 2005 (the lease restatement year) are profitable. In 2006, the median restating company breaks even despite the very negative average ROA.

Figure 13 — **Average Return on Assets for Restating and Compustat Companies**

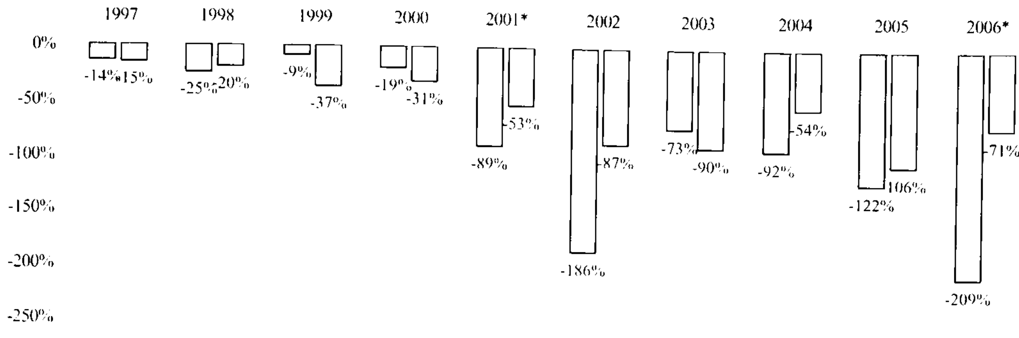
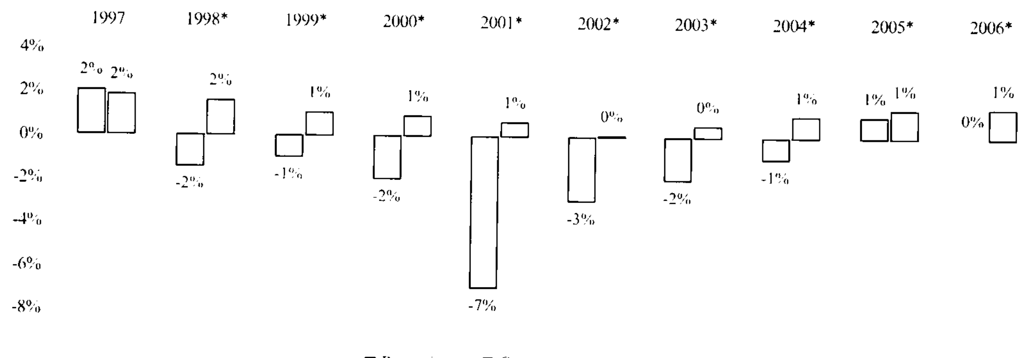


Figure 14 — **Median Return on Assets for Restating and Compustat Companies**



Regression analyses testing associations between profitability and restatement characteristics indicate that profitability is not consistently associated with most restatement characteristics.[61]

Summary of Size and Profitability Analysis

The average size of restating companies increases from 1997 through 2005. All measures suggest a leveling off or decrease in restating company size in 2006, relative to both prior years and Compustat companies. In most years, the average restating company is similar in size to the average Compustat company, whether measured by assets or revenue. Similar to the analysis of exchange membership and accelerated filer status, years when restating companies are significantly larger are characterized by specific restatement issues, IPR&D and leases, or the well-known accounting scandal year of 2002. However, by 2006, median results suggest restating company size has reverted to pre-2002 levels, and are much smaller than the median Compustat company.

Slightly more than half of all restating companies report a net loss in the year prior to the restatement announcement. Both average and median return on assets show restating companies tend to be less profitable than Compustat companies. Few restatement characteristics are associated with profitability.

---

61 The models test the restatement characteristics shown in Table 6. Two measures of profitability are considered: ROA, and net income versus net loss. Using ROA, no restatement characteristics are associated with profitability. Using a logisitic regression model and net loss vs. net income, income companies tend to restate more years, loss companies tend to restate operating expenses, debt/interest and asset valuations.

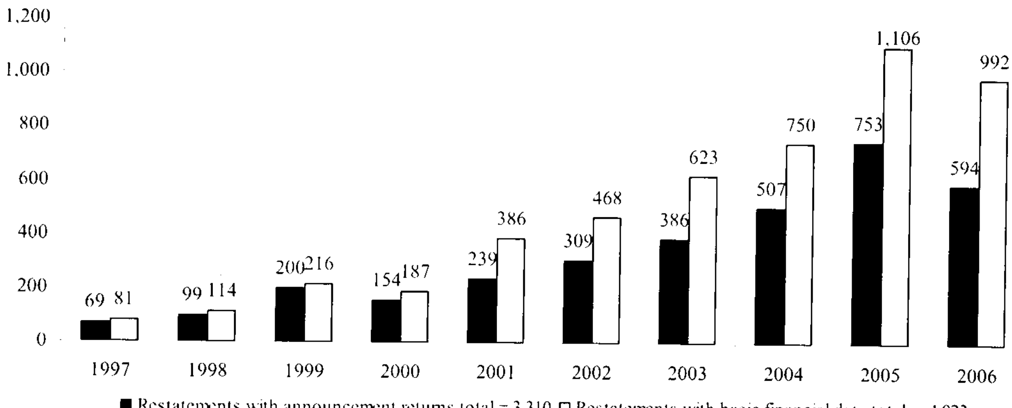
On the other hand, there are several regularities between the size measures and restatement characteristics. Larger restating companies are associated with fraudulent restatements and restatements of longer time periods. In addition, most accounting issues appear to be associated with company size, some with smaller companies and others with larger. This suggests that accounting challenges vary with different levels of complexity and scope.

V. ANALYSIS OF MARKET REACTIONS TO RESTATEMENTS

This stage of the analysis focuses on the market reaction to the announcement of a restatement. The market return in the year following the announcement is analyzed later in this section. To be included in the return analysis, the company must appear in the CRSP database, and returns must be available at the restatement announcement date.[62] Only 3,310 restatement announcements have return data available, 67% of the 4,923 restatements with basic financial data and 50% of the initial sample of 6,633. The number of restatement announcements per company ranges from one (1,786 companies) to seven (one company).

The distribution of available returns and attrition across study years is shown in Figure 15. Again, most of the attrition is in later years of the study. Returns are available for more than 80% of restatements announced from 1997-2000, and for 60% to 70% for the remaining years.

Figure 15 — **Distribution of Restatements with Market Returns Across Study Period**



A. Profile of Restatements Lacking Return Data

Restating companies lacking announcement returns are significantly smaller than those remaining in the analysis, whether measured by assets or revenues. They also report smaller profits or greater losses prior to the restatement. Restatements lacking return data are less likely to involve fraud or affect revenue. However, they are more likely to decrease reported income.[63]

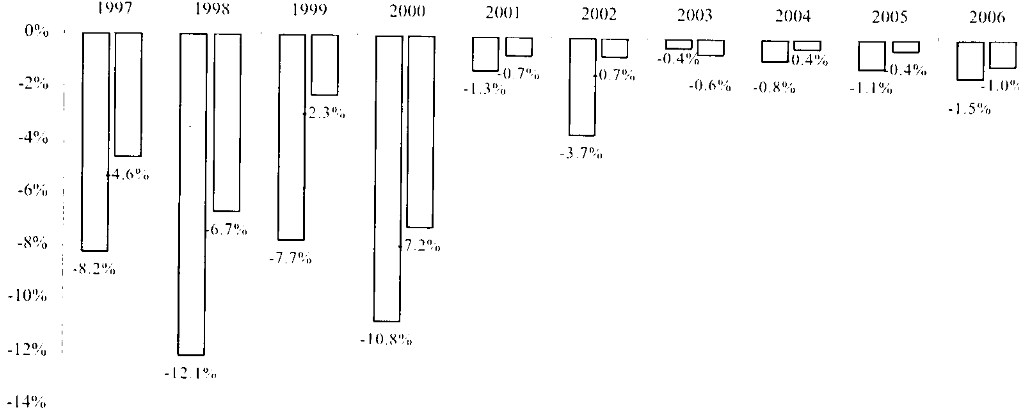
62 CRSP is a database of securities prices produced by the University of Chicago's Graduate School of Business. CRSP is the stock price database used in most accounting and finance research. It includes daily prices of all listed NYSE, AMEX and NASDAQ National Market common stocks. More information is available at http://www.crsp.com. Returns in this analysis are estimated using the Eventus program; see http://www.eventstudy.com.

63 Median assets (revenues) for restating companies without return data are $17.4 ($12.6) million. This compares to median assets (revenues) of $331.8 ($224.8) million for the remaining restating companies. All t-statistic and Chi-square p-values for comparisons noted between restating companies with and without return data are less than .001.

B. Stock Market Returns at Announcement

All returns analyzed in this study are market-adjusted returns estimated over a two-day announcement window, where the window is the announcement date and the following trading day. For simplicity, this measure is called "returns."[64] Figure 16 shows average and median announcement returns by year.

Figure 16 — **Average and Median Announcement Returns Across Study Period**



On average, returns are negative each year, statistically less than zero every year except 2003. However, returns are much *less* negative beginning in 2001. Average returns for restatements announced from 1997-2000 are -9.5%, but only -1.3% for those announced from 2001-2006.[65] To some degree, this may be attributable to relatively fewer restatements with severe characteristics, as noted in previous sections. However, Figure 17 shows the market reaction to fraud and income-decreasing restatements also attenuates in 2001. Still, returns are statistically negative for restatements involving fraud every year except 2004, and for income-decreasing restatements all years except 2001 and 2003.[66]

64 Cumulative abnormal returns (CARs) are calculated by subtracting an equally-weighted market return from the individual company's return on each day of the announcement window. This gives an estimate of the daily abnormal return for the company. The abnormal returns for the two days are summed to obtain the CAR for the announcement window. The window does not include the day prior to the announcement, because there appears to be relatively little reaction on this day, suggesting little news leakage prior to the announcement. The window does include the day after because announcements are often made after market close, so reactions are recorded in prices the following trading day. The window and methodology are consistent with prior research in this area. Raw returns and abnormal returns estimated using value-weighted market averages are similar to the CARs analyzed here.

65 T-tests for each year except 2003 indicate returns are significantly less than zero (p-values < .05). Returns from 1997-2000 announcements differ significantly from those announced from 2001-2006 (t-test p-value < .001).

66 T-tests indicate returns for fraud and income-decreasing restatements are significantly less than zero in all years except those noted above (one-tailed p-values < .10). Returns for fraud in 2006 include relatively few stock options backdating restatements. That is, to date there is no indictment, SEC AAER, or admission of fraud by the company for most of these restatements. If all 2006 stock options backdating restatements are assumed to be fraudulent, the average return for fraud restatements in 2006 is -3%; less severe than the -8% average shown here. This may be due to the market anticipating some of these restatements prior to announcement.

Figure 17 — **Average Returns for Fraud and Income-Decreasing Restatements**

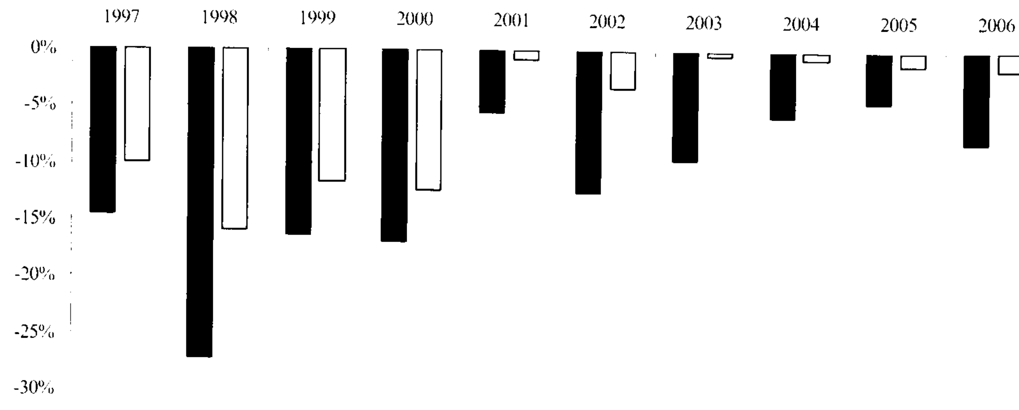


Figure 18 presents announcement returns for revenue, core expense and all other restatements. Non-core expenses and reclassification and disclosure issues are combined here, due to small numbers of restatements for the latter group in some years. The figure shows the market reaction to revenue and core expense restatements is less severe beginning in 2001. Smaller reactions continue through the end of the study period, although responses to revenue and fraud restatements appear to increase again in 2006.[67] Note that in Figures 16-18, the shift in the market response occurs prior to the well-known accounting scandals and the enactment of SOX in July 2002. This suggests the change may be attributable to overall economic and market conditions.

Figure 18 — **Average Announcement Returns for Accounting Issue Classifications**

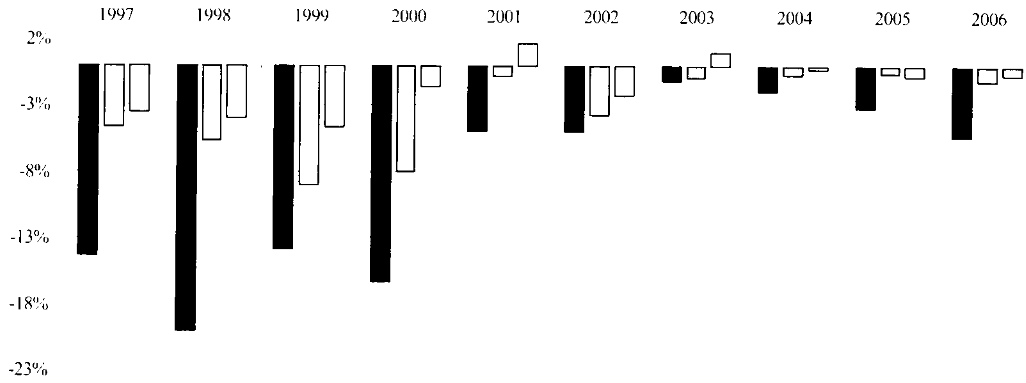


Table 8 provides detail behind the returns charted in Figures 16-18. It also provides the median return in each category. In nearly every year and category, median returns are less pronounced than averages. The most negative returns for each year and category are also given in Table 8. The restatement with the most negative return affected revenues and fraud in seven of the ten years, although the years are not the same for each. The overall most negative return, -93%, is the Worldcom fraud announced in 2002. Although a primary Worldcom problem was accounting for core expenses, the final restatement also decreased revenue. See more detail of restatements with the most negative announcement returns in each year in Appendix G.

[67] The average abnormal return at announcement for lease restatements in 2005 is +.002%, which is not statistically different from zero. This may be partly due to market anticipation effects.

The final rows of the table show that for a minority of companies, returns are positive at the time of the restatement announcement. About one-third of the returns are positive from 1997-2000, while during the latter years of the study period, over 40% of the returns are positive. It is unlikely that a restatement is good news, so it is probable that these cases have some combination of other good news released at the same time and relatively benign restatement characteristics. Without these positive-return restatements, the average return is -8% overall, -16% from 1997-2000, and -6% from 2001-2006.

Table 8 — **Average, Median and Most Negative Returns for Restatement Characteristics Across Sample Period**

		1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	Overall
All restatements with announcement returns												
	Number	69	99	200	154	239	309	386	507	753	594	3,310
	Average	-.08	-.12	-.08	-.11	-.01	-.04	.00	-.01	-.01	-.01	-.03
	Median	-.05	-.07	-.02	-.07	-.01	-.01	-.01	.00	.00	-.01	-.01
	Most negative	-.80	-.92	-.81	-.79	-.70	-.93	-.75	-.53	-.64	-.50	-.93
Fraud restatements:												
	Number	20	27	28	42	29	39	21	12	25	21	264
	Average	-.15	-.27	-.16	-.17	-.06	-.13	-.10	-.06	-.05	-.08	-.13
	Median	-.13	-.19	-.03	-.08	-.02	-.09	-.05	-.03	-.04	-.04	-.06
	Most negative	-.59	-.92	-.76	-.79	-.70	-.93	-.75	-.53	-.64	-.28	-.93
Income-decreasing restatements:												
	Number	53	72	98	122	220	274	338	429	684	499	2,789
	Average	-.10	-.16	-.12	-.12	-.01	-.03	.00	-.01	-.01	-.02	-.03
	Median	-.05	-.09	-.04	-.07	-.01	-.01	.00	.00	.00	-.01	-.01
	Most negative	-.80	-.92	-.81	-.79	-.70	-.93	-.75	-.53	-.64	-.50	-.93
Accounting issue classifications:												
Revenue												
	Number	27	48	45	75	76	98	118	125	130	72	814
	Average	-.14	-.20	-.14	-.16	-.05	-.05	-.01	-.02	-.03	-.05	-.06
	Median	-.14	-.15	-.05	-.12	-.02	-.01	.00	-.01	-.01	-.03	-.02
	Most negative	-.59	-.92	-.81	-.76	-.70	-.93	-.75	-.53	-.64	-.38	-.93
Core Expenses												
	Number	27	21	46	48	81	120	135	172	361	240	1,251
	Average	-.05	-.06	-.09	-.08	-.01	-.04	-.01	-.01	-.01	-.01	-.02
	Median	-.02	-.03	-.02	-.01	.00	-.01	-.01	-.01	.00	-.01	-.01
	Most negative	-.80	-.21	-.67	-.79	-.44	-.51	-.65	-.48	-.21	-.31	-.80
Non-core expenses and other												
	Number	15	30	109	31	82	91	133	210	262	282	1,245
	Average	-.04	-.04	-.05	-.02	.02	-.02	.01	.00	-.01	-.01	-.01
	Median	-.05	-.02	-.02	.00	.00	.00	-.01	.00	.00	-.01	-.01
	Most negative	-.24	-.52	-.41	-.35	-.23	-.55	-.57	-.26	-.41	-.50	-.57
Positive return at announcement												
	Number	19	22	66	44	108	132	170	224	321	231	1,337
	Percent	28%	22%	33%	29%	45%	43%	44%	44%	43%	39%	40%
	Average	.07	.06	.06	.07	.07	.06	.08	.05	.03	.04	.05
	Median	.05	.03	.05	.06	.03	.04	.03	.02	.02	.02	.03

Regression Analysis of Announcement Returns

Regression analysis assesses which restatement and company characteristics are associated with more negative announcement returns, while controlling for market trends. Restatement characteristics include fraud, whether reported income decreased, number of years restated, and which financial statement elements are affected. Company characteristics include size, measured by total assets, and profitability, measured by return on assets. Also, there is a variable that notes if a company's stock price was less than \$5.00 the day prior to announcement.[68] This is to capture possible liquidity effects, as companies with small share prices are more likely to be thinly traded.

The model also includes a variable to identify companies that both issued ICFR reports and restated in 2003-2005 (SOX Section 404 accelerated filers). This is to assess market reaction to restatements that may be due to ICFR implementation.

Negative reactions may be less pronounced in down markets and more pronounced in periods of greater market volatility.[69] Figure 19 shows the NASDAQ began a sharp decline in March 2000, not leveling off until October 2002. The NYSE began a long decline about January 2001. Therefore, the model identifies NASDAQ companies announcing restatements from March 2000 through October 2002 and NYSE companies announcing restatements from January 2001 through February 2003.

Figure 19 — **NYSE and NASDAQ Indices**

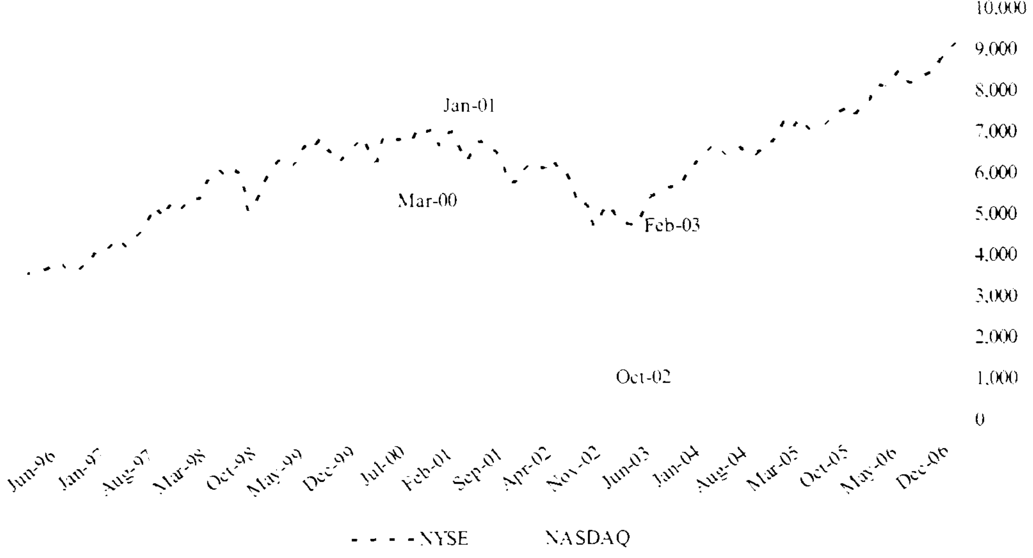


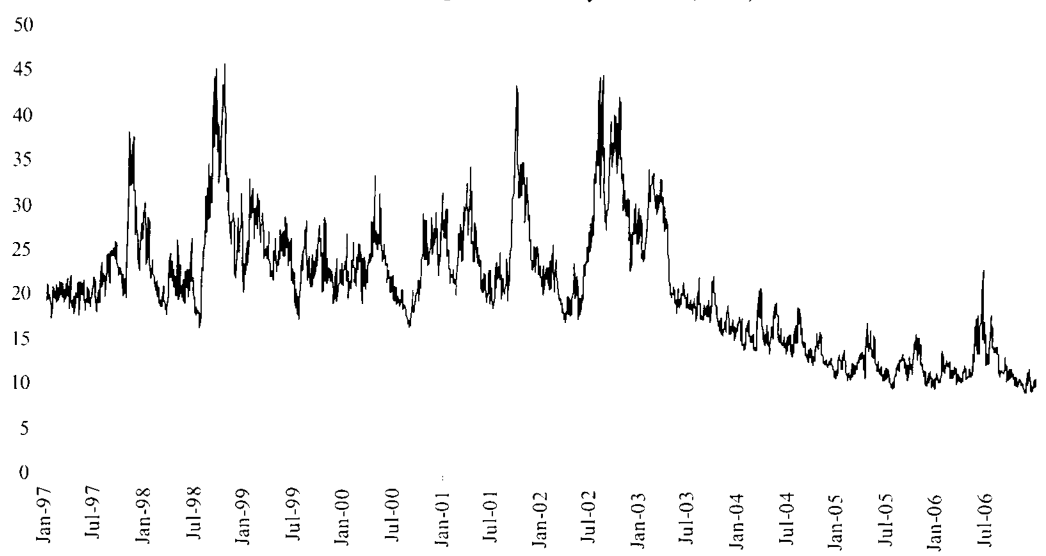
Figure 20 shows the Chicago Board Options Exchange's volatility index (VIX) over the study period. It indicates market volatility varied widely over the study period, and is also included in the model.

68 There are 1,047 restatements in this group (32% of 3,310). As might be expected, these companies are significantly smaller. The median price the day prior to the announcement is \$2.24.

69 Negative returns may be attenuated in a down market because the returns studied here are adjusted for market returns.

There is no control for concurrent news. This approach is consistent with prior research, and is mainly due to problems with identifying and categorizing the wide variety of information that might or might not be included in a restatement announcement or in contemporaneous commentary.[70]

Figure 20 — **Chicago Board Options Exchange's Volatility Index (VIX) 1997-2006**



Results of the regression model are shown in Table 9. Statistically significant associations are indicated in the "significant associations" column with these symbols:

- Item is associated with more negative returns: -
- Item is associated with less negative returns: +

The cell is left blank if an item is not statistically associated with announcement returns.[71]

70 Market reactions to restatement announcements are fairly similar whether they were revealed in earnings announcements or not. See Zoe-Vonna Palmrose, Vernon J. Richardson and Susan Scholz, *Determinants of Market Reactions to Restatement Announcements*, 37 JOURNAL OF ACCOUNTING AND ECONOMICS 59 (Feb. 2004). For another study that specifically addresses the content of press announcements, see Elizabeth A. Gordon, Elaine Henry, Marietta Peytcheva and Lili Sun, *Disclosure Credibility and Market Reaction to Restatements* (Working Paper, 2007).

71 The model is highly significant (F-statistic = 25.7, p-value < .001. The adjusted R^2 is .089. A constant is included in the model; it is not significant. Results for the accounting issue categories are relative to restatements involving only reclassifications and disclosures, which are used as the baseline. Inferences are not changed by using raw returns, substituting company revenue (ln(revenue)) for assets, substituting a net loss indicator for ROA, or adding indicator variables for industry groups. None of the industry indicators is significant. If abnormal returns for the thirty days prior to the announcement are included, worse prior returns are associated with more severe announcement returns, but other results do not change.

Table 9 — **Restatement and Company Characteristics Associated with Returns**

	Significant associations	Coefficient	t-statistic	p-value
Restatement characteristics				
Fraud involved	-	-.096	-12.05	.00
Income-decreasing		-.003	-.54	.59
Years restated	+	.003	2.48	.01
Revenue restated	-	-.050	-5.84	.00
Core expenses restated	-	-.017	-2.07	.04
Non-core expenses restated		-.012	-1.47	.14
Company characteristics				
Company assets (ln)	+	.002	1.79	.07
Company ROA		.001	.28	.78
Stock price less than $5.00	+	.017	3.18	.00
SOX Section 404 accelerated filers	+	.024	4.79	.00
Timing effects				
NYSE down market	+	.023	2.25	.02
NASDAQ down market	+	.022	2.58	.01
Volatility Index (VIX)	-	-.001	-2.46	.01

The model confirms returns are more severe when the restatement involves fraud. Restatements of revenue or core expenses are more negative, relative to the baseline group of reclassification and disclosure restatements, but restatements of non-core expenses are not significantly different.

Larger companies typically experience less negative reactions, particularly accelerated filers announcing restatements during the ICFR implementation period. However, companies with quite small share prices, and presumably less liquidity, also have less severe reactions.

Interestingly, restatements of longer time periods tend to have *less* of a reaction. Both lease restatements and ICFR restatements tend to affect longer time periods and have less negative reactions. However, longer time periods still tend to have less negative reactions even if these two groups are excluded from the analysis. It may be that the reversing nature of accrual accounting causes smaller net income effects over more time. It may also be that errors that persist for a long period before being detected and corrected are relatively small in any one of the restated periods, and therefore of less concern to current investors at the restatement announcement.

Finally, the market variables confirm that reactions tend to be less negative during down markets and more negative in periods of greater volatility. The remaining factors in the model (whether the restatement decreases income and company profitability) are not associated with announcement returns.[72]

72 The model is also estimated using announcements partitioned into two groups: pre-2001 and 2001 and beyond. In the earlier time period, fraud and income-decreasing restatements are negatively associated with returns. Indicators for accelerated filers and the NYSE down market are not applicable during this period. In the later period, fraud and the accounting issue indicators are associated with more negative returns, and accelerated filers are associated with less negative returns. Although ROA is not associated with returns in Table 9, in the pre-2001 period, less profitable companies tend to have *less* negative returns, while in the later period, less profitable companies tend to have *more* negative returns. The earlier effect may be associated with the technology bubble, as profitability was not emphasized during that period. In contrast, post-2000, investors seem to have less tolerance for misstatements by unprofitable companies.

Announcement Returns and Specific Accounting Issues

Table 10 provides more detail about the relationship between various accounting issues and returns. These results are a summary based on a series of iterations of the regression model in Table 9. As there are a variety of ways to break out sub-groups of components, this table aggregates results for eight regressions with different combinations of accounting issue groups and sub-groups.[73] Statistically significant associations are indicated in the "association with returns" column with these symbols:

- Item is associated with more negative returns: -
- Item is associated with less negative returns: +

To give an indication of how consistent the statistical relations are, the percentage of times the item is statistically significant when included in one of the eight regressions is noted in the last column.

The cell in the first column is left blank if an item is not statistically associated with announcement returns in any of the regressions.

Table 10 — **Summary of Regression Results for Various Accounting Issues**

		Association with returns	Percent significant
Revenue recognition		-	100%
Core earnings components:			
	Cost of sales	-	67%
	Reserve and accrual failures	-	100%
	Expense capitalization	-	100%
	Lease expenses (includes depreciation)	+	67%
	Other expense recording issues		0%
	Stock-based and deferred compensation		0%
Non-core earnings components:			
	Debt, interest and equity issues	-	80%
	Intercompany/investment in subsidiaries	-	80%
	Legal, contingency and commitment	+	40%
	Financial derivatives		0%
	Asset valuation or impairment		0%
	Gain or loss recognition		0%
	Tax issues		0%
	Other	-	40%
Classification and disclosure issues:			
	Balance sheet classifications		0%
	Income statement classifications & EPS		0%
	Cash flow statement classifications	+	75%
	Disclosures		0%

73 Results for other variables in the model are consistently similar to Table 9. See Appendix A for additional explanation of the categories.

Revenue restatements are consistently associated with negative returns. Several components of core expenses are also associated with more negative announcement returns: cost of sales, reserve and accrual failures and capitalization issues. However, reactions to lease restatements tend to be less negative. There is no association between returns and stock-based compensation restatements.

Among non-core earnings components, only debt and intercompany investment and "other" restatements tend to have more negative returns,[74] while problems with contingencies and commitments tend to have less negative returns. Two issues attracting recent attention, taxes and derivatives, are not associated with returns. Finally, among classification and footnote disclosure problems, cash flow statement reclassifications tend to have less negative returns.[75]

Overall, it appears that in general, the market views restatements of core earnings accounts negatively, except for clusters of specific accounting issues that are corrected within a condensed period of time. On the other hand, corrections of non-core earnings generally do not appear to elicit negative market returns.

C. Post-Restatement Returns

The post-announcement period is measured from trading day +2 to +250, representing approximately one calendar year. This analysis focuses on the years from 1997-2005, because returns for a full year following the 2006 restatement announcements are not available at the time this study was conducted.[76]

Attrition

From 1997-2005, there are 2,714 restatements with announcement returns. One-year returns are available for 2,287, or 84%. The 427 companies without one-year returns are significantly smaller and less profitable than those with available returns.[77] Their restatements are more likely to involve fraud and revenue accounts, and the average announcement return is -7%, compared to -2% for the 2,287 restatements with one-year returns.

Compustat provides some information about the eventual outcomes for about half of these 427 companies. At least 39% appear to be acquired or merge with another company. This is particularly likely for restatements announced in 1999 and 2005. Another 7% are noted as entering bankruptcy or liquidation. These are more frequent in early years of the sample. Two percent went private and nearly all of the privatizations are associated with 2004 restatements. The remaining 52% are either attributed to "other" reasons, or no indication is provided. As a caveat, specific dates for the events noted above are not given, and so they do not necessarily occur during the year following the restatement announcement.

There are no post-announcement returns at all for 22 of these 427 companies. The remaining 405 have some post-announcement returns which cease at some point during the year. On average, companies in the latter group have return information for 119 days, a little less than half a year. The average return for these available days is -24% (median is -25%), not including any delisting return.

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74 Debt includes issues such as beneficial conversion features of convertible debt. It does not include long-term/current debt classification issues. They are included with balance sheet classification issues.

75 None of the underlying issues – consolidation, foreign subsidiaries or acquisition – is associated with returns in either direction. However, in early years of the study, changes from pooling to purchase accounting for acquisitions tend to have negative returns.

76 All of the 2006 restating companies have at least some return data for the post-announcement period. The number of returns available range from 3 to 249 days, the average is 138 days. These returns range from -.89% to 2.80%, with an average of -1% and a median of -3%. On average, these returns are not significantly different from zero (t-statistic p-value = .37).

77 Median assets for restating companies without one-year returns are $131 million, compared to $376 million for restating companies with one-year returns. Median net loss for restating companies without one-year returns is $5.48 million, with 66% reporting losses. This compares to net income of $2.55 million reported by companies with one-year returns, and only 41% reporting losses.

One-Year Post-Announcement Returns

Figure 21 shows average and median one-year returns for restating companies. The average one-year return is -4%, and the median is -17%.[78] Median returns are negative each year. Average one-year returns are positive for restatements announced in 1999 and 2003.

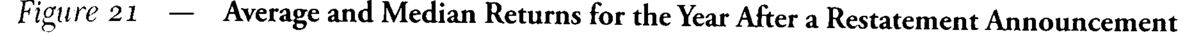
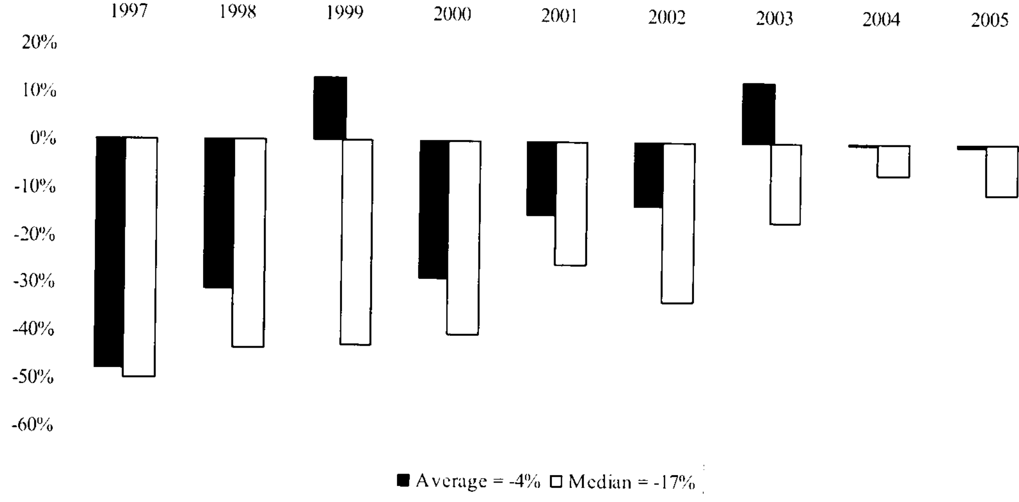


Figure 21 — **Average and Median Returns for the Year After a Restatement Announcement**



A regression model for the one-year returns is reported in Table 11. This model is the same as the model in Table 9, except it also includes announcement returns. This is to assess the association between announcement and subsequent returns. Again, statistically significant associations are indicated in the "significant associations" column with these symbols:

- Item is associated with more negative one-year returns: -
- Item is associated with less negative one-year returns: +

The cell is left blank if an item is not statistically associated with one-year returns.[79]

78 Both average and median returns are statistically negative with p-values < .001.

79 The overall model is significant (F-statistic = 4.99, p-value < .001, adjusted-R^2 = .03). The model also includes a constant (negative) and variables noting the year of the restatement announcement. Year indicators are to control for prevailing economic conditions. Indicators are significantly positive for companies announcing restatements in 1999 and 2001-2005, relative to the baseline year of 1997. Significance for model variables is based on two-tail p-values < .10.

Table 11 — **Restatement and Company Characteristics Associated with Subsequent Returns**

	Significant associations	Coefficient	t-statistic	p-value
More negative announcement return	-	0.365	2.003	.05
Restatement characteristics				
Fraud-involved		0.014	0.178	.86
Income-decreasing	-	-0.126	-2.175	.03
Years restated		0.014	0.964	.34
Revenue restated		-0.033	-0.396	.69
Core expenses restated		-0.066	-0.833	.40
Non-core expenses		-0.006	-0.069	.95
Company characteristics				
Company assets (ln)		-0.010	-0.889	.37
Company ROA		0.000	-0.002	1.00
Stock price less than $5.00	+	0.250	4.912	.00
SOX Section 404 accelerated filer	+	0.130	2.244	.02

When a restatement triggers a more negative return, the company tends to continue to have more negative returns in the following year. Accounting issues are not directly associated with one-year returns. In particular, neither fraud nor revenue restatements are directly associated with one-year returns, despite their consistent association with more negative announcement returns.[80] However, restatements that decrease reported income do tend to have more negative one-year returns. This is interesting, since income-decreasing restatements are not associated with announcement returns.

Companies likely to be restating due to SOX Section 404 ICFR implementation have less negative one-year returns. This is consistent with the benign effects noted for these restatements throughout the study. Companies with stock prices less than $5.00 at announcement also tend to have less negative one-year returns, although the reason for this is unclear. Overall, it appears that the announcement return captures the market effect of restatement and restating company characteristics rather than future returns. This result is not as obvious as it may seem, since all information about a restatement is not always released on the announcement date. For example, fraud is often formally revealed after a company or SEC investigation. Nonetheless, the market reaction to these restatement characteristics appears to occur mainly at announcement, rather than later dates.

80 Using more detailed accounting issues, reclassifications and IPR&D write-offs have less negative one-year returns. No other group is significant.

VI. APPENDICES

Appendix A: Accounting Issues Taxonomy

Accounting issues are classified into four groups, based on the classification scheme developed by Palmrose and Scholz (2004).[81] The groups are:

- Revenue Recognition: These are restatements involving revenue. Revenue restatements are considered separately because they are consistently associated with more serious outcomes in prior research.[82]
- Core Expenses: These are restatements of companies' on-going operating expenses. They include cost of sales, compensation expense (including stock-based), lease and depreciation costs, selling, general and administrative expenses, and research and development costs.
- Non-Core Expenses: These are restatements of items that typically affect net income, but do not arise from on-going operating activities. The group includes accounting for interest, taxes and derivatives. It also includes misstatements arising from accounting for non-recurring events or special items.
- Reclassifications and Disclosures: These likely do not affect net income at all. They include restatements to reposition balance sheet, income, cash flow statement line items or changes in earnings per share. Disclosure restatements typically revise footnote information.

Specific issues included in each of the four classifications are listed below. The descriptions are lightly edited from information provided by AA. The table also provides the total number and percentage of restatements identified with each issue.[83] Because companies usually restate multiple issues, the sum of the sub-classification frequencies exceeds both classification and overall totals.[84] The table also provides an indication of the association between each issue and market returns at announcement and in the subsequent year. These codes are used:

- The category is associated with a less negative market return: +
- The category is associated with a more negative market return: -
- The category is not associated with market returns: none.[85]

81 See Zoe-Vonna Palmrose and Susan Scholz, *The Circumstances and Legal Consequences of Non-GAAP Reporting: Evidence from Restatements*, 21 CONTEMPORARY ACCOUNTING RESEARCH 139 (Spring 2004).

82 For example, see Cristi A. Gleason, Nicole Thorne Jenkins and W. Bruce Johnson, *The Contagion Effects of Accounting Restatements*, 83 ACCOUNTING REV.83 (Jan. 2008), in addition to Palmrose and Scholz (2004), noted above.

83 Coding for 1997-2000 restatements is based on categories identified by Palmrose and Scholz (2004), citation above. Coding for 2001-2006 is based primarily on AA's identification of issues. The two schemes are similar, but not identical. All earlier classifications are matched with an AA group, but a few categories include only restatements from later years of the study. Both AA and Palmrose and Scholz (2004) define each category to include all errors, irregularities or omissions in the accounting area described.

84 These frequencies differ from those in Section III.C because the counts in this table include all restatements identified with each issue. That is, restatements with multiple issues are included multiple times. The classification counts in Section III.C limit each restatement to its most serious classification.

85 As market returns are available for only about half of the 6,633 restatements, the association tests are based on a smaller sample. An association ('+' or '-') is noted only if the category is significantly associated with returns when included in the regression model in Section V. That is, they are included if they are incrementally significant after controlling for other restatement and restating company characteristics such as fraud. Statistical significance is based on p-values < .10.

Classification / Category	Description	Count	Percent of 6,633	Association with returns: Announce.	One-year
Revenue recognition	Any restatement involving revenue. Includes timing of, and fictitious revenue recognition. May originate from a failure to properly interpret sales contracts for hidden rebate, return, barter or resale clauses. May relate to sales returns, credits and allowances.	1,314	20%	-	None
Core expenses	Any restatement involving correction of on-going operating expenses.	3,316	50%	-	None
Cost of sales (inventory, vendor)	Transactions affecting inventory, vendors (including rebates) and/or cost of sales. Such errors primarily are related to inventory capitalization or the calculation of balances at year end.	625	9%	-	None
Expense recording (payroll, SG&A, other)	Expensing assets or understatement of liabilities. These issues include failure to record certain expenses, reconcile certain accounts or record certain payables on a timely basis. Issues with payroll expenses or SG&A expenses are identified with this category.	948	14%	None	None
Liabilities, payables, reserves and accrual estimate failures	Accrual or identification of liabilities on the balance sheet. These could range from failures to record pension obligations, to problems with establishing the correct amount of liabilities for leases, capital leases and other. This category could also include failures to record deferred revenue obligations or normal accruals.	942	14%	-	None
Capitalization of expenditures	Capitalized expenditures related to leases, inventory, construction, intangible assets, R&D, product development and other purposes.	467	7%	-	None
Deferred, share-based and/or executive compensation	Recording of deferred, share-based or executive compensation. The majority of these errors are associated with the valuation of options or similar derivative securities or rights granted to key executives. Stock options backdating is included here.	793	12%	None	None
Lease, leasehold and FASB 13 and 98	Lease-related issues.	360	5%	+	None
Depreciation, depletion or amortization errors	Depreciation of assets, amortization of assets and/or amortization of debt premiums or discounts. A significant number of these items can be attributed to the recalculation of depreciation associated with revised leasehold improvements and the revised lease accounting rules.	515	8%	(see Lease, leasehold and FASB 13 and 98)	(see Lease, leasehold and FASB 13 and 98)
Non-core expenses	Any restatement including correction of expense (or income) items that arise from accounting for non-operating or non-recurring activities.	3,111	47%	None	None
Debt, quasi-debt, warrants & equity security issues (including beneficial conversion features)	These restatements are often due to errors in the calculation of balances arising from debt, equity or quasi-debt instruments with conversion options (including beneficial conversion features). In addition, certain debt instruments may be erroneously valued.	1,280	19%	-	None
Derivatives / hedging (FAS 133)	Valuation of financial instruments such as hedges on currency swings, interest rate swaps, purchases of foreign goods, guarantees on future sales and many other examples.	231	3%	None	None
Gain or loss recognition	Recording sales of assets, interests, entities or liabilities. Errors in these areas often result from calculating an inappropriate basis for items that were sold, or the proper sales amount from barters.	321	5%	None	None
Inter-company / investment in subsidiaries and affiliates.	These restatements often arise when inter-company balances are not recognized or income figures are misstated by affiliates (foreign or U.S. based). Also includes investment valuations or transactions.	88	1%	-	None
Legal, contingency and commitments	Issues associated with the disclosure or accrual of legal exposures.	149	2%	+	None

Classification / Category	Description	Count	Percent of 6,633	Association with returns Announce.	One-year
PPE or intangible asset valuation or impairment	Recording of assets that are required to be valued or assessed for diminution in value on a periodic basis. Examples include: intangible assets, goodwill, buildings, securities, investments, leasehold improvements, etc. The IPR&D restatements (95) are included here.	874	13%	None	None
Tax expense / benefit / deferral / other FAS 109 issues	Accounting for tax obligations or benefits. Many of these restatements relate to foreign tax, specialty taxes or tax planning issues. Some deal with failures to identify appropriate differences between tax and book adjustments.	585	9%	None	None
Unspecified adjustments (Other)	The company does not identify what areas of accounting or financial reporting the actual restatements affect.	92	1%	None	None
Reclassification and disclosure	Any restatement including reclassification or disclosure issues. These typically do not affect reported income.	1,502	23%	+	+
Accounts/loans receivable, investments & cash	Includes investments, allowance for bad debts, notes receivables and/or related reserves. These mistakes often manifest themselves in balance sheet and income statement errors or misclassifications.	480	7%	None	+
Balance sheet classification of assets	This includes how assets were classified as short term/long term, how they were described or whether they should have been netted against some other liability.	438	7%	None	+
EPS, ratio and classification of income statement issues	Disclosure of financial/operational ratios or margins and earnings per share calculation issues. Also income statement item misclassification, often between COS and SG&A.	273	4%	None	None
Cash flow statement classification	These misclassifications can affect cash flow from operations, financing, non-cash and other.	360	5%	+	None
Footnote & segment disclosures issues	Financial statement, footnote and/or segment reporting information.	111	2%	None	None
Underlying events	Circumstances underlying some misstatements				
Accounting for acquisitions, mergers, disposals and re-organizations	Mergers, acquisitions, disposals, reorganizations or discontinued operation accounting issues. Restatements in this category can be varied but they all arise from a company's failure to properly record an acquisition (such as valuation issues) or a failure to properly record a disposal (such as discontinued operations) or reorganization (such as in bankruptcy). It can also include failures to properly revalue assets and liabilities associated with fresh start rules.	1127	17%	None	None
Consolidation issues (including Fin 46 variable interest & off-balance sheet entities)	This can include mistakes in how joint ventures, off-balance sheet entities or minority interests are recorded or manifested. It can also include issues associated with foreign currency translations of foreign affiliates.	514	8%	None	None
Foreign, related party, affiliated, or subsidiary issues	The most prevalent issues in this category arise from problems with foreign affiliates and their related accounting or financial reporting. They include disclosures about related, alliance, affiliated and/or subsidiary entities.	509	8%	None	None

Appendix B: Industry Membership Tables

Industry membership is defined by SIC code as follows:

Industry	SIC Codes
Agriculture, construction, mining	0000 – 1999
Manufacturing	2000 – 3999 (except Technology and Biotechnology)
Biotechnology	2834 – 2836
Technology	3570 – 3579 & 7370 – 7379
Transportation	4000 – 4799
Communication	4800 – 4899
Utilities	4900 – 4999
Wholesale/Retail	5000 – 5999
Financial	6000 – 6999
Services	7000 – 8999 (except Technology)

These tables show restatement activity by industry across study years. See Section IV.B., Figure 9 in the main text, for a discussion of this restatement activity. These frequencies and percentages are based on the 4,923 companies with basic financial data.

Restatement activity by industry											
Count per year	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**Total**
Agriculture	2	4	6	7	31	34	41	50	69	75	319
Manufacturing	24	30	62	53	111	114	163	197	307	311	1,372
Technology	15	40	61	46	57	67	77	86	109	110	668
Transportation	0	0	5	8	7	9	15	17	17	19	97
Communication	2	3	5	8	25	21	34	50	55	48	251
Utilities	2	1	6	6	10	23	48	43	46	29	214
Wholesale/Retail	11	11	16	9	33	53	57	74	197	104	565
Financial	10	18	20	18	41	63	83	93	147	124	617
Service	10	6	30	19	51	61	80	95	121	130	603
Biotechnology	5	1	5	11	18	23	24	39	34	39	199
Unknown	0	0	0	2	2	0	1	6	4	3	18
Total	81	114	216	187	386	468	623	750	1,106	992	4,923
Percent per year	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**Total**
Agriculture	2%	4%	3%	4%	8%	7%	7%	7%	6%	8%	6%
Manufacturing	30%	26%	29%	28%	29%	24%	26%	26%	28%	31%	28%
Technology	19%	35%	28%	25%	15%	14%	12%	11%	10%	11%	14%
Transportation	0%	0%	2%	4%	2%	2%	2%	2%	2%	2%	2%
Communication	2%	3%	2%	4%	6%	4%	5%	7%	5%	5%	5%
Utilities	2%	1%	3%	3%	3%	5%	8%	6%	4%	3%	4%
Wholesale/Retail	14%	10%	7%	5%	9%	11%	9%	10%	18%	10%	11%
Financial	12%	16%	9%	10%	11%	13%	13%	12%	13%	13%	13%
Service	12%	5%	14%	10%	13%	13%	13%	13%	11%	13%	12%
Biotechnology	6%	1%	2%	6%	5%	5%	4%	5%	3%	4%	4%
Unknown	>1%	>1%	>1%	1%	1%	>1%	>1%	1%	>1%	>1%	>1%
Total	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%

This table of accounting issues by industry provides the frequencies and percentages underlying Section IV.B., Figure 10 in the main text. Industries with statistically higher proportions of each accounting issue are shown in bold.

Accounting issue classifications by industry							
	Revenue	%	Core Expenses	%	Non-core & Reclass.	%	Total
Manufacturing	261	19%	583	42%	528	39%	1,372
Technology	**271**	**40%**	192	29%	205	31%	668
Financial	101	16%	203	33%	**313**	**51%**	**617**
Service	164	27%	207	34%	232	39%	603
Wholesale/Retail	82	14%	**314**	**56%**	169	30%	565
Other	208	19%	411	37%	479	44%	1,098
Overall	1,087	22%	1,910	39%	1,926	39%	4,923

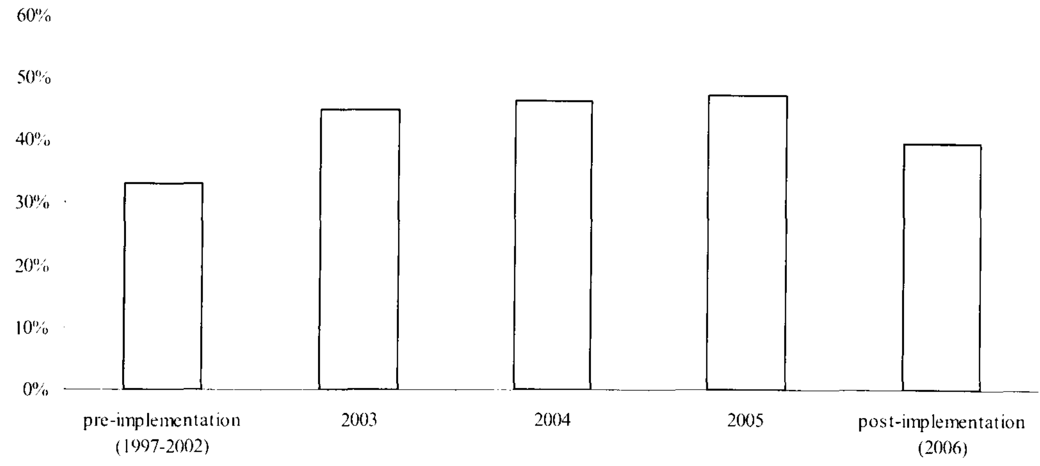
Appendix C: Restatements and SOX Section 404 Internal Control Reporting

Section 404 of the Sarbanes-Oxley Act (SOX) requires companies to report on the effectiveness of their internal controls over financial reporting (ICFR). Briefly, management is required to assess the company's internal controls and report whether they believe the controls are effective or ineffective in preventing material misstatements. The company's auditor is required to attest to management's assertion. SOX Section 404 reporting was mandated in July 2002, and the initial ICFR reports for accelerated filers were required for fiscal years ending on or after November 15, 2004. These reports would typically be filed beginning in early 2005. However, due to documentation and testing required under SOX Section 404, most accelerated filers began ICFR implementation fairly soon after the enactment of SOX.[86] Thus, misstatements attributable to ICFR implementation are most likely to be identified in 2003-2005.

During the study period, ICFR implementation is required only for companies meeting accelerated filer criteria. A primary criterion for accelerated filer status is related to market capitalization ($75 million and greater), so accelerated filers are typically larger companies. AA provides data indicating which companies asserted their controls were effective or ineffective at the first fiscal year of ICFR reporting. These reports were typically issued in early 2005, and report on controls in place at the end of the 2004 fiscal year. For this analysis, companies noted by AA as providing either type of assertion in 2005 are identified as accelerated filers, and this status is assumed to be constant for the entire study period.

The chart and table below show the percentage of restatements announced by accelerated filers in the pre-implementation, implementation and post-implementation periods.

Percentage of Restatements Announced by Accelerated Filers



	Pre-ICFR Implementation 1997-2002	ICFR Implementation 2003-2005	Post-ICFR Implementation 2006
All restatements announced	1,452	2,479	992
Company filed ICFR report in 2005	481	1,156	396
Percent of restatements by 2005 ICFR companies	33%	47%	40%

86 For example, see Diya Gullapalli, *Grasping 'Internal Controls'*, WALL STREET J., Nov. 3, 2004, at C1, C3.

There is a significant increase in restatements by 2005 accelerated filers during the 2003-2005 ICFR implementation period. During this time, accelerated filers announce 47% of restatements. In contrast, in the pre-2003 period, companies destined to be classified as accelerated filers for 2005 are responsible for 33% of all restatements. The percentage drops to 40% in 2006.[87]

Although surely some accelerated filers would have announced restatements absent ICFR implementation, nearly a quarter of all 4,923 restatements (1997-2006) are made by 2005 accelerated filers during ICFR implementation (2003-2005). Further, if pre-implementation ratios between non-accelerated and accelerated filers had held steady through 2003-2005, about 500 fewer restatements by the 2005 accelerated filers would have been expected during this period.[88]

AA data indicates about 3,700 companies issued ICFR reports in the first year of required reporting. This suggests approximately 31% (1,156 of 3,700) of accelerated filers restated their financial reports over the three-year period.

Not all restating accelerated filers reported ineffective controls. Of the 349 accelerated filers restating in 2004, only 137 (39%) reported ineffective controls in their initial report for fiscal year end 2004, typically filed in early 2005. Of the 527 companies announcing restatements in 2005, 263 (50%) initially reported ineffective controls. This count was later revised upward, presumably because companies later discovered misstatements. Thus, the final percentage of accelerated filers both restating in 2005 and reporting ineffective controls is 59% (309 of 527). Of the 396 restatements by accelerated filers announced in 2006, only 93 (23%) reported ineffective controls in their 2005 report.

Restatement Characteristics of Accelerated vs. Non-Accelerated Filers

Logistic regression analysis is used to compare restatements announced by accelerated and non-accelerated filers during the ICFR implementation period. It indicates accelerated filers are more likely to restate accounting issues involving:

- revenues;
- leases;
- stock-based compensation;
- expense capitalization; and
- cash flow statement reclassifications.

Upon further examination, the higher frequency of revenue restatements is mainly due to the sub-set of accelerated filers both restating and reporting ineffective ICFR. No other restatement characteristics differ between the two groups.

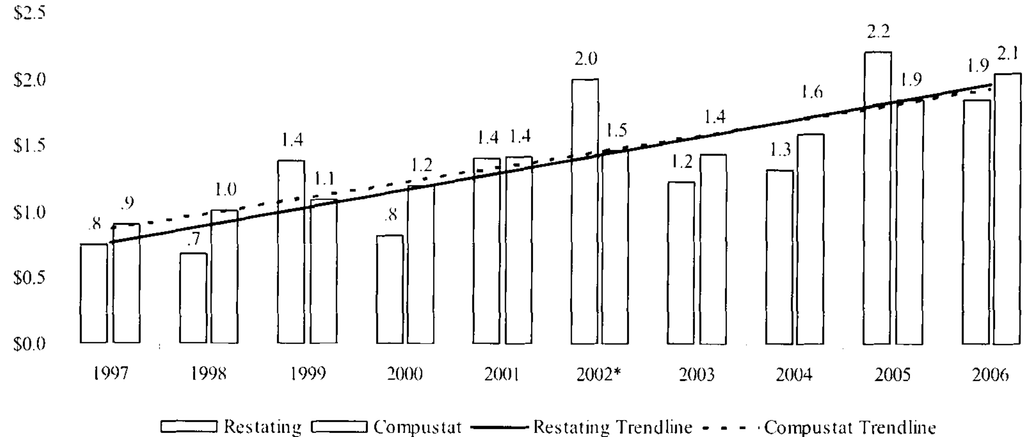
87 Comparisons between accelerated filer announcement frequencies during ICFR implementation, pre-ICFR implementation and post-ICFR implementation periods are statistically significant (p-values < .001).

88 Based on a ratio of nearly 2:1 non-accelerated to accelerated filer restatements in the pre-implementation period, the 1,323 restatements by non-accelerated filers during 2003-2005 suggests about 654 total restatements expected for accelerated filers, compared to the 1,156 announced. However, this period also includes the lease restatements, which disproportionately involved accelerated filers, so the number would likely have been higher than the 654 otherwise expected.

Appendix D: Restating Company Revenues

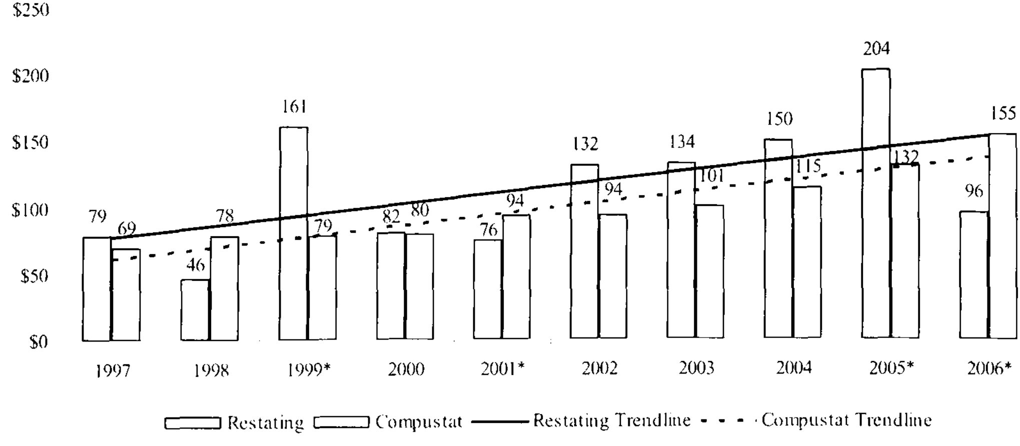
Average revenues for the 4,923 restating companies with basic data are $1.65 billion. Restating companies report lower revenues than the Compustat average except in 1999 (IPR&D restatements), 2002 (accounting scandals and the enactment of SOX) and 2005 (lease restatements). The only significant difference in the averages of restating and Compustat companies is in 2002, noted with an asterisk in the figures below.[89]

Average Revenue for Restating and Compustat Companies ($B)



Median revenues for restating companies are $127 million. Similar to previously noted patterns, median revenues are significantly higher for restating than Compustat companies in 1999 (IPR&D), and 2005 (lease restatements). Again, restating companies' median revenues drop dramatically in 2006, both in absolute dollars and relative to the Compustat median.

Median Revenues for Restating and Compustat Companies ($M)



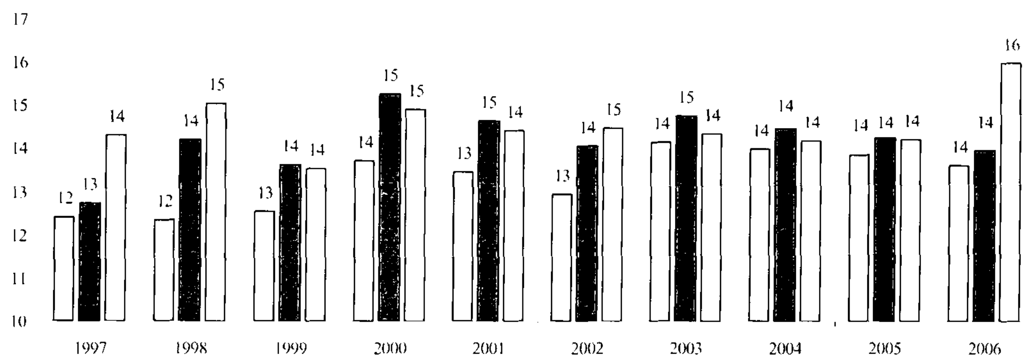
89 Statistical significance for averages is based on t-tests. Median significance is based on non-parametric Z-scores. Statistical significance is indicated for p-values < .10.

Appendix E: Restatements and Debt Ratings

Compustat's debt ratings are based on the Standard & Poor's rating system, which assigns lower numbers to companies assessed as better credit risks. The highest ranking, AAA, is coded "2" by Compustat. The lowest ranking, D, is coded "27." This is applied when payment is in default. Rankings of BBB and better are considered investment grade. BBB corresponds with an "11" in the Compustat ratings code.

For restating companies with financial data, analyzed in Section IV, announcement year debt rankings are available for 1,283 restating companies (26% of 4,923). Of these, ratings are available for 1,188 the year before the announcement and 957 the year after the announcement. The average rating for the year prior to, of and after the restatement announcement is shown across the study years in the figure below. Median, highest and lowest ratings for each year are provided in the table.

Average debt ratings in years surrounding restatements



□ Pre-ann. year (average = 13.7) ▪ Announcement year (average = 14.3) □ Post-ann. year (average = 14.3)

Debt ratings around restatement years											
	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	Overall
Announcement year											
Number	12	24	61	39	85	133	174	224	316	218	1,286
Highest rating	AA	A+	AAA	A	AA-	AAA	AAA	AAA	AAA	AA-	AAA
Lowest rating	CCC	D	D	D	D	D	D	D	D	D	D
Average debt rating for years surrounding restatement											
Pre-announcement	12.4	12.4	12.5	13.7	13.5	13.0	14.2	14.0	13.9	13.6	13.7
Announcement year	12.7	14.2	13.6	15.3	14.7	14.1	14.8	14.5	14.3	14.0	14.3
Post-announcement	14.3	15.1	13.5	14.9	14.4	14.5	14.4	14.2	14.3	16.0	14.3
Median debt rating for years surrounding restatement											
Pre-announcement	13	12	12	14	14	14	14	15	15	15	14
Announcement	14	15	15	15	14	14	15	15	15	15	15
Post-announcement	14	15	15	15	14	15	15	15	15	16	15

Debt ratings for restating companies range from AAA to D. However for nearly half of the years, the highest rating for restating companies is only AA (5) to A (8). The lowest rating for restating companies every year except 1997 is D. Average and median debt ratings are in the BBB- (12) to B+ (16) range, below investment grade.

Debt ratings decline significantly around the time of a restatement announcement whether the change is measured between the pre-announcement and announcement years or the pre-announcement to post-announcement years. The average rating decreases .59 from the pre-announcement to the announcement year, a little more than half a rating category. The average rating decreases .79 between the pre-announcement and post-announcement years.[90]

In regression analysis, debt ratings are more likely to be lowered from the pre-announcement to post-announcement years if the restatement:

- involves fraud;
- affects a shorter time period;
- affects revenue or core expenses; and
- generates a negative announcement return.

Results are similar if rating changes are measured from the pre-restatement announcement to the end of the announcement year, except the length of the restated period and core expenses are not associated with lowered ratings.

For restating company characteristics, rating reductions are associated with:

- large companies;
- less profitable companies; and
- companies with share prices less than $5.00.[91]

In summary, debt ratings worsen around the time of a restatement. As many restating companies are otherwise troubled and often unprofitable, it is not clear that a restatement itself is a reason for a downgrade. However, downgrades are associated with restatement characteristics that are also often associated with more negative stock returns; this suggests that the ratings agencies may be sensitive to similar issues.[92]

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90 Paired t-tests require data for both years. These results are based on 1,188 and 896 pairs, respectively (t-statistic p-values < .001.) Market-based regression model variables are available for some companies, and post-announcement year ratings are not yet available for 2006 announcements. Therefore, regression results are based on samples of 909 and 692 observations.

91 Both models are significant (F-statistic > 5.0, p-values < .001, adjusted-R^2 > .14). The models include year indicators to control for economic conditions. Adding industry variables does not change these results.

92 This analysis focuses on restatement effects on public debt ratings. For a study of restatement effects on private loans during the early years of this study, see John R. Graham, Si Li and Jiaping Qui, *Corporate Misreporting and Bank Loan Contracting*, JOURNAL OF FINANCIAL ECONOMICS (forthcoming).

Appendix F: Limited Analysis of SEC Staff Accounting Bulletin No. 99: Materiality and Net Income Effects

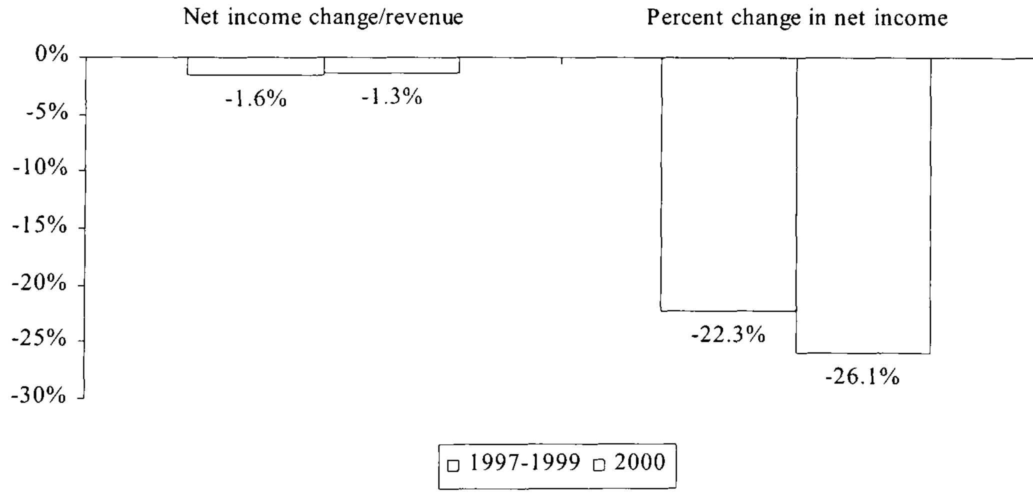
The SEC issued Staff Accounting Bulletin 99 (SAB 99) in August 1999, which emphasized that materiality considerations should include qualitative as well as quantitative factors.[93] SAB 99 may have led to an increase in restatements if it caused companies and auditors to begin formally restating errors that otherwise did not meet assessed quantitative materiality thresholds. That is, to the degree SAB 99 expanded the number of misstatements deemed to be material, because of qualitative characteristics, the number of restatements would have increased. If these additional qualitative-based restatements affected reported income relatively less, the overall magnitude of income effects would likely decrease. Comparing changes from original to reported income pre- and post-SAB 99 provides some evidence regarding possible shifts in the magnitude of restatement income effects.

Information about the effect of restatements on net income is unavailable for a meaningful percentage of restatements past 2000, but data from 1997-2000 is presented here to provide a limited analysis. Pre-SAB 99 (1997-1999), the change from originally reported to restated net income is available for 340 restating companies. For 2000, it is available for 185 restating companies.[94]

Two measures of the change in reported income are compared pre- and post-SAB 99 in the figure below. The first measure is the change from original to restated net income divided by company revenue (change in profit margin). The second is the percentage change in net income. Medians of both these measures are shown.

In the pre-SAB 99 period, the median restatement effect on profit margin is -1.6%. This is slightly reduced in 2000, when the median is -1.3%. On the other hand, the median effect on the percentage change in net income became larger in 2000, as the median increased from -22% to -26%.

Median Changes in Net Income Pre- and Post-SAB 99



93 SEC, *Staff Accounting Bulletin: No. 99 – Materiality* (Aug. 12, 1999), available at http://www.sec.gov/interps/account/sab99.htm.

94 These include only non-IPR&D restatements. As discussed previously, a number of 1999 restatements were to reduce amounts previously written off as IPR&D allocations. These restatements uniformly *increased* previously reported income. If IPR&D restatements are included, the pre-SAB 99 percentage change in net income is -12% instead of -22%.

Medians are presented in the figure because the influence of extreme values on the averages makes medians a preferable statistic for evaluating these effects. However, averages for both of the income change measures are also provided in the table below. Showing patterns opposite to the analysis of medians, the average profit margin change grows much larger post-SAB 99, but the average percent change in net income is smaller. However, none of these differences is statistically significant.

Changes in restatement effects on net income pre- to post-SAB 99				
	Change in net income / revenues		Percent change in net income	
	Median	Average	Median	Average
1997-1999	-1.6%	-17%	-22%	-191%
2000	-1.3%	-128%	-26%	-102%

Overall, this limited analysis does not indicate any consistent effect of SAB 99 on the magnitude of the income effects of restatements in the year following SAB 99's issuance.

Appendix G: Restatements with Most Negative Announcement Returns in Each Year

			Restatement facts:								*Share prices and returns:*				*Other:*			
	Industry Group	No. of Restates	Date Ann.	Years Restated	Original NI ($M)	Restated NI ($M)	Percent Change	Income to loss	Discovered by	Acct'ing Issues	Price Day -1 ($)	Mkt-adj Ann Return	Price Day +5 ($)	Mkt-adj Longer Returns	Fraud	Litigate	Ch.11/ Delist	Other News
1997																		
Health Management, Inc.	Whls/Retl	1	17-Mar	.50	-10.2	-12.8	-26%			2	0.97	-80%	0.34	-45%		yes		1 2
Unison Healthcare	Service	1	11-Mar	.75	0.1	-10.7	<-1,000%	yes	auditor	1 2 3	9.63	-59%	3.75	-136%	yes	yes*	yes	2
First Merchants Acceptance	Finance	1	16-Apr	1.00	10.5	4.0	-62%		company	1 2	7.00	-56%	3.00	-22%	yes	yes*	yes	1 2 3
NUKO Information System	Manuf	2	20-May	.75	-8.0	-9.0	-12%		auditor	2	6.63	-39%	4.44	-112%		yes	yes	
Pegasystems	Tech	4	29-Oct	.25	2.2	-0.9	-139%	yes	auditor	1	28.00	-35%	20.13	-44%		yes		2
Fine Host	Whls/Retl	1	12-Dec	3.75	11.1	-16.4	-248%	yes	company	1 2 3	15.50	-34%	.	-55%	yes	yes*	yes	
Insignia Solutions	Tech	1	27-Feb	.50	2.2	0.3	-84%			1	3.88	-30%	2.38	-79%	yes	yes		1
Craig Consumer Electronics	Manuf	1	10-Mar	1.50	0.8	-0.3	-138%	yes	auditor	2	3.38	-26%	1.38	-90%	yes	yes*	yes	1
Photran Corporation	Manuf	2	24-Mar	.75	0.4	-1.0	-358%	yes		1 2 3	2.63	-25%	2.25	102%	yes	yes*	yes	3
Universal Seismic	Ag, Constr	2	16-May	.50	0.7	-0.1	-108%	yes	company	1 2	2.63	-24%	1.75	-68%		yes	yes	1
1998																		
CyberGuard	Tech	3	24-Aug	1.75	-18.4	-27.2	-48%		auditor	1 2	6.19	-92%	1.13	27%	yes	yes	yes	3 4 5
Physician Computer	Tech	1	3-Mar	3.75	26.9	-34.1	-227%	yes	auditor	1 2 3	4.25	-72%	1.47	21%	yes	yes*	yes	1 3
Digital Lightwave	Tech	2	22-Jan	.50	2.1	-4.5	-310%	yes	company	1	13.00	-70%	3.88	-47%	yes	yes		1
Telxon	Tech	1	11-Dec	3.50	10.9	-6.5	-160%	yes	auditor	1 2 3	27.25	-54%	12.75	-21%	yes	yes*		1
Data Systems Network	Tech	1	24-Feb	1.75	2.1	-4.1	-293%	yes	company	1 2	13.13	-53%	6.06	-67%	yes	yes	yes	1 5
Texfi	Manuf	1	16-Jun	1.25	0.4	-4.1	<-1,000%	yes	regulator	3	2.19	-52%	1.31	-74%			yes	
Vesta Insurance	Finance	2	1-Jun	3.25	109.7	86.8	-21%		company	1 2	52.00	-46%	.	.	yes	yes*		3
Raster Graphics	Tech	1	3-Feb	.75	3.2	-6.7	-311%	yes	auditor	1 2	4.56	-45%	2.88	-72%	yes	yes		1
Smartalk Teleservices	Comm	2	10-Aug	1.50	-63.1	-67.3	-7%		auditor	1	15.00	-43%	8.25	-90%	yes	yes*	yes	2
Norland Medical System	Manuf	1	16-Mar	1.75	-11.8	-14.0	-19%		company	1	7.06	-42%	3.75	-69%		yes	yes	
1999																		
Smartalk Teleservices	Comm	2	7-Jan	.25	-22.5	-28.3	-26%		company	1 2	3.25	-81%	2.41	68%		yes*	yes	5
Inso Corp (EBT International)	Tech	1	1-Feb	.75	5.6	2.5	-56%		company	1	25.00	-76%	8.38	-3%	yes	yes	yes	1
Pacific Research and Engineering	Manuf	1	29-Mar	2.75	0.3	-2.6	<-1,000%	yes		1 2	1.56	-74%	0.75	257%				1 5
American Bank Note Holographic	Manuf	1	19-Jan	2.75	19.2	10.3	-46%		auditor	1	15.06	-70%	1.81	-67%	yes	yes*		
Navigant Consulting	Service	1	22-Nov	.75	43.8	26.5	-39%		auditor	2 3	26.00	-67%	10.63	-77%		yes		5
Total Renal Care	Service	2	17-Feb	3.75	53.3	39.4	-26%		regulator	2 3	20.63	-55%	8.63	-120%		yes		1
NutraMax Products	Manuf	1	18-Aug	1.00	-2.9	*	.		auditor	2	4.75	-55%	2.03	-37%		yes*	yes	2
McKesson/HBOC	Whls/Retl	1	28-Apr	2.75	232.9	73.9	-68%		auditor	1	65.75	-52%	35.44	-88%	yes	yes*		1
Engineering Animation	Tech	2	1-Oct	.25	-9.8	-13.9	-42%		company	1	15.81	-41%	10.44	14%	yes	yes		1 3
Plains All American Pipeline	Trans	2	29-Nov	1.75	46.7	73.3	-257%	yes	company	3	19.50	-41%	11.81	82%		yes		1 5
2000																		
Rent-Way, Inc.	Service	2	30-Oct	2.75	12.8	-6.6	-151%	yes	company	2 3	23.44	-79%	5.69	17%	yes	yes*		1 3
MicroStrategy	Tech	1	20-Mar	2.75	15.2	-19.7	-230%	yes	auditor	1	226.75	-76%	113.00	-83%	yes	yes*		
HomeSeekers.com, Inc.	Tech	2	6-Oct	.50	-10.1	-10.5	-4%			1	2.13	-72%	1.00	-2%			yes	
Stone & Webster	Service	1	30-Apr	1.00	-28.8	-48.1	-67%		company	2	13.19	-60%	3.38	-17%		yes*	yes	1 5
Nhancement Technologies	Tech	2	19-Dec	.75	-3.1	-5.3	-70%		auditor	1 2 3	9.91	-56%	4.44	-86%				1
Aurora Foods	Manuf	2	18-Feb	1.75	-18.4	-68.6	-272%		auditor	1 2	7.31	-53%	3.00	21%	yes	yes		
Interspeed, Inc.	Tech	1	6-Oct	.75	-8.6	-12.0	-40%		company	1	3.84	-52%	1.34	-68%	yes	yes	yes	1 3
Quintus Corporation	Tech	1	15-Nov	1.25	-27.1	.	.		auditor	1	6.00	-51%	.	.	yes	yes*	yes	1 2
Legato	Tech	1	19-Jan	.75	16.1	3.1	-81%		company	1	54.63	-48%	28.44	-53%	yes	yes		1
FLIR Systems	Manuf	2	6-Mar	1.75	9.1	-10.0	-210%	yes		1 2	17.13	-45%	10.00	-7%	yes	yes*		1 3
2001																		
Critical Path	Tech	1	2-Feb	.25	-131.4	-139.4	-6%			1 2	10.06	-70%	.	-87%	yes	yes*		1
Sagent Technology	Tech	1	14-Nov	.50	-16.8	-17.5	-4%		company	1 2	1.39	-47%	0.81	-62%		yes*		
Jore Corporation	Manuf	1	1-Mar	1.75	3.3	-2.1	-164%	yes	company	2 3	3.63	-44%	2.06	-95%			yes	1
Covad Communications	Comm	2	16-Feb	.75	-433.6	-535.6	-24%		company	1 2	3.01	-39%	1.84	-72%		yes		1
Dollar General	Whls/Retl	2	30-Apr	2.75	536.0	440.4	-18%		auditor	2	23.88	-37%	16.10	-20%	yes	yes*		2
SRI Surgical Express	Service	1	27-Nov	.25	1.8	1.5	-15%		company	1	23.50	-34%	15.35	-68%	yes	yes		
NCI Building System	Manuf	1	12-Apr	2.25	101.8	91.8	-10%			2	18.09	-32%	9.89	53%	yes	yes		1
Infospace	Tech	1	13-Feb	1.75	-266.2	-262.5	2%			1 2 3	5.00	-27%	3.44	-70%		yes*		1
Lecroy	Manuf	1	15-May	1.50	-2.5	-2.5	0%		regulator	4	18.68	-23%	16.65	-20%				
Pre-Paid Legal Services, Inc.	Finance	1	16-May	3.00	112.8	44.8	-60%		regulator	1	19.00	-22%	16.51	50%		yes*		

			Restatement facts:								Share prices and returns:				Other:			
2002	Industry Group	No. of Restates	Date Ann.	Years Restated	Original NI ($M)	Restated NI ($M)	Percent Change	Income to loss	Discovered by	Acct'ing Issues	Price Day -1 ($)	Mkt-adj Ann Return	Price Day +5 ($)	Mkt-adj Longer Returns	Fraud	Litigate	Ch.11/ Delist	Other News
Worldcom	Comm	3	25-Jun	2.25	5,709.0	-64,979.0	-1000%	yes	company	1 2 3 4	0.83	-93%	0.09		yes	yes*	yes	
Metawave Communications	Manuf	1	14-Mar	.75	-58.6	-60.7	-4%		company	1 2 3 4	1.20	-80%	0.38	-92%		yes	yes	6
Peregrine Systems	Tech	2	6-May	2.75	-1,555.0	-2,318.8	-49%		auditor	1 2	2.57	-69%	1.58	-29%	yes	yes*	yes	
Enterasys Network	Tech	2	1-Feb	1.50	-954.6	-1,188.9	-25%		regulator	1 2 3	11.02	-61%	4.63	-58%	yes	yes		1 2 8
Annuity and Life Re	Finance	2	25-Jul	2.25	9.5	9.0	-6%		regulator	3	13.40	-55%	7.13	-144%		yes*		1
Corrpro Companies	Service	2	20-Mar	1.75	-3.0	-8.3	-174%		company	1 2 3	2.30	-52%	1.15	-47%	yes	yes		
Dynegy	Ag. Minc. Constr	2	25-Apr	3.00	1,301.0	1,033.0	-21%		regulator	2 3 4	27.30	-51%	15.08	-76%	yes	yes*		1
Gemstar-TV Guide International	Manuf	2	1-Apr	3.25	-939.4	-1,012.9	-8%			1 2 3	14.79	-40%	10.65	-60%	yes	yes*		1
Nicor	Util	2	18-Jul	.25	39.9	35.5	-11%			3	38.44	-38%	23.74	13%		yes		1
Pharmaceutical Resources	Biotech	2	19-Feb	4.00	11.7	16.4	40%		regulator	1 3	25.84	-38%	17.15	112%				
2003																		
ClearOne Communications	Manuf	2	15-Jan	2.25	13.7	-7.4	-154%	yes	regulator	1 2 3	3.96	-75%	.	.	yes	yes*	yes	3 7 8
Fleming Companies	Whls/Retl	1	28-Mar	1.75	29.3	-57.7	-297%	yes	regulator	2	1.14	-65%	.	.	yes	yes*	yes	1 3
BAM! Entertainment	Tech	1	29-Sep	.25	-13.4	-13.4	0%		company	4	2.24	-57%	1.51	-95%			yes	
Topaz Group	Manuf	1	20-Aug	.25	-0.4	-0.6	-42%		company	2	0.82	-44%	0.57	-39%		yes	yes	
Singing Machine Company	Manuf	1	27-Jun	.25	12.2	10.0	-18%			3	5.40	-40%	3.20	-128%				1 2
Aerosonic Corp	Manuf	2	17-Mar	4.75	2.4	1.0	-60%		company	1 2	15.12	-39%	10.01	-120%	yes	yes*		
Sportsline.Com	Tech	1	26-Sep	2.50	-131.6	-145.3	10%		auditor	1 2 3 4	1.76	-28%	1.25	12%		yes		1
AFC Enterprises	Whls/Retl	2	24-Mar	2.5	77.7	50.3	35%		company	1 2 3	18.04	-26%	13.46	-44%		yes*		
Elite Pharmaceuticals	Biotech	1	15-Jul	2.00	-15.7	-15.7	0%			4	3.60	-26%	2.43	-48%				
BearingPoint	Service	2	14-Aug	.75	44.0	31.0	-29%			1 2 3	10.31	-26%	8.48	-23%		yes		1
2004																		
Tripath Technology, Inc	Manuf	1	22-Oct	.25	-1.9	-2.6	-40%		auditor	1	1.58	-53%	1.29	-50%	yes	yes	yes	4
Global Crossing	Comm	3	27-Apr	1.00	-107.0	-174.0	63%		company	2	18.20	-48%	7.93	-14%		yes		
AaiPharma	Service	2	1-Mar	1.75	41.4	4.7	-89%		company	1 2	15.28	-36%	10.00	-92%		yes*	yes	
Intelligroup	Tech	2	24-Sep	3.25	-27.2	-34.1	-26%		company	1 2 3 4	1.73	-35%	1.78	-13%		yes	yes	5
OmniVision Technologies	Manuf	1	9-Jun	.75	35.2	37.9	8%		company	1	25.47	-33%	15.31	-22%		yes		1
StonePath Group	Trans	4	21-Sep	1.50	-8.2	-24.9	-204%		company	1 2	1.59	-29%	0.86	-21%		yes		
Asconi Corporation	Manuf	1	23-Mar	1.75	3.0	-37.7	>1000%	yes	regulator	3	6.64	-26%	.	-65%		yes	yes	8
Autobytel	Tech	1	21-Oct	2.50	-10.0	-13.1	-31%			1 2 3 4	8.75	-23%	6.65	-48%		yes		1
Sourcecorp	Tech	1	27-Oct	3.50	82.9	67.3	-19%		company	1 2	22.21	-23%	17.09	15%		yes		
Quality Distribution	Trans	1	30-Apr	5.75	-109.4	-124.4	-14%		company	2	19.98	-22%	15.01	-60%	yes	yes		1
2005																		
Orthodontic Centers of America	Service	2	7-Jun	.75	-68.7	^	.		company	1 2 3 4	4.03	-64%	1.44	-52%	yes	yes	yes	2 3 5
Anchor Glass Container	Manuf	2	5-Aug	4.25	-179.5	-188.9^	-5%			1	0.45	-48%	0.16	-45%		yes*	yes	9
Napster	Tech	2	11-May	.25	12.8	12.8	0%			4	6.35	-41%	3.88	-27%				1
Aaipharma	Service	2	15-Apr	.25	-33.8	-36.0	-6%		company	1	0.63	-38%	.	.		yes*	yes	9
America Service Group	Service	2	24-Oct	4.50	-5.2	-7.2	-40%			1 2	18.16	-32%	15.43	2%	yes	yes		
City Network	Service	1	28-Sep	.50	-1.1	-1.1	0%		auditor	4	0.21	-32%	0.18	-26%			yes	
Collins & Aikman	Manuf	3	17-Mar	.75	-108.6	-120.6^	11%		company	1 2	1.63	-31%	1.36	-28%	yes	yes*	yes	1
Continucare	Service	1	13-May	1.50	9.7	8.3	15%			1 2	3.14	-26%	2.40	-12%				1
ParmaNet Development Group	Service	1	3-Nov	.50	12.6	12.1	-4%			1	37.89	-25%	30.70	-45%				
Hi Shear Technology	Manuf	1	14-Apr	.50	1.2	0.9	-27%			3	4.85	-21%	3.51	69%				
2006																		
Sea Containers Ltd.	Trans	1	24-Mar	.75	-58.5	-65.2^	-11%			3	12.06	-50%	7.21	-82%		yes	yes	5 6
Simclar	Manuf	1	15-Aug	1.25	2.0	1.5	-26%			1 2	8.92	-38%	5.31	-9%				2
Astea International	Tech	1	31-Mar	.75	2.7	2.5	-9%		company	2	16.50	-31%	9.78	-49%		yes		1
Caraustar Industries	Manuf	1	3-Nov	.50	72.4	64.021	-12%			3	10.11	-30%	7.19	7%				
Vitesse Semiconductor	Manuf	1	26-Apr	3.25	-341.1	^	.			1 2	2.53	-28%	1.84	-26%	yes	yes*	yes	
Par Pharmaceutical	Biotech	2	5-Jul	5.25	285.3	231.8	-19%		company	1 2 3 4	18.75	-28%	14.32	55%		yes		
GMH Communities Trust	Finance	1	13-Mar	.75	5.1	2.2	-56%		company	1 2 3	16.83	-28%	11.55	-23%		yes		1 5
Tag It Pacific	Manuf	1	3-Apr	.50	-23.3	-24.4	-5%			1	0.81	-25%	0.62	59%			yes	
Infosonics	Comm	2	9-Jun	.25	1.7	1.2	-32%			3	23.60	-24%	15.49	-58%		yes		
WJ communications	Manuf	1	2-Nov	.50	-3.8	-4.3	-15%			2	2.33	-22%	1.96	-.20%				6

Notes and definitions:

Industry group	See Appendix B for industry definitions.
No. of restates	Total number of restatements announced by the company during the study period.
Date Ann.	Date restatement is announced.
Years restated	Number of years restated, where one quarter = .25.
Original NI	Originally reported net income summed over all restated periods.
Restated NI	Restated net income summed over all restated periods. * indicates company did not file amended reports: if an amount is provided, it is estimated from press announcements.
Percent change	Percent change from originally reported to restated net income. Truncated at -1,000%.
Income to loss	"Yes" means originally reported net income changed to a restated net loss. Blank means it did not.
Discovered by	"Auditor" means the misstatement/need for a restatement is discovered by the auditor in press releases or filings. Company means company management.Regulator usually means the SEC.
Acc'ting Issues	Revenue affected = 1, core expenses = 2, non-core expenses = 3, reclassifications and disclosure = 4. See Appendix A for further detail.
Price Day -1	Stock price at close of trading on the day prior to restatement announcement.
Mkt-adj ann return	Market-adjusted return summed over announcement day and day following announcement.
Price Day +5	Stock price at close of trading five days after announcement.
Mkt-adj longer returns	Buy and hold market-adjusted returns for the year following the announcement, or until delisting.
Fraud	"Yes" means an AAER was issued, the company admitted to fraud or irregularities or officers were indicted. Blank means none of these were found.
Litigate	"Yes" means the company was sued over this restatements. "*" means the auditor was sued too. Blank if no litigation.
Ch.11/Delist	"Yes" means the company either filed for bankruptcy or was delisted in the following year or two. Blank if not.
Other news	News announced on the same day as the restatement:1: earnings-related information, 2: filing delayed, 3: executives terminated or suspended, 4: auditor resigned dismissed, 5: financing needed/covenant violations, 6: restructuring, 7: going concern likely 8: SEC investigating, 9: Bankruptcy or delisting.

Additional 2001-2002 notes:

Enron return at November 8 restatement announcement date is -5%.
Adelphia return at April 16 restatement announcement date is -6%.
Global Crossing in Chapter 11 by restatement announcement on October 21.

^ Company had not filed amended results at the time of this study. Any amount is estimated from press releases or 8-K reports.

VII. ACKNOWLEDGMENTS

· These colleagues provided careful critiques and thoughtful comments on the analyses and exposition of this study. I appreciate their considerable time and efforts greatly. In particular, Bill Kinney commented on several drafts. Any remaining errors and infelicities are my own.

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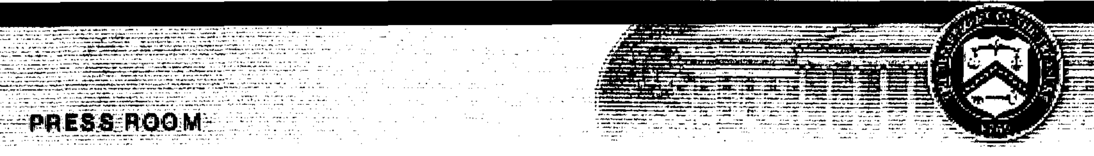

April 9, 2008
HP-915

Prepared Statement by Treasury Under Secretary David H. McCormick in Advance of G-7 Finance Ministers and Central Bank Governors Meeting

Washington – Good afternoon. The G-7 Finance Ministers and Central Bank Governors will hold their next meeting here at the Treasury Department on April 11, against the backdrop of the IMF and World Bank Spring meetings. A good part of the G-7 meeting will be devoted to current economic conditions, financial market developments, and the policy response to recent financial market turmoil. They will also discuss progress on the reform of the International Monetary Fund among other topics.

Our G-7 colleagues will be keenly interested in hearing first hand about the U.S. economic outlook, and Secretary Paulson will tell them that the housing correction, financial market turmoil, and high energy prices are weighing on U.S. economic growth. There are significant downside risks to the outlook, and we are taking action to support the economy as we work through these challenges. The economic stimulus package passed in February will provide over $150 billion of individual and business tax relief in 2008, leading to the creation of over half a million additional jobs by the end of the year. In addition, the Administration has taken a number of steps specifically designed to ease the strain from the housing downturn, such as convening the HOPE NOW alliance and implementing the FHASecure program.

I share Secretary Paulson's confidence in the resiliency, flexibility and strength of our economy and our capital markets. Since last August, markets have been re-pricing and reassessing risk and there will be more bumps in the road. As we work through this period, our highest priority is limiting its impact on the real economy. We are focused on maintaining efficient and liquid financial markets and ensuring that our banks are able to continue supporting the economy by making credit available to consumers and businesses.

In addition to measures to bolster the economy in the near term, the Administration is taking steps to enhance the functioning and stability of the U.S. financial system going forward. The President's Working Group on Financial Markets (PWG) reviewed policy issues and issued its policy statement on March 13. The PWG recommendations include steps to improve market transparency and disclosure, risk awareness and risk management, capital and regulatory policies, practices regarding the use of credit ratings, and market infrastructure for over-the-counter derivatives products. Implementation of these recommendations can strengthen market discipline, enhance risk management, and improve the efficiency and stability of our capital markets. We expect that the PWG will report on progress towards implementation in the fourth quarter of 2008 and consider whether further steps are needed to address weaknesses in financial markets, institutions and related supervisory policies. The PWG is working with foreign regulators, finance ministries, and central banks through the international Financial Stability Forum (FSF) to address these challenges globally.

At our upcoming meeting, Mario Draghi, head of the Financial Stability Forum, will brief the ministers and governors on the FSF's work on assessing underlying weaknesses and formulating policy recommendations. As the G-7 requested, the FSF has focused its efforts on risk management; transparency, accounting, and valuation of structured products; credit rating agencies; and cooperation among supervisors and authorities. We look forward to discussing the rapid and effective implementation of the FSF findings with our colleagues. We will urge that FSF member organizations, including the Basel Committee on Banking Supervision, the International Organization of Securities Commissions, the International Accounting Standards Board, and the Joint Forum of banking, securities, and insurance supervisors, accelerate their timetables to conclude their efforts by end-2008. We look forward to a report by the FSF on progress implementing the policy recommendations at the G-7 Ministerial meeting in October. These efforts are a

critical example of cooperation among the G-7.

You will be aware that the Secretary recently announced a blueprint for modernizing financial regulation. Some may view these recommendations as a response to the circumstances of the day; yet this report is the culmination of a year's worth of work at the Department. Our first and most urgent priority is working through this capital market turmoil and housing downturn, and that will be our priority until this situation is resolved. With few exceptions, the recommendations in this Blueprint should not and will not be implemented until after the present market difficulties are past.

The United States is the world leader in financial services. We recognize that a competitive market requires regulation, investor protection and market stability. But our financial regulatory structure has not kept pace with innovations in the markets. The blueprint takes an expansive look at financial regulation in the United States, making recommendations for short, intermediate and long term improvements to our system.

Turning to the global outlook, as you know, the global economy was exceptionally strong the last four years, averaging nearly 5 percent growth annually. It was perhaps inevitable that some slowdown would occur but the financial headwinds and other adjustments underway pose significant challenges to the outlook for 2008. The extent to which particular economies will be affected varies; some commodity producers and emerging market economies are likely to continue to enjoy robust economic growth. Others face downside risks and will need to be more attentive to measures that can support growth. In particular, downside risks persist in view of the ongoing weakness of U.S. residential housing markets, stressed global financial market conditions, continued high oil and commodity prices, and consequent inflation pressures. That said we remain positive about the long-term resilience of the global economy, as well as the long-term resilience of the U.S. economy, and we believe that the IMF's latest WEO projections are unduly pessimistic.

While the bulk of the meeting will undoubtedly center on the global economic situation and financial turmoil, the G-7 will also discuss a range of issues pertaining to the IMF. The U.S. will underscore that the IMF must vigorously reform itself to remain legitimate and relevant and resemble today's world economy. We will emphasize the need for firm implementation of the IMF's new framework for exchange rate surveillance. To date, the Fund has strengthened its focus on exchange rate analytics, but implementation of the new framework is a work in progress and there is clearly far more progress to be made.

The U.S. will also back the recent agreement on IMF quota and voice reform, which – though not as ambitious as we would have liked – represents an improvement on the status quo and a first step in recognizing the growing role of dynamic emerging market economies in the global system. The Secretary will also underscore his support for the approved work plan to deliver a final set of best practices for sovereign wealth funds by the IMF Annual Meetings in October. We will discuss the progress made toward putting the IMF's finances on a more sustainable footing by tackling both expenditures and revenues. In this regard, we commend the Managing Director for putting a concrete plan on the table to tackle the IMF's administrative expenses and the Secretary will reaffirm our intention to support limited gold sales to create a stable revenue base.

After the G-7 meeting, Secretary Paulson will host a dinner that will bring together the G-7 Finance Ministers and Central Bank Governors and leaders from several leading financial services companies to have a further discussion on the causes and consequences of the recent financial market turmoil, and how leaders in the private and public sectors are responding to this challenge.

Secretary Paulson will also be meeting bilaterally with a number of his counterparts from within and outside the G-7. He will be attending a breakfast meeting of the International Monetary and Financial Committee of the IMF, a Ministerial meeting of the Financial Action Task Force, and a meeting of the World Bank's Development Committee. Secretary Paulson will also host a roundtable meeting with the Finance Ministers from a number of sub-Saharan African countries with demonstrated commitment to economic reform. Following up on his trip to Africa last November, Secretary Paulson will discuss with the Ministers options for addressing critical challenges to sustainable, private-sector led growth including financing basic

infrastructure and improving the investment climate.

Thank you for coming this morning, and I look forward to answering your questions.

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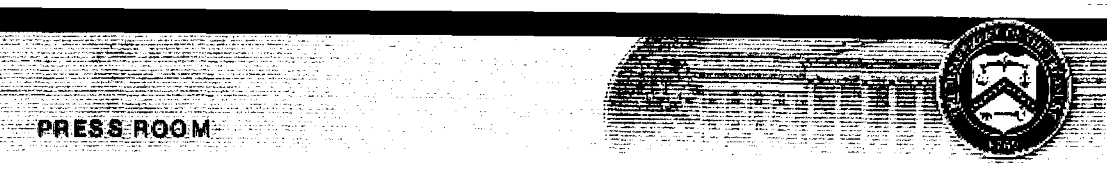

April 10, 2008
hp-916

Secretary Paulson Statement on House Trade Vote

Washington, DC -- Treasury Secretary Henry M. Paulson, Jr. today issued the following statement on the House of Representatives vote to change Trade Promotion Authority rules:

"The Trade Promotion Authority process has served America well, enabling us to open markets around the world to U.S. exports. And today, exports are the bright spot in our economy. I can't recall another time when trade has played such a vital role in creating jobs for American workers. Changing the rules in the middle of the game is fundamentally unfair to Colombia, a good friend of the United States, and to all those in the region who have stood with Colombia as it has created stability and opportunity for its people. Changing the TPA process could have lasting impact, undermining our country's ability going forward to open foreign markets to American goods and services. It also sends an unwelcomed signal to global markets at an economically sensitive time. I urge the Congress not to chip away at an agreed process, and in so doing isolate US workers from opportunities around the globe."

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PRESS ROOM

April 10, 2008
HP-917

**Opening Statement by Secretary Henry M. Paulson, Jr.
before the House Committee on Appropriations
Subcommittee on State, Foreign Operations and Related Programs
on the FY 2009 International Programs Budget**

Washington – Chairwoman Lowey, Congressman Wolf, Members of the Committee: Thank you for the opportunity to discuss the President's FY 2009 Budget request for the Department of the Treasury's International Programs. This Budget request of approximately $2.241 billion reflects the Bush Administration's commitment to promote economic growth and reduce poverty in the developing world. The Budget request provides support for the on-going efforts of the multilateral development banks (MDBs), debt restructuring programs and technical assistance. In providing these resources, the United States invests in economic, social and political stability around the world. Our support for these programs helps countries establish the policies and programs necessary to create the conditions for long-term private sector-led growth.

The FY 2009 Budget request also includes funding for a new, multilateral clean technology fund that will help major developing countries move towards a low carbon growth path. I will talk about this new initiative first.

International Clean Technology Fund

In September 2007, President Bush proposed the creation of the international clean technology fund (CTF) to help developing countries adopt clean energy technologies. As these countries build infrastructure that will exist for 30 years or more, we need to assist them to take advantage of cleaner, more advanced technologies. Otherwise, developing countries may be locked into a legacy of highly-polluting, less efficient – though less expensive – technologies. The proposed CTF would help cover the cost difference between older, dirtier technologies and cleaner, more advanced technologies. It would be created as a multilateral trust fund administered by the World Bank, and implemented through the MDBs. This fund represents a truly international approach to reduce rapid greenhouse gas emission growth in major developing countries.

The FY 2009 budget request includes $400 million for the first installment of a total U.S. pledge of $2 billion over three years. With additional funding from other countries, we will help finance clean energy projects in the developing world, which will benefit people around the world.

Multilateral Development Banks

In addition to this new initiative, the President's FY 2009 Budget requests a total of $2.071 billion for MDB funding, including $42 million to pay a portion of outstanding U.S. arrears to the International Development Association. The Budget request also includes U.S. contributions to replenish the International Development Association and the African Development Fund. This replenishment pledge will cover the U.S. contribution to the Multilateral Debt Relief Initiative from FY 2009 to 2011.

Through U.S. leadership, the MDBs are reforming their business practices. We have seen important progress in how the banks measure results. They are better at encouraging private sector development and business climate reforms. The MDBs are also showing improvements in transparency, anti-corruption systems and strengthening performance-based allocation systems to ensure that countries with stronger policies receive higher funding priority.

This progress is reflected in the new replenishment agreements that require policies

which should deliver results for the world's poorest people and improve the Banks' effectiveness as it works with fragile states such as Afghanistan and Liberia. These measures will also expand the MDB work on anti-corruption policies, regional economic integration, and climate change initiatives.

In response to U.S. urging, the MDBs have made substantial progress to improve the debt sustainability of many developing countries. This includes the 2005 Multilateral Debt Relief Initiative (MDRI) and last year's agreement by the Inter-American Development Bank to provide 100 percent debt relief to the bank's five poorest borrowing countries. To ensure the gains from debt relief are not lost, all MDBs now use the World Bank/IMF debt sustainability framework to determine the appropriate mix of grants and concessional loans.

While efforts to make the MDBs more effective must continue, the banks are more accountable, transparent and results-oriented today than when President Bush took office in 2001.

Debt Restructuring Programs

This request also includes $141 million for debt restructuring programs. These funds will meet U.S. commitments for bilateral debt reduction for Heavily Indebted Poor Countries (HIPCs) and U.S. pledges for contributions to the HIPC Trust Fund. This request also includes $20 million for the Tropical Forest Conservation Act. The HIPC initiative is lifting crippling debt burdens off many of the world's poorest countries, freeing resources for poverty reduction, when those countries have demonstrated both sound economic policy and a commitment to fighting poverty.

Technical Assistance

The third component of this request includes $29 million for Treasury's Technical Assistance program. This is a small program that never makes the headlines. But from my travels around the world I know that it is both cost effective and valuable. Treasury's financial experts help countries strengthen their capacity to manage public finances, lay the financial groundwork for private sector led growth, and combat money laundering and terrorist financing. Building that capacity is also a vital complement to investments in other areas – debt relief, for example – and to the effectiveness of development assistance generally. If developing countries' fiscal houses are not well managed, our investments in schools, hospitals, roads and other critical infrastructure will not be sustained, or will have to be sustained by us indefinitely.

Conclusion

Overall, we believe that full funding of these international programs will allow Treasury to work with and support developing countries throughout the world as they strive to lift their people out of poverty and provide greater opportunities for prosperity and security.

Thank you for your past support and for your current consideration of these programs. I look forward to working with you during your deliberations and welcome your questions.

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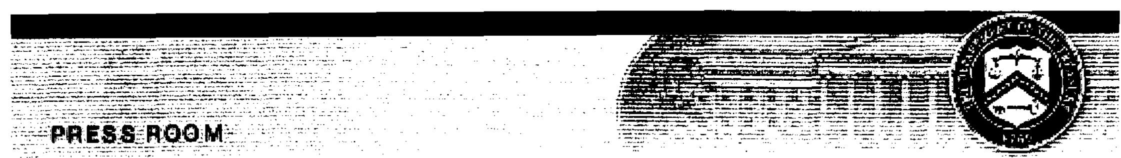

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April 11, 2008
HP-918

Treasury, IRS Issue Funding Guidance for Single-Employer Defined Benefit Plans

Washington, DC--The Treasury Department and the Internal Revenue Service issued today proposed regulations under section 430 of the Internal Revenue Code that provide employers sponsoring single-employer defined benefit plans with guidance regarding the determination of minimum required contributions under the new funding rules enacted as part of the Pension Protection Act of 2006.

The proposed regulations, together with three earlier sets of proposed regulations, enable plan sponsors to determine the contribution requirements that apply to their defined benefit plans under the new funding regime, including the application of the quarterly contribution requirements.

Although the new funding rules are generally effective for plan years beginning on or after January 1, 2008, these regulations are proposed to be effective for plan years beginning on or after January 1, 2009. Plan sponsors, however, can rely on the proposed regulations for purposes of satisfying the minimum funding requirements for plan years beginning in 2008.

On December 19, 2007, the Senate passed an amended version of the Pension Protection Technical Corrections Act of 2007 and on March 13, 2008, the House of Representatives passed similar legislation. These proposed regulations, like the earlier proposed regulations, do not reflect those technical corrections. After technical corrections are enacted, the regulations will be modified to reflect the new provisions.

A copy of the proposed regulations is attached.

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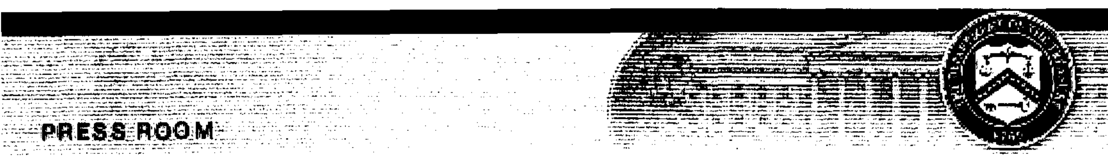

April 11, 2008
HP-919

Statement of G-7 Finance Ministers and Central Bank Governors

Washington, DC – We met today amid ongoing challenges to the world economy and international financial system.

The global economy continues to face a difficult period. We remain positive about the long-term resilience of our economies, but near-term global economic prospects have weakened. While economic conditions differ in our countries, downside risks to the outlook persist in view of the ongoing weakness in U.S. residential housing markets, stressed global financial market conditions, the international impact of high oil and commodity prices, and consequent inflation pressures. The performance of emerging markets has been a bright spot, but these countries as well are not immune from global forces.

The turmoil in global financial markets remains challenging and more protracted than we had anticipated. In the context of a weaker economic outlook, financial markets confront the interrelated issues of: re-pricing of risk and significant de-leveraging; managing counterparty risks; accommodating balance sheet adjustments; raising capital; improving the liquidity and functioning of key markets. We welcome efforts by many financial institutions to improve disclosure of exposures to structured products and related risks, and raise significant new capital.

We reaffirmed our strong commitment to continue working closely together to restore sustained growth, maintain price stability, and ensure the smooth and orderly functioning of our financial systems. We welcome the coordination by major central banks to address liquidity pressures in funding markets and recognize the importance of their coordinated actions to address disruptions in global financial markets. In particular, the recent steps taken by some central banks to expand access to central bank lending facilities and expand the range of collateral that they will accept is providing liquidity to financial institutions and helping to support improved market functioning. In addition, we welcome other measures that have been taken including monetary and fiscal policy that aim to give support to underlying economic activity and ensure price stability. Each of us remains committed to taking action, individually and collectively as appropriate, consistent with our respective domestic circumstances.

We reaffirm our shared interest in a strong and stable international financial system. Since our last meeting, there have been at times sharp fluctuations in major currencies, and we are concerned about their possible implications for economic and financial stability. 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 encourage accelerated appreciation of its effective exchange rate.

Last fall we tasked the Financial Stability Forum (FSF) for a report identifying the underlying causes and weaknesses in the international financial system that contributed to the financial market turmoil. We thank Mario Draghi, the chairman of the Financial Stability Forum, and FSF members, for the report that sets out detailed recommendations to enhance market and institutional resilience. We, the G-7, strongly endorse the report and commit to implementing its recommendations. Rapid implementation of the FSF report will not only enhance the resilience of the global financial system for the longer term but should help to support confidence and improve the functioning of the markets.

The FSF report presents a specific and substantive set of recommendations across five major areas. We have identified the following recommendations among the immediate priorities for implementation within the next 100 days:

- Firms should fully and promptly disclose their risk exposures, write–downs, and fair value estimates for complex and illiquid instruments. We strongly encourage financial institutions to make robust risk disclosures in their upcoming mid-year reporting consistent with leading disclosure practices as set out in the FSF's report.
- The International Accounting Standards Board (IASB) and other relevant standard setters should initiate urgent action to improve the accounting and disclosure standards for off-balance sheet entities and enhance its guidance on fair value accounting, particularly on valuing financial instruments in periods of stress.
- Firms should strengthen their risk management practices, supported by supervisors' oversight, including rigorous stress testing. Firms also should strengthen their capital positions as needed.
- By July 2008, the Basel Committee should issue revised liquidity risk management guidelines and IOSCO should revise its code of conduct fundamentals for credit rating agencies.

We endorse the following FSF proposals for implementation by end-2008:

- *Strengthening prudential oversight of capital, liquidity, and risk management:* The Basel II capital framework needs timely implementation. The Basel Committee should raise capital requirements for complex structured credit instruments and off-balance sheet vehicles, require additional stress testing, and enhance their monitoring.
- *Enhancing transparency and valuation*: The Basel Committee should issue further guidance to enhance the supervisory assessment of banks' valuation processes to strengthen disclosures for off-balance sheet entities, securitization exposures, and liquidity commitments.
- *Changing the role and uses of credit ratings*: Investors need to improve their due diligence in the use of ratings. Credit rating agencies should take effective action (consistent with IOSCO's revised code of conduct) to address the potential for conflicts of interest in their activities, clearly differentiate the ratings for structured products, improve their disclosure of rating methodologies, and assess the quality of information provided by originators, arrangers, and issuers of structured products.
- *Strengthening the authorities' responsiveness to risk*: Supervisors and central banks should further strengthen cooperation and exchange of information, including the assessment of financial stability risks. It is important that an "international college of supervisors" be established for each of the largest global financial institutions. Market authorities also should act cooperatively and swiftly to investigate and penalize fraud, market abuse, and manipulation.
- *Implementing robust arrangements for dealing with stress in the financial system*: Central banks should be able to supply liquidity effectively during financial system stress, and authorities should review and where necessary strengthen their arrangements for dealing with weak and failing banks, domestically and cross-border.

We ask the FSF and its working group to monitor actively the implementation of the report's recommendations. It is important that member bodies of the FSF, including the Basel Committee, IOSCO, the IASB, and the Joint Forum, accelerate their timetables of work to conclude their efforts by end-2008 and that the recommendations of the FSF be fully and effectively implemented. We look forward to an update at the Osaka meeting in June and a comprehensive follow-up report by the FSF at our meeting in the fall. We welcome the strengthened cooperation between the FSF and IMF, which should enhance the early warning capabilities of key risks to financial stability.

We also welcome efforts by private-sector participants to develop proposals to contribute to a better functioning of the financial system.

The current financial market turmoil also has raised broad policy issues about the appropriate regulatory frameworks of our financial sectors. We have reaffirmed the importance of reviewing regulatory frameworks to consider whether changes are necessary to ensure that our financial systems are as efficient and stable as possible in the future.

We reaffirm the important role for the IMF in securing global financial stability. In this light we endorse the significant progress on IMF reform:

- We welcome the agreement on quota and voice reform in the IMF as an important step to recognize the greater global weight of dynamic economies, many of which are emerging markets, and increasing the voice of low income countries.
- We reiterate the importance we place on the IMF's new framework for surveillance, including for exchange rates, and urge its firm and even-handed implementation.
- We welcome progress toward putting the IMF's finances on a more sustainable footing, including a $100 million annual reduction in administrative expenses. Ongoing budget discipline will be required. We support new sources of income, including an endowment financed by a limited sale of IMF gold.

Taken together, these important reforms will boost the IMF's legitimacy, effectiveness, and credibility.

Upholding open trade and investment regimes is critical to realizing global prosperity and fighting protectionism. We highlight the urgent need for a successful conclusion to the Doha Development Round. We also commend the OECD work on open investment and the IMF's commitment to deliver a set of best practices for Sovereign Wealth Funds by the IMF Annual Meetings in October. The policy principles put forward by Abu Dhabi, Singapore, and the United States should be helpful inputs into these processes.

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April 11, 2008
HP-920

Statement by Secretary Paulson
Following Meeting of G7 Finance Ministers And Central Bank Governors

Washington, DC-- Today G-7 Finance Ministers and Central Bank Governors met in Washington at a time of slowing global growth and increased downside risks to the global economy. As you might expect, most of our discussion focused on the ongoing challenges in the global economy and the international financial system, and the policy responses to these challenges.

I am confident in the long-term economic prospects of the United States. However, the housing correction, together with high energy prices and financial market turmoil, are weighing on U.S. economic growth. Given the significant short-term downside risks, we are taking action. The economic stimulus package passed in February will provide over $150 billion of individual and business tax relief in 2008, leading to the creation of over half a million additional jobs by the end of the year. The Administration has taken a number of steps specifically designed to minimize the spillover from the housing sector to the real economy, such as convening the HOPE NOW alliance and implementing the FHASecure program. The Administration continues to push for legislative action on FHA modernization and reform of Government-Sponsored Enterprises as well.

I have the greatest confidence in the resiliency, flexibility and strength of our economy and our capital markets. We have been undergoing a period of financial market stress since last August. Markets are pricing and reassessing risk and there are always difficulties during periods such as this. There may be more bumps in the road. As we work through this period, our highest priority is limiting its impact on the real economy. We are focused on maintaining stable, orderly and liquid financial markets and ensuring that our banks continue to support the economy by raising capital when necessary and making credit available to consumers and businesses.

The financial market turmoil and its impact on global growth underscore the need for all countries to remain open to trade and investment. I reiterated the United States' commitment to open investment policies and to combating rising protectionism. Protectionist pressures threaten to deprive countries of the significant benefits generated by foreign investment. I support the work of the IMF to develop best practices for sovereign wealth funds (SWFs) and look forward to a final set of best practices by the IMF Annual Meetings in October. I encourage the OECD to continue its work, and to identify this year, best practices for the inward investment regimes of countries that receive government-controlled investment, including from SWFs. We agreed that a successful completion of Doha is also critical to this effort.

Many actions across the globe are being taken to address the financial market turmoil. International cooperation and coordination has been excellent. We have worked, and will continue to work, closely to address global challenges and take concrete actions. Here in the United States, the Administration is taking steps to enhance the functioning and stability of the U.S. financial system going forward. I briefed my colleagues on the work of the President's Working Group on Financial Markets (PWG) and Treasury's analysis on an optimal financial regulatory structure for the United States, which benefited from comments that we sought from around the globe. The PWG issued a policy statement in mid-March, with recommendations to improve market transparency and disclosure, risk awareness and risk management, capital and regulatory policies, practices regarding and use of credit ratings, and market infrastructure for over-the-counter derivatives products. Implementation of these recommendations can strengthen market discipline, enhance risk management, and improve the efficiency and stability of our capital markets. Later this year the PWG will report on progress towards implementation of its recommendations. The PWG is working closely with foreign regulators, finance ministries, and central banks through the Financial Stability Forum (FSF) on

financial market issues. Working together, we can strengthen market discipline, enhance risk management and improve the efficiency and stability of our capital markets.

I welcomed the update from Mario Draghi, Chairman of the Financial Stability Forum, on the Forum's report identifying the underlying causes and weaknesses in the international financial system that have contributed to the financial market turmoil, and formulating detailed policy recommendations to enhance market and institutional resilience. The FSF report presents recommendations in several key areas: risk management; transparency, accounting, and valuation of structured products; credit rating agencies; dealing with stress in the financial system; and strengthening cooperation among supervisors and authorities. We discussed the importance of rapid and effective implementation of the FSF findings, and I support efforts encouraging the FSF member organizations, including the Basel Committee on Banking Supervision, the International Organization of Securities Commissions, the International Accounting Standards Board, and the Joint Forum of banking, securities, and insurance supervisors, to accelerate their timetables to conclude their efforts by the end of the year. The broadly consistent recommendations of the FSF and those of the PWG complement each other and strengthen the effectiveness of our response. The G-7 will review an update on the implementation of the FSF policy recommendations at its October Ministerial.

Following our extensive discussion on the global economy and international financial markets, we discussed several key issues of IMF reform. I stressed that the IMF must vigorously reform itself in order to remain legitimate and relevant in today's global economy. I underscored the need for firm implementation of the IMF's new framework for exchange rate surveillance. The Fund has worked to strengthen its focus on exchange rate analytics, but there is clearly a great deal more progress to be made on implementation of the new framework. The Fund has an important role to play in surveillance and its success moving forward as an institution will depend critically on its ability to demonstrate this.

The United States supports the recent agreement on IMF quota and voice reform. It is a modest, but important, step forward in realigning the distribution of IMF quota shares to be more reflective of the current global economy. The deal is not as ambitious as we would have liked, but we were impressed that many dynamic emerging markets consider it an improvement on the status quo and a first step in recognizing their growing role in the international monetary system. I welcomed the progress that has been made toward putting IMF finances on a more sustainable footing, which includes a significant downsizing of IMF staff. I am pleased that both expenditures and revenues are being addressed, and I commend Dominique Strauss-Kahn, the Managing Director, for putting a concrete plan on the table to deal with the IMF's administrative expenses. As part of this reform, I explained to my colleagues that the U.S. will seek Congressional authorization for a limited gold sale for an IMF endowment.

Finally, we reaffirmed our commitment to vigorously counter money laundering, terrorist and proliferation financing in order to safeguard the integrity of the global financial system. We remain particularly concerned about the ongoing risks of illicit finance emanating from Iran and urge all countries to urgently and fully implement the financial provisions of UN Security Council resolutions 1737, 1747, and 1803. We strongly support the public actions of the Financial Action Task Force (FATF) to protect the international financial system from these risks, as well as the risks arising from substantial jurisdictional deficiencies in Iran's anti-money laundering and counter-terrorist financing regime. We agreed that FATF should continue its important work in identifying and responding to emerging illicit financing threats to the international financial system. We also agreed that FATF should continue to apply its expertise in providing guidance to assist states in implementing their financial obligations under U.N. Security Council resolutions to combat WMD proliferation. We strongly support the continued cooperation of the IMF and World Bank with the FATF to combat money laundering and terrorist financing worldwide.

PRESS ROOM

April 12, 2008
HP-921

Statement by Secretary Henry M. Paulson, Jr.
at the International Monetary and Financial Committee Meeting

Washington, DC –Today's meeting takes place against the backdrop of considerable challenges to the global economy. In recent years, global economic conditions have been quite favorable, with growth averaging nearly 5% per year. 2008 will be a more difficult year, with headwinds coming from adjustments in the U.S. economy, financial market stress, higher commodity prices, and higher than desirable inflation. Downside risks will vary, and many European and emerging market economies have stood up relatively well so far to the recent financial turmoil, but no economy is entirely immune from global forces. In this context, it is critical for policy makers to put in place sound policy frameworks that support growth and enhance economic resilience.

Following several years of what, in retrospect, was unsustainable home price appreciation, the U.S. economy is undergoing a significant housing correction. The weak housing market, together with high energy prices and stress in financial markets is penalizing U.S. economic growth. While I am confident in the long-term economic prospects of the United States, clearly for the moment, the risks facing the U.S. economy are to the downside. We are responding vigorously. First, we have adjusted macroeconomic policy to support the broad U.S. economy while the corrections take place in the housing and credit markets. The President and Congress responded with a bipartisan fiscal stimulus package that will inject more than $150 billion into our economy in the near term and boost GDP growth this year. Second, the Administration has supported a number of initiatives – both private-sector led and public-sector initiatives – in response to the housing correction, designed to prevent avoidable foreclosures and maintain viable credit markets while allowing the needed adjustment to proceed.

Since last August, financial markets have been reassessing risk, re-pricing assets and de-leveraging. It took time to build up recent excesses and it will take time to work through the consequences. We must expect more bumps in the road. Global financial institutions are making progress, with some announcing write-downs and acting to raise capital. Additional disclosures of risks and material conditions and sound capitalization continue to be important, as does the ability of financial market participants to provide liquidity and of banks to extend credit. I have confidence in our capital markets and in their resilience, flexibility, and strength.

In the United States, the President's Working Group on Financial Markets (PWG) released recommendations in mid-March to improve market transparency and disclosure, risk awareness and risk management, capital and regulatory policies, practices regarding and use of credit ratings, and market infrastructure for over-the-counter derivatives products. We are working closely through the G-7 and the Financial Stability Forum (FSF) to address global challenges and take concrete actions. We support the recommendations of the FSF, which are broadly consistent and complementary to PWG recommendations. The FSF has focused its efforts on risk management; transparency, accounting, and valuation of structured products; credit rating agencies, prudential oversight and arrangements for dealing with stress in the financial system. While no silver bullet exists to prevent the excesses of the past from re-occurring, working together we can strengthen market discipline, enhance risk management and improve the efficiency and stability of our capital markets.

The IMF, as a member body of the FSF, has an important role to play in providing analytic support and conducting financial surveillance of its member countries. We support complementary roles, with the IMF reporting findings from its monitoring of financial stability risks to FSF meetings, and in turn incorporating FSF conclusions into its surveillance work.

Openness to trade and investment helps underpin global growth and has been a source of strength for the U.S. economy. We remain committed to opposing protectionist sentiment wherever it may be found and to advancing greater openness globally. The Doha Development Round is at a critical juncture if negotiations are to be completed by the end of the year. The United States is willing to step forward with the necessary leadership – however, a significant contribution by the advanced developing countries is critical to Doha's success. Doha's development promise can only be met through agreement to significantly open markets, including financial services markets.

IMF Reform

In today's rapidly evolving global economy, the IMF must reform to retain its relevance and legitimacy. Strong international cooperation – and an effective IMF at the center of such cooperation-- remains as important as ever to global growth and financial stability. But to meet today's challenges, the Fund must sprint quickly and far to adapt to rapid technological change, the rise of dynamic emerging market economies, and the increasing internationalization of financial markets. In this context, the IMF needs to sharpen its focus on: 1) exchange rate surveillance; 2) openness to international investment, particularly meeting policy challenges posed by sovereign wealth funds; and 3) supporting global financial market stability. The Fund must also maintain its capacity to provide balance of payments support to countries in crisis, and to promote macroeconomic stability in low-income countries, while avoiding straying into the World Bank's development mandate.

Fundamental to the IMF's relevance is the vigor with which it carries out its core mission of surveillance over members' exchange rate policies. The Fund's surveillance work on fiscal, monetary policy and financial sector issues is strong. The new exchange rate surveillance decision provides an improved framework, but more important is how IMF staff carries out its day-to-day work in this area. We believe surveillance discussions have become more focused on key exchange rate issues, but staff must follow through consistently with strong analytics and clear views and judgments on exchange rate policies, particularly where currencies are not set by market forces in deep, liquid markets. The IMF's implementation of the new surveillance decision is still a work in progress. Strengthened implementation of this core mandate is integral to IMF legitimacy; insufficient progress would put success of the broader modernization effort at risk.

Last October, the IMFC recognized the systemic importance of rapidly growing sovereign wealth funds. The IMF has responded to the international community's call for analytic work on sovereign wealth fund best practices by setting forth a broad framework and process to guide work going forward. We welcome these steps, and look forward to a timely and credible set of sovereign wealth fund best practices ahead of the Annual Meetings this fall. It will be important for the Fund to work closely with both sovereign wealth fund countries and recipient countries to ensure a comprehensive, high-quality product.

Reform of the IMF's governance structure is overdue. I welcome the opportunity to join emerging market countries and the broader IMF membership in supporting a quota reform package. While we would have preferred a more ambitious reform package, this reform is a first step forward in the right direction, which boosts the weight of dynamic emerging markets and will result in a governance structure that better reflects the realities of the global economy. It improves on the status quo. We are particularly pleased that GDP will have a stronger weight in the quota formula, which will position dynamic emerging markets to see their voice in the IMF rise in the years to come. The voice of the poorest countries will also be protected. Achieving consensus on an issue of this kind was not easy, as political realities posed significant constraints and headwinds. But this package has gained the broad support of emerging market and developing countries, and represents a consensual first step forward. With this package, the Fund cannot rest on its laurels, however. Its governance structure will need to continue evolving in the years ahead, and in particular the Fund must refine the new quota formula to better reflect the realities of trade among countries.

As part of governance reform, we call on other IMF members to join us in supporting a smaller, more strategically focused Board. The Board is simply too costly and a smaller and more streamlined Board could focus more strategically on the management of the institution and less on the voluminous crush of papers. In this regard, we favor reducing the number of Board chairs from 24 seats presently

to 22 seats by 2010 and 20 seats by 2012. To facilitate consolidation of seats, we also favor eliminating the current practice of permitting the five largest shareholders to appoint their own directors, and instead believe all Board chairs should be elected.

We welcome progress toward putting IMF finances on a sustainable footing. We support Managing Director Strauss-Kahn's proposal for staff cuts on the order of 10% and a $100 million reduction in the medium-term administrative budget, in real terms, to meet a medium-term budget gap estimated at $400 million. For our part, we recognize that new sources of income are also necessary and we are committed to seeking Congressional authorization for a limited sale of IMF gold to finance an endowment. Looking forward, on-going budget discipline will be critical to ensure that savings are not eroded.

Other Key Issues

We must continue to apply vigorous efforts to combat money laundering, terrorist financing and other forms of illicit finance, in order to protect the international financial system from abuse and to support global financial stability and economic development. To this end, we have revised the mandate of the Financial Action Task Force (FATF) to include in its important work combating the financing of WMD proliferation, in addition to other forms of illicit financing. We commend the ongoing close cooperation between the FATF, the IMF and the World Bank. We emphasize the importance of preserving the IMF's capacity to provide assistance in implementing international standards to countries that are systemically important to the global financial system.

We urge all nations to vigorously implement the financial provisions of UNSCR 1803, particularly with respect to the financial institutions identified in the resolution. We further underscore the recent statements by the FATF highlighting the money laundering and terror financing risks to the international financial system emanating from Iran. Accordingly, we urge all nations to advise their financial institutions of these risks of dealing with Iranian commercial banks, and the Central Bank of Iran, and we recommend increased vigilance towards all Iranian commercial and financial relationships.

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PRESS ROOM

April 13, 2008
HP-922

**Statement by U.S. Treasury Secretary Henry M. Paulson, Jr.
at the Development Committee Meeting**

Washington, DC –While the long-run economic fundamentals remain sound, the U.S. economy faces challenges. The housing correction, credit market turmoil, and high oil prices are all weighing on growth and short-term risks are to the downside. However, the fundamental drivers that make the U.S. economy healthy over the long term are sound, including the flexibility, innovation, and entrepreneurship that characterize our country.

These risks notwithstanding, it is important to remember that developing countries are on track to record their sixth consecutive year of average GDP growth in excess of 6%, an accomplishment unparalleled in recent history. Stronger macroeconomic policies, buoyant external demand, low real interest rates, and increased access to private capital markets – over $600 billion in net private inflows in 2007 – are major factors for strong growth performance.

Recent Market Developments – Challenges and Opportunities Resulting from Higher Commodity Prices

The strong upward movements in world commodity prices in recent years have generally produced large beneficial shifts in the terms of trade for many developing countries. For these countries, we support the recommendations contained in this year's Global Monitoring Report (GMR) that sound management of these windfall revenues is essential to translate this boom into the foundations for higher sustainable growth. This will require establishing and maintaining sound institutions, combined with good governance and public finance management to ensure quality spending.

Governments of countries that are experiencing severe negative shifts in the terms of trade due to higher commodity prices, including higher food prices, may need to implement better energy demand policies and targeted safety net programs while considering longer term measures, such as promoting sustainable energy development and agricultural growth. Existing international facilities can also help mitigate the impacts of negative terms of trade movements when appropriate. Governments, however, need to resist the temptation of price controls and consumption subsidies that are generally not effective and efficient methods of protecting vulnerable groups. They tend to create fiscal burdens and economic distortions while often providing aid to higher-income consumers or commercial interests other than the intended beneficiaries.

Challenges and Opportunities for Low and Middle Income Countries

Despite impressive advances in most developing countries, the World Bank and other development partners have a large unfinished agenda. While many developing countries have been able to capitalize on the opportunities offered by increased globalization and a favorable export environment, a key challenge for the international financial institutions is to assist those countries whose growth is lagging. We agree with the assessment in the GMR that three broad areas emerge as major factors necessary for strong growth: sound macroeconomic policies, favorable private investment climates, and good governance.

We also agree with the conclusion in the GMR that the relationship between trade expansion and economic growth is positive and that trade reforms are critical means to lifting people out of poverty. Reducing barriers to trade in goods and services enables local firms to access low-cost and high-quality services such as telecommunications, transport and distribution services and financial intermediation, thus enhancing their ability to compete more effectively in international markets.

Overcoming Poverty in Fragile States and Post-Conflict Countries

The development challenges are all the more formidable in fragile and post-conflict states. It is increasingly becoming apparent that the international development community needs to be more effective in its efforts to lay the groundwork for economic growth and employment so that the people living in these states believe they have a stake in the future.

The development programs for these countries, which are mostly located in sub-Saharan Africa, will require a challenging mixture of security enhancement, political reform and consolidation, capacity building, and actions to build private sector growth opportunities. While international aid flows are an important element for successful development, establishment of basic government capacity is required to ensure that aid is used effectively. The Bank Group, working with other members of the international community, has done much in the last year – including in IDA15 – to develop a more effective strategy for promoting development in these countries and we urge swift implementation of these measures.

Environmental Sustainability and Climate Change

The World Bank and its sister institutions face multiple and growing challenges in incorporating environmental sustainability into their development and anti-poverty mandates. For instance, the MDBs are generally financing a shrinking share of investment projects relative to other lenders (especially in International Bank for Reconstruction and Development countries), which reflects positively on these countries economic development and access to private markets but dilutes MDB leverage with respect to the overall environmental performance of projects in those countries.

The Bank needs to continue to emphasize its core mandate while becoming more creative in utilizing the linkages between environmental trends and poverty. Potential areas for this include leveraging its own tools – for example safeguard policies, environmental capacity-building, payments for ecological services, techniques for adaptation to climate change, and monitoring trends in natural capital. Second, the bank should maximize the global as well as local benefits of its work in the areas of environment and climate change.

We welcome the Bank's increasing focus on climate change as it becomes clear that the issue must be addressed in the context of development efforts. However, we realize that addressing climate change is also technically and financially challenging. In this vein we applaud the Bank's work to create the Climate Investment Funds, which we intend to support with a $2 billion contribution over the next three years through the Clean Technology Fund that will help developing countries invest in a clean energy future.

Conclusion

President Zoellick outlined six strategic themes for the World Bank Group at the Development Committee meeting last fall. As these strategic themes evolve and are incorporated into a strategic framework, the Bank Group will need to make key decisions on where it will focus its resources and how to best coordinate and lead activities with other development partners. We look forward to working with President Zoellick as this strategy unfolds.

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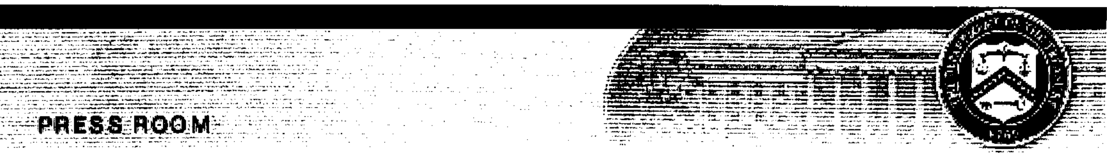

April 14, 2008
HP-923

Paulson to Deliver Remarks
as PWG Hedge Fund Committees Release Industry Best Practices

The two private sector committees created by the President's Working Group on Financial Markets will release their separate sets of best practices for hedge fund investors and asset managers tomorrow. U.S. Treasury Secretary Henry M. Paulson, Jr. will deliver remarks with Eric Mindich, chairman of the Asset Managers' Committee, and Russell Read, chairman of the Investors' Committee. Treasury Assistant Secretary for Financial Markets Anthony W. Ryan will answer questions with the committee chairmen following their opening remarks.

The following event is open to credentialed media:

Who
U.S. Treasury Secretary Henry M. Paulson, Jr.
Assistant Secretary Anthony W. Ryan
What
Release of PWG Private Sector Committees' Best Practices
When
Tuesday, April 15, 11:30 a.m. (EDT)
Where
Treasury Department
Media Room (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.

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

We recommend printing this release using the PDF file below.
To view or print the PDF content on this page, download the free Adobe® Acrobat® Reader®.

April 15, 2008
HP-924

Treasury International Capital (TIC) Data for February

Treasury International Capital (TIC) data for February 2008 are released today and posted on the U.S. Treasury web site (www.treas.g
release, which will report on data for March, is scheduled for May 15, 2008.

Net foreign purchases of long-term securities were $72.5 billion.

- Net foreign purchases of long-term U.S. securities were $82.8 billion. Of this, net purchases by foreign official institutions were $
  purchases by private foreign investors were $76.6 billion.
- U.S. residents purchased a net $10.2 billion of long-term foreign securities.

Net foreign acquisition of long-term securities, taking into account adjustments, is estimated to have been $60.1 billion.

Foreign holdings of dollar-denominated short-term U.S. securities, including Treasury bills, and other custody liabilities increased $3.4 b
of Treasury bills increased $14.6 billion.

Banks' own net dollar-denominated liabilities to foreign residents increased $0.5 billion.

Monthly net TIC flows were positive $64.1 billion. Of this, net foreign private flows were $73.1 billion, and net foreign official flows were

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TIC Monthly Reports on Cross-Border Financial Flows

(Billions of dollars, not seasonally adjusted)

				12 Months Through			
		2006	2007	Feb-07	Feb-08	Nov-07	Dec-(
	Foreigners' Acquisitions of Long-term Securities						
1	Gross Purchases of Domestic U.S. Securities	21077.1	29729.8	21750.9	31981.5	2902.5	2314
2	Gross Sales of Domestic U.S. Securities	19933.9	28724.9	20589.5	31026.1	2831.5	2244
3	**Domestic Securities Purchased, net** (line 1 less line 2) /1	**1143.2**	**1004.8**	**1161.4**	**955.4**	**71.0**	**69**
4	**Private, net /2**	**946.6**	**817.1**	**978.7**	**732.8**	**59.2**	**33**
5	Treasury Bonds & Notes, net	125.9	198.2	161.8	185.7	24.4	-9
6	Gov't Agency Bonds, net	193.8	107.0	168.2	140.8	20.6	-7
7	Corporate Bonds, net	482.2	331.5	511.7	255.3	9.9	29
8	Equities, net	144.6	180.4	137.0	150.9	4.3	21
9	**Official, net /3**	**196.6**	**187.7**	**182.6**	**222.7**	**11.8**	**35**
10	Treasury Bonds & Notes, net	69.6	3.0	46.4	38.2	0.4	11
11	Gov't Agency Bonds, net	92.6	119.1	100.5	100.0	6.0	4
12	Corporate Bonds, net	28.6	50.6	30.4	51.0	4.9	8
13	Equities, net	5.8	15.1	5.3	33.5	0.5	12

14	Gross Purchases of Foreign Securities from U.S. Residents	5515.9	8187.2	5816.7	8514.1	731.7	59
15	Gross Sales of Foreign Securities to U.S. Residents	5766.8	8410.0	6072.3	8735.8	711.1	611
16	**Foreign Securities Purchased, net** (line 14 less line 15) /4	**-250.9**	**-222.8**	**-255.6**	**-221.7**	**20.6**	**-12**
17	Foreign Bonds Purchased, net	-144.5	-128.0	-145.2	-135.0	11.0	-12
18	Foreign Equities Purchased, net	-106.5	-94.8	-110.4	-86.7	9.6	0
19	**Net Long-Term Securities Transactions** (line 3 plus line	**892.3**	**782.0**	**905.8**	**733.7**	**91.6**	**57**
20	**Other Acquisitions of Long-term Securities, net /5**	**-169.9**	**-188.9**	**-178.9**	**-181.8**	**-13.6**	**-11**
21	**Net Foreign Acquisition of Long-Term Securities** (lines 19 and 20):	**722.4**	**593.1**	**726.8**	**552.0**	**78.0**	**46**
22	**Increase in Foreign Holdings of Dollar-denominated Short- U.S. Securities and Other Custody Liabilities: /6**	**146.2**	**215.5**	**181.3**	**253.3**	**37.2**	**33**
23	**U.S. Treasury Bills**	**-9.0**	**48.8**	**-18.8**	**68.6**	**15.6**	**15**
24	Private, net	16.1	29.3	14.7	46.2	10.8	4
25	Official, net	-25.0	19.5	-33.5	22.3	4.8	11
26	**Other Negotiable Instruments and Selected Other Liabilities: /7**	**155.1**	**166.7**	**200.1**	**184.7**	**21.5**	**18**
27	Private, net	174.9	90.6	204.7	104.5	4.3	17
28	Official, net	-19.8	76.1	-4.6	80.2	17.3	1
29	**Change in Banks' Own Net Dollar-Denominated Liabilities**	**198.0**	**-108.6**	**8.8**	**-196.1**	**21.2**	**-4**
30	**Monthly Net TIC Flows** (lines 21,22,29) /8 **of which**	**1066.5**	**699.9**	**917.0**	**609.1**	**136.3**	**75**
31	Private, net	926.2	401.9	746.0	299.8	91.3	23
32	Official, net	140.3	298.0	171.0	309.3	45.0	51

/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 r of other foreign investors is subject to a "transaction bias" described in Frequently Asked Questions 7 and 10.a.4 on tl

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

/5 Minus estimated unrecorded principal repayments to foreigners on domestic corporate and agency asset-backed securitie
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 C

/6 These are primarily data on monthly changes in banks' and broker/dealers' custody liabilities. Data on custody claims are 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 brok

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

REPORTS

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

U.S. TREASURY DEPARTMENT OFFICE OF PUBLIC AFFAIRS

EMBARGOED UNTIL 9 a.m. (EDT), April 15, 2008
CONTACT Brookly McLaughlin, (202) 622-2920

TREASURY INTERNATIONAL CAPITAL DATA FOR FEBRUARY

Treasury International Capital (TIC) data for February 2008 are released today and posted on the U.S. Treasury web site (www.treas.gov/tic). The next release, which will report on data for March, is scheduled for May 15, 2008.

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Net foreign acquisition of long-term securities, taking into account adjustments, is estimated to have been $60.1 billion.

Foreign holdings of dollar-denominated short-term U.S. securities, including Treasury bills, and other custody liabilities increased $3.4 billion. Foreign holdings of Treasury bills increased $14.6 billion.

Banks' own net dollar-denominated liabilities to foreign residents increased $0.5 billion.

Monthly net TIC flows were positive $64.1 billion. Of this, net foreign private flows were $73.1 billion, and net foreign official flows were negative $9.0 billion.

TIC Monthly Reports on Cross-Border Financial Flows

(Billions of dollars, not seasonally adjusted)

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2	Gross Sales of Domestic U.S. Securities	19933.9	28724.9	20589.5	31026.1	2831.5	2244.5	3062.8	2910.1
3	**Domestic Securities Purchased, net** (line 1 less line 2) /1	**1143.2**	**1004.8**	**1161.4**	**955.4**	**71.0**	**69.6**	**77.2**	**82.8**
4	**Private, net /2**	**946.6**	**817.1**	**978.7**	**732.8**	**59.2**	**33.8**	**23.9**	**76.6**
5	Treasury Bonds & Notes, net	125.9	198.2	161.8	185.7	24.4	-9.1	-0.1	24.2
6	Gov't Agency Bonds, net	193.8	107.0	168.2	140.8	20.6	-7.4	20.0	35.7
7	Corporate Bonds, net	482.2	331.5	511.7	255.3	9.9	29.3	0.2	14.9
8	Equities, net	144.6	180.4	137.0	150.9	4.3	21.0	3.8	1.8
9	**Official, net /3**	**196.6**	**187.7**	**182.6**	**222.7**	**11.8**	**35.8**	**53.4**	**6.1**
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12	Corporate Bonds, net	28.6	50.6	30.4	51.0	4.9	8.2	3.9	4.4
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14	Gross Purchases of Foreign Securities from U.S. Residents	5515.9	8187.2	5816.7	8514.1	731.7	599.2	769.8	693.7
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16	**Foreign Securities Purchased, net** (line 14 less line 15) /4	**-250.9**	**-222.8**	**-255.6**	**-221.7**	**20.6**	**-12.0**	**-20.2**	**-10.2**
17	Foreign Bonds Purchased, net	-144.5	-128.0	-145.2	-135.0	11.0	-12.5	-17.2	5.6
18	Foreign Equities Purchased, net	-106.5	-94.8	-110.4	-86.7	9.6	0.5	-2.9	-15.8
19	**Net Long-Term Securities Transactions** (line 3 plus line 16):	**892.3**	**782.0**	**905.8**	**733.7**	**91.6**	**57.5**	**57.1**	**72.5**
20	**Other Acquisitions of Long-term Securities, net /5**	**-169.9**	**-188.9**	**-178.9**	**-181.8**	**-13.6**	**-11.3**	**-14.8**	**-12.4**
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26	**Other Negotiable Instruments and Selected Other Liabilities: /7**	**155.1**	**166.7**	**200.1**	**184.7**	**21.5**	**18.2**	**62.3**	**-11.2**
27	Private, net	174.9	90.6	204.7	104.5	4.3	17.1	55.3	-5.6
28	Official, net	-19.8	76.1	-4.6	80.2	17.3	1.0	6.9	-5.6
29	**Change in Banks' Own Net Dollar-Denominated Liabilities**	**198.0**	**-108.6**	**8.8**	**-196.1**	**21.2**	**-4.6**	**-80.3**	**0.5**
30	**Monthly Net TIC Flows** (lines 21,22,29) /8	**1066.5**	**699.9**	**917.0**	**609.1**	**136.3**	**75.0**	**35.7**	**64.1**
	of which								
31	Private, net	926.2	401.9	746.0	299.8	91.3	23.2	-42.5	73.1
32	Official, net	140.3	298.0	171.0	309.3	45.0	51.7	78.3	-9.0

/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.

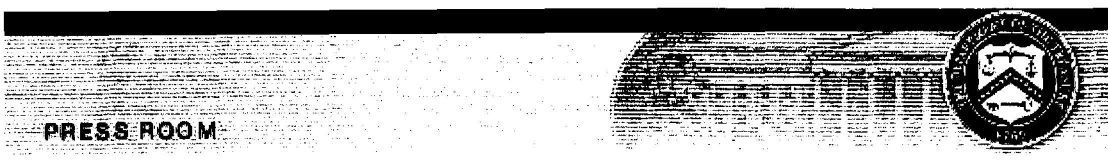
/4 Net transactions in foreign securities by U.S. residents. Foreign purchases of foreign securities = U.S. sales of foreign securities to foreigners. Thus negative entries indicate net U.S. purchases of foreign securities, or an outflow of capital from the United States; positive entries indicate net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



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April 15, 2008
HP-925

Testimony of U.S. Treasurer Anna Escobedo Cabral before the House Committee on Financial Services

Washington- Good morning. Thank you, Chairman (Barney) Frank. I want to thank you Ranking Member (Spencer) Bachus, and the members of the committee for this opportunity to appear today.

Also, I would like to thank the Committee and the House for their leadership on financial literacy, including the Congressional resolution declaring April as Financial Literacy Month. I commend you for focusing a national spotlight on this issue.

The attention is timely. Today, many Americans are struggling – we have young adults struggling with debt, families struggling to understand the terms of their mortgages, and older Americans struggling with retirement issues. These are complex problems and there are no simple solutions. But what we can do to make a difference – and what is greatly needed in this country – is a little preventative medicine. That is, to teach *all* Americans how to make smart, sound financial choices.

During this financial literacy month, it is appropriate that we step back, assess our efforts, and enhance our financial literacy outreach. But be assured, our assessment and promotion of financial literacy doesn't begin on the 1st and end on the 30th of April. It is a 365-day effort every year.

During my term in office as Treasurer, I have traveled across the country from the Bay Area to the Boroughs of New York to cities and towns in between spreading the financial literacy message to as many Americans as I can. This is more than just a message to me. I am the daughter of farm workers who grew up in communities where being unbanked was common, where saving for college was a rarity, and where financial education was oftentimes nonexistent. So for me, promoting financial literacy isn't just good policy. It's personal.

The President and Secretary Paulson are equally committed to their beliefs in the value of financial literacy. The President's new USA Freedom Corps Financial Literacy Volunteer Initiative, established just last month, provided more proof of this commitment. This initiative will encourage everyday Americans to volunteer to teach financial education in their communities.

I want to talk about three ways that we are addressing financial literacy. The most recent of these efforts is an advisory group created by the President.

The President's Advisory Council

The President's Advisory Council was launched on January 22, 2008. The Council is comprised mostly of financial education leaders from the private sector, with one state government representative. It is chaired by Charles Schwab.

This private-sector group, in addition to the federal efforts of the Financial Literacy and Education Commission, will increase the level of our nation's resources dedicated to financial literacy. To ensure close coordination with the Financial Literacy and Education Commission, the Council recently named a liaison to the Commission who will attend Commission meetings and report on them to the Council.

The Financial Literacy and Education Commission

An abundance of our financial literacy efforts are through the Financial Literacy and Education Commission. This 20-agency group was established by the Fair and Accurate Credit Transactions (FACT) Act of 2003. The FACT Act named the Secretary of the Treasury as chair of the Commission and gave the Commission and Treasury four mandates: a Web site, a hotline, a multimedia campaign and a national strategy.

I am pleased to provide progress on each of these projects.

1. Web Site

In October 2004, the Commission launched MyMoney.gov, a Web site designed to be a one-stop shop for federal financial education information. The Website is available in English and Spanish and is operated by the General Services Administration (GSA). It is organized intuitively by topic rather than by agency. Web site topics include "Paying for Education," "Saving and Investing," "Home Ownership," "Privacy," and "Frauds and Scams."

MyMoney.gov also provides links to financial education grants offered by different Commission member agencies. The site has 402 links and has had more than 2 million hits. Visitors can access an interactive, instructional quiz on financial literacy, view a public service announcement promoting MyMoney.gov and get information on the activities of the Commission.

The Commission works to ensure that the topics are timely and relevant. For example, during hurricane season it features information on how to financially prepare for a weather-related emergency. More recently, the Commission has added a link explaining the economic stimulus payments, and the front-page features information on how to avoid foreclosure rescue scams.

2. Toll Free Hotline

In October 2004, the Commission also launched a toll-free hotline called 1-888-MyMoney. Operated by the GSA, the hotline is available in English and Spanish and permits callers to order a free MyMoney toolkit. The English language toolkit contains eight federal publications covering topics from savings to investing to understanding the Social Security system. The Spanish language toolkit has seven publications. Since its launch in October 2004, the MyMoney hotline has received more than 20,200 calls.

3. Multimedia Campaign

The Treasury is working with the Ad Council on the production of a campaign that will address the topic of credit literacy, emphasizing the impact of one's credit score. The project has progressed through the research, focus group, and creative stages, and is now in production. The campaign is scheduled to launch in the summer of 2008. It will feature television spots, radio spots, and a new Web site.

4. National Strategy

The FACT Act also required the Commission to develop a national strategy for financial literacy. In April of 2006, the Commission released *Taking Ownership of the Future: The National Strategy for Financial Literacy*. The *Strategy* is a comprehensive blueprint for improving financial literacy in America, covering 13 areas of financial education in 13 chapters. Approximately 7,600 copies of the *Strategy* have been distributed, and the *Strategy* has been downloaded an additional 102,860 times.

This month, the Commission submitted its third annual *Strategy for Assuring Financial Empowerment Report*. The report contains updated information regarding the implementation of the Commission's principal duties and provides further details of current and future activities in which the Commission is or will be involved.

GAO Report

A December 2006 Government Accountability Office (GAO) report on the Commission's activities made several recommendations. The Commission welcomed the insights of GAO on how we could better accomplish our important mission on behalf of the American people.

The Commission incorporated many of the GAO recommendations into its 2007 revisions to the *Strategy*. For instance, GAO recommended that definitions to "financial education" and "financial literacy" be added to the *Strategy*, and the Commission defined and incorporated both terms. GAO recommended more of a focus on partnerships, and the Commission is highlighting agency partnerships with the private sector on its Web site. In response to a GAO recommendation, the Commission is also planning to conduct usability testing of and measure customer satisfaction with MyMoney.gov.

Additionally, GAO suggested an independent review of federal financial education programs and resources. Although the FACT Act does not require an independent review of such programs and resources, the Commission decided to pursue such a review, with the first series of assessments to be completed in 2009.

The GAO also recommended that the Commission work closely with private entities and state and local governments to improve financial literacy. In response, on April 17, 2007 Treasury and the Office of Personnel Management co-hosted the Commission's inaugural meeting of the "National Financial Education Network" of federal, state and local governments at Treasury. This network will facilitate precisely the type of cooperation called for in the GAO report.

We continue to work to respond to the GAO recommendations.

Calls to Action

At the end of each chapter of the *Strategy* are specific, numbered Calls to Action. Most of the actions are assigned to the federal government, but some of the activities are recommendations for the private sector or for individuals. Since the launch of the *Strategy* two years ago, the Commission has been hard at work implementing these calls. The Calls to Action are milestones for the Commission, and allow it to measure performance on many initiatives that would not be possible without the cooperation of all 20 member agencies.

I am pleased to provide a summary of progress on the *Strategy's* Calls to Action:

Chapter 1: General Saving

1-1 In April of 2007, Treasury and the American Savings Education Council launched a public service announcement (PSA) on the importance of saving. The PSA promotes the Web site, MyMoney.gov and toll-free hotline, 1-888-MyMoney. This ad can be viewed on MyMoney.gov.

Chapter 2: Homeownership

2-1 In July of 2006, the Department of Housing and Urban Development (HUD) and Treasury co-hosted a roundtable which highlighted successful partnerships that have advanced homeownership. During the meeting, the complexity of identifying partners to advance homeownership was discussed at length. Participants cited best practices which have helped with foreclosure prevention, non-traditional mortgage products, and the identification of a variety of hidden costs to consumers.

In July of 2007 in Boston, Massachusetts, HUD, in partnership with the Treasury Department, hosted the second meeting highlighting successful partnerships that have advanced homeownership. The discussion was focused on how public-private sector partnerships can better deliver grassroots counseling and training programs. The Federal Deposit Insurance Corporation and the Federal Reserve Bank of Boston also contributed to the dialogue.

Chapter 3: Retirement Saving

3-1 In 2008, the Treasury Department and the Department of Labor (DOL) will co-

host a roundtable with large employers on retirement saving. Topics will include successful strategies in integrating the delivery of financial education into the workplace and other options for increasing participation and contributions in private pensions, such as automatic enrollment.

An agenda is being developed. The roundtable is planned for the summer of 2008 in Washington, D.C.

3-2 In April 2006, the Small Business Administration (SBA) linked its online retirement training tools for small businesses to MyMoney.gov. In addition, the Department of Labor and the Internal Revenue Service (IRS) developed and released a new publication, *Payroll Deduction IRAs*, to complement a series on retirement plan options for small employers. DOL, as part of its ongoing Fiduciary Education Campaign, *Getting It Right - Know Your Fiduciary Responsibilities*, conducted 27 Fiduciary Compliance Assistance Seminars, in coordination with the IRS, the American Institute of Certified Public Accountants, and the Society of Human Resources Management.

3-3 DOL, working in partnership with a national non-profit organization and the IRS, has implemented the multi-faceted campaign to educate small businesses and their accountants about options for employee retirement plans. The DOL and its national non-profit organization partner created a DVD that provides first-hand observations from small employers and their employees as well as the accountants for the businesses on the benefits of their retirement plans. The DOL and the IRS are working on a new publication on the automatic enrollment 401(k) plan which will be published this spring and are updating the popular publication, *401(k) Plans for Your Small Business*. The DOL and its national non-profit organization partner are completing work on an interactive Web site that will help small businesses and their accountants find the retirement plan options that are appropriate for their business. This site will be available to the public later this spring.

Chapter 4: Credit

4-1 Through an agreement with the Ad Council, Treasury has been working to develop and execute a multimedia public service announcement campaign on credit literacy for young adults, emphasizing the impact of one's credit score. The project has progressed through the research, focus group, and creative stages, and is now in production. The campaign is scheduled to launch in the summer of 2008. It will feature television spots, radio spots, and a new Web site. Some elements of the Web site will also be available in Spanish.

Chapter 5: Consumer Protection

5-2 In April of 2006, Treasury released the DVD, *Identity Theft: Outsmarting the Crooks*, and made it available to the public through MyMoney.gov and 1-888-My Money.

All copies of the DVD, which totaled 60,750, were distributed. A transcript of the DVD can be found online at http://treas.gov/offices/domestic-finance/financial-institution/cip/pdf/library_transcript.pdf.

Chapter 6: Taxpayer Rights

6-2 The Department of the Treasury and a Federal Reserve Bank have continued the national public education campaign, "*Go Direct*." The campaign is designed to encourage Americans who receive federal benefit payments, particularly Social Security, to use direct deposit. From the start of the pilot program in September, 2004, through February 8, 2008, there were more than 1,670,000 conversions of paper check recipients to direct deposit enrollees. The U.S. Senate declared February 2008 as "Go Direct Month" to motivate more Americans to select direct deposit for their Social Security and other federal benefit payments.

6-3 As a result of the Department of Health and Human Services' (HHS) public awareness campaign on the new Medicare drug benefit that encourages seniors and people with disabilities to take a look at their prescription drug coverage options, over 90 percent of those with Medicare have some form of drug coverage. Of those, almost 24 million have prescription drug coverage through the new

Medicare Part D benefit. HHS worked with 40,000 partners and conducted more than 12,000 events to educate taxpayers and beneficiaries on enrolling in the Part D program. More than 1.4 million beneficiaries have enrolled in Medicare's Part D program since June of 2006, bringing the total number of people with Medicare receiving comprehensive prescription drug coverage to more than 39 million.

Chapter 8: The Unbanked

8-1 Four regional conferences have been held on how to reach the unbanked. The conferences were held in Chicago, IL in May 2006; Edinburg, TX in December 2006; Seattle, WA in March 2007; and New York, NY in October 2007. The conferences have touched on topics such as building partnerships and identifying solutions, serving immigrant communities, reaching young customers, providing financial education to help new and potential bank customers, and what can be learned from alternative lenders. The conferences were accomplished by the Treasury along with the Federal Deposit Insurance Corporation (FDIC), National Credit Union Administration (NCUA), the Office of the Comptroller of the Currency (OCC), the Office of Thrift Supervision ,the Federal Reserve Banks of Chicago, Dallas, New York, Philadelphia, Richmond, and San Francisco, and with assistance from HUD, the Washington State Department of Financial Institutions and the New York City Department of Consumer Affairs, Office of Financial Empowerment. These conferences brought together a wide range of attendees on the topic of serving the unbanked population.

Chapter 9: Multilingual / Multicultural Populations

9-1 The Department of the Treasury has held three roundtable discussions on financial education topics of special concern to specific communities. In March of 2007, the first roundtable took place at Treasury and was focused on American Indian or Alaskan Native populations. Topics included public and private partnerships, access to financial institutions and services, and public awareness events on reservations.

In July of 2007, the second conference on multicultural and multilingual communities took place at Treasury. The focus was Asian and Native Hawaiian or other Pacific Islander communities. The main topics covered were financial education programs and partnerships that have successfully promoted financial education in the Asian and Native Hawaiian or other Pacific Islander communities. Representatives from the business world, from nonprofits and from government participated in the discussion.

In March of 2008, the third conference took place and focused on Black or African American communities. The main topics covered were using media to reach Black or African American markets, credit literacy, youth and higher education, and preparing for retirement.

On June 10, 2008, the fourth and final conference, which will focus on Hispanic or Latino communities, is expected to be held at the Treasury.

Chapter 10: Kindergarten – Postsecondary Financial Education

10-1 In February of 2007, the Department of Education (ED) and Treasury co-hosted a two-day summit on kindergarten through postsecondary financial education. The summit brought together teachers, students, program providers and researchers from across the country to discuss the role of financial education at school, non-school venues and college-level programs. As part of this summit, a request for comments was published in the *Federal Register* on the topic of raising the financial literacy levels of kindergarten through postsecondary students. The findings from this summit and the request for comment are currently being reviewed. The findings are expected to be made available by June of 2008.

Chapter 11: Academic Research and Program Evaluation

11-1 The Treasury Department, along with the Department of Agriculture's Cooperative State Research, Education and Extension Service, will convene a symposium of researchers who specialize in financial education. The goal of the symposium is to raise awareness of existing academic research and to define

questions that require additional analysis. The symposium will result in a white paper that will survey current financial education research and will also identify areas of potential future research. The symposium is scheduled for the fourth quarter of 2008.

Chapter 12: Coordination

12-1 The Commission has continued to update the Web site to make available the most current information on federal resources as well as federal financial education grant programs. In the past year, the My Money Web site has added a new feature: a calculator resource page. There are calculators for mortgage computations, home buying, college planning, savings bonds, and tax withholding. In 2008, a new link was added that takes users to the Money Math Lessons for Life curriculum. Currently, all Commission members have links to MyMoney.gov from their agencies' Web sites.

The Commission continues to enhance MyMoney.gov. In 2006, the "Money 20" interactive quiz was added to the Web site, where visitors can test their knowledge with a 20-question online quiz which covers a variety of personal finance issues. The quiz has proven to be popular. Since its inception in fiscal year 2006 through the end of March 2008, 60,051 people have taken the quiz.

12-2 In August of 2006, GSA and Treasury completed the first survey of federal financial education programs and resources. Findings have shown very little overlap or duplication among federal financial education efforts. The overlap noted was found to be minor and necessary to the completeness of a particular resource or topic. Subsequent surveys have produced similar results.

12-4 The Web site Subcommittee developed criteria and features existing partnerships on MyMoney.gov. The Commission also encourages new partnerships through MyMoney.gov.

12-5 In April of 2007, Treasury and the Office of Personnel Management (OPM) hosted the inaugural meeting of the "National Financial Education Network" of federal, state and local governments. The Network, which brings together representatives from different areas and levels of government across the nation to advance financial education efforts, will meet regularly to discuss topics related to financial education.

The Commission, in partnership with the Washington State Department of Financial Institutions and Washington Mutual, hosted the West Coast Summit of the National Financial Education Network on October 30 and 31, 2007.

One of the accomplishments of the Network is the creation of a Web site. A non-profit organization, in consultation with the Financial Literacy and Education Commission and the Network developed a Web site (www.flecnationalnetwork.org) which is comprised of materials submitted by the members of the Network to provide resources on financial literacy to the general public. The Web site addresses various topics including credit, retirement, financial planning and savings among others. To date, the Network is comprised of over 60 members and continues to broaden its membership.

Chapter 13: International Perspective

13-1 The Treasury Department will host an international summit on financial education. To bring about this multinational discussion the Treasury Department will invite the central government authorities responsible for financial literacy in their respective nations to convene and discuss recent developments, innovative methods, and successful strategies for improving financial literacy in their home countries. Treasury is partnering with the Organization for Economic Cooperation and Development to co-host an international summit on financial literacy in May 2008, in Washington, D.C.

Department of the Treasury

The third and final way we implement financial literacy initiatives is through Treasury's own outreach and education efforts.

Within Treasury, several bureaus and offices work in the field of financial education. These include the Bureau of Public Debt (BPD), the IRS, the U.S. Mint, the Office of the Comptroller of the Currency, the Office of Thrift Supervision, and, at department headquarters, my office and the Office of Financial Education.

While all of these offices perform important tasks in financial education, the bulk of Treasury's efforts in the field are conducted by its Office of Financial Education. This office was designated by Congress to lend its expertise and provides primary support to the Financial Literacy and Education Commission.

Since its establishment in 2002, the Office of Financial Education has undertaken a tremendous outreach effort. The staff has traveled to 47 states, plus the District of Columbia and Puerto Rico, has held 369 financial education sessions reaching more than 30,000 people. The office produces and disseminates guidelines for quality financial education, provides technical assistance to local programs in English and Spanish, forms partnerships with groups nationwide to connect them with resources, and coordinates the activities across the federal government through the Financial Literacy and Education Commission.

Conclusion

I hope this discussion has given a useful overview of our work.

As Americans, we share the desire to provide for our families, achieve financial security, and have a comfortable retirement. Being financially literate makes those goals more attainable. We hope that through our efforts to increase financial literacy people will lead better, more prosperous lives.

Through our continued outreach and education effort, as well as through the ongoing work of both the Financial Literacy and Education Commission and the President's new Advisory Council on Financial Literacy, Treasury can help more Americans become financially literate.

Now, I will be happy to answer any questions from the Committee concerning financial literacy.

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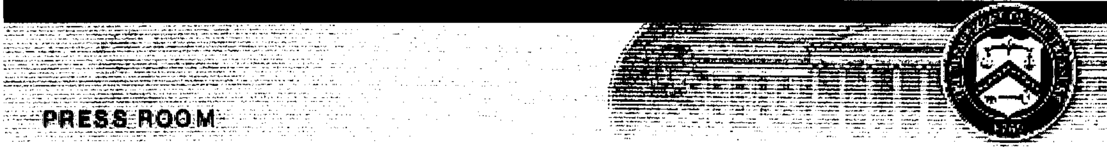

April 15, 2008
HP-926

Secretary Paulson Opening Remarks at Release of Best Practice Recommendations by PWG Private Sector Committees

Washington- Thank you all for coming this morning. Assistant Secretary for Financial Markets, Tony Ryan, is on stage with me, as are Eric Mindich and Russell Read. A special thank you to Eric and Russell for your leadership and the good work done by you and your committee members. I will say a few words about the origin of these private sector committees on private pools of capital and then Eric and Russell will discuss their work.

In February of 2007, the President's Working Group on Financial Markets, the PWG, released principles and guidelines for private pools of capital to guide market participants and regulators. The PWG principles and guidelines were not at the time, nor are they today, an endorsement of the status quo. When the Treasury Department and key independent financial regulators come together and speak with a unified voice, it sends a strong message that heightened vigilance is necessary and appropriate and that all stakeholders have an important role to play.

The PWG principles have already been put into practice, and today's release reinforces our belief that a combination of robust market discipline and regulatory policies best protect investors and mitigate systemic risk. For over a year, regulators have been implementing these principles for public policy objectives. Likewise, lenders, counterparties and creditors are also using them to strengthen their practices. To complement and further improve the effectiveness of these efforts, the PWG called on a diverse set of leaders from both the asset management and investment communities to review and significantly enhance their respective market practices.

Last September, experienced industry professionals from some of the most respected institutions agreed to serve on two new committees to address market issues and develop "best practices" for private pools of capital – one from the perspective of investors and one from the perspective of asset managers. The President's Working Group encouraged the committees to use the PWG principles and guidelines as the foundation for their best practices, and they have done so. As we said when announcing these committees --- we want the world's highest investor protection standards; we want to guard against systemic risk and keep the United States the most competitive financial marketplace in the world.

As these committees were formed, their Chairmen and the PWG believed that markets benefit when experienced and respected participants develop best practices and new accountability standards. The committees have received input from many others within the financial community, and now present their comprehensive recommendations for public comment.

These are important issues, and these recommendations represent tangible steps towards our goals. Both market and regulatory practices will evolve from here, but this is certainly a logical step at this time. All stakeholders, including regulators, must remain on top of these issues. We must implement best practices and continually seek to strengthen our market and regulatory practices.

We were fortunate that so many able and experienced industry members agreed to serve, particularly given the capital market challenges of the past seven months. With the two distinct sets of practices released today, we now have a comprehensive approach to implementing the principles and guidelines put forth by the PWG in February, 2007. Also, given the global nature of the asset management industry, I should add that these best practices are consistent with the work recently completed in the United Kingdom by Sir Andrew Large's Hedge Fund Working Group.

These best practices are coming at the height of robust discussions about the need for stronger market discipline. While they are aimed at specific market participants, and obviously not intended as a policy response to specifically address current, broader financial market issues, the practices are consistent with the spirit and intent of the PWG's recommendations for enhancing market transparency and risk management that I announced three weeks ago. As those recommendations are implemented and these best practices are adopted by market participants, we are taking further steps to support the process of normalizing our financial markets today and to protect against future systemic risk.

The two committees have gone about their work efficiently, effectively and quickly. The process leading to today began over one year ago; after the public comment period ends in 60 days, we will have final recommendations. And these committees will continue to work on raising the bar for industry standards.

Again, I want to thank all members for offering their time for this effort. Now, I will turn to the committee chairmen to provide details. Thank you.

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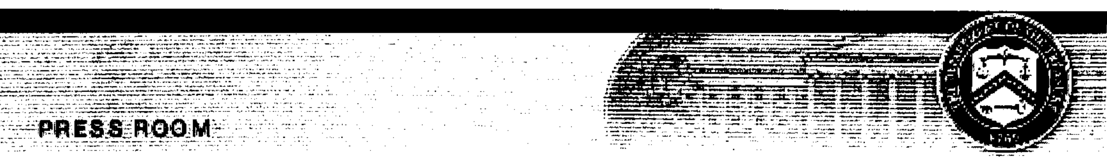

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April 15, 2008
HP-927

PWG Private-Sector Committees Release Best Practices for Hedge Fund Participants

Washington- Two blue-ribbon private-sector committees established by the President's Working Group released separate yet complementary sets of best practices for hedge fund investors and asset managers today, in the most comprehensive public-private effort to increase accountability for participants in this industry.

"As we said when announcing these committees --- we want the world's highest investor protection standards; we want to guard against systemic risk and keep the United States the most competitive financial marketplace in the world. As these committees were formed, their Chairmen and the PWG believed that markets benefit when experienced and respected participants develop best practices and new accountability standards," said Treasury Secretary Henry M. Paulson, Jr., who chairs the PWG. "These are important issues, and these recommendations represent tangible steps towards our goals."

The PWG tasked the committees, selected in September 2007 and comprised of well-respected asset managers and investors, with collaborating on industry issues and developing a set of best practices for their respective groups of stakeholders. Their work was based on the PWG's Principles and Guidelines Regarding Private Pools of Capital issued in February 2007, which sought to enhance investor protections and systemic risk safeguards. The best practices may be viewed at the committees' websites, www.amaicmte.org.

The PWG includes the heads of the U.S. Treasury Department, the Federal Reserve, the Securities and Exchange Commission and the Commodity Futures Trading Commission.

The best practices for the asset managers call on hedge funds to adopt comprehensive best practices in all aspects of their business, including the critical areas of disclosure, valuation of assets, risk management, business operations, compliance and conflicts of interest. Eric Mindich, CEO of Eton Park Capital Management, chairs the Asset Managers' Committee.

The best practices for investors include a Fiduciary's Guide and an Investor's Guide. The Fiduciary's Guide provides recommendations to individuals charged with evaluating the appropriateness of hedge funds as a component of an investment portfolio. The Investor's Guide provides recommendations to those charged with executing and administering a hedge fund program once a hedge fund has been added to the investment portfolio. Russell Read, Chief Investment Officer of the California Public Employees' Retirement System, leads the Investors' Committee.

Both best practices documents recommend innovative and far-reaching practices that exceed existing industry standards. The recommendations complement each other by encouraging both types of market participants to hold the other more accountable. Given the global nature of financial markets, the best practices were designed to be consistent with the work that was done in the United Kingdom to improve hedge fund oversight.

The PWG Principles and Guidelines Regarding Private Pools of Capital issued in early 2007 provided a clear but flexible approach to address issues presented by the growth and dynamism of these investment vehicles. The PWG designed the principles to endure as financial markets evolved and identified four stakeholders

who contribute to hedge fund vigilance: asset managers, creditors, investors and regulators.

Regulators moved to implement these principles and worked to encourage the industry to adopt the principles. Secretary Paulson in June 2007 announced that the PWG would call upon experienced industry participants who could lead the charge to raise standards for improving transparency and accountability. The group selected chairmen to lead two private-sector committees to develop the best practices.

The PWG and the committee chairmen sought a range of experience and leadership when considering committee members. The Investors' Committee included representatives from labor organizations, endowments, foundations, corporate and public pension funds, investment consultants, and non-U.S. investors. The Asset Managers' Committee includes representatives from a diverse group of hedge fund managers representing many different investment strategies.

The recommendations will be open for public comment for 60 days. The committees then will review and, as necessary, revise these best practices and standards. Comments may be submitted at the Committees' website. The committees will continue to meet to discuss raising the standards for industry participants after the best practices are complete.

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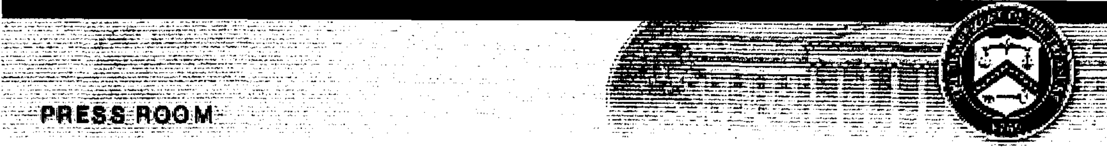
REPORTS

- Fact Sheet: Asset Managers' Committee Best Practices Summary
- Asset Managers' Committee Best Practices
- Fact Sheet: Investors' Committee Best Practices Summary
- Investors' Committee Best Practices



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September 25, 2007
HP-575

PWG Announces Private Sector Groups to Address Market Issues for Private Pools of Capital

Washington - The President's Working Group on Financial Markets announced the chairs, members and mission statements for two private sector committees, one comprised of investors and the other comprised of asset managers. These private sector committees will assess and foster a private sector dialogue on issues of significance to their industry and the market. The first task of the committees will be to develop best practices using the PWG's principles-based guidance released in February. The committees will create and publicly release the best practices so market participants may enhance investor protection and systemic risk safeguards consistent with the PWG principles and guidelines.

"These groups are drawn from among the industry's finest in their respective areas," said Treasury Secretary and PWG Chairman Henry M. Paulson, Jr. "The market will benefit if experienced participants develop and implement best practices."

The President's Working Group is encouraging market participants to move beyond the status quo as they work to strengthen market discipline. The committees represent a milestone toward a more competitive U.S. marketplace with the world's highest standards for protecting investors and safeguarding against systemic risks.

Russell Read, Chief Investment Officer of the California Public Employees Retirement System, will serve as the chair of the Investors' Committee. Eric Mindich, CEO of Eton Park Capital Management, will serve as the chair of the Asset Managers' Committee.

The PWG and the committee chairmen sought a broad range of experienced members, listed below, to participate on the Committees. The Investors' Committee includes representatives from labor organizations, endowments, foundations, corporate and public pension funds, investment consultants, and non-U.S. investors. The Asset Managers' Committee includes representatives from a diverse group of hedge fund managers representing many different strategies.

The groups will make the best practices available for public comment before they are finalized.

The PWG first discussed the establishment of these groups in June, with the announcement of the second stage of Treasury's capital markets competitiveness plan. The PWG created the groups to complement the work underway between the global regulators and the financial institutions they regulate that serve as creditors, lenders and counterparties to these private pools of capital.

Asset Managers' Committee	Investors' Committee
Mission Statement	Mission Statement
Eric Mindich, Chair Eton Park Capital Management	**Russell Read, Chair** CalPERS
Anne Casscells	**Sandra Urie, Vice-Chair**

AETOS Capital, LLC

James S. Chanos
Kynikos Associates LP

Anne Dinning
D. E. Shaw & Co., L.P.

Jonathon S. Jacobson
Highfields Capital Management

Marc Lasry
Avenue Capital Group

Edward A. Mulé
Silver Point Capital

Daniel S. Och
Och-Ziff Capital Management

Daniel H. Stern
Reservoir Capital Group

William Von Mueffling
Cantillon Capital

Michael Vranos
Ellington Management Group LLC

Cambridge Associates, LLC

Gary Bruebaker
Washington State Investment Board

Myra Drucker
Commonfund

Tom Dunn
New Holland Capital

Peter Gilbert
Lehigh University Endowment Fund

Andrew Golden
Princeton University Investment Company

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-30-

ASSET MANAGERS' COMMITTEE RELEASES
COMPREHENSIVE REPORT ON BEST PRACTICES
Report Sets New Standards for Hedge Fund Industry

Today, the Asset Managers' Committee (AMC), formed by the President's Working Group on Financial Markets in September 2007, released "Best Practices for the Hedge Fund Industry," a comprehensive report that sets new standards to reduce systemic risk and foster investor protection. The AMC report:

- Calls on hedge funds to adopt comprehensive best practices in all aspects of their business, including the critical areas of disclosure, valuation of assets, risk management, business operations, compliance and conflicts of interest.
- Recommends innovative and far-reaching practices that exceed existing industry-wide standards.
- Increases accountability for hedge fund managers: This is the first time that an industry best practices report is being released with a separate Investor report that will promote accountability and help ensure these best practices are adopted.

The first task of the AMC was to develop best practices for the hedge fund industry. The AMC includes representatives from a diverse group of hedge fund managers representing many different strategies. All authors of today's report, firms with over $140 billion in assets under management, will implement this report.

"The hedge fund industry has a critical responsibility to adopt strong business practices that reflect both its growth and the important role it plays in global financial markets," said Eric Mindich, Chair of the AMC and CEO of Eton Park Capital Management.

CONTEXT FOR THIS REPORT: This report comes at a critical time in the hedge fund industry. Over the past three decades, the hedge fund industry has grown to 8,000 funds with close to $2 trillion in assets and has become an important participant in the financial markets. As hedge funds have expanded in scope by investing and trading in markets and products all over the world and as sophisticated institutional investors have committed more of their portfolios to hedge funds, there is a need for more robust business practices.

This report is also being released at a time when financial markets are facing considerable stress. It is clear that a substantial debate is underway among policymakers on how to address these challenges. The current stress on our financial infrastructure underscores the need for hedge funds, along with other market participants, to evaluate and implement strong practices to better manage their businesses and reduce systemic risk. No set of best practices can provide solutions to all of the complex issues facing the financial industry. However, we believe that regardless of the outcome of the broader policy

debate, the robust practices set forth in this report will be critical to and consistent with the goal of reducing systemic risk.

KEY FEATURES OF THE REPORT

I. **Calls on Hedge Funds to take a Comprehensive Approach to Strengthening Business Practices:** Today's report asks hedge funds to accept that they play an important role in the financial marketplace and therefore must take a comprehensive approach to best practices in all phases of their business. This report emphasizes controls and enhanced procedures in five critical areas:
   - **Disclosure**: Strong disclosure practices that provide investors with the information they need to determine whether to invest in a fund, to monitor an investment, and to make a decision to redeem their investment.
   - **Valuation**: Robust valuation procedures that call for a segregation of responsibilities, thorough written policies, oversight and other measures for the valuation of assets, including a specific emphasis on hard-to-value assets.
   - **Risk management**: Comprehensive risk management that emphasizes measuring, monitoring and managing risk, including stress testing of portfolios for market and liquidity risk management.
   - **Trading and business operations**: Sound and controlled operations and infrastructure, supported by adequate resources and checks and balances in operations and systems to enable a manager to achieve best industry practice in all of the other areas.
   - **Compliance, conflicts, and business practices:** Specific practices, such as a written code of ethics and compliance manual, to address conflicts of interest and promote the highest standards of professionalism and a culture of compliance.

II. **Recommends Innovative and Far-Reaching Protections That Exceed Current Industry Practices.** These include:

   - **Disclosing Hard-to-Value Assets:** Some of the challenges financial institutions have faced in the past several months relate to the valuation of hard-to-value financial products, such as complex derivatives. There will soon be new accounting standards in place that require financial institutions to categorize assets in three levels based on how difficult they are to value. This report calls on hedge funds both to implement these new standards and then go beyond them by disclosing, on a quarterly basis, the portion of their assets and profit (or loss) attributable to assets in each of the three levels.

   - **Comprehensive Investor Disclosure Based on Public Company Model:** Each year, public companies provide investors with an annual summary of their performance; qualitative and quantitative quarterly reports; and timely updates of significant events. This report, for the first time, draws

from the key principles of the public company disclosure regime and calls for hedge funds to:

- Provide investors with a comprehensive summary of their performance, including a qualitative discussion of hedge fund performance and annual and quarterly reports;
- Make timely disclosures of material events; and
- Produce independently audited, GAAP-compliant financial statements so investors get accurate, independently verified financial information.

- **Segregating Duties to Minimize Conflicts of Interest**: Having a system of checks and balances where key functions are segregated to minimize conflicts of interests is critical to all complex financial institutions. As such, we developed new practices to:

  - **Address conflicts:** Because it is impossible to anticipate every potential conflict of interest relevant to the hedge fund industry, the report recommends managers establish a Conflicts Committee to review potential conflicts and address them as they arise.
  - **Segregate functions:** This report recommends segregating functions between portfolio managers and non-trading personnel who are responsible for implementing the valuation process.

- **Assessing Counterparty Risk**: Recognizing the extent to which hedge funds deal with many counterparties, the report recommends managers assess the creditworthiness of counterparties and understand the complex legal relationships they may have with these counterparties.

III. Increases Accountability for Hedge Fund Managers: This report is released together with a separate report authored by some of the leading institutional investors, including pension funds, foundations, and labor organizations. These reports underscore that both the investor and the hedge fund manager are accountable and must implement appropriate practices to maintain strong controls and infrastructure. This is the first time investors and managers have come together to achieve this goal. The Investor report, which is designed to help investors considering hedge fund investments, recommends that investors use the AMC best practices as a guide to conduct due diligence reviews of hedge funds. As a result, taken together, these reports will provide a new kind of accountability, help ensure better managed hedge funds and better educated investors and help ensure these best practices are adopted.

The full Report can be found at www.amaicmte.org.

* * *

THE ASSET MANAGERS' COMMITTEE

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Anne Casscells (Aetos Capital, LLC)
Marc Lasry (Avenue Capital Group)
William Von Mueffling (Cantillon Capital Management)
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Daniel H. Stern (Reservoir Capital Group)
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COUNSEL TO THE ASSET MANAGERS' COMMITTEE

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* * *

INVESTORS' COMMITTEE RELEASES
COMPREHENSIVE REPORT ON BEST PRACTICES
Report Sets New Standards for Fiduciaries and Investors in Hedge Funds

Today, the Investors' Committee (IC), formed by the President's Working Group on Financial Markets in September 2007, released "Principles and Practices for Hedge Fund Investors," a report that sets new standards to address the decision to invest in hedge funds, and the management and oversight of hedge fund investments. The IC report:

- Includes both a Fiduciary's Guide and an Investor's Guide. The Fiduciary's Guide provides recommendations to individuals charged with evaluating the appropriateness of hedge funds as a component of an investment portfolio. The Investor's Guide provides recommendations to those charged with executing and administering a hedge fund program once a fiduciary has decided to add hedge funds to the investment portfolio.
- Recommends best practices that offer a guide for responsible investment in hedge funds.
- Increases accountability for hedge fund investors and managers: This is the first time that an industry best practices report is being released with a separate Asset Managers' report that is geared to promote the adoption of healthy practices for both the management of and investment in hedge funds.

The first task of the IC was to develop best practices for hedge fund investors and those with fiduciary responsibilities for investment portfolios. The IC includes representatives from a broad array of investors and investor advocates. The committee members include public and private pension funds, endowments, foundations, hedge funds, labor organizations and hedge fund consultants. All authors of today's report strongly endorse the widespread adoption of these best practices for fiduciaries and investors who are considering or are already invested in hedge funds.

"Not only are we trying to provide the very best practices recommendations, our goal is to have those practices be accepted by both investors and hedge fund managers and perhaps most importantly, to have those recommendations become common practice throughout the industry," said Russell Read, Chair of the IC and CIO of the California Public Employees' Retirement System.

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KEY FEATURES OF THE REPORT

I. **Provides a Fiduciary's Guide defining a set of practice standards and guidelines for fiduciaries considering or already investing in hedge funds on behalf of qualified individuals and institutions.** Today's report asks hedge fund fiduciaries to accept that they play an important role and therefore must take a comprehensive approach to investing in hedge funds. This section of the report emphasizes the following areas:
   - **Hedge fund investment and allocation**: The report lists the questions that should be addressed to determine if a hedge fund program is appropriate for their investment portfolio.
   - **Hedge fund investment policy**: Fiduciaries should develop explicit policies that define the key features and objectives of the hedge fund investment program.
   - **Due diligence process**: The report provides a framework for understanding and assessing the appropriateness of hedge fund investments.
   - **Conclusion:** Prior to embarking on a hedge fund program fiduciaries should be satisfied that incorporating hedge funds into a portfolio would improve its risk and reward profile, and increase the probability of meeting the applicable investment objectives.

II. **Recommends best practices for investors in hedge funds.** These include:

   - **Due diligence process:** Proper due diligence needs to be tailored to the circumstances and objectives of each investor and to the particular risk and reward character of each hedge fund investment.

   - **Comprehensive Investor Risk Management:** This overview proposes best practices for establishing the investor's own risk management framework and best practices for evaluating the risk management framework employed by a hedge fund manager.

- **Legal and Regulatory**: This section provides best practices on investment structure, assessing the domicile of hedge fund investments, understanding the terms, establishing fiduciary duties of the hedge fund manager, assessing the regulators, and understanding the rights of other investors.

- **Valuation**: A full understanding of valuation can be the key to deciding whether to make an investment and for assessing properly the returns from that investment over time.

- **Fees and expenses**: Each investor should develop a comprehensive philosophy regarding the payment of fees and expenses for all investment management services contracted, relative to the returns sought and risk taken by an investment strategy.

- **Reporting**: Reporting is a key concern for investors particularly with regard to the type of transparency needed to assess risk exposures properly. Investors should seek sufficient reporting to allow them to make informed investment decisions.

- **Taxation**: This section recognizes the extent to which hedge fund disclosures explain all tax considerations that may impact a hedge fund's returns.

- **Conclusion**: Hedge funds are a legal construct and represent a wide range of strategies. They are not an asset class in the traditional sense. More than many other investment vehicles, hedge funds require in-depth and continuous oversight by their investors.

III. Increases Accountability for Hedge Fund Investors and Managers Alike: This report is released together with a separate report authored by some of the leading hedge fund managers, representing many different strategies. These reports underscore that both the investor and the hedge fund manager are accountable and must implement appropriate practices to maintain strong controls and infrastructure. This is the first time investors and managers have come together to achieve this goal. The Asset Managers' report is designed to help set forth best practices that will be critical and consistent with the goal of reducing systemic risk. As a result, taken together, these reports are intended to provide a new kind of accountability to promote better managed hedge funds and better educated investors, and to help ensure these best practices can become widely adopted.

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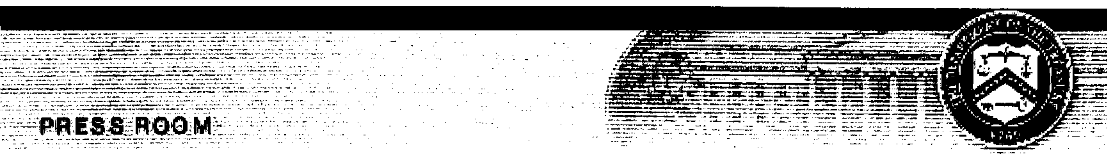

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April 15, 2008
HP-928

OFAC Again Targets Network of Colombian Drug Trafficker

Washington – The Department of the Treasury's Office of Foreign Assets Control (OFAC) today added nine individuals and fifteen companies to its list of Specially Designated Narcotics Traffickers. These OFAC designations target two long-time associates of Carlos Alberto Renteria Mantilla – Carlos Currea Correa (a.k.a. "Cucu") and Ramiro Rengifo Puentes (a.k.a. "William Torrijos"). Carlos Alberto Renteria Mantilla ("Beto Renteria") is the only remaining leader of Colombia's North Valle drug cartel, and the U.S. Department of State is offering up to $5 million for information leading to his capture.

"Yesterday, Ramiro Rengifo Puentes was masquerading as a seemingly legitimate businessman with an extensive financial network," said Adam J. Szubin, Director of OFAC. "OFAC's financial strike today exposes him for who he really is – a significant drug trafficker known in the underworld as William Torrijos."

The individuals designated today are two of Beto Renteria's closest drug trafficking associates. Ramiro Rengfio Puentes controls an extensive corporate network in Colombia and Spain that includes *Miracana Inmobiliaria Quilichao S.A. & Cia. S.C.A.*, a sugar cane company in Cali, Colombia; *Frontera Virtual S.A.*, a business services company in Bogota, Colombia; *Red de Servicios Inmobiliario Profesionales S.A.* (RIPSA), a real estate company in Bogota, Colombia; *Ruiz de Alarcon 12 S.L.*, a real estate development company in Madrid, Spain; and several construction and real estate development companies located in Cali, Colombia - *Constructora Umbria S.A.*, *Agroganadera La Isabela S.A.*, *Centro Comercial Guss S.A.*, *Construcciones La Reserva S.A.*, *Constructora Juanambu S.A.*, and *Constructora Loma Linda S.A.* Also designated today are seven other individuals who work for and on behalf of Ramiro Rengifo Puentes, including Edwin Amir Rengifo Ospina and Monica Moreno Fernandez.

Today's designation is OFAC's seventh action against the financial network of Beto Renteria since 2005. In March 2005, OFAC named Beto Renteria as a principal individual under the Specially Designated Narcotics Trafficker program pursuant to Executive Order 12978. Beto Renteria is the subject of two U.S. criminal indictments. He was indicted in the Southern District of Florida in 1994 on narcotics trafficking charges and in the District of Columbia in 2004 on Racketeer Influenced and Corrupt Organizations Act (RICO) charges, stemming from his role as a leader of Colombia's North Valle drug cartel.

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

A detailed look at the program against Colombian drug organizations is provided in OFAC's March 2007 *Impact Report on Economic Sanctions Against Colombian Drug Cartels.*

http://www.treasury.gov/offices/enforcement/ofac/reports/narco_impact_report_05042007.pdf

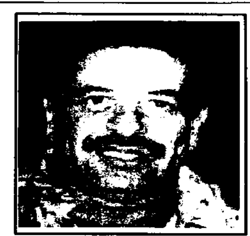
REPORTS

- Beto Renteria's Drug Network

RENTERIA MANTILLA Organization
April 2008

Department of the Treasury
Office of Foreign Assets Control

Carlos Alberto CURREA CORREA
a.k.a. "Cucu"
C.C. 16347900



Carlos Alberto RENTERIA MANTILLA
"Beto" RENTERIA
DOB 11 Mar 1945

Ramiro RENGIFO PUENTES
a.k.a. "William Torrijos"
DOB 18 Nov 1950
C.C. 19187359

"La Llaveria"

Key Individuals

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c.c. 31903968

Edwin Amir
RENGIFO OSPINA
c.c. 79696032

James
NARVAEZ PUENTES
c.c. 16634261

Jefferson
RENGIFO OSPINA
c.c. 94511007

Maria OSPINA PRADA
c.c. 41700627

Lina
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Agroganadera
La Isabela S.A.
Cali
NIT # 900100335-6

Venecia Inmobiliaria
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NIT # 800026554-3

Inversiones Inmobiliaria
Quilichao S.A. y Cia S.C.A.
Cali
NIT # 800132909-8

Constructora
Loma Linda S.A.
Cali
NIT # 900100191-2

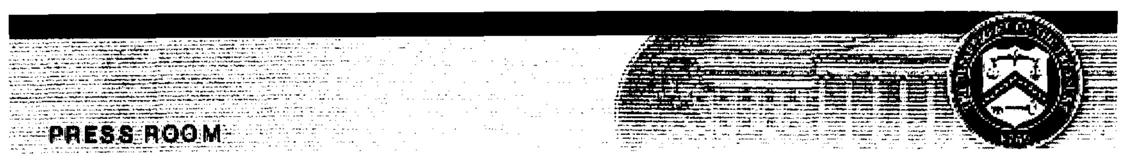
Constructora Juanambu S.A.
Cali
NIT # 900100334-9

Rengifo O.A.M. y Cia S.C.A.
Bogota
NIT # 900110717-9

Rengifo Mancera & Cia S.C.A.
Bogota
NIT # 800138803-3

Construcciones La Reserva S.A.
Cali
NIT # 900100336-3

Inmobiliaria Quilichao S.A
Cali
NIT # 817002547-1



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April 16, 2008
hp-929

Paulson Approves Puerto Rico Plan to Distribute Stimulus Payments

Treasury Secretary Henry M. Paulson, Jr. this morning approved a stimulus payment distribution plan submitted by the Commonwealth of Puerto Rico detailing how the Puerto Rican government would send payments to residents of the island. As required by the Economic Stimulus Act of 2008, Puerto Rico had to submit a plan outlining how the government would distribute "recovery rebates" before a one time payment could be made from the U.S. Treasury to the Puerto Rico Treasury Department. The final distribution plan, along with the signed approval letter is attached.

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REPORTS

- Puerto Rico Rebate Distribution Plan
- Paulson Approval Letter

DEPARTMENT OF THE TREASURY
OF THE
COMMONWEALTH OF PUERTO RICO

Commonwealth of Puerto Rico
Plan for Distribution of Recovery Rebates
Enacted by Pub. L. 110-185

April 8, 2008

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1 Introduction

This Plan for the Distribution of Recovery Rebates has been developed by the Puerto Rico Department of the Treasury ("PRDT") and approved by the U.S. Secretary of the Treasury, pursuant to the requirements in Section 101(c) of the Economic Stimulus Act of 2008, Pub. L. 110-185 ("Act"). The Act establishes that in order for the Commonwealth of Puerto Rico ("Commonwealth") to be able to receive funds from the U.S. Department of the Treasury for the distribution to its residents of the recovery rebates authorized in the Act, the Commonwealth must have a plan, approved by the Secretary of the Treasury, under which the Commonwealth will promptly distribute the recovery rebates to its residents.

Section 101(c)(1)(B) of the Act establishes that the payment to be made by the U.S. Secretary of the Treasury to the Commonwealth will be "in an amount estimated by [him/her] as being equal to the aggregate benefits that would have been provided to residents of [the Commonwealth] by reason of the amendments made by this section if a mirror code tax system had been in effect in such possession." The Act does not prescribe any specific rules as to how the funds are to be distributed to residents of the Commonwealth. The Act simply states that funds have to be distributed "promptly," keeping in line with the overall economic stimulus purposes of the legislation. It is in the interest of both the Commonwealth and the U.S. Department of the Treasury that all funds made available to the Commonwealth be distributed promptly through rebate payments.

The U.S. Department of the Treasury and the Commonwealth recognize that there are various differences between the Puerto Rico Internal Revenue Code of 1994, as amended ("P.R. Code") and the U.S. Internal Revenue Code of 1986, as amended ("U.S. Code"), as well as administrative differences that affect the ability of the Commonwealth to distribute funds. In the Commonwealth, close to fifty percent of all taxpayers file their tax returns on April 15 and the overwhelming majority do so in paper format; consequently, the PRDT is unable to process the 2007 income tax returns as quickly as the Internal Revenue Service ("IRS"). Accordingly, this Plan establishes a procedure for the distribution of an advance payment of rebates using information from 2006 income tax returns that were filed in 2007. PRDT will use 2007 income tax returns filed in 2008 to make final rebate payments to eligible individuals. It is the intention of the Commonwealth to make advance and final rebate payments for timely filed returns in calendar year 2008 and to resolve all claims and disputes with respect to these rebates by the end of calendar year 2010.

All tax references in the Plan are to the P.R. Code, unless otherwise specified.

2 Definitions

For purposes of recovery rebates, the following definitions apply:

a. Net income tax liability. The term " net income tax liability" means the excess of the taxpayer's individual income tax liability over nonrefundable credits allowed under the P.R. Code or other Puerto Rico statutes.

b. Earned income. The term "earned income" means wages, salaries, tips and other employee compensation included in gross income, the amount of net income from self employment reported in Schedules K, L and M of the Puerto Rico income tax return, and combat zone pay excluded from Puerto Rico gross income, but reported in a W-2 form filed with the taxpayer's Special Rebate Qualification Form.

c. Social Security benefit. The term "social security benefit" means any amount received by the individual as a monthly benefit under title II of the Social Security Act or a tier 1 railroad retirement benefit. The term "social security benefit" does not include any benefits as a result of the Supplemental Security Income ("SSI") or Aid to the Aged, Blind and Disabled ("AABD") programs.

d. Veterans benefit. The term "veterans benefit" means any disability, pension, or survivor's benefit received under chapters 11, 13, or 15 of the title 38 of the United States Code.

e. Joint return. The term "joint return" means a tax return or a Special Rebate Qualification Form (as described in Section 3.1.2 herein) filed with the PRDT by married taxpayers using the "Married living with spouse and filing jointly" filing status as defined in the P.R. Code.

f. Combat zone pay. The term "combat zone pay" means remuneration for serving in the U.S. Armed Forces in a combat zone, which is any area that the President of the United States designates by Executive Order as an area in which the U.S. Armed Forces are engaging or have engaged in combat.

3 Determination of Eligibility and Amount of Recovery Rebate

3.1 *Eligible Individuals*

In general. Any individual who is a resident of Puerto Rico, under the P.R. Code, other than:

a. An estate or trust, or

b. An individual who is eligible to be claimed as a dependent on another Puerto Rico income tax return or a U.S. income tax return.

3.1.1 Identification requirement.

To be eligible for the basic recovery rebate, an individual must file a tax return with a valid social security number issued by the Social Security Administration ("SSA") for said individual, the spouse if a joint return is filed, and any children for whom a Child Recovery Rebate will be paid. The absence of valid social security numbers for qualifying children, as defined in Section 3.3.3., will not disqualify the individual from receiving the basic rebate to which he or she is entitled.

3.1.2 Exemption from tax filing requirement for recipients of social security and veterans benefits and combat zone pay.

Eligible individuals who received social security and/or veterans benefits in 2007, but are not otherwise required to file a Puerto Rico income tax return and do not file a return, will receive a basic rebate with the Advance Payments, as described in Section 4, without the need to file any additional documents. Eligible individuals who received combat zone pay in 2007, but are not otherwise required to file a Puerto Rico income tax return and do not file a return, are eligible to receive a recovery rebate with the Final Payments, as described in Section 5, without filing a tax return, but must instead file a special form created by the PRDT for this purpose ("Special Rebate Qualification Form") that will allow the individual to demonstrate that he or she received combat zone pay and evidence the name and social security of his or her spouse and qualifying children. Eligible individuals who received social security and/or veterans benefits and received an Advance Payment from the PRDT for their basic rebate may also file a Special Rebate Qualification Form to receive any child recovery rebate to which they are entitled based on their 2007 eligibility. Individuals who are required to file a Puerto Rico income tax return for 2007 and

on that basis would be eligible for a basic rebate of less than $300 ($600 if filing a joint return) may also file a Special Rebate Qualification Form if their social security and/or veterans benefits and/or combat zone pay would entitle them to a larger basic rebate.

3.2 *Basic Recovery Rebate*

3.2.1 Amount

The basic recovery rebate for an eligible individual is equal to the greater of:

a. Net income tax liability up to $600 ($1,200 for a joint return); or

b. $300 ($600 for a joint return) if the individual satisfies one of the following criteria:

   i. The sum of earned income, social security benefits and veterans benefits is at least $3,000, or

   ii. Net income tax liability is greater than zero and gross income determined under the P.R. Code is greater than the sum of the applicable Puerto Rico standard deduction and personal exemption.

3.3 *Child Recovery Rebate*

3.3.1 Eligibility

The Child Recovery Rebate may be claimed only by an individual eligible to receive a Basic Recovery Rebate greater than zero.

3.3.2 Amount

The amount of the child recovery rebate is equal to $300 for each qualifying child of the taxpayer.

3.3.3 Qualifying child

For purposes of the Child Recovery Rebate, the term "qualifying child" means a dependent who was born after December 31, 1989, but before January 1, 2008.

3.4 *Limitation on Recovery Rebates*

The combined amount of the Basic and Child Recovery Rebates shall be reduced, but not below zero, by five percent of the taxpayer's adjusted gross income as determined under the P.R. Code that exceeds $75,000 ($150,000 in the case of a joint return).

3.5 *Special Rules.*

3.5.1 Exclusion from income

Any payment attributable to recovery rebates shall not be taken into account as taxable income.

3.5.2 Joint returns

In the case of an Advance Payment made with respect to a joint return, half of the amount shall be treated as having been made or allowed to each individual filing such return.

3.5.3 Federally funded programs

Any payment attributable to recovery rebates shall not be taken into account as resources for the month of receipt and the following 2 months, for purposes of determining the eligibility of any individual for benefits or assistance, or the amount or extent of benefits or assistance, under any Federal program or any program financed in whole or in part with Federal funds.

3.5.4 No offsets by PRDT for debts to PRDT

Regardless of the status of tax liability of a taxpayer to the PRDT, the PRDT shall not deduct or offset from the rebate payments any amounts owed to the PRDT. Pursuant to the requirements of the Act, rebate payments will be subject to offsets as a result of any past due child support obligations.

3.5.5 No offsets by taxpayers

Taxpayers filing 2006 or 2007 tax returns shall not deduct any anticipated rebate amounts from their tax liability to the PRDT.

3.5.6 Fraud or mistake

If any taxpayer receives a rebate from the PRDT based on incorrect information provided by the taxpayer or information omitted by the taxpayer as a result of either fraud or mistake, or if the taxpayer is otherwise not eligible for a rebate paid to him or her by the PRDT, the PRDT may claim such incorrectly paid rebate from the taxpayer through any method available to the PRDT to collect debts

from taxpayers, and any amount recovered from the taxpayer, except interests and penalties, shall be deposited in the Recovery Rebate Fund described below. The IRS may also claim any incorrectly paid rebate from the taxpayer through any method available to the IRS to collect debts from taxpayers.

4 Advance Payment of Recovery Rebates

4.1 *Determination of Advance Payment*

PRDT shall determine, based on valid 2006 Puerto Rico individual income tax return information available as of December 31, 2007, the amount of recovery rebate that each individual would have been allowed if the recovery rebate were effective for tax year 2006 ("Advance Payment"). The PRDT shall make an Advance Payment to eligible individuals who filed a 2006 Puerto Rico income tax returns on or before December 31, 2007 and an Advance Payment for the basic rebate of individuals who received social security and/or veterans benefits in 2007. For purposes of the Advance Payment, a qualifying child means a child who is less than 17 as of December 31, 2006, and the PR Code for tax year 2006 shall be used to determine the amount of the basic recovery rebate.

4.2 *Treatment of combat zone pay.*

Qualifying income from combat zone pay will not be included in the calculation of the Advance Payment, but will instead be included in the Final Payment.

4.3 *Timing of Payment*

Advance Payments based on 2006 tax returns filed on or before December 31, 2007 and on 2007 social security and/or veterans benefits will be paid by the PRDT between May 1, 2008 (but not before the Commonwealth receives the payment for the estimated aggregate recovery rebate benefits from the U.S. Department of the Treasury) and July 31, 2008.

5 Final Payment of Recovery Rebates

5.1 *Determination of Final Payment Amount*

The PRDT shall make a Final Rebate Payment ("Final Payment") to eligible individuals who file 2007 Puerto Rico income tax returns on or before October 15, 2008 (or later in the case of eligible military personnel, as described in Section 5.4.2). The Final Payment will be the difference between the amount for which the individual is eligible based on his 2007 information (including social security and veterans benefits) minus the amount the taxpayer was paid as an Advance Payment. Individuals who were eligible for a higher rebate based on their 2006 information (compared to what they would be eligible for based on their 2007 information) will not be required to return any funds.

5.2 *Social security and veterans benefits and combat zone pay*

Qualifying income from social security and veterans benefits and combat zone pay will be included in the calculation of the Final Payment of individuals that file the Special Rebate Qualification Form.

5.3 *Filing obligation*

In order to be eligible to receive a Final Payment, eligible individuals are required to file a 2007 individual income tax return. This filing obligation does not apply to individuals who are using only their social security and veterans benefits and/or their combat zone pay to determine their qualifying income and who file the Special Rebate Qualification Form.

5.4 *Timing of Payment*

5.4.1 Timely returns

Final Payments based on 2007 individual income tax returns filed on or before May 15, 2008 (or June 15, 2008 in the case of individuals filing a Special Rebate Qualification Form) will be processed for payment by the PRDT between August 1, 2008 (but not before the Commonwealth receives the payment for the estimated aggregate recovery rebate benefits from the U.S. Department of the Treasury) and October 31, 2008.

5.4.2 Late returns

Final Payments based on 2007 individual income tax returns filed after May 15, 2008 (June 15, 2008 in the case of individuals filing a Special Rebate Qualification Form) will be handled on a first come, first serve basis until funds made available by the U.S. Department of the Treasury for the recovery rebates are exhausted. However, the PRDT will first pay any Final Payments associated with individual income tax returns filed after May 15, 2008 by individuals serving in the military outside of the United States and a reserve will be created to pay any rebates that can be claimed by individuals that are permitted to file their 2007 tax returns after October 15, 2008 because they are serving in the military in active duty outside of the United States as provided by the P.R. Code. Individuals with combat zone pay otherwise not required to file a 2007 income tax return may file a Special Rebate Qualification Form on or before the date by which they would have been required to file a 2007 income tax return as a result of their military service. Final Payments based on 2007 individual income tax returns filed after May 15, 2008 (or Special Rebate Qualification Forms filed after June 15, 2008) will be paid by the PRDT after February 1, 2009. The PRDT will not make any Final Payments based on individual income tax returns or Special Rebate Qualification Forms filed after October 15, 2008, except in the case of individuals eligible to file a 2007 income tax return after such date because of their military service.

6 Coordination with U.S. Government

6.1 *Dual Filers*

Individuals eligible to receive a recovery rebate from the PRDT are not eligible to receive a recovery rebate from the U.S. Department of the Treasury.

6.2 *Information Sharing*

This exchange of taxpayer information between PRDT and the IRS will be conducted under the Tax Coordination Agreement Between the United States and the Commonwealth of Puerto Rico dated May 26, 1989 or as otherwise authorized by law.

The PRDT shall provide to the U.S. Secretary of the Treasury, on a monthly basis once it begins to issue recovery rebates, information regarding the taxpayer identification numbers of individuals receiving recovery rebates from the PRDT during the previous month.

7 Recovery Rebate Fund

7.1 *Establishment of Trust Fund*

The Secretary of the PRDT shall establish a trust fund at the Government Development Bank for Puerto Rico herein referred to as the "Recovery Rebate Fund."

a. Amounts received from the U.S. Secretary of the Department of the Treasury to cover the estimated aggregate cost of the recovery rebates paid by the PRDT shall be deposited in the Recovery Rebate Fund.

b. The balance of the Recovery Rebate Fund shall be reduced by withdrawals equivalent to payments made by the PRDT of recovery rebates.

c. Overpayments of recovery rebates reclaimed by the PRDT shall be deposited in the Recovery Rebate Fund.

d. The Recovery Rebate Fund shall have no authority to borrow.

e. The funds received by the PRDT from the U.S. Department of the Treasury shall be used exclusively for the payment of recovery rebates, and not for administrative expenses.

f. Any interest generated by funds in the Recovery Rebate Fund shall not be credited to the Recovery Rebate Fund and may be deposited in a separate account of the PRDT at the Government Development Bank for Puerto Rico. If the funds in the Recovery Rebate Fund are extinguished, however, and there are individuals eligible to receive recovery rebates that have not received the amount to which they are entitled under this Plan, the PRDT shall deposit into the Recovery Rebate Fund any interest earned on the amount received from the U.S. Department of the Treasury that would be necessary to pay rebates that cannot otherwise be paid with the funds remaining in the Recovery Rebate Fund.

g. The PRDT shall submit to the U.S. Department of the Treasury quarterly reports indicating the amount of funds in the Recovery Rebate Fund, the amount of funds paid in rebates during such quarter and any interest earned on the amount received from the U.S. Department of the Treasury for recovery rebates. Quarterly reports shall be submitted within 45 days

of the end of a quarter. Quarters will be January to March, April to June, July to September and October to December.

7.2 *Return of Unused Amounts*

The balance of the Recover Rebate Fund as of December 31, 2010, if any, shall be returned the U.S. Secretary of the Department of the Treasury without interest.

7.3 *Liability of the Commonwealth of Puerto Rico*

Liability of the Commonwealth for making or allowing recovery rebates is limited to funds available in the Recovery Rebate Fund.

7.4 *Liability of the United States*

Consistent with Section 101(c) of the Act, the U.S. Department of the Treasury will make one estimated payment to the Commonwealth; the U.S. Department of the Treasury will not be liable for any payments or adjustments beyond the single estimated amount. The PRDT recognizes that the United States has not waived its sovereign immunity for a suit by either the Commonwealth or the residents of the Commonwealth in connection with recovery rebates paid or payable to either the Commonwealth or its residents.

8 Claims and Disputes

8.1 *Claims*

Any individual who believes that he or she has not received a rebate in accordance to this Plan may file a written claim with the PRDT addressed to the Assistant Secretary for Internal Revenue, PO Box 9024140, San Juan, PR 00902-4140 or in person at Office 620, Intendente Ramirez Building, 10 Paseo Covadonga, San Juan, PR 00901. Claims for Advance Payments must be filed on or before October 15, 2008, but not before the later of either the date in which the taxpayer received an Advance Payment that is lower than what he or she claims or September 15, 2008. Claims for Final Payment based on 2007 social security and veterans benefits or on Puerto Rico income tax returns filed on or before May 15, 2008 must be filed on or before December 15, 2008, but not before the later of either the date in which the taxpayer received a Final Payment that is lower than what he or she claims or November, 15, 2008. Claims on Final Payments based on Puerto Rico income tax returns filed after May 15, 2008 must be filed on or before September 30, 2009, but not before the later of either the date in which the taxpayer received a Final Payment that is lower than what he or she claims or June 30, 2009. In the case of individuals eligible to file their 2007 tax returns after October 15, 2008 as a result of their military service, claims for a Final Payment based on their 2007 income tax return or on a Special Rebate Qualification Form must be filed on or before the later of either three months after they file their 2007 income tax return or Special Rebate Qualification Form or two months after the taxpayer received a Final Payment that is lower than what he or she claims. The PRDT will issue a written final decision on each properly filed claim.

8.2 *Administrative Review of PRDT's Determination Regarding Claims*

An individual who disagrees with PRDT's final decision on a claim pursuant to Section 8.1 of this Plan may file a request for hearing and administrative review before the Secretary of Adjudicative Procedures of the PRDT, pursuant to Puerto Rico Act No. 170 of August 12, 1988, as amended. This request must be made in writing, within thirty days from the date PRDT's final decision is notified to the individual, pursuant to Puerto Rico Regulation No. 7389 of July 13, 2007. Requests may be filed in person at PRDT's offices located at Intendente Ramírez Building, 10 Paseo Covadonga; 6th floor, Office 611, San Juan, PR 00901 or by mail at Department of Treasury, Attn. Office 611, P.O. Box 9024140, San Juan, PR 00902-4140.

8.3 *Best Effort.*

The dates included in this Plan for distribution of Advance Payments and Final Payments are target dates, but given the accelerated schedule for the same, it is understood that there are various circumstances, unforeseen at the time of approval of this Plan, that could affect the timing of payments. Accordingly, these dates represent the estimated dates for distribution of rebates based on best efforts as can calculated in advance of this first time ever program. There shall be no liability or claim for interest against the PRDT for failure to meet the target dates established herein.

8.4 *No interest*

No individual shall be entitled to receive any kind of interest by reason of receiving a rebate as a result of a claim or otherwise.

9 Functional Plan

The PRDT will establish a functional group that will be accountable and responsible for the following activities of the Plan:

9.1 *Confirmation of the Eligibility Rules and Basic Recovery Rebate*

Once the Plan is approved, the Functional Group will evaluate final determinations and will prepare adequate documentation to the PRDT's Information Technology Area. This documentation will be essential for the proper identification, data extract and selection of eligible taxpayers. This will also include the rules for the recipients of social security and veterans benefits.

9.2 *Selection Testing and Validation*

Based on the defined rules provided to the Information Technology Area, the Functional Group will test and validate data extract and basic recovery rebate. The possible scenarios of amounts of wages combined with social security and veteran benefits will be tested between the possibilities of married with children, married with no children, head of household with children and single with no children.

After an initial data extract is provided from the Information Technology Area, a testing of the basic recovery rebate will be computed for those taxpayers identified in the cross reference report as beneficiaries of one of the benefits and reported wages.

Additional validation will be made between PRDT and the U.S. Department of the Treasury for the data received for the social security and veteran benefits. This validation will help to address further claims related to those benefit recipients.

9.3 *Process and Procedures Documentation*

The Functional Group will be in charge of preparing the supporting processes and procedures documentation of the Plan. Procedures will include:

- Data Test and Validation
- Production Control
- Printing Process
- ACH Transmissions

- Claims Procedures
- Return Mail Management
- Sharing Information with the U.S. Treasury

9.4 *Issues and Risk Management Plan*

The purpose of an Issue Management Plan is to outline the appropriate follow-up and escalation procedures that will ensure Distribution Plan issues are addressed by the appropriate decision makers and resolved in a timely matter.

The Risk Management Plan will help in the identification of mitigation activities that will minimize the potential occurrence of a risk and mitigate the effects if the risk occurs.

9.5 *Disbursement Control and Financial Reporting*

The proper establishment of disbursement controls will be and important part of the Functional Group responsibilities. Additionally, the Functional Group will be responsible for control and reporting of the administrative costs incurred that will be assigned to the PRDT.

10 Information Technology Plan

10.1 *Summary*

This section of the plan covers the areas of Identification Strategy, Production Strategy, Data Management Strategy, Control Strategy, Reporting Strategy and Support to the Functional and Support Areas. It is the PRDT's intention to re-utilize as many readily available resources as possible. Another objective of this plan is to create a processing operation that would result non invasive to our regular seasonal objectives, especially the individual tax filing process.

10.2 *Identification Strategy*

The initial phase of the proposed Processing Strategy consists of the extraction of the 2006 individual tax filings into an image copy database to be used as the baseline to all of the processes that are going to be implemented during this initiative. It is the PRDT's intention to use this database as the main resource for most of its processing.

A set of eligibility business rules to be prepared by the functional group will be translated into application code and applied against the database. The result will be validated by the functional group and streamlined as necessary until all of the selection criteria have been met. After successful validation, a live production run will produce a record set of tax filings containing the prospects that qualify for the Advance or Final Payments described in sections 4 and 5.

A parallel effort to the initial identification of prospects should be on its way in order to load data acquired from SSA and DVA into the same database. When the data from SSA and DVA is available, the PRDT should start the process of identification of prospects that have records in at least two of the data sources (PR Tax Filers 2006, SSA and DVA). Cross reference reports should be generated to identify new prospects, e.g. "A filer with an income too low to qualify for the rebates in excess of net income tax liability as per the tax records but has sufficient income from SSA and/or VA to qualify for rebates in excess of net income tax liability".

The result of the Cross Reference Report should be the identification of new prospects for the initial advance. Following this second round of prospect identification, a validation process should be in place to insure that all prospects have been included. After this final validation is completed, it could be said that most recipients of the Advance Payment have been identified. The PRDT at this point should be ready to share this information with the U.S. Department

of the Treasury. At this point all estimates for the Advance Payment can be revised.

After conclusion of the extraction and prospect identification phase, begins the Production Phase. See Appendix 1 Identification of Prospects Process. A similar process will be performed with 2007 data for the Final Payments.

10.3 *Production Strategy*

During this phase, payments will be issued for all those prospects that have been validated as prospects. The first part of this phase will be to create the production groups. These groups or batches will be processed during daily processes that will create the payments, for each group or batch the system should assign a production date and a printing date entry. It is the PRDT's intention to process all of the Advance Payments in a period no longer than six weeks, but the Plan provides for twelve weeks to account for unanticipated delays.

Before check payments are issued, a process will be invoked to validate the prospect's address. All addresses must adhere to the U.S. Post Office standards that include the Zip+4, address structure and pre-sort standards. Exceptions of the standardization process will be sent to an address correction process, payments for the exceptions will be held until a compliant address is produced. Electronic payments will be issued without address verification.

All successful payment transactions will be logged into a payment table or subsidiary, a check emission file will be generated and transmitted to the bank, so that whenever those checks or payments are presented for clearing the bank already knows its origin. Electronic payments will be processed into an Automatic Clearing House (ACH) file and transmitted to the ACH network on a daily basis.

A spool file will be generated for printing; the printing process will run six days of the week on a sixteen hour window. An off-day would be provided within the production schedule with the intention of providing an equipment maintenance window and would also provide for printing or processing of any extraordinary items. At the end of the printing process, all payment transactions will be marked as paid and the check number will be added to that record.

At the end of the daily processing cycle, all checks will be registered by the Treasury Area of the PRDT and will be delivered to the Central Post Office for public distribution. Finalized check registers will be issued and stored as supporting documents. For a more detailed production schedule, please see

10.4 *Data Management Strategy*

All information related to this process will be managed and stored utilizing relational databases created and designed exclusively for this purpose. The relational database will provide the process with referential integrity, security and audit ability to support the process.

This database will also provide means for supporting the tax payers, reporting and data exchange capabilities. The database will be initially loaded with 2006 Individual Tax Filings, SSA beneficiaries and VA beneficiaries.

Database will also contain security, audit and transaction logs.

10.5 *Control Strategy*

General controls relate to the environment within which automated application systems are developed, maintained and operated and which are, therefore, applicable to all the applications. They ensure the proper development, implementation and maintenance of all automated applications, and the integrity of program and data files and of computer operations.

The Control Strategy consists in the establishment of control procedures. These procedures should follow best practices from the industry as adopted by organizations like ISACA (Information Systems Audit and Control Association).

After the implementation of the controls, the PRDT will solicit the service of internal and external auditors to test the controls. Auditor's reports will be used to add strength to the controls already in place.

Some of the controls to be established include, but are not limited to, access controls, run controls, output controls, reporting controls, hashing controls and reconciliation processes.

10.6 *Reporting Strategy*

PRDT's intention is to provide the U.S. Department of the Treasury with all required information and data relative to the disbursement process. The U.S. Department of the Treasury and PRDT should agree on the information and data required as well as the reporting schedule and formats.

10.7 *Support to the Functional Areas Strategy*

Besides the previously mentioned operation's strategy, PRDT believes that support to the taxpayers and the functional officers (Internal Revenue Area Personnel), is critical to the success of the initiative.

The Information Technology Area proposes a support approach based on the use of dynamic information. To accomplish this goal, it has been identified the need to provide an internet portal that will provide the information needed to assist taxpayers during the process. This portal will be used to provide information to the taxpayers via online access or through the planned Call Center. The list of resources that should be available at the portal includes:

- General information about the process
- Links to content produced by the IRS, PRDT, SSA and the DVA
- Verification of eligibility
- Qualifying payment amount
- Estimated date of pay
- Request payment type (check or electronic payment)
- Update address information
- Obtain status of checks returned by the post office

The portal shall have an English and Spanish version suited to accommodate most of the island's taxpayers, social security and veterans beneficiaries.

11 Support Plan

The support personnel executing this plan will be accountable and responsible for the management of interactions between the recovery rebate beneficiaries and the operational areas of the PRDT.

11.1 *Communications Plan*

An effective communication plan in the written media, radio and internet will contribute to a better understanding of the primary intention of the recovery rebate. Simple language, clear and easily explainable concepts are important factors for the success of the communications plan.

Definitions of the determination of eligibility, amount of recovery rebate, special rule for the recipients of social security and veterans benefits, child recovery rebate, limitation on recovery rebates and other special rules are part of the concepts that will be included in the different media strategies. Additional topics will be the explanation of the Advance Payment and Final payment computations and range of dates to file claims.

The Communications Plan will start on April 2008 and will cover the periods of Advance Payments, Final Payments and Claims.

11.2 *Orientations and Trainings*

Adequately trained and oriented employees will support the efforts of the Communications Plan. PRDT will provide a complete training to the PRDT Taxpayer Service Bureau in order for its personnel to manage frequently asked questions.

Orientation materials with different scenarios and frequently asked questions will be available at the Taxpayer Services Regional Offices to all employees and recovery rebate beneficiaries. Trainers will also be in charge of training and support of Call Center personnel.

11.3 *Call Center*

A dedicated Call Center will be established for recovery rebate recipients. This will be the main tool to manage the interactions between the recipients and the operational areas of the PRDT. The following information will be available through the Call Center:

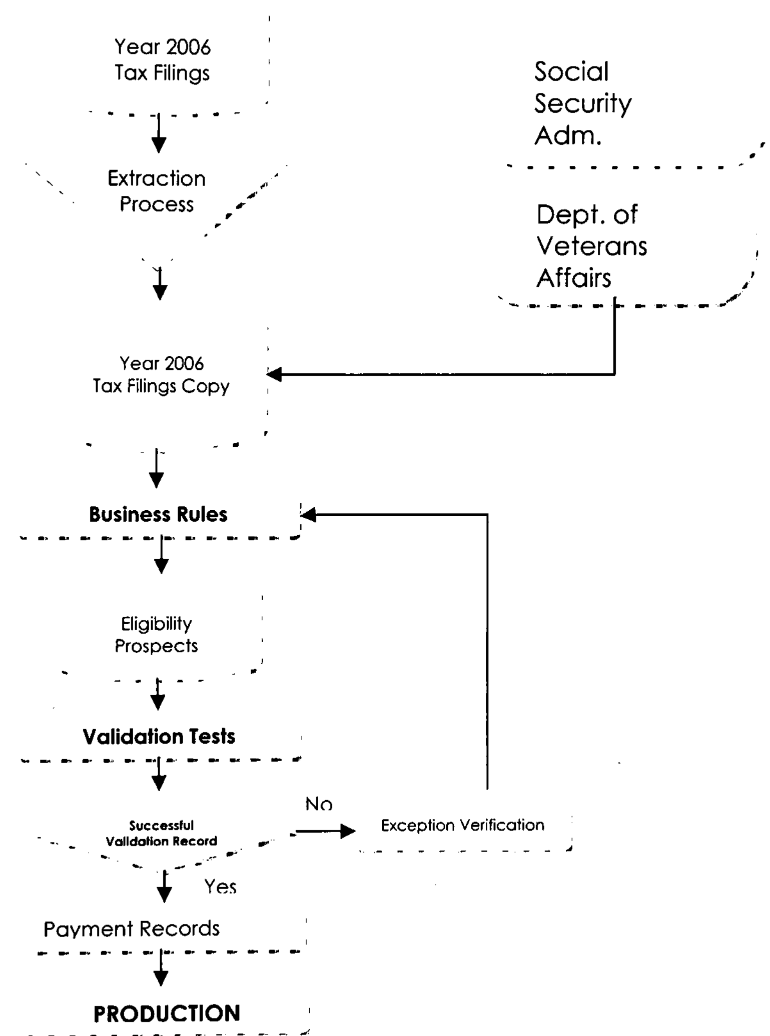
1. General information about the process
2. Verification of eligibility
3. Qualifying payment amount
4. Payment Status
5. Request payment type (check or electronic payment)
6. Update address information
7. Obtain status of checks returned by the post office
8. Claims management

11.4 *Exception Handling*

It is expected that after address standardization, ten percent of all checks (approximately 100,000) will be returned by the post office. When the telephone information is available, an effort will be made to contact beneficiaries. We will direct the effort to the Call Center and they will update the address information. Once the address is updated, the Call Center will notify the procedure to receive the rebate.

A procedure will be established for the claims of checks not received within the expected date that were not returned by mail. Identification protocols and verification of checks already exchanged at the bank will be made before any type of re-impression. This will manage the double payment and misappropriation of funds.

Appendix 1 Identification of Prospects Process



Appendix 2. Production Process Tentative Schedule

Distribution of Recovery Rebates - Advanced Payment Check Production Plan

Production System

May 4 - June 10, 2008

Shift	Monday	Tuesday	Wednesday	Thursday	Friday	Saturday	Sunday	Success Rate @ 100%	Success Rate @ 75%	Success Rate @ 50%
1						25,000	25,000			
2	25,000	25,000	25,000	25,000	**Maint	25,000	25,000			
3	25,000	25,000	25,000	25,000		25,000	25,000			
Daily Total	50,000	50,000	50,000	50,000	0	75000	75000			
Weekly Cumulative	50000	100,000	150,000	200,000	200,000	275,000	350,000	*350,000*	262,500	175,000

May 11 - May 17, 2008

Shift	Monday	Tuesday	Wednesday	Thursday	Friday	Saturday	Sunday	Success Rate @ 100%	Success Rate @ 75%	Success Rate @ 50%
1						25,000	25,000			
2	25,000	25,000	25,000	25,000	**Maint	25,000	25,000			
3	25,000	25,000	25,000	25,000		25,000	25,000			
Daily Total	50,000	50,000	50,000	50,000	0	75000	75000	*700,000*	525,000	350,000
Weekly Cumulative	50,000	100,000	150,000	200,000	200,000	275000	350000			

May 18 - May 24, 2008

Shift	Monday	Tuesday	Wednesday	Thursday	Friday	Saturday	Sunday	Success Rate @ 100%	Success Rate @ 75%	Success Rate @ 50%
1						25,000	25,000			
2	25,000	25,000	25,000	25,000	**Maint	25,000	25,000			
3	25,000	25,000	25,000	25,000		25,000	25,000	*1,050,000*	787,500	525,000
Daily Total	50,000	50,000	50,000	50,000	0	75,000	75,000			
Weekly Cumulative	50,000	100,000	150,000	200,000	200,000	275,000	350,000			

May 25 - May 31, 2008

Shift	Monday	Tuesday	Wednesday	Thursday	Friday	Saturday	Sunday	Success Rate @ 100%	Success Rate @ 75%	Success Rate @ 50%
1						25,000	25,000			
2	25,000	25,000	25,000	25,000	**Maint	25,000	25,000	*1,125,000*	843,750	562,500
3	25,000	25,000	25,000	25,000		25,000	25,000			
Daily Total	50,000	50,000	50,000	50,000	0	75,000	75,000			
Weekly Cumulative	50,000	100,000	150,000	200,000	200,000	275,000	350,000			

June 1 - June 7, 2008

Shift	Monday	Tuesday	Wednesday	Thursday	Friday	Saturday	Sunday	Success Rate @ 100%	Success Rate @ 75%	Success Rate @ 50%
1						25,000	25,000			
2	25,000	25,000	25,000	25,000	**Maint	25,000	25,000	*1,200,000*	900,000	600,000
3	25,000	25,000	25,000	25,000		25,000	25,000			
Daily Total	50,000	50,000	50,000	50,000	0	75,000	75,000			
Weekly Cumulative	50,000	100,000	150,000	200,000	200,000	275,000	350,000			

*Success rate will vary depending on the total number of payments based on the eligibility process; production plan is based on actual capacity not on the estimates of eligible beneficiaries.

** Production schedules are considering a weekly 24 hour equipment maintenance window. Additional unplanned maintenance might be necessary depending on actual circumstances.

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

SECRETARY OF THE TREASURY

April 16, 2008

The Honorable Aníbal Acevedo Vilá
Governor of Puerto Rico
La Fortaleza
San Juan, PR 00901

Dear Governor Acevedo Vilá:

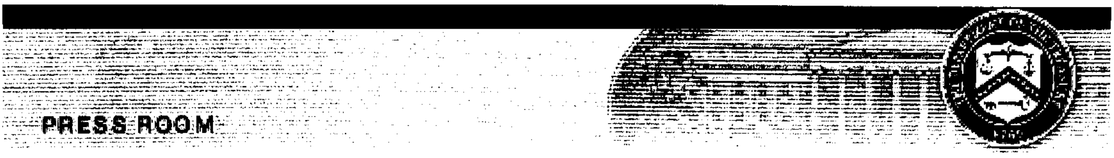
Thank you for your letter of April 9, 2008, submitting the Plan for Distribution of Recovery Rebates in the Commonwealth of Puerto Rico. The Economic Stimulus Act of 2008, P.L. 110-185 (the Act), requires that I approve the Commonwealth's plan for distributing stimulus payments to residents of Puerto Rico. The Act also requires that once such a plan is approved, the Treasury Department make a payment to the Commonwealth in an amount estimated as being equal to the aggregate benefits that would have been provided to residents of Puerto Rico by reason of the amendments made to the Internal Revenue Code by section 101 of the Act if a "mirror code" tax system had been in effect in Puerto Rico.

In accordance with the Act, I approve the Plan for Distribution of Recovery Rebates in the Commonwealth of Puerto Rico dated April 8, 2008, a copy of which is enclosed. Also, we have estimated the aggregate benefits that would have been provided to residents of Puerto Rico by reason of section 101(c) of the Act if a mirror code tax system had been in effect in Puerto Rico at $1.282 billion. A payment in this amount will be made by the Treasury Department to the Commonwealth to fund the prompt distribution of stimulus payments to residents of Puerto Rico pursuant to the Commonwealth's plan.

Sincerely,

Henry M. Paulson, Jr.

Enclosure



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April 16, 2008
hp-930

Treasury Releases Fourth in A Series of Social Security Papers

Washington – Treasury today released the fourth in a series of papers on Social Security. Issue Brief No. 4 is entitled Social Security Reform: Mechanisms for Achieving True Pre-Funding.

-30-

REPORTS

- Issue Brief No. 4: Social Security Reform: Mechanisms for Achieving True Pre-Funding

ISSUE BRIEF NO. 4

SOCIAL SECURITY REFORM: MECHANISMS FOR ACHIEVING TRUE PRE-FUNDING

INTRODUCTION

This is the fourth in a series of Treasury issue briefs on Social Security reform. It expands on a point introduced in the second issue brief; namely, that making Social Security reform fair to future generations requires building up and safeguarding resources in the near term that can be used to fund future benefits as the number of retirees per worker increases. As was discussed in the second brief, there is nothing currently in place to prevent current contributions in excess of current benefits from being unwound by larger deficits in the non-Social Security portion of the federal budget. This brief reviews the need for true pre-funding and its implications for reforms that achieve a financially sustainable Social Security system. The brief then analyzes possible mechanisms to help ensure that attempted pre-funding is in fact real pre-funding.

The institutional reforms considered in this issue brief, including several variants of personal accounts, are discussed solely in terms of the contribution they make to ensuring that attempts to pre-fund Social Security actually result in an accumulation of resources to fund future benefits. Accordingly, elements of these reforms that do not directly bear on the question of pre-funding—for example, the inheritability of personal accounts—are not discussed. In addition, it should be emphasized at the outset that none of the mechanisms for pre-funding considered here involve the privatization of any function of Social Security.

FAIR REFORM REQUIRES SUBSTANTIAL PRE-FUNDING

The connection between fairness and the need for pre-funding is straightforward. As shown in Figure 1, the old-age dependency ratio—the ratio of retirees to workers—is expected to rise rapidly over the next thirty years and then to rise slowly but steadily in every year thereafter. This pattern reflects the imminent retirement of the relatively large baby-boomer birth cohorts together with projected sustained improvements in longevity. This demographic shift has important implications for Social Security, since the revenues of the system take the form of contributions paid by workers while expenditures go largely to retirees (as in previous briefs, the discussion here focuses on the retirement portion of Social Security rather than on disability benefits).

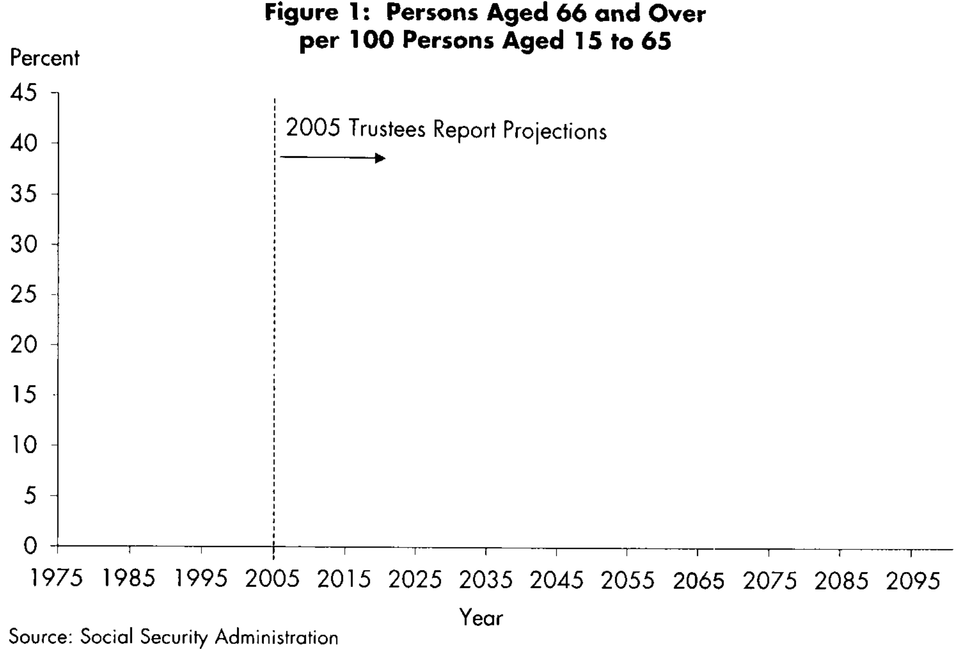


Figure 1: Persons Aged 66 and Over per 100 Persons Aged 15 to 65

Source: Social Security Administration

In these circumstances, any reform of Social Security that makes the system permanently solvent and that seeks to maintain contributions and benefits at some stable fraction of people's wages while working must accumulate resources in the near term when there are relatively more workers (that is, when the old-age dependency rate is relatively low) so as to help finance benefit payments in later years when there are relatively more retirees (that is, when the old-age dependency rate is relatively high). This accumulation of resources is known as "pre-funding," and is accomplished by having current revenues exceed expenditures *and* by safeguarding the resulting surpluses so that they provide resources with which to fund future benefits. If instead no attempt is made to pre-fund future benefits, then it will be necessary in a solvent system to reduce benefits for the cohorts of retirees that are relatively large and/or to require higher contributions from the later, relatively small cohorts of workers who are paying for the retirement benefits of the earlier cohorts. Either outcome would be viewed as unfair by most people because it causes the net value of Social Security to vary across birth cohorts depending on their size.

The amount of pre-funding that is needed depends on both demographics and the size of benefits to be afforded to future retirees. A convenient reference point for assessing the rough magnitude of pre-funding that would occur under a fair Social Security reform plan is given by the amount of planned pre-funding under the "Nonpartisan Reform Plan" that was recently proposed by Jeffrey Liebman, Maya MacGuineas, and Andrew Samwick.[1] That plan calls for cuts to defined benefits that are partly made up by benefits payable from mandatory personal retirement accounts, and brings more revenue into the system by raising the maximum taxable earnings threshold and requiring that individuals make some out-of-pocket contributions to their retirement accounts.

1 For a description of the Nonpartisan Reform Plan and a link to the Social Security Administration's scoring of it, see http://www.nonpartisanssplan.com/pages/1/index.htm. The plan is used here strictly for illustrative purposes; this discussion does not represent an endorsement or a policy proposal.

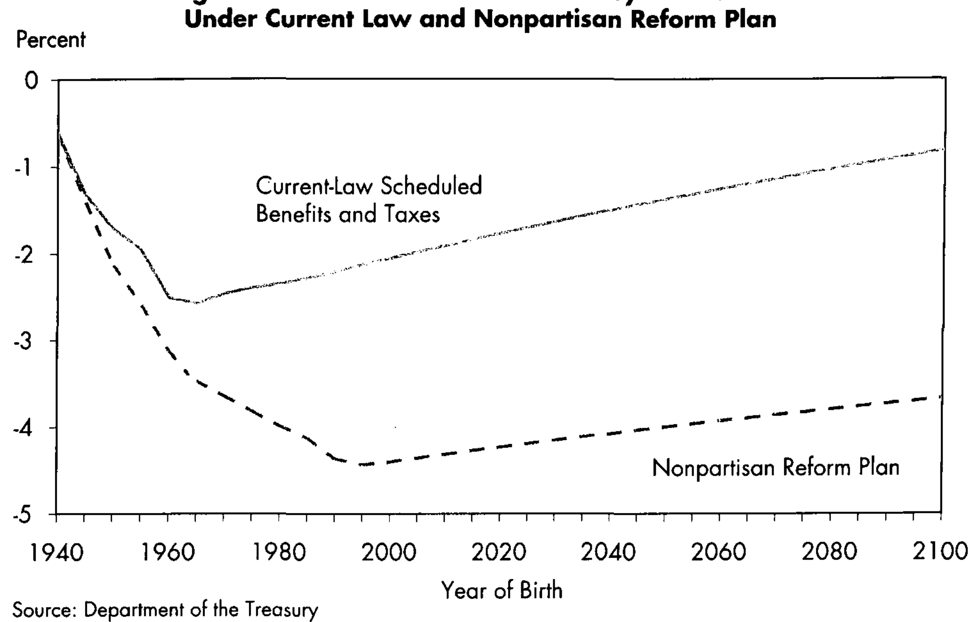
The Nonpartisan Reform Plan involves significant planned pre-funding. This can be seen from Figure 2, which gives the projected time profile of contributions in excess of benefit payments (expressed as a share of GDP) implied by the plan. (Both contributions and benefits include the contributions and benefits that are attributable to the plan's personal retirement accounts.) Annual planned pre-funding under the plan would be about 1 percent of GDP between 2008 and 2018 and would slowly decline thereafter, with negative pre-funding starting in 2034 as resources are used to pay benefits. To put the magnitude of this planned pre-funding in perspective, note that it is equivalent to putting aside 15.5 percent of GDP in 2007 to help pay benefits after 2034; by comparison, past attempted pre-funding from the inception of Social Security to 2007—the accumulated value of all past Social Security surpluses—corresponds to 16.4 percent of 2007 GDP.

Figure 2: Annual Attempted Prefunding Under the Nonpartisan Reform Plan (Current Contributions in Excess of Current Benefits Paid As Share of GDP, Based on 2005 Trustees Report Assumptions)

Source: Social Security Administration

Other Social Security reform plans call for less planned pre-funding than the Nonpartisan Reform Plan; this can be done by reducing benefits and/or increasing contributions relatively more gradually. In both cases, the effect is to impose a larger share of the Social Security reform burden on distant future generations. To assess whether the Nonpartisan Reform Plan provides a reasonable guide to the *appropriate* level of pre-funding, therefore, Figure 3 shows how the plan distributes Social Security's reform burden across birth cohorts as measured by the *lifetime net benefit rate*. As is explained in Treasury's second and third issue briefs, 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. 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.

Figure 3: Lifetime Net Benefit Rates by Birth Cohort Under Current Law and Nonpartisan Reform Plan



Source: Department of the Treasury

Figure 3 shows that the Nonpartisan Reform Plan's provisions are fully phased in beginning with the 1995 birth cohort.[2] After the 1995 birth cohort, the lifetime net benefit rate creeps upward as life expectancies rise for successive birth cohorts, which results in their receiving benefits over a longer period of time. On this score, it is noteworthy that the plan probably does not achieve permanent solvency, but likely would do so if it were modified to include benefit reductions that offset the effect of increasing longevity on the value of lifetime benefits beginning with the 1996 birth cohort. Such a modification would not change the amount of planned pre-funding under the plan, but would result in a flat lifetime net benefit rate starting with the 1995 birth cohort. As was discussed in Treasury's third issue brief, a lifetime net benefit profile that is flat in the long run is arguably fairer than one that forever rises.

Whether pre-funding under this plan is too small or too large depends on one's judgment as to how quickly a Social Security reform should be phased in. This particular plan is fully phased in starting with the 1995 birth cohort, whose members are 13 years old when the plan's reforms are assumed to begin. If a more rapid phase-in were desired, then planned pre-funding would be larger and future generations would be made better off at the expense of current generations; similarly, if a less rapid phase-in were desired, then planned pre-funding would be smaller and current generations would be made better off at the expense of future generations.

WHAT HAPPENS WHEN PLANNED PRE-FUNDING IS NOT REAL?

Pre-funding is an effective financing strategy provided that the near-term surplus revenues are safeguarded in a way that allows them to be used to pay for future benefits. The present Social Security system has its surpluses accumulate in the trust fund. These surpluses will increase the government's capacity

2 The Nonpartisan Reform Plan's benefit reductions end with the 1988 birth cohort, but rules concerning the share of personal account contributions that are made out-of-pocket make the accounts decreasingly generous for birth cohorts born between 1986 and 1997.

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 when the bonds in the trust fund are redeemed.

Many analysts believe that Social Security surpluses under the present system 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 near-term Social Security surplus causes the non-Social Security budget to be more profligate, and the future Social Security cash deficit will require future non-Social Security budgets to have either higher taxes or lower spending than would have been the case had today's surpluses resulted in true pre-funding. 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.

WHAT NEEDS TO BE UNDERSTOOD FOR SOCIAL SECURITY SURPLUSES TO BE SAVED?

In order for Social Security surpluses to be saved, taxes and spending in the non-Social Security portion of the budget must be set with the recognition that the special-issue government securities held by the trust fund represent liabilities that are every bit as real and important as debt held by the public. While the non-Social Security budget must ultimately redeem those special-issue securities in any case, it is only when they are recognized as equivalent to publicly held debt that the non-Social Security budget will plan in advance for their redemption by using Social Security surpluses to reduce public debt issuance. When used to lower publicly held debt today, the surpluses increase the government's capacity to issue publicly held debt to pay for Social Security benefits in the future. Otherwise, those future benefits must be financed with lower non-Social Security spending or higher non-Social Security revenues.

The meaning of this can be illustrated using actual budget numbers for a particular year. Table 1 shows how federal finances in the 2006 fiscal year can be divided into a Social Security component and a non-Social Security component. In that year, the unified budget deficit was $248 billion, and was comprised of a $185 billion Social Security surplus and a $433 billion non-Social Security deficit. Debt held by the public at the beginning of the year was $4.6 trillion, and was comprised of a $6.4 trillion non-Social Security obligation and a $1.8 trillion Social Security credit. Interest on the non-Social Security obligation puts its size in perspective; in the year shown, it was $324 billion, which is 18 percent as large as non-interest non-Social Security outlays.

When looking at Table 1, the pertinent question is whether the $109 billion non-Social Security deficit excluding interest (the *primary deficit*) was entered into with the full understanding that a $6.4 trillion debt was outstanding that must be serviced exclusively with non-Social Security revenues, or whether the $185 billion loan made by Social Security to the non-Social Security budget was viewed as an ongoing unconditional grant, with grants of that magnitude assumed to persist into the indefinite future.

In the latter case, the non-Social Security deficit is larger than it would have been had the Social Security surpluses not existed; Social Security surpluses are therefore not wholly saved.

Table 1
Fiscal Year 2006 Federal Finances
In Billions of Dollars

	Social Security	Non-Social Security	Unified
Primary Surplus	87	-109	-22
Interest Received*	98	-324	-227
Total Surplus	185	-433	-248
Debt Held by Public			
End of Fiscal 2005	-1,809	6,401	4,592
End of Fiscal 2006	-1,994	6,823	4,829

* Interest received is entered as a positive number; interest paid is entered as a negative number.
Source: *Historical Tables, Budget of the U.S. Government.*

FOUR STRATEGIES TO INCREASE THE LIKELIHOOD THAT PLANNED SOCIAL SECURITY PRE-FUNDING REPRESENTS REAL PRE-FUNDING

This section analyzes four strategies to help ensure that planned Social Security pre-funding is in fact real pre-funding. Ordered from most aggressive and most likely to work to least aggressive and least likely to work, the strategies are as follows.

Strategy 1. Pre-fund in full-service personal accounts.

Strategy 2. Pre-fund in bare-bones accounts administered by a quasi-governmental entity.

Strategy 3. Invest the Social Security trust fund in private-sector assets.

Strategy 4. Invest the Social Security trust fund in marketable federal debt.

STRATEGY 1: PRE-FUND IN FULL-SERVICE PERSONAL ACCOUNTS

If current trust fund accumulations do not represent true saving, it is because the special-issue government securities that are held by the trust fund are not regarded as liabilities to the non-Social Security budget that are as real and important as debt held by the public, despite the fact that these securities will ultimately be redeemed. In that case, introducing personal accounts to Social Security would remedy this problem by effectively converting the special-issue government securities into publicly held debt.

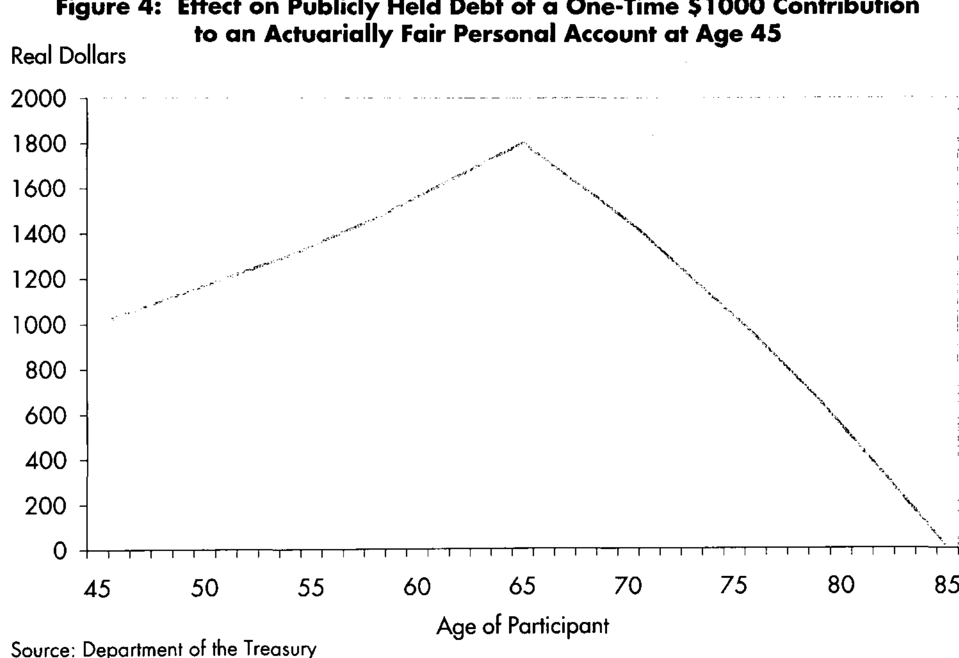
To see how this occurs, consider the following simple exercise. Start from any Social Security reform without accounts that makes Social Security permanently solvent, and imagine modifying the plan to

allow one individual to direct $1,000 of his or her payroll tax payments to a personal account in exchange for reducing his or her future defined benefits in an actuarially fair manner. For this simple case, it will be shown that 1) the personal account will have no direct effect on the government's underlying fiscal condition; and 2) the account would better reveal the true state of fiscal policy and might thereby result in smaller non-Social Security deficits being chosen.

The Personal Account's Direct Effect on the Government's Fiscal Condition

The personal account's effects on the time profile of publicly held federal debt and the unified deficit are shown in Figures 4 and 5, respectively.[3] The example assumes that the individual is 45 years old at the time of the personal account contribution, begins collecting benefits as a single person at age 65, and is certain to die at age 85; and that the real government borrowing rate is always 3 percent. In this case, then, the actuarially fair reduction in defined benefits is $121 per year.

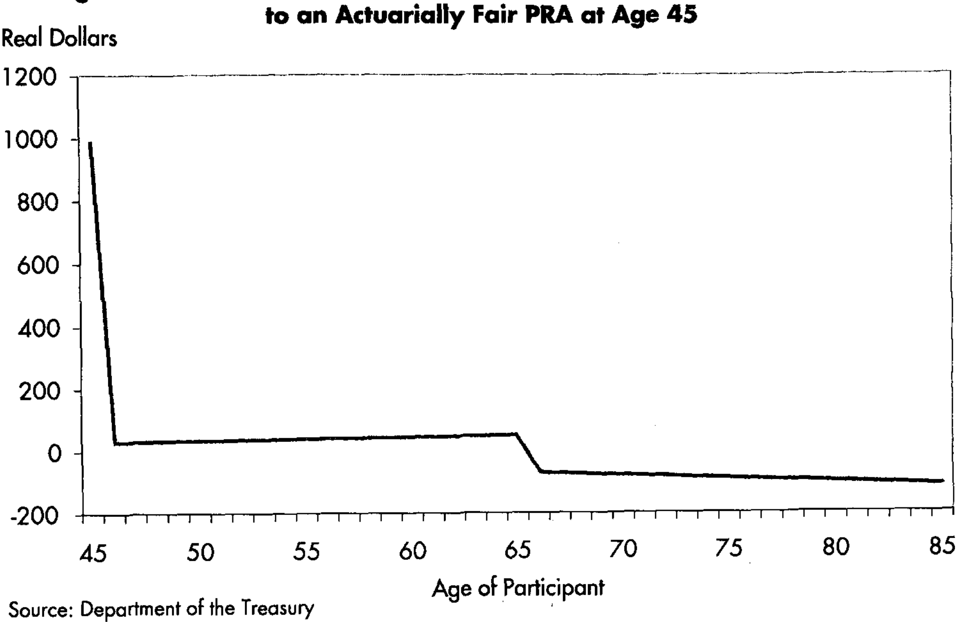
Figure 4: Effect on Publicly Held Debt of a One-Time $1000 Contribution to an Actuarially Fair Personal Account at Age 45



Source: Department of the Treasury

3 The profile for the unified deficit shown in Figure 5 is the annual change in the level of publicly held debt shown in Figure 4.

Figure 5: Effect on the Unified Deficit of a One-Time $1000 Contribution to an Actuarially Fair PRA at Age 45



Source: Department of the Treasury

At the time of the $1,000 account contribution, when the contributor is age 45, government outlays are increased by $1,000 and government revenues are unchanged, so the increment to publicly held debt is $1,000. Between the ages of 45 and 65, the increment to real publicly held debt rises at a 3 percent rate (the assumed real government borrowing rate) because the incremental debt must be continually rolled over. After the contributor retires at age 65, annual defined benefit payments are reduced by $121 (this amount is made up by the benefits paid from the personal account); this reduction in defined benefits results in a smaller unified deficit (Figure 5), which in turn causes the increment to publicly held debt to steadily decline (Figure 4). When the person dies at age 85, the increment to publicly held debt is precisely zero, which is what it means in this context for the defined benefit reductions to be actuarially fair.

Figure 4 demonstrates that adding actuarially fair personal accounts to a reform plan that is permanently solvent results in a plan that is also permanently solvent. But while actuarially fair accounts do not compromise permanent solvency, they do cause near-term unified deficits and publicly held debt to increase. The presence of this increment to near-term debt levels—which is often referred to as *transition debt*—is sometimes enlisted as an argument against instituting personal accounts.[4] In fact, "transition debt" does not represent a new obligation of the government, it merely substitutes publicly held debt for an existing implicit debt—namely, the obligation to pay defined benefits. Total government obligations are left unchanged at every point in time, which implies that the incremental public debt profile shown in Figure 4 is exactly matched by the time profile of reductions in the present value of defined benefit promises. (It is also true that the increase in publicly held debt is exactly matched by a reduction in the special-issue government securities held by the trust fund.)

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4 While transition debt associated with each individual's account is ultimately zero, total transition debt would always be positive for an ongoing Social Security system with personal accounts. In the hypothetical situation where accounts are invested exclusively in government debt, transition debt is simply equal to aggregate account balances; in an ongoing Social Security system, such balances will always be positive. Hence, the term "transition debt" is a misnomer for two reasons: It does not represent an addition to government liabilities, and it is not merely transitory.

Substituting explicit public debt for an existing implicit debt should in principle have little impact on financial markets. This is most obvious in the case where personal accounts are invested in federal government bonds and are paid out as actuarially fair real annuities, and where the accounts' administrative costs are kept low. In that case, introducing actuarially fair accounts as described here leaves total benefit levels essentially unchanged; all that occurs is that participants hold federal debt, an explicit government obligation, in lieu of defined benefit promises, an implicit government obligation. Because the accounts are invested in federal debt, they absorb all the increment to publicly held debt and there is no pressure for market interest rates to change.

The story is more complicated if personal accounts are invested in assets other than federal debt. In that case, the annual increase in purchases of private assets (equal to the account contributions) is precisely matched by the annual increase in public debt, so accounts increase the supply and demand for financial assets by precisely the same amounts. Any effect on interest rates should therefore be modest.[5]

These conclusions have been arrived at for what might seem to be a special case—one in which personal accounts are an actuarially fair modification to a permanently solvent plan that includes no accounts. As Box 1 explains, however, these conclusions in fact apply to any plan that includes personal accounts.

BOX 1

A CONCEPTUAL FRAMEWORK FOR UNDERSTANDING THE EFFECTS OF PERSONAL ACCOUNTS

This brief isolates the effects of personal accounts on solvency and benefit levels by beginning with a Social Security system *without* accounts and then introducing actuarially fair personal accounts. This analytical framework clearly applies to reform plans whose personal accounts are described as actuarially fair. For example, plans with voluntary personal accounts that are funded with payroll tax revenues have two components: (1) defined benefits if there were no personal accounts; and (2) diversions of payroll tax revenues to personal accounts and offsets to defined benefits for those choosing a personal account. These plans conform to the analytical framework used here to analyze the effects of personal accounts if the defined benefit offsets are actuarially fair.

But the effects of personal accounts that are derived using this framework and discussed in the body of the brief apply to *any* plan that includes personal accounts, not just those that describe the accounts as being actuarially fair. To see that this is true, consider the hypothetical example given by the table below. The first two columns of figures (labeled columns 1 and 2) relate to "Plan A," in which a worker has the option of putting some of his or her payroll taxes into a personal account. If a personal account is not elected, column 1 indicates that defined benefits are $95 and payroll taxes are $100. Alternatively, if a personal account is elected, column 2 indicates that $10 of payroll taxes are diverted to a personal account and defined benefits are reduced by $5. Because the defined benefit offset is less than the payroll tax diversion, the personal account as described is more than fair to the worker. To focus on the effects of personal accounts, assume that the personal account is elected (this could equally describe a hypothetical plan with a mandatory account as in column 2). With the account chosen, Plan A is described in column 2: defined benefits are $90, payroll taxes are $100, and $10 of payroll taxes are diverted to a personal account.

5 The point here is that the economic fundamentals determining interest rates are not changed when explicit public debt is substituted for implicit obligations to pay defined benefits. That said, if market participants fail to understand this—for example, if they were to believe that changes in publicly held debt have a larger effect on interest rates than do changes in implicit debt—then such a policy change would temporarily affect asset prices and interest rates. Eventually, however, market perceptions must come into alignment with underlying economic reality—deviations of market rates from fundamentals will not be permanent.

The effect of personal accounts in Plan A is the difference between the effects of that plan and the effects of a comparable plan that includes only defined benefits. For this purpose, the comparable defined-benefit-only plan is a modification of Plan A that diverts each person's $10 personal account contribution to the trust fund and increases their defined benefits by the maximum amount possible while keeping the plan's long-run actuarial balance unchanged. The resulting plan, "Plan B," is shown in the third column of the table; it boosts defined benefits by $10 relative to Plan A. It is apparent, therefore, that Plan A with accounts selected (or mandatory) is just Plan B plus actuarially fair personal accounts. So the effect of Plan A's personal accounts is found by comparing a plan without personal accounts—Plan B—with the same plan modified to include actuarially fair personal accounts—Plan A. This is precisely the analytical framework utilized in the brief.

Some analysts mistakenly infer the effects of personal accounts by comparing columns 1 and 2 in the table. The reasoning is that within the context of how the plan is described, electing an account moves an individual from column 1 to column 2, so the effect of the accounts is naturally associated with the effect of moving between these two columns. Under this way of thinking, the personal account increases total benefits (defined benefits plus benefits payable from personal accounts) by $5 and worsens Social Security's long-run actuarial balance by $5. But the same outcome could be achieved simply by boosting defined benefits by $5; hence, this interpretation does not properly isolate the effects of the accounts as they differ from the effects of a defined benefit change that costs the same amount.

Table 2
Isolating the Effects of Personal Accounts for a Plan That Describes Them as Being More Than Fair

	Plan with Personal Accounts (Plan A)		
Item	**If Personal Account Not Elected (1)**	**If Personal Account Is Elected (2)**	**Comparable Plan Without Personal Accounts (Plan B) (3)**
Defined Benefits	95	90	100
Payroll Taxes	100	100	100
Diversion of Payroll Tax to Personal Account	–	10	–
Memo:			
Implied Defined Benefit Offset	–	-5	–

It should be noted that because any Social Security reform plan with personal accounts can be conceptualized as a defined-benefit-only plan combined with actuarially fair personal accounts, it is not really meaningful to assess the degree to which personal accounts contribute to making Social Security permanently solvent as traditionally measured. True solvency requires the system's inflow and outflow over the indefinite future to be in balance in present-value terms (the traditional solvency measure), and also requires attempted pre-funding to be real pre-funding. Personal accounts do not help to improve the traditional solvency measure, but they would help to ensure that attempted pre-funding is real.

The Effect of Personal Accounts on the Conduct of Fiscal Policy

The discussion thus far suggests that introducing actuarially fair, conservatively invested personal accounts to a permanently solvent Social Security system in which accounts are initially absent carries no important consequences: Accounts do not directly change the time profile of the government's total liabilities; they should have little or no direct impact on financial markets; and they would have little effect on benefit levels.

However, the essential point of making personal accounts part of Social Security is to better reveal the state of the government's budget so that more prudent fiscal policy decisions are made outside of Social Security. Specifically, by transforming implicit promises to pay future Social Security benefits into explicit quantities of publicly held debt, personal accounts could result in smaller non-Social Security fiscal deficits today. To the extent that this is true, personal accounts are beneficial rather than merely benign as they would indirectly reduce the time profile of total government liabilities, thereby improving the well-being of future generations and putting downward pressure on interest rates.

What Role Does the Equity Premium Play?

Some analysts argue that personal accounts would also make Social Security more generous by giving participants access to equity returns that are normally higher than the returns earned on trust fund investments. This argument is flawed for two reasons, however. First, while equities do have an expected return that is greater than that offered by government bonds, the additional expected return (the so-called "equity premium") comes at the cost of assuming a larger amount of risk. To the extent that the equity premium merely compensates for this additional risk, cashing in a bond and buying equities does not make an investor any better off. In this case, the value of personal accounts is well approximated by their value when they are invested exclusively in government debt; hence, the presence of accounts would make Social Security no more or no less generous. A second and perhaps more compelling point concerns aggregate private-sector portfolio returns. Because personal accounts have no direct effect on national saving (as opposed to the indirect effect that they might have through fostering greater fiscal discipline), equities held in the accounts simply displace equities that would otherwise be held elsewhere in the consolidated portfolio of the private sector. Thus, accounts can only change the *distribution* of equity returns across the population, not total equity returns in the economy.

Equity returns do nevertheless have some relevance for assessing the advantages of personal accounts. First, to the extent that the accounts lead to smaller non-Social Security deficits, they result in an increase in government saving that boosts national saving and national wealth. The returns that would be earned on the additional national wealth are closely connected to the return on equities. Second, while the direct effect of personal accounts is to merely redistribute aggregate equity returns across the population, that redistribution could itself be beneficial. Although it is true that investors who wish to accumulate safe assets at a pace at least as rapid as the rate at which Social Security's defined benefit accrues should be indifferent to whether their personal accounts are invested in equities or bonds, young individuals with little financial wealth probably do not fit that description. Because many young people's primary access to equity investments would come through their personal accounts, their financial well-being would suffer if their personal account investments were restricted to bonds alone.

Administrative Costs Under Full-Service Personal Accounts

An important downside of full-service personal accounts is that they would substantially increase the costs of administering Social Security. Even if such accounts could be administered as efficiently as the current defined contribution plan for federal employees (the Thrift Savings Plan), a recent CBO study estimated that annual administrative costs would be $25 per participant (in 2004 dollars), which would raise the overall cost of administering Social Security to about three times its current level.[6] If accounts were to receive contributions equal to 2 percent of wages, the study estimated that administrative costs of this magnitude would reduce account balances at retirement by about 5 percent.

STRATEGY 2: PRE-FUND IN ACCOUNTS OFFERING NO INVESTMENT CHOICES AND ADMINISTERED BY A QUASI-GOVERNMENTAL ENTITY

In order to keep the administrative costs of accounts very low, it would be possible to create bare-bones accounts administered by a quasi-governmental entity like the Federal Reserve System. Such accounts might be invested exclusively in federal debt, or might include private-sector assets, but in either case investments would be pooled and no investment choice would be permitted. Without any investment choice, administrative costs would be very low because customer service would be limited to an annual account statement and a payout determination at retirement.[7]

A Social Security system consisting of bare-bones accounts and an ordinary defined benefit component could be designed to closely match benefit payments made by a defined-benefit-only system. Again, it is useful to imagine starting from a defined-benefit-only system that is permanently solvent—call this System A—and then introducing actuarially fair accounts (as in the discussion above) to arrive at a new system, System B. The System B accounts would be invested exclusively in government debt and would be paid out as real annuities. Because there would be no investment or payout choice, administrative costs would be very small and total benefits could be essentially the same as in System A. With such accounts, it should be clear that contributions made to the accounts are not available to finance non-Social Security programs. Similarly, it should be clear that the debt held by the accounts' administrator represents claims on the non-Social Security budget that are no different than other publicly held debt.

Investing accounts exclusively in federal debt would reduce risk and ensure that a reform plan that includes accounts could pay benefits that closely match the benefits that would be paid by any given defined-benefit-only system. Some, however, might prefer the higher expected returns offered by a riskier portfolio, even though there would be some chance that the portfolio's return would be lower than that offered by federal debt.[8]

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6 Congressional Budget Office, "Administrative Costs of Private Accounts in Social Security," March 2004.

7 Another advantage of accounts with no investment choice is that the current time lag between when employers make payroll tax payments and when those payments are allocated to individuals (which can be as long as 18 months) would be of no consequence, as allocated and unallocated funds would be invested in the same way.

8 A possible disadvantage of investing accounts exclusively in federal debt is that policymakers would perceive that the accounts' administrator is a captive buyer of federal debt whose existence reduces the cost of issuing public debt. However, a contrary view is that what matters to policymakers when deciding deficit levels is the government borrowing rate; as discussed in the text, that rate should be little affected by how the accounts are invested.

Budgetary Treatment Issues

How personal accounts would affect official measures of deficits and debt depends on whether the accounts are judged to be owned by individuals or by the government. The Office of Management and Budget (OMB) would determine the status of accounts based on the source of funds, legal terms of ownership, and control over use and disposition of the accounts. One important criterion for the private-property designation under current budgeting rules would be that an individual's defined benefits not be too closely linked to the individual's personal account balance. This would rule out the possibility that the reduction in each individual's ordinary defined benefits would be set equal to the annuity value of his or her account balance at retirement, as was assumed in the illustration given above of actuarially fair accounts.[9] If that possibility is ruled out, it would not be possible for a system with accounts to exactly mimic benefit levels payable from any given defined-benefit-only plan. But provided account administrative costs are kept very low, it would be possible for a Social Security system with accounts to pay the same benefits *on average* as does any given defined-benefit-only plan.[10]

If the accounts were determined to be government owned and if they were invested in federal government debt, they would be treated very much like the current trust fund. Account contributions would be treated as an outlay of the general fund and an offsetting receipt by the accounts, while the accounts' investments in federal securities would not be recorded as an outlay. Hence, there would be no effect on the unified deficit, and any pre-funding for Social Security would continue to mask the size of the non-Social Security deficit. In that case, the accounts would offer only one advantage: The government-owned account balances would be exactly offset by an easily identifiable offsetting obligation (benefits payable from the account balances). This would be analogous to specifying the current $2 trillion trust fund balance as the financing source for some portion of defined benefits going forward. It is not clear that this would have a material effect on the conduct of fiscal policy.

If the accounts were determined to be government owned and if they were invested in private assets, then they would be accounted for like the current trust fund would be if it were invested in private assets. In both cases, the purchase of private-sector assets by a government account would be recorded as an outlay, so the unified deficit and publicly held debt would both increase.[11] Compared to investing the trust fund in private-sector assets (an option that is discussed below), introducing government-owned accounts that were invested in private assets would have one advantage—they would result in an easily identifiable obligation (benefits payable from the account balances) that exactly offsets the value of the government-owned account balances. This situation would be analogous to investing the trust fund in private-sector assets and specifying the trust fund balance to be the financing source for some portion of defined benefits going forward. As before, the key question is whether this would lead to a material change in the conduct of fiscal policy.

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9 In this case, any increase in account balances would result in a reduction in ordinary defined benefits that leaves account owners with no net gain and leaves the government with no net change in its fiscal position. Hence, it is reasonable to rule that the account is not really private property.

10 An offset to defined benefits might depend on a hypothetical account balance at retirement computed using specific prospective assumptions about earned rates of return. While these offsets can be defined so that expected benefit levels are unchanged, actual benefit levels would change depending on how actual rates of return compare with expected returns. Also, essentially similar benefits could be defined directly without explicit reference to account balances.

11 It is possible that current budgeting conventions might be modified if government-owned accounts were to purchase private assets so that the asset purchases would not be recorded as outlays.

Other Possibilities for Administering Bare-Bones Accounts

Thus far, it has been assumed that the bare-bones accounts would be administered by a quasi-governmental entity. This would presumably allow some of the actual operations to be performed by private companies. For example, if accounts were invested in private assets, then the buying and selling of those assets would almost certainly be contracted out to a private company. Recordkeeping could also be contracted out, but that would probably be uneconomical given the amount of government oversight that would be necessary to assure privacy and accuracy.

The bare-bones accounts could also be administered by a government agency, with the Social Security Administration being an obvious choice. In that case, cash flows to and from the accounts would be scored the same as in the case where the administrator is a quasi-governmental entity (or a private company, for that matter). The only potentially important difference is that policymakers might be more apt to view the assets held by the administrator as being available to help finance non-Social Security programs if the administrator were not viewed as being separate from the government.

It is possible that the Social Security Administration could administer a system of accounts at lower cost than could a new quasi-governmental entity. However, it would seem that any such cost advantage would be slight. The only synergies between the Social Security Administration's current functions and account administration would concern data collection and recordkeeping, and data sharing between the Social Security Administration and a separate account administrator would be inexpensive if properly automated.

STRATEGY 3: INVEST THE TRUST FUND IN PRIVATE-SECTOR ASSETS

A less-aggressive strategy to help safeguard Social Security surpluses would be to invest all or part of the trust fund in private-sector assets. As with personal account balances scored as privately owned investments, every dollar invested in such assets would most likely increase official measures of outlays and the unified deficit by a dollar.[12] But in this case, the assets purchased would be the property of the government rather than of individuals, and there would be no easily identified offsetting government obligation. There is a risk, therefore, that any deficits that would have to be run to purchase private assets for the trust fund would be netted against the value of the assets purchased, which would in effect result in policy choices being made with an eye toward the implications for the unified deficit less the trust fund's investments in private assets (and publicly held debt less the value of private assets held in the trust fund). In that case, non-Social Security taxes and spending would be the same as they would be absent the purchase of private-sector assets by the trust fund, and the strategy would therefore fail to effectively safeguard Social Security surpluses.

What distinguishes privately owned accounts from trust fund purchases of private-sector assets is the implication each proposal would carry for the time path of government financial net worth. Privately owned accounts increase publicly held debt, thereby reducing the time profile of government financial net worth and widening the unified deficit. Investing the trust fund in private-sector assets increases the government's financial assets and its financial liabilities by the same amount, and hence has no effect on its financial net worth. If budgeting decisions are made with reference to the government's financial net worth rather than to publicly held debt, then investing the trust fund in private-sector assets would not increase the chances that Social Security pre-funding is truly put aside to help pay future Social Security benefits.

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12 The Congressional Budget Office (CBO) made this determination in scoring President Clinton's fiscal year 2000 budget.

Some analysts have advocated investing the trust fund in private-sector assets as a means of increasing trust fund rates of return rather than as means of safeguarding Social Security surpluses. However, as in the case of personal accounts, this is a poor rationale: The higher expected rates of return on risky assets merely compensate for risk that would ultimately be borne by taxpayers. And risky trust fund investments would not increase national saving, so risky assets held in the trust fund would just displace risky assets held in the consolidated portfolio of the private sector (the private sector would hold fewer risky assets and more federal debt). To the extent that risky assets held by the trust fund would earn higher returns, therefore, the resulting gain to taxpayers would be offset by lower returns earned on private-sector assets. Moreover, budget politics are such that it is likely that the taxpayers who would gain if trust fund equity returns were high would not be the same taxpayers who would lose if trust fund returns were low. This would occur, for example, if the policy response to movements in equity prices involved passing through higher equity returns to benefits relatively quickly, but delayed reducing benefits in the face of lower returns until Social Security's finances were in crisis. In that case, current generations would enjoy the upside risk while future generations would bear the downside risk.

Trust fund equity investments might also reduce the perceived urgency for Social Security reform, thereby delaying reform and causing Social Security to be less fair to future generations. This would occur if the Social Security trustees were to decide to project Social Security's finances under the assumption that trust fund equity holdings are certain to receive the expected return on equities rather than the proper risk-adjusted return, which is the return received on risk-free assets. In that case, trust fund equity investments would only result in an illusory improvement in Social Security's projected finances.

Finally, there is one additional important downside to investing the trust fund in private-sector assets: Political considerations might influence investment choices and how equity shares are used to influence questions of corporate governance.

STRATEGY 4: INVEST THE TRUST FUND IN MARKETABLE FEDERAL DEBT

If the trust fund were invested in marketable federal debt rather than in special-issue government securities, there would be essentially no change in the way the trust fund is accounted for in budgetary calculations. Current budget accounting norms dictate that the purchase of federal debt is not scored as an outlay; in addition, any publicly held debt purchased by the trust fund becomes public debt held by a federal government account (as are the current special-issue government securities held by the Trust Fund), thereby ceasing to be publicly held debt. Hence, the time path for the unified deficit, publicly held debt, and government financial net worth would not be affected by this policy. There would therefore appear to be no reason for the government's fiscal situation to be perceived any differently in this case.

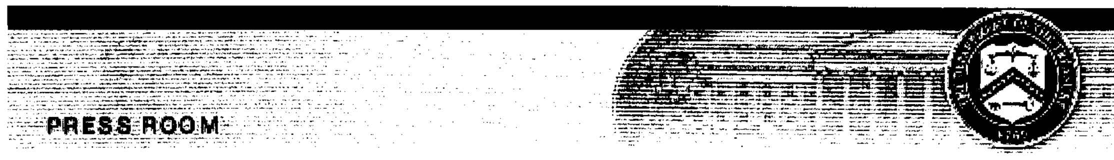
CONCLUSION

Making Social Security fair to future generations requires reforms that involve substantial true pre-funding of future Social Security benefits. Attempting such pre-funding through the trust fund runs a significant risk that it would be offset by higher non-Social Security deficits, in which case a Social Security policy that is more fair to future generations will be offset by a non-Social Security fiscal policy that is less fair. Large dividends would be realized, therefore, if a mechanism could be found to increase the odds that attempted Social Security pre-funding would represent true pre-funding.

Nearly all analysts agree that personal account assets owned by participants would constitute true pre-funding. Moreover, if account investments were conservative and pooled (*i.e.*, if no investment choices were permitted), then accounts would be relatively inexpensive to administer and would have very little effect on the level and certainty of total Social Security benefits. In that case, accounts would offer the benefit of increased confidence that Social Security pre-funding is true pre-funding. Making policymakers and voters aware of these facts will require some effort, as some mistakenly believe that the *principal* benefit of accounts is to permit access to equities' higher expected returns.

Investing the trust fund in private assets might increase the odds that trust fund accumulations would constitute true pre-funding. Such a policy would increase publicly held debt and official measures of the unified deficit, but it would be easy to see that the increased publicly held debt is offset by the value of private assets owned by the government. It is quite possible that policymakers would be unconcerned by any deficits that result from purchasing private assets for the trust fund, and would therefore make policy choices based on their implications for the unified deficit less trust fund investments in private assets and publicly held debt less the value of private assets held in the trust fund. In that case, non-Social Security taxes and spending would be the same as they would be absent the purchase of private-sector assets by the trust fund, and the strategy would therefore fail to effectively safeguard Social Security surpluses. Moreover, there is a substantial risk that trust fund equity investments would be improperly scored as reducing Social Security's actuarial imbalance, and that political considerations would influence investment choices and how equity shares are used to influence questions of corporate governance. And, as with personal accounts, the prospect of earning high returns on private assets is largely irrelevant to the pros and cons of investing the trust fund in private assets.

Finally, investing the trust fund in marketable federal debt rather than in special-issue government securities is least likely to affect policymaker perceptions of the state of fiscal policy. The official measure of the unified deficit would not be affected, and once the marketable debt is purchased by the government it would be officially scored as public debt held by a government account, the same designation currently given to special-issue government securities held by the trust fund.



April 16, 2008
hp-931

Remarks by Under Secretary David H. McCormick to the CFA Society of Chicago

The International Response to Financial Market Turmoil

Chicago – Thank you for your invitation to be here today. I'm delighted to meet this distinguished group.

Today, I've been asked to speak about the public policy response to financial market turmoil. Unfortunately, the rhetoric surrounding this subject has sometimes drifted towards sweeping regulation or unbounded injections of public money. Such suggestions seem motivated by hope for a simple and easily implemented solution.

But in fact, there are no quick fixes, no simple solutions. The reality of market developments since August 2007 is much more complicated and requires multi-dimensional responses. Recent events highlight some age-old truths and the ever-present need to cultivate strong market discipline, greater transparency and disclosure, prudent regulatory policies and robust risk management.

Today, I'd like to discuss with you the forces that led to current market conditions and I plan to explain an ambitious combination of domestic and international actions which are being undertaken to address these challenges. While there will inevitably be more bumps in the road ahead, U.S. long-run economic fundamentals remain sound, and the flexibility, resilience and strength of our capital markets and our economy will prevail.

The Market Turmoil in Perspective

The current turmoil finds its original roots in a long period of benign macroeconomic and financial conditions that encouraged widespread complacency about risk. Investors in search of higher yields created significant demand for structured credit products but, in many cases, did not conduct adequate due diligence.

Meanwhile, demand for housing began to slow in 2004, and credit standards loosened significantly, particularly for subprime mortgages. Hybrid-adjustable-rate mortgages (ARMs) with low teaser rates, interest-only features, low or no down payments, and even negative amortization, became popular. In 2005 and 2006, non-traditional ARMs comprised about one-quarter of mortgage originations, exposing mortgage holders to far greater risk than traditional fixed rate mortgages.

At the same time, the pace of financial innovation gathered momentum and the trend toward securitization of assets accelerated. Financial innovation clearly brought enormous benefits to investors and consumers, and contributed to domestic and global economic growth. We also see, however, that the resulting dramatic increase in leverage and complexity of financial instruments brought new risks to financial markets – not only to the United States but to other interconnected markets in Europe and around the world.

The looser credit standards, combined with the aforementioned complacency, inevitably contributed to an unexpected rise in mortgage delinquencies. This, in turn, triggered a global reassessment of risk beginning in August 2007, followed by significant de-leveraging. The dramatic swing in sentiment, subsequent market volatility and heightened uncertainty ratcheted up demand for cash and liquidity. Many structured finance markets seized up, causing markets for asset-backed commercial paper to contract substantially.

These developments revealed serious weaknesses in risk management practices at

many large U.S. and European financial institutions, particularly in the area of liquidity risk management. Some institutions experienced significant losses and significant balance sheet pressures, contributing to a tightening of lending standards and potential impact on economic growth.

U.S. Domestic Actions

The Administration has responded vigorously, both on the domestic and the international fronts. Here at home, the Administration's response addresses near-term as well as longer-term measures. The goals are straightforward: minimize the impact on the real economy; maintain efficient and liquid markets; ensure continued availability of credit; and enhance risk management. Our domestic approach includes three sets of actions to help accomplish these goals.

First, the Administration has acted aggressively to support the economy as it weathers the housing correction and financial market challenges. The housing correction will undoubtedly take time to run its course. The fiscal stimulus package, signed into law by President Bush on February 13, provides temporary tax relief to over 130 million American households and temporary tax incentives for businesses. This year's $150 billion infusion will support the creation of over half a million additional jobs by year end.

Our housing market initiatives also seek to increase the availability of affordable mortgage financing, prevent avoidable foreclosures, and minimize the economic disruption of the housing correction. They include temporary actions to raise the conforming loan limit, which will allow Fannie Mae and Freddie Mac to inject more capital into the mortgage market. Two other key initiatives include FHA Secure, launched in September, and the HOPE NOW Alliance, launched in October at the encouragement of the Treasury. To date, the Federal Housing Administration has refinanced more than 155,000 borrowers into affordable loans, while the HOPE NOW Alliance recently announced that nearly 1.2 million homeowners have been helped through workout plans since the middle of last year. As this effort progresses, the Administration will continue to look for new ways to assist more struggling homeowners, as was evident with the recent expansion of FHA Secure to help additional borrowers qualify for government-insured mortgage loans.

Second, U.S. policymakers have also initiated a number of medium-term efforts to strengthen market discipline and address regulatory gaps. Secretary Paulson chairs the President's Working Group on Financial Markets – the PWG – an interagency policy coordination group that includes the Fed, the SEC, and the CFTC. On March 13, the members of the PWG issued a comprehensive review of policy issues related to recent financial market turmoil. That review identified several areas of underlying weaknesses, including:

- lax underwriting standards for mortgages, particularly for subprime mortgages;
- an erosion of market discipline in the securitization process;
- flaws in credit rating agencies' assessments of some complex structured credit products;
- risk management weaknesses at global financial institutions; and
- regulatory policies that failed to mitigate risk management weaknesses.

The President's Working Group recommended measures to reform mortgage origination, strengthen risk management, enhance disclosure and market discipline in the securitization process, and reform the use of credit ratings. Secretary Paulson also has proposed establishing a new federal Mortgage Origination Commission to fill an important gap in the current regulatory structure.

Finally, the Administration also is working on longer-term efforts to maintain competitive capital markets. Long before our current challenges, Secretary Paulson had launched a broad Capital Markets Competitiveness Initiative to improve financial regulation effectiveness. Since then, work has proceeded in a variety of areas such as accounting and auditing, disclosure, and financial education. These long-term efforts remain central to the resilience of our financial markets, and their ability to support sustainable economic growth.

Of particular note, there is a pressing need to modernize our regulatory framework, which resembles a patchwork of overlapping agencies and responsibilities

conceived over the last 75 years. After extensive consultations, Treasury concluded in its Blueprint for modernized financial regulation that the optimal financial regulatory model mirrors the reasons we regulate: market stability, safety and soundness associated with federal guarantees, and consumer and investor protection. This proposal includes a market stability regulator, prudential financial regulator and business conduct regulator. This approach would foster innovation, mitigate risk, and enhance competitiveness.

International Coordination

These concerted domestic efforts notwithstanding, financial turmoil witnessed on a global scale also has required an international response. Internationally, as market turmoil began to spread, Treasury quickly engaged with our counterparts in the Group of Seven (G-7) countries and the Financial Stability Forum.

Across global markets, and with the support of their national regulators, many financial institutions took aggressive action to write down assets, disclose losses and raise new capital. Write downs and losses in the past six months total well over $200 billion with U.S. financial institutions accounting for about half, Europeans over a third, and Asians, Canadians and others the remainder. Global financial institutions have raised over $150 billion in capital, with sovereign wealth funds making significant contributions. It remains vital that financial institutions act promptly to recognize the losses, secure adequate capital, and ensure credit availability for consumers and businesses.

In September, the G-7 asked the Financial Stability Forum to examine underlying weaknesses and develop appropriate international responses. The Financial Stability Forum (FSF), formed by the G-7 in 1999 following the Asian financial crisis, occupies a unique place in the international landscape. The FSF brings together supervisors, central banks, finance ministries, the International Monetary Fund and the World Bank, and other international regulators. Together, the members of the FSF assess international financial system vulnerabilities and identify needed actions among responsible authorities. This provides critical coordination between globally integrated capital markets and national regulatory agencies.

The FSF presented its findings to the G-7 last week. The report's conclusions and recommendations are consistent to those of the President's Working Group, but on a global scale. The recommendations include:

- Strengthening prudential oversight of capital, liquidity and risk management.
- Enhancing transparency and valuation.
- Changing and clarifying the role and use of credit ratings.
- Strengthening the authorities' responsiveness to risks.
- Creating robust arrangements for dealing with stress in the financial system.

Let me expand briefly on each of these areas.

Prudential oversight: Firms need to strengthen their risk management practices, liquidity buffers and capital. The Basel Committee should raise capital requirements for complex securities and off-balance sheet vehicles. Supervisors need to issue revised liquidity risk management guidelines by July 2008, enhance monitoring, and require more stress testing.

Transparency and valuation: Well-functioning markets rely on timely disclosure and robust valuations. Firms need to fully disclose their risk exposures and fair value estimates for complex securities. Supervisors need to require improved transparency for off-balance sheet entities. The International Accounting Standards Board should urgently act to improve standards for off-balance sheet entities and improve guidance for fair value accounting.

Credit ratings: Investors should improve their due diligence efforts, reducing their reliance on credit ratings. Credit rating agencies need to clearly differentiate the ratings for structured products, improve their disclosures, and reassess the quality of the information they use to determine ratings for structured products.

Authorities' responsiveness to risks: Supervisors and central banks need to increase their cooperation and information exchanges, including assessments of

financial stability risks.

Dealing with stress in the financial system: Central banks need to effectively provide liquidity when the financial system is under stress. In addition, authorities should strengthen arrangements for dealing with weak and failing banks, domestically and across borders.

These recommendations, while primarily aimed at filling regulatory gaps, also include suggestions that could enhance market conditions. These include, for example, encouraging stronger mid-2008 financial reporting, enhanced transparency for off-balance sheet entities, and fair value estimates for complex securities. These are important and immediate steps for boosting market confidence.

Work is already underway in many areas. Last week, the G-7 committed to the timely implementation of the FSF recommendations by the end of 2008. The Financial Stability Forum will report on progress on this ambitious agenda to the G-7 Finance Ministers next October. This important work – and this important body – will continue efforts to strengthen market discipline and encourage efficient and competitive markets.

Moving Ahead

Over the past 8 months, we have learned that our efforts must evolve quickly and creatively as events unfold and new information becomes available. And, we must maintain our perspective. Secretary Paulson, drawing on years of experience, has observed that: "every period of prolonged turbulence seems to be the worst until it is resolved. And it always is resolved."

Recent events highlight the ever present need to cultivate strong market discipline, greater transparency and disclosure, prudent regulatory policies and robust risk management. The actions being taken are doing just that.

I believe we will work through this period as we have those in the past, and will return to robust growth. The long-term prospects of the U.S. economy remain solid. Inevitably, more challenges lie ahead, but we will learn from this experience. We will adapt and we will emerge stronger. The flexibility, resilience and strength of U.S. capital markets and the U.S. economy will prevail.

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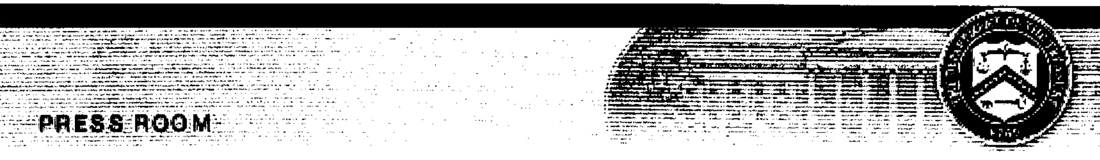

April 16, 2008
hp-932

Assistant Secretary David G. Nason Testimony before the House Committee on Financial Service Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises

Washington - Thank you, Chairman Kanjorski, Ranking Member Pryce, and Members of the Subcommittee for inviting me to appear before you today to discuss the need for insurance regulatory reform.

Treasury's Blueprint for Financial Regulatory Reform

On March 31, the Treasury Department ("Treasury") released a report on financial services regulation entitled, "Blueprint for a Modernized Financial Regulatory Structure." The Blueprint reflects a year-long effort in addressing complex, long-term issues and ideas intended to provoke thoughtful discussion as we collectively work toward modernizing all sectors of the financial services industry. The Blueprint is not, and has never been, intended to be a response to recent stress in the credit markets, but rather is a series of Treasury's recommendations to improve our regulatory structure in the future.

The Blueprint presented a conceptual model for an optimal regulatory framework. This structure is an objectives-based regulatory approach, with a distinct regulator focused on one of three objectives--market stability regulation; safety and soundness regulation associated with government guarantees; and business conduct regulation. The regulation of all financial services products, including insurance, is addressed in the optimal regulatory framework.

Treasury's Blueprint also presented a series of "short-term" and "intermediate-term" recommendations that could, in our view, immediately improve and reform the U.S. financial services regulatory structure. Some of our recommendations focus on eliminating some of the duplication inherent in the U.S. regulatory system, but more importantly, they try to modernize the regulatory structure applicable to certain sectors in the financial services industry within the current framework – including insurance.

Today, I will address some of Treasury's recommendations with regard to modernizing insurance regulation in the near-term.

The Need for Insurance Regulatory Modernization

Insurance performs an essential function in our domestic and global economies by providing a mechanism for businesses and citizens to safeguard their assets from a wide variety of risks. Insurance is similar to other financial services in that its cost, safety, and ability to innovate and compete are heavily affected by the substance and structure of its system of regulation.

Unlike banks and other financial institutions that are regulated primarily at the federal level or on a dual federal/state basis, insurance companies in the United States are regulated almost entirely by the states. The constitutional and statutory allocation of regulatory power between the federal government and the states has a complex evolution.

For over 135 years, states have regulated insurance with little direct federal involvement. In 1869, the U.S. Supreme Court concluded that the issuance of an insurance policy was not interstate commerce, and therefore outside the constitutionally permitted scope of the federal government's legislative and regulatory authority (Paul v. Virginia). In 1944, some 76 years later, the Court reversed itself holding that insurance was indeed subject to federal regulation and

federal antitrust law (United States v. South-Eastern Underwriters Association). In 1945, before any assumption of federal regulatory authority over insurance, Congress passed the McCarran-Ferguson Act, which "returned" the regulatory jurisdiction over the business of insurance back to the states, and generally exempted the business of insurance from most federal laws unless they specifically relate to the business of insurance. While a state-based regulatory system for insurance may have been appropriate over some portion of U.S. history, changes in the insurance marketplace have increasingly put strains on the system.

Much like other financial services, over time the business of providing insurance has developed a more national focus even within the state-based regulatory structure. The inherent nature of a state-based regulatory system makes the process of developing national products cumbersome and more costly, thereby directly impacting the competitiveness of U.S. insurers.

There are a number of inherent inefficiencies associated with the state-based insurance regulatory system. Economic inefficiency appears to have resulted both from the substance of regulation (such as price controls), and also from its structure (multiple non-uniform regulatory regimes). Even with the efforts of the National Association of Insurance Commissioners (NAIC) to foster greater uniformity through the development of model laws and other coordination efforts, the ultimate authority still rests with individual states. For insurers operating on a national basis, this means not only being subject to licensing requirements and regulatory examinations in all states where the insurer operates, but also operating under different laws and regulations in each state.

In addition to a more national focus today, the insurance marketplace also operates globally with many significant foreign participants. A state-based regulatory system creates increasing tensions in such a global marketplace, both in the ability of U.S.-based firms to compete abroad and in the allowance of greater participation of foreign firms in U.S. markets. In particular, foreign government officials have continued to raise issues associated with having at least 50 different insurance regulators, which makes coordination on international insurance issues difficult for foreign regulators and companies. The NAIC has attempted to fill this void by working closely with international regulators on a number of projects. The NAIC itself is not a regulator but facilitates communications among the states on international regulatory issues. In the end, whatever the NAIC accomplishes in the international arena, given the NAIC's structure as a coordinating body and the inherent nature of the state-based system, it will be increasingly difficult for the United States to speak effectively with one voice on some international insurance regulatory issues.

A number of countries are pushing forward with regulatory systems seeking more uniform, efficient and stronger insurance sectors, in order to underpin more and better products for their consumers with less risk to the financial system. In particular, the European Union is working on its Solvency II project to forge one insurance market for all of its member states. The interaction between the U.S. regulatory system and its foreign counterparts in these types of discussions will likely impact the ability of U.S. firms to conduct business abroad and the flow of capital to the United States.

Treasury believes the fundamental question is whether our current state-based system of insurance regulation is up to the task of meeting the challenges of today's evolving and increasingly global insurance market. In other words, is the state-by-state regulatory approach, as chosen by the Congress in 1945, and as it exists today, still the most effective and efficient system for regulating an evolving insurance marketplace?

A number of reform proposals have been considered over the years to modernize the U.S. system of insurance regulation: total federal preemption; dual federal/state systems under an optional federal charter (OFC) approach; mandating national standards on the state-based system; and harmonizing and making more uniform regulation among the states. In Treasury's view, the establishment of a dual federal/state system with an OFC provides the best opportunity for the establishment of a modern and comprehensive system of insurance regulation.

Optional Federal Charter

The establishment of an OFC structure would provide insurance market participants

with the choice of being regulated at the national level or continuing to be regulated by the states. Such a structure is broadly consistent with the current regulatory structure that applies to banks and other insured depository institutions. An OFC insurance regulatory structure should enhance competition among insurers in national and international markets, increase efficiency, promote more rapid technological change, encourage product innovation, reduce regulatory costs, and, importantly, provide high quality consumer protection.

Treasury believes that an OFC structure should provide for a system of federal chartering, licensing, regulation, and supervision for insurers and insurance producers (i.e., agents and brokers). It should also provide that the current state-based regulation of insurance would continue for those insurers not electing to be regulated at the national level. States would not have jurisdiction over those electing to be federally regulated. However, insurers holding an OFC could still be subject to some continued compliance with other state laws, such as state tax laws, compulsory coverage for workers' compensation, and individual auto insurance, as well as the requirements to participate in state mandatory residual risk mechanisms and guarantee funds.

The establishment of an OFC should incorporate a number of fundamental regulatory concepts. For example, the OFC should ensure safety and soundness, enhance competition in national and international markets, increase efficiency in a number of ways, including the elimination of price controls, promote more rapid technological change, encourage product innovation, reduce regulatory costs, and provide consumer protection.

Treasury also recommends the establishment of the Office of National Insurance (ONI) within Treasury to regulate those engaged in the business of insurance pursuant to an OFC. The Commissioner of National Insurance would head the ONI and would have specified regulatory, supervisory, enforcement, corrective action, and rehabilitative powers to oversee the organization, incorporation, operation, regulation, and supervision of national insurers and national agencies. The ONI could be required to integrate current portions of the state-designed body of regulation into the new national system, which would limit major disruptions to the marketplace.

There are currently pending bills in both the House (H.R. 3200) and Senate (S. 40) entitled the "National Insurance Act of 2007" that would create an OFC and establish an ONI. These bills contain many of the core concepts surrounding the establishment of an OFC structure. We look forward to evaluating further the specific provisions of these bills.

Office of Insurance Oversight (OIO)

While Treasury believes an OFC offers the best opportunity to develop a modern and comprehensive system of insurance regulation in the near term, we acknowledge that the OFC debate in the Congress is ongoing. At the same time, however, Treasury believes that some aspects of the insurance segment and its regulatory regime require immediate attention. In particular, Treasury recommends that the Congress establish an Office of Insurance Oversight (OIO) within Treasury. The OIO through its insurance oversight would be able to focus immediately on key areas of federal interest in the insurance sector.

The OIO should be established to accomplish two main purposes. First, the OIO should exercise newly granted statutory authority to address international regulatory issues, such as reinsurance collateral. Therefore, the OIO would become the lead regulatory voice in the promotion of international insurance regulatory policy for the United States (in consultation with the NAIC), and it would be granted the authority to recognize international regulatory bodies for specific insurance purposes. The OIO would also have authority to ensure that the NAIC and state insurance regulators achieved the uniform implementation of the declared U.S. international insurance policy goals. Second, the OIO would serve as an advisor to the Secretary of the Treasury on major domestic and international policy issues. Once the Congress does enact significant insurance regulatory reform establishing an OFC, the OIO could be incorporated into the OFC framework.

Conclusion

We appreciate the efforts of the Chairman and Members of the Subcommittee in evaluating issues associated with modernizing insurance regulation.

We look forward to continuing to work with the Congress toward finding an appropriate balance as proposals for dual federal/state regulation of insurance are considered. Thank you.

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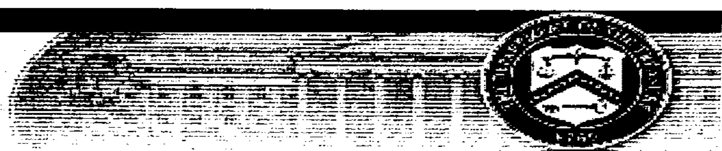


April 16, 2008
2008-4-16-14-37-56-5488

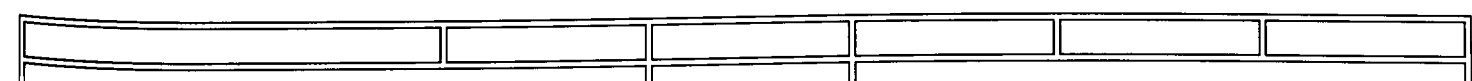
U.S. International Reserve Position

The Treasury Department today released U.S. reserve assets data for the latest week. As indicated in this table, U.S. reserve assets totaled $75,590 million as of the end of that week, compared to $75,293 million as of the end of the prior week.

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

	April 11, 2008		
A. Official reserve assets (in US millions unless otherwise specified)	Euro	Yen	Total
(1) Foreign currency reserves (in convertible foreign currencies)			75,590
(a) Securities	15,801	12,118	27,919
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	15,682	6,789	22,471
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	4,291		
(3) SDRs	9,868		
(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)	75,590
--currencies in SDR basket	75,590
--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.

**Deputy Assistant Secretary for Terrorist Financing
and Financial Crimes Daniel Glaser
Testimony Before the House Committee on Foreign Affairs
Subcommittee on the Middle East and South Asia
and the Subcommittee on Terrorism, Nonproliferation and Trade**

Washington - Chairman Ackerman, Chairman Sherman, Representative Pence, Representative Royce and distinguished members of the Committee, thank you for the opportunity to speak with you today about the Treasury Department's efforts to counter Iran's nuclear program and its deliberate support of terrorism. I want to thank this Committee for its continued support and guidance in our efforts against an Iranian regime that continues to pursue threatening activities. Today, I will focus my remarks on the Treasury Department's strategy and actions to counter this threat and the impact we have achieved on Iranian financial institutions and businesses.

The Iranian Threat

Iran poses significant threats to the international community. Chief among them is the regime's continued pursuit of nuclear ambitions in defiance of United Nations Security Council resolutions. Another paramount threat is Iran's provision of financial and material support to terrorist groups. The combination of these two threats presents a lethal challenge that is exacerbated by Iran's integration into the international financial system, and its deceptive financial practices.

Threat of Iran's Nuclear Ambition

Iran's continued pursuit of nuclear and missile programs present a deliberate and intolerable threat to the international community. Iran has ignored calls from the international community to suspend its enrichment-related reprocessing and heavy water-related activities, and defied numerous U.N. Security Council resolutions including:

- Resolution 1696 (2006)
- Resolution 1737 (2006)
- Resolution 1747 (2007)
- Resolution 1803 (2008)

The international community reiterated its position on this issue most recently on March 3, 2008, when the U.N. Security Council adopted Resolution 1803, imposing further sanctions on Iran for its refusal to suspend its proliferation sensitive nuclear activities. Iran has thus far ignored this recent resolution, announcing that it would proceed forward in expanding its uranium enrichment activities. Iran's defiance and disregard for international concern adds to the gravity of the threat.

Threat of Iran's Support of Terrorism

The threat we face from Iran is not limited to its pursuit of a nuclear capability. Another dynamic of Iran's threat is its provision of financial and material support to terrorist groups. Iran has long been a state sponsor of terrorism and continues to support an unparalleled range of terrorist activities. For example, Tehran arms, funds, and advises Hizballah, an organization that has killed more Americans than any terrorist network except for al-Qa'ida, and does so via the Qods Force, a branch of the Islamic Revolutionary Guard Corps. In addition, Iran provides extensive support to Palestinian terrorist organizations, including the Palestinian Islamic Jihad (PIJ) and Hamas. In the case of PIJ, Iran's financial support has been contingent upon the terrorist group carrying out attacks against Israel. And we are

all familiar with Iran's funding, training, and equipping of select Shi'a extremist groups in Iraq, further destabilizing that country and resulting in deaths of Americans, Iraqis and others. Iran's Qods Force also provides weapons and financial support to the Taliban to support anti-U.S. and anti-Coalition activity in Afghanistan

Iran utilizes the international financial system as a vehicle to fund these terrorist organizations. As Under Secretary Levey has previously testified, the Iranian regime operates as the central banker of terrorism, spending hundreds of millions of dollars each year to fund terrorism.

Iran's Integration into the International Financial System

Iran is deeply integrated in the international financial system. Iranian state-owned banks have dozens of branches located all over the world. Additionally, Iranian banks have correspondent accounts at foreign banks for an even broader reach into the international financial system. Moreover, Iranian individuals and entities maintain accounts at foreign financial institutions.

Iran's integration into the global economy and the international financial system gives the Iranian regime global financial capability to support its threatening activities and exposes the international financial system to illicit financing risks posed by the regime.

Iran's Deceptive Financial Practices

Iran uses its global financial ties to pursue both the threat of terrorism and a nuclear program through an array of deceptive practices specifically designed to avoid suspicion and evade detection from the international financial community. Iran uses its state-owned banks for its nuclear and missile program and for financing terrorism. For example, Tehran uses front companies and intermediaries to engage in ostensibly legitimate commercial transactions that are actually related to its nuclear and missile programs. These front companies and intermediaries enable the regime to obtain dual-use technology and materials from countries that would typically prohibit such exports to Iran.

Another method Iranian banks use to evade controls is to ask other financial institutions to remove their names when processing transactions through the international financial system. This practice is intended to elude the controls put in place by responsible financial institutions and has the effect of potentially involving those institution in transactions they would never engage in if they knew who, or what, was really involved. This practice allows Iran's banks to remain undetected as they move money through the international financial system to pay for the Iranian regime's illicit and terrorist-related activities. This practice is even used by the Central Bank of Iran to facilitate transactions for sanctioned Iranian banks.

Fundamental Deficiencies in Iran's AML/CFT Regime

In addition to Iran's deceptive financial conduct, substantial deficiencies in Iran's anti-money laundering and combating the financing of terrorism (AML/CFT) regime present a significant vulnerability to the international financial system. Iran lacks an acceptable system of laws and enforcement capabilities that would allow it to detect and prevent money laundering or terrorist financing. Although Iran adopted an anti-money laundering law this year, its content has been heavily criticized by both the Financial Action Task Force (FATF) and International Monetary Fund (IMF) for failing to meet international standards. Moreover, both the FATF and IMF have recognized broader deficiencies in Iran's AML/CFT regime to include:

1. Insufficient criminalization of money laundering.
2. Failure to criminalize terrorist financing.
3. Lack of AML/CFT supervision.
4. Lack of a financial intelligence unit.
5. Lack of sanctions implementation.
6. Lack of international cooperation in AML/CFT investigations.

As FATF has stated in its advisories to the international financial system, these core AML/CFT deficiencies present a substantial vulnerability to the international

financial system. The FATF took unprecedented measures to warn the international financial system about the risks arising from the deficiencies in Iran's AML/CFT.

Treasury's Actions to Address the Threat

Addressing this multifaceted threat – the threat of both proliferation and terrorism, reinforced by Iran's deceptive financial conduct and systemic AML/CFT deficiencies –requires a multifaceted strategy, including an essential financial component. In the years since September 11, we have substantially increased our understanding of vulnerabilities in the international financial system and how terrorist and other illicit financial networks exploit those vulnerabilities. Treasury's strategy to combat the threat that Iran presents, and application of financial pressure to the Iranian regime, builds upon these experiences and consists of three inter-related initiatives:

- Developing and implementing targeted financial measures to combat Iran's proliferation and terrorism support activities;
- Maximizing the impact of U.S. financial actions by securing international support; and
- Engaging in a strategic dialogue with the international private sector to explain the risks of doing business with Iran.

A. Direct U.S. Action Utilizing Treasury Authorities

The U.S. has maintained trade and financial-related sanctions program against Iran for almost 30 years. The current program prohibits virtually all commercial trade between the U.S. and Iran. Our efforts in recent years have focused on a conduct-based targeted financial action aimed at disrupting Iran's proliferation and terrorism activities. We have shown that these types of targeted, conduct-based financial measures aimed at particular bad actors can be quite effective, in part because they unleash market forces by highlighting risks and encouraging prudent and responsible financial institutions to make the right decisions about the business in which they are engaged. They give us a concrete way in which to target directly those individuals and entities we know are bad actors and to strike at the heart of their operations.

Executive Order 13382 – Targeting WMD Proliferators and Their Networks

The Treasury Department relies on Executive Order 13382, a targeted financial sanctions authority, for imposing targeted financial sanctions against weapons of mass destruction (WMD) proliferators and their supporters to pressure Iran. Executive Order 13382 was issued by President Bush in 2005 and added a powerful tool to the array of options available to combat WMD proliferation. By prohibiting U.S. persons from engaging in transactions with entities and individuals targeted by the order, we can effectively deny proliferators and their supporters access to the U.S. financial and commercial systems, cutting them off from the benefits of our economy. These prohibitions have powerful and far-reaching effects, as the suppliers, financiers, transporters, and other facilitators of WMD networks tend to have commercial presences and accounts around the world that make them vulnerable to exactly this kind of financial action, particularly since so many of the transactions are denominated in dollars.

To date, under Executive Order 13382 the Departments of Treasury and State have designated 52 Iran-related individuals and entities as supporting Iran's and missile programs. Targeted entities could range from those under the direct control of the Government of Iran to facilitators in the support network that act as conduits. Some prominent examples include:

- **Aerospace Industries Organization -** The Aerospace Industries Organization (AIO), a subsidiary of the Iranian Ministry of Defense and Armed Forces Logistics, is the overall manager and coordinator of Iran's missile program. AIO oversees all of Iran's missile industries and was designated in 2005 when the Executive Order 13382 was first issued. AIO was also identified by the UNSC Resolution 1737 the following year in 2006 and subject to target sanctions for its involvement in Iran's nuclear program.
    - Treasury has designated numerous related AIO organizations, including, **Sanam Industrial Group** and **Ya Mahdi Industries Group**, both designated for their ties to AIO. Sanam Industrial Group has purchased millions of dollars worth of equipment on behalf of

the AIO from entities associated with missile proliferation. Ya Mahdi Industries Group is subordinate to AIO and has been involved in international purchase of missile-related technology and goods on behalf of the AIO. These entities were also identified and sanctioned under UNSCR 1747.

- **Atomic Energy Organization of Iran** - The Atomic Energy Organization of Iran (AEOI) is the main Iranian organization for research and development activities in the field of nuclear technology, including Iran's centrifuge enrichment program. Treasury also designated AEOI in 2005, which was then followed by its designation under UNSC Resolution 1737. Treasury has designated numerous subsidiaries of AEOI network including:
    - Kalaye Electric Company, Kavoshyar Company, and Pioneer Energy Industries Company are owned or controlled by the AEOI or acting for or on its behalf. Kalaye Electric Company has been linked to Iran's centrifuge research and development efforts. Kalaye is also listed in the Annex to UN Security Council Resolution 1737 as subject to targeted sanctions because of its involvement in Iran's nuclear program. Kavoshyar Company's sole shareholder is AEOI. Pioneer Energy Industries Company provides services to AEOI, including technological support.
    - Pars Tarash and Farayand Technique are owned or controlled by, or act or purport to act for or on behalf of the AEOI. Pars Tarash and Farayand Technique were also listed in the Annex to UNSCR 1737 as subject to targeted sanctions for their involvement in Iran's centrifuge program and were identified in reports of the International Atomic Energy Organization (IAEA).

Treasury has also used this authority to designate several state-owned Iranian banks, including:

- **Bank Sepah** – Bank Sepah is the fifth largest Iranian state-owned bank, designated in January 2007 for providing extensive financial services to Iranian entities responsible for developing missiles capable of carrying weapons of mass destruction. Bank Sepah was sanctioned by UNSCR 1747 in March that same year. Since at least 2000, Bank Sepah has also provided a variety of critical financial services to Iran's missile industry, arranging financing and processing dozens of multi-million dollar transactions for AIO, which has been designated by the U.S. for its role in overseeing all of Iran's missile industries. By cutting off Sepah from the U.S. and the international financial system, we have made it more difficult for Iran to finance some of its proliferation-related activities.
- **Bank Melli** – Bank Melli is Iran's largest bank and provides banking services to entities involved in Iran's nuclear and ballistic missile programs, including entities listed by the UN for their involvement in those programs. Through its role as a financial conduit, Bank Melli has facilitated numerous purchases of sensitive materials for Iran's nuclear and missile 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 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** - 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 respectively. 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.

Executive Order 13224 - Targeting Entities that Commit, or Support Terrorism

The Treasury Department targets Iran's support for terrorism utilizing Executive Order 13224. This Executive Order, issued immediately after the September 11 attacks, allows Treasury to designate and block the assets of individuals and entities controlled by, acting on behalf of, or providing support to named terrorist organizations. This has the effect of freezing the target's assets that are held by U.S. persons and preventing U.S. persons from having any future dealings with them.

Using this terrorism authority, we have been able to expose Iran's terrorist support infrastructure. Two examples include:

- **Bank Saderat Iran** – In 2006, the Treasury Department initially took action against one of Iran's largest state-owned banks under the country sanctions program, cutting the bank from indirect access to the U.S. financial system revoking its authority to conduct U-turn transactions. In 2007, we intensified the action against Bank Saderat and officially designated it under E.O. 13224 as a supporter of terrorism.
    - Government of Iran uses Bank Saderat to transfer money to terrorist organizations, most notably Hizballah and Hamas. 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.
- **Qods Force (IRGC Qods Force)** - The Qods Force, a branch of the IRGC, 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 organization is the regime's primary instrument for providing lethal support to the Taliban. It provides weapons and financial support to the Taliban to support to anti-U.S. and anti-Coalition activity in Afghanistan. The Qods Force has also funded Hizballah with $100 to $200 million and has assisted Hizballah in rearming in violation of UN Security Council Resolution 1701.

B. Securing International Action

The effectiveness of targeted financial sanctions and other measures is significantly enhanced when other countries take similar actions. Accordingly, a significant part of the Treasury Department's efforts related to Iran has been devoted to a broader U.S. government campaign to facilitate international action against Iran's support of terrorism and nuclear program.

Facilitating International Action to Combat Iran's Support of Terrorism

The FATF is the premier standard-setting body for AML/CFT (anti-money laundering and combating financing of terrorism) and provides a unique opportunity for Treasury to engage our international counterparts regarding the risks posed by Iran's AML/CFT regime deficiencies. Treasury leads the U.S. delegation to the FATF. Taken as a whole, the FATF's AML/CFT standards are recognized by more than 175 countries and have been endorsed by the United Nations, the World Bank and the International Monetary Fund.

In addition to setting the AML/CFT international standards, the FATF also identifies jurisdictions with serious vulnerabilities in their AML/CFT framework. In early 2007, Iran was identified by FATF as having significant deficiencies in its AML/CFT regime. As a result, the FATF issued a public statement in October 2007 expressing its concern that Iran's lack of a comprehensive AML/CFT regime represents a significant vulnerability within the international financial system. Iran subsequently adopted an anti-money laundering law and met with FATF to discuss its legal framework for AML/CFT. The FATF, however, concluded that the deficiencies in Iran's AML/CFT regime warranted the issuance of another statement that reiterated previous concerns. The latest FATF advisory issued on February 2008, called on all members and non-members alike to advise their financial institutions about the risks posed by Iran's AML/CFT regime. In response many countries – including the UK, Canada, France, Germany, Japan and Malaysia - have advised their financial institutions of the risks inherent in doing business with Iran.

Treasury also issued such advisories to the U.S. financial sector following FATF's advisories, warning them of the general risks of Iranian business and providing

specific information about areas of concern related to Iran, including Iran's deceptive financial conduct. The most recent Treasury advisory identified Iranian state-owned and private banks and their branches and subsidiaries abroad. Significantly, it also warned financial institutions about the conduct of the Central Bank of Iran, both in obscuring the true parties to transactions and facilitating transactions for sanctioned Iranian banks.

Facilitating International Action to Combat Iran's Nuclear Ambition

The U.S. has worked within both the United Nations and the FATF to reinforce our targeted financial actions to counter Iran's proliferation activities. Indeed, the international community is working to establish a global framework that addresses the threats posed by Iran and develops effective financial measures. These efforts have focused on increasing multilateral implementation of both targeted financial measures and other financial prohibitions against entities involved in Iranian nuclear and missile proliferation. We have worked with the FATF to provide guidance on the effective implementation of those obligations.

(i) UN Obligations

The State Department has led important U.S. efforts at the UN in the adoption of three Chapter VII resolutions related to Iran's nuclear and missile programs that include significant financial components:

- **Targeted financial sanctions:** UN Security Council Resolution 1737, adopted December 23, 2006, requires the worldwide freezing of the assets of designated key actors associated with Iran's nuclear and missile programs. The Resolution targeted Iran's proliferation infrastructure, requiring all States to freeze the assets of identified individuals and entities and effectively deny them access to the international financial system. The adoption of the resolution and its successor resolution, 1747, also globalizes Treasury's action against Iran's proliferation infrastructure. Many of the individuals and entities identified in the UN Security Council resolutions were already publicly designated by Treasury and State under E.O. 13382.
- **Activity-based financial prohibitions:** UNSCR 1737 also requires states to prevent the provision to Iran of any financial assistance, or the transfer of any financial resources or services, related to the supply, sale, transfer, manufacture, or use of prohibited items associated with Iran's nuclear and missile programs. This measure effectively prohibits the provision of financial services that would allow Iran to procure the prohibited items needed for nuclear or missile programs. It places strong responsibilities on states to press financial institutions to make efforts to ensure they do not provide those financial services. This is a daunting task for financial institutions, and we have worked with the FATF to provide guidance that would assist financial institutions in this preventative effort.
- **Exercising vigilance over financial institutions' activities with Iranian banks:** With the most recent adoption of UNSCR 1803, the Security Council calls upon UN member states to exercise vigilance over the activities of financial institutions in their territories with all financial institutions domiciled in Iran, and their branches and subsidiaries abroad. This provision makes special mention of the risks posed by Bank Melli and Bank Saderat. This measure has critical importance to us, as it significantly reinforces the concerns Treasury has expressed for many months regarding some Iranian financial institutions' deceptive financial conduct and terrorism and proliferation support activities.

(ii) Working with the FATF to Implement UN Obligations

Treasury is working within the FATF to ensure effective implementation of the financial provisions contained in the UN Security Council resolutions. This guidance by the FATF works in conjunction with the UN's effort to develop international commitment and create a framework for countries to counter Iranian financial threat.

- In June 2007, the FATF issued initial guidance on the implementation of sanctions and finance-related provisions of UN Security Council resolutions related to proliferation activities in Iran, as well as the threat from other states and non-state actors.
- In September 2007, the FATF issued an annex intended to provide

guidance on implementing targeted financial sanctions against financial institution, in particular, Bank Sepah, named in UNSCR 1747.
- In October 2007, FATF issued additional guidance on implementing activity-based financial sanctions identifying categories of high-risk customers and transactions on which financial institutions could focus their efforts. Risk factors include Iran-related customers or transactions, as well as transactions involving sectors that potentially produce the prohibited goods, among other factors.

UN Security Council Resolution 1803 welcomed the work of FATF and its efforts to provide guidance on how to implement targeted financial measure. Treasury will work with its counterparts within the FATF to continue these efforts.

C. Strategic Dialogue with the Private Sector

We have also reached out to another important stakeholder: the international private sector. Since 2006, we have conducted an unprecedented, high-level strategic dialogue with the international financial private sector, meeting with more than 40 banks worldwide to discuss the threat Iran poses to the international financial system. Secretary Paulson initiated this effort in the fall of 2006 in Singapore during the annual IMF/World Bank meetings. Secretary Paulson met with executives from major banks throughout Europe, the Middle East, and Asia and discussed the various threats posed by Iran. Deputy Secretary Kimmitt, Under Secretary Stuart Levey and Assistant Secretary Patrick O'Brien continue to engage with these institutions abroad, as well as in Washington and New York. Through this outreach, Treasury has shared information about Iran's deceptive financial behavior and raised awareness about the high financial and reputational risk associated with doing business with Iran and the international financial institutions have taken action.

Impact of U.S. Outreach Efforts to the Private Sector

International financial institutions have responded to our message with action that reinforces governmental pressure on Iran. As evidence of Iran's deceptive practices has mounted, financial institutions and other companies worldwide have begun to reevaluate their business relationships with Tehran. Many leading financial institutions have either scaled back dramatically or even terminated their Iran-related business entirely. Many global financial institutions have limited their exposure to Iranian business by cutting off Iranian business in dollars but have not yet done so in other currencies. Regardless of the currency, the core risk with Iranian business – that you cannot be certain that the party with whom you are dealing is not connected to some form of illicit activity – remains the same.

Importance of Private Sector and Targeted Financial Measures

The private sector plays a central role in the implementation of our sanctions. Our ability to effectively communicate with the private sector about Iran has been essential to the success of Treasury's broader efforts. The private sector has been receptive in part due to Treasury's targeted financial strategy that we have increasingly used to combat Iranian threats as well as other threats to the U.S.

When we use reliable financial intelligence to build conduct-based cases, it is much easier to achieve a multilateral alignment of interests. It is difficult for another government, even one that is not a close political ally, to oppose isolating actors who are demonstrably engaged in conduct that threatens global security or humanitarian interests. The private sector also reacts positively to the use of these targeted measures. Rather than comply with just the letter of the law, we have seen many in the banking industry voluntarily go beyond their legal requirements because they do not want to handle illicit business.

The private sector and Treasury share a common interest in protecting the international financial system from illicit conduct. Financial institutions want to identify and avoid dangerous or risky customers who could harm their reputations and business. And we want to isolate those actors and prevent them from abusing the financial system. Once some in the private sector decide to cut off companies or individuals we have targeted, it becomes an even greater reputational risk for others not to follow, and they often do. Such voluntary implementation in turn makes it even more palatable for foreign governments to impose similar measures

because their financial institutions have already given up the business, thus creating a mutually-reinforcing cycle of public and private action.

By partnering with the private sector, including by sharing information and concerns with financial institutions, we are increasingly seeing less of a tendency to work around sanctions. In meetings with bank officials abroad, Treasury officials have learned that even those institutions that are not formally bound to follow U.S. law pay close attention to our targeted actions and often adjust their business activities accordingly.

Conclusion

Financial measures are an integral component of U.S. and international efforts to counter Iran's threatening behavior. Through our authorities and our engagement with counterparts around the world, we are implementing a financial strategy that is having an impact. This impact will only be enhanced as the international community continues to crack down on Iran's illicit financial behavior through national action and through organizations such as the UN and FATF. The international financial system is becoming an increasingly challenging and unfriendly environment for Iran's illicit conduct. But it is important that we and our international partners keep up the pressure. This remains a top priority for the Treasury Department and we will continue to work closely with our colleagues in the State Department, foreign governments and international financial community to maximize the effectiveness of our efforts.

Thank you again for the opportunity to appear before you today. I look forward to any questions you have regarding my testimony.

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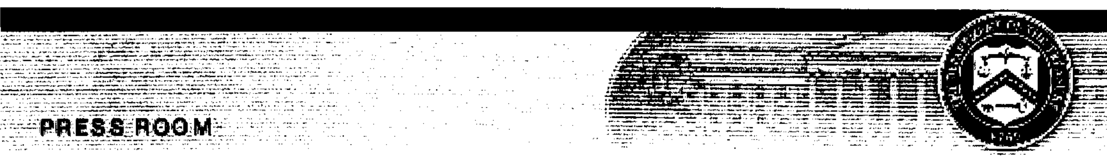


April 17, 2008
HP-934

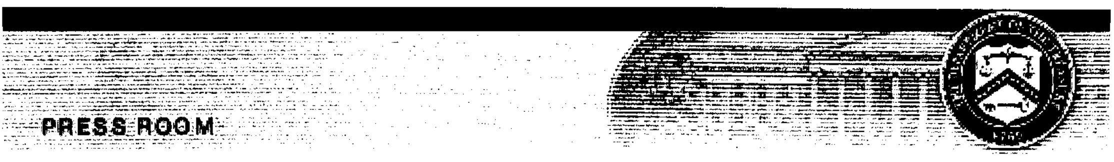
Treasurer Anna Escobedo Cabral to Participate in Financial Literacy and Education Summit

U.S. Treasurer Anna Escobedo Cabral will participate in a panel discussion during a financial literacy summit at the Federal Reserve Bank of Chicago Monday. The summit brings together public policy, education and private sector individuals in the financial education field to discuss how best to establish a sound financial future for the 18 -25 year old generation.

The following event is open to the media:

- **Who** Treasurer Anna Escobedo Cabral
- **What** Panel Remarks
- **When** Monday, April 21, 9:00 a.m. CDT
- **Where** Practical Money Skills for Life Financial Literacy and Education Summit 2008
  Federal Reserve Bank of Chicago
  230 South LaSalle Street
  Chicago, Ill.
- **Note** The event will be webcast at 3:00 pm CDT. Press must register at http://www.practicalmoneyskills.com/summit2008/registration.php to view the webcast.

- 30 -



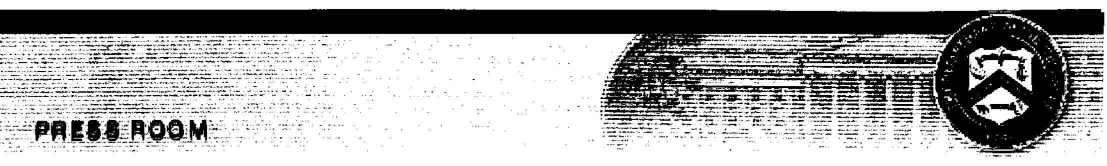
April 18, 2008
HP-935

Nason Statement On Insurance Information Act

Washington- *Treasury Assistant Secretary for Financial Institutions David G. Nason released the following statement today regarding H.R. 5840, the Insurance Information Act of 2008*:

"The Treasury Department welcomes Subcommittee Chairman Kanjorski and Ranking Member Pryce's introduction of legislation to create a federal insurance adviser within the Department of the Treasury. This legislation, similar to a proposal in Treasury's *Blueprint for a Modernized Regulatory Structure*, would help the United States address international regulatory issues affecting our markets' competitiveness. We look forward to working with Congress to move this idea forward."

-30-



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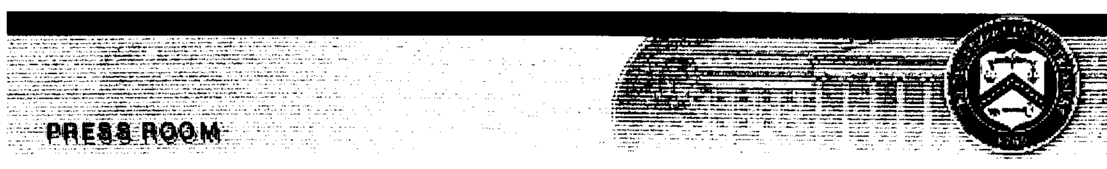
April 18, 2008
HP-936

FY 2009 Budget Request

FY 2009 Budget Request

REPORTS

- (PDF) FY 2008 Budget Request



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April 21, 2008
HP-937

Treasury Issues Proposed CFIUS Regulations; Lowery to Hold Briefing Today

Washington, D.C.--The Treasury Department today issued proposed regulations that implement the Foreign Investment and National Security Act of 2007 (FINSA). The proposed regulations provide an update to regulations issued in 1991 that govern the Committee on Foreign Investment in the United States (CFIUS) and its process for national security review of certain foreign investments in U.S. businesses. They reflect reforms made to the CFIUS process by FINSA and the CFIUS executive order issued by President Bush on January 23 of this year.

"These regulations reflect America's strong and continued commitment to safeguarding U.S. national security in a manner that reinforces the longstanding U.S. policy of welcoming foreign investment. The proposed regulations increase clarity and make additional improvements based on experience," said Assistant Secretary for International Affairs Clay Lowery.

The Treasury Department is requesting comments on the proposed regulations; a public comment period will extend for 45 days from publication later this week in the Federal Register. The Treasury Department will hold a public meeting to receive comments on the proposed regulations on May 2, 2008 in the Department's Cash Room. Further details on the meeting and submission of comments can be found in the opening pages of the regulations.

Assistant Secretary for International Affairs Clay Lowery will hold a briefing for media on the proposed regulations this afternoon.

Who
Assistant Secretary for International Affairs Clay Lowery

What
Pen-and-pad Briefing on Proposed CFIUS Regulations

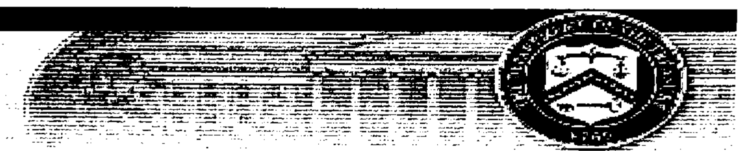
When
Monday, April 21, 3:00 p.m. EST

Where
U.S. Treasury Department
1500 Pennsylvania Avenue, NW – Media Room (4121)
Washington, D.C.
Note
Media without Treasury press credentials should contact Frances Anderson at (202) 622-2439, or frances.anderson@do.treas.gov with the following information: full name, Social Security number and date of birth. No cameras will be permitted into the briefing.

REPORTS

- Proposed Regulations

PRESS ROOM



April 21, 2008
2008-4-21-16-34-4-21792

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 $74,782 million as of the end of that week, compared to $75,590 million as of the end of the prior week.

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

	April 18, 2008		
A. Official reserve assets (in US millions unless otherwise specified)	Euro	Yen	Total
(1) Foreign currency reserves (in convertible foreign currencies)			74,782
(a) Securities	15,673	11,707	27,380
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	15,640	6,566	22,206
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	4,290		
(3) SDRs	9,865		
(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	

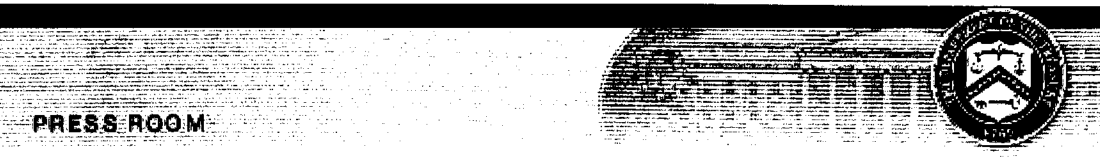
--lent or repoed but not included in Section I	
--borrowed or acquired and included in Section I	
--borrowed or acquired but not included in Section I	
(e) financial derivative assets (net, marked to market)	
--forwards	
--futures	
--swaps	
--options	
--other	
(f) derivatives (forward, futures, or options 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)	74,782
--currencies in SDR basket	74,782
--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.



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April 22, 2008
hp-938

Treasury Targets FARC Financial Network in Colombia

Washington –The U.S. Department of the Treasury's Office of Foreign Assets Control (OFAC) today designated two entities and four individuals for acting on behalf of the Revolutionary Armed Forces of Colombia or FARC, a narco-terrorist group.

"Today's designation continues our targeted campaign to take down the FARC's financial networks, especially those utilized to launder their narcotics proceeds," said Barbara C. Hammerle, Deputy Director of OFAC. "This is OFAC's third action in the last five months against the FARC's deadly narco-terrorist organization. Our actions complement the efforts of the Colombian government against the FARC."

On May 29, 2003, President George W. Bush identified the FARC as a significant foreign narcotics trafficker pursuant to the Foreign Narcotics Kingpin Designation Act. In November 2001, the FARC was designated as a Specially Designated Global Terrorist pursuant to Executive Order 13224. In October 1997, the FARC was designated as a Foreign Terrorist Organization by the Secretary of State.

Today's designations focus on a FARC financial network that involves two Colombian money exchange business, Cambios El Trebol and Cambios Nasdaq Ltda. Both are based in Bogota, Colombia. The FARC used these Colombian money exchange businesses, or "profesionales del cambio" as they are commonly known in Colombia, to launder narcotics proceeds. Cambios El Trebol and Cambios Nasdaq Ltda. accepted foreign currency from the FARC that was derived from drug sales. In exchange, the two businesses provided pesos to the FARC that could fund its activities in Colombia. Myriam Rincon Molina and Jose Edilberto Camacho Bernal, two individuals who are tied to these money exchange businesses and who act on behalf of the FARC, were also designated today.

Today's OFAC action also targets Nilson Calderon Velandia (alias "Villa") and Carlos Olimpo Diaz Herrera, both major drug traffickers for the FARC. Nilson Calderon Velandia is responsible for the production and sale of cocaine for the FARC's 27th Front and also manages contacts with other drug traffickers who export the FARC's drugs from Colombia. Carlos Olimpo Diaz, in addition to being responsible for the production and sale of cocaine for the FARC's 27th Front, owns Cambios Nasdaq Ltda.

The FARC's 27th Front is led by Luis Eduardo Lopez Mendez (alias "Efren Arboleda"), who ultimately reports to FARC Secretariat Member Victor Julio Suarez Rojas (alias "Mono Jojoy"). Suarez Rojas is the FARC's Chief of Military Operations and has served as commander of the Eastern Bloc of the FARC. Victor Julio Suarez Rojas and Luis Eduardo Lopez Mendez were previously designated by OFAC on February 18, 2004, and November 1, 2007, respectively.

Today's action today continues ongoing efforts under the Foreign Narcotics Kingpin Designation Act to apply financial measures against significant foreign narcotics traffickers worldwide. In addition to the 68 drug kingpins that have been designated by the President, 392 businesses and individuals have been designated pursuant to the Kingpin Act since June 2000. Today's designation would not have been possible without support from the Drug Enforcement Administration.

Today's designation action freezes any assets the six designees may have under U.S. jurisdiction and prohibits U.S. persons from conducting financial or commercial transactions with these individuals and entities. Penalties for violations of the Kingpin Act range from civil penalties of up to $1,075,000 per violation to more

severe criminal penalties. Criminal penalties for corporate officers may include up to 30 years in prison and fines of up to $5,000,000. Criminal fines for corporations may reach $10,000,000. Other individuals face up to 10 years in prison for criminal violations of the Kingpin Act and fines pursuant to Title 18 of the United States Code.

REPORTS

- 27th FARC Front Financial Flow

For a complete list of the individuals and entities designated today, please visit: http://www.treasury.gov/offices/enforcement/ofac/actions/index.shtml

To view previous OFAC actions directed against the FARC, please visit:

- Treasury Action against the FARC on January 15, 2008
- Treasury Action against the FARC on November 1, 2007
- Treasury Action against the FARC on September 28, 2006
- Treasury Action against the FARC on February 19, 2004

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Department of the Treasury
Office of Foreign Assets Control

FARC 27th FRONT FINANCIAL FLOW
APRIL 2008

Victor Julio SUAREZ ROJAS
alias "Mono Jojoy"
FARC Secretariat Member
Previously designated on February 18, 2004

Luis Eduardo LOPEZ MENDEZ
alias "Efren Arboleda"
27th FRONT COMMANDER
Previously designated on November 1, 2007

Carlos Olimpo DIAZ HERRERA
CC #11250581
DOB 7 Feb 1954
Drug Trafficker

Nilson CALDERON VELANDIA
CC #91348897
DOB 18 Jul 1974
alias "Villa"
Drug Trafficker

① DRUGS

INTERNATIONAL DESTINATIONS

② DRUG PROCEEDS IN FOREIGN CURRENCY

③ DRUG PROCEEDS IN FOREIGN CURRENCY

④ COLOMBIAN PESOS

CONTACT

Jose Edilberto CAMACHO BERNAL
CC #11374416
DOB 28 Feb 1954

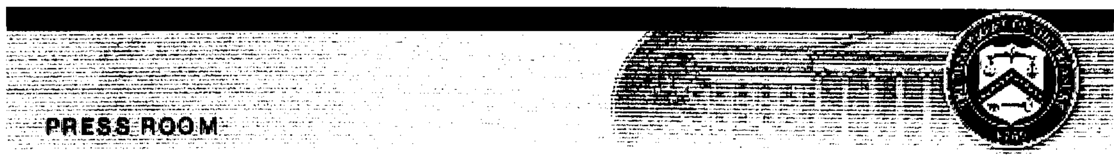
MONEY EXCHANGE PROFESSIONALS
Bogota, Colombia

CAMBIOS NASDAQ LTDA
NIT #8301284123
Bogota, Colombia

CAMBIOS EL TREBOL
Matricula Mercantil #1404087
Bogota, Colombia

←OWNER—

Myriam RINCON MOLINA
CC #20622294
DOB 29 Jan 1959



April 22, 2008
HP-939

Secretary Paulson Recognizes Individuals for Dedication to Volunteer Service

Washington, D.C. – Secretary Henry M. Paulson, Jr. presented the President's Lifetime Volunteer Service Award to Clint Hogbin, Gwen Lee, Ethel S. Kennedy, and Rodney Stotts as part of the USA Freedom Corps Volunteer Service Recognition Program today. These individuals have answered the President's call to service by serving over 4,000 hours each to various volunteer activities over their lifetimes.

Clint Hogbin has been active in numerous recycling, solid waste and land preservation programs since 1992. In 2007, he alone worked 728 hours on these volunteer activities while working as an Information Technology Specialist at the IRS.

Gwen Lee has demonstrated the call to service by hosting information booths, stuffing information packages, and serving on committees promoting and encouraging good environmental practices. She recently rented a billboard on I-15 (in Utah) and posted pro-environmental messages, a different one each month for 12 months.

Ethel S. Kennedy, a founding and current board member of the Earth Conservation Corps, has used her considerable influence and passion to fight for the health of the Anacostia River by engaging the underserved young people of the Anacostia River communities. Kennedy negotiated with Pepco, the U. S. Department of Interior, and the District Government to help secure the Earth Conservation Corps' two environmental learning centers on the river, which to date has served over 50,000 youth and adults and 500 Earth Conservation Corps members.

In 1992, Rodney Stotts and eight other youth from Anacostia set the bar for environmental service by pulling 5,000 tires out of Lower Beaver Dam Creek. He also participated in re-introducing the bald eagle to the Anacostia Watershed after it had disappeared from the area for nearly 50 years. Stotts is now on staff at Earth Conservation Corps as Youth Program Coordinator and manages and coordinates the AmeriCorps program.

In his January 2002 State of the Union Address, President Bush called on all Americans to make a difference in their communities through volunteer service. He created USA Freedom Corps, an Office of the White House, to strengthen and expand volunteer service. Americans are responding to the President's Call to Service. Go to www.volunteer.gov or call 1-877-USA-CORPS to find an existing volunteer service opportunity in your area or to find more information about service programs, including national service programs such as the Peace Corps, AmeriCorps, Senior Corps, and Citizen Corps. USA Freedom Corps is also highlighting youth volunteer service. Visit www.volunteerkids.gov for games and ideas designed to show how America's youth are making a difference.

The President's Volunteer Service Award was created at the President's direction by the President's Council on Service and Civic Participation. The Award is available to youth ages 14 and under who have completed 50 or more hours of volunteer service; to individuals 15 and older who have completed 100 or more hours; and to families or groups who have completed 200 or more hours. For more information about the Award, please visit www.presidentialserviceawards.gov

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PRESS ROOM

April 23, 2008
HP-940

Under Secretary David H. McCormick
Remarks to the Confederation of Indian Industry
& the American Chamber of Commerce

"The Way Ahead for the U.S.-India Economic Partnership"

Chennai, India – Thank you for your kind introduction. It is a pleasure for me to be here with you today. CII and the American Chambers of Commerce around the world have long been strong and reliable partners with the U.S. Treasury Department as we work toward our shared goals of economic growth, prosperity, and stability.

This is a remarkable time in India's history. Over the past 15 years, India has emerged as a strong and confident player in the global economy, an important trading partner, a major consumer of global commodities, goods, and services, and an attractive destination for global investment capital. Average growth of nearly 7 percent over the past decade has allowed India to raise its GDP per capita by over 50 percent since 2000, creating a large and growing middle class in the process. Trade between the United States and India has continued to expand, reaching over $50 billion last year, and the United States is India's largest trading partner. Cultural ties are also strong, with nearly three million Americans of Indian descent and 80,000 Indian students in the United States. The U.S. Consulate right here in Chennai issues more visas for skilled workers than any other U.S. diplomatic post in the world.

Throughout this period of remarkable growth, we have also witnessed a deepening U.S.-India partnership. We cooperate on everything from increasing trade and investment, to educational exchanges, to research and development, and of course power generation, most notably with the civil nuclear agreement.

We have also learned together that the success of India's economic policy and the acceleration in growth presents its own challenges. These challenges include ensuring India's physical infrastructure grows by enough to support the country's expanding economy and ensuring that India's newfound growth and prosperity is shared by all. And, as India's presence in global markets expands, it is also increasingly called upon to address global challenges. India can only be a major player in the global community if it demonstrates much-needed leadership on common challenges and opportunities such as climate change, energy security, non-proliferation, global trade, and investment.

The deepening U.S.-India partnership is the byproduct of a range of dialogues and growing friendships inside and outside government. The relationship between the Treasury Department and our Indian counterparts, for example, is particularly strong. Each Treasury Secretary since the early-1990s (when India launched its first wave of economic reform) has visited India at least once during his tenure. These regular contacts have led to concrete initiatives on a number of financial and economic issues.

The U.S.-India High Technology Cooperation Group, initiated in 2002, stimulates high-technology commerce between our two countries, promoting investment in the technology sector that has been one of the primary drivers of India's remarkable economic emergence. The U.S.-India CEO Forum, launched in 2005, is aimed at incorporating the advice and experience of our private sectors into the U.S.-India Economic Dialogue. And the U.S.-India Financial and Economic Forum, a cornerstone of Treasury's economic engagement with India, brings together Treasury, the Ministry of Finance, and financial regulators on both sides to address key issues in our respective financial markets, not only improving skills and capabilities, but also ensuring systemic stability and integrity.

The bottom line is that we have accomplished much together in the past several years. Yet, there is much more we can and should do in the future. Today, I will discuss five important global challenges and opportunities: infrastructure investment, financial sector liberalization, bilateral investment, clean technology, and multilateral trade. These areas of interest are particularly promising for the US. and India to stand together as global leaders and make meaningful progress, and should provide the basis for a common agenda going forward.

1. Infrastructure Investment

Providing the physical infrastructure – roads, ports and airports, power generation, water supply and sewage, and communications links – India needs to support accelerated growth is a critical challenge. Official estimates suggest that India requires upwards of $500 billion in infrastructure investment over the next five years. Policymakers are counting on a significant portion of this investment to come from the private sector, and the U.S. Treasury Department has been actively involved in promoting greater private sector investment in India. Secretary Paulson participated in last October's CEO Forum conference on infrastructure finance, which was held in Mumbai, and we plan to organize a "U.S.-to-India" road show to introduce U.S. investors and project developers to the opportunities this sector offers.

But increasing private infrastructure investment is not simply a matter of arranging introductions. Our engagement also highlights specific issues that inhibit domestic and foreign private investment. These concerns include regulatory environments, dispute settlement and investor protection, financial sector development, and capital account issues.

Legal and judicial reform are an important part of improving the investment environment in both of our countries. As potential investors know, resolving commercial disputes in India can be a long and difficult process. With more than 20 million cases currently in the Indian legal system, it can take a company 25 years to obtain a verdict. Concrete steps to strengthen its arbitration law and reform its judiciary to render dispute resolution more effective would help India attract the investment dollars that will otherwise flow to other emerging markets.

2. Financial Sector Liberalization and Reform

Mobilizing foreign investment is only one part of the equation for addressing India's infrastructure challenges and demands of its robust growth. Financial sector liberalization and capital markets reform will effectively be the linchpin for sustaining India's growth trajectory and mobilizing the huge amount of capital needed to meet the country's development needs. The World Bank estimates that financial sector liberalization adds an additional two percentage points to a country's growth. Liberalization frees up capital in the financial sector that can be used to fund development projects and the borrowing needs of India's consumers and firms. Coupled with comprehensive reforms, accelerated liberalization will enable India's capital markets to efficiently mobilize and allocate financial resources.

For example, the development of a corporate bond market would deepen capital markets, provide a source of stable long term domestic financing, and enable a vibrant institutional investor base – all of which are essential for corporate and infrastructure financing.

Enabling an efficient and competitive financial system is also critical as economies depend more on competitive service sectors, productivity growth, technology, and human capital. Competition drives growth and dynamic innovation, but requires removing barriers to entry and creating a "level playing field" for all institutions. Allowing greater participation of international financial services firms will accelerate the development and competitiveness of India's capital markets. We already see how U.S. and foreign financial firms are working with India to meet its goals for greater financial inclusion for the estimated 600 million people without access to finance. They are driving innovation in financial products by rolling out biometric ATMs in rural areas and offering affordable mobile banking.

In parallel, it is essential for any economy to create an enabling regulatory framework based on international standards and best practices. A strong regulatory framework will help to ensure capital enters India in a transparent and productive

way. The Treasury Department and U.S. regulators are working with our partners in the Finance Ministry, the Securities and Exchange Board of India (SEBI) and the Reserve Bank of India (RBI), including through regular technical dialogue and assistance, to share "best practices" and lessons learned. Underpinning this collaboration is our shared belief that India will benefit from an effective and transparent regulatory regime that reflects international best practices in regulation and supervision for banks, insurance companies, and other financial services firms.

3. Bilateral Investment Treaty (BIT)

A bilateral investment treaty (BIT) between the United States and India would provide an enormous opportunity for both countries. By ensuring legal protection for investors, BITs are great incentives for two-way investment. This is particularly true of infrastructure industries, which require large investments in immobile capital.

India is a party to at least 45 BITs based on a European model that protects existing investors. In February 2008, the U.S. government began exploratory discussions with our Indian counterparts about the U.S. model, which goes further than the European model by allowing investors to establish businesses in all sectors except where specifically prohibited. While BIT negotiations are always difficult, we appreciate India's enthusiasm for moving forward promptly. I am hopeful we can make greater progress by the end of the year.

4. Investment in Clean Technology

In any large and rapidly growing economy, many of the economic choices we have been discussing have environmental consequences. India's rapid economic growth and expanding middle class have placed additional demands on an already strained power sector, and India must more than double its current generation capacity in the next decade. For finance ministries, the question becomes: how do rapidly-industrializing economies finance the deployment of clean technology needed to power their economies in environmentally-sustainable ways?

In India, coal-based power already represents half of the total generation capacity. America's goal, both through bilateral and multilateral efforts, is to help India expand the share of renewables in its power generation mix as the country's overall generation capacity grows. Tamil Nadu traditionally has been an energy-rich state, and has the potential to lead the way in terms of development and wide adoption of alternative energy projects.

The Civil Nuclear Agreement pledged by President Bush and Prime Minister Singh in July 2005 is an important step in this direction. Equally important is the multilateral Clean Technology Fund (CTF) that the U.S., along with our partners in the U.K. and Japan, announced in February. The World Bank, which will administer the CTF, estimates that transitioning to low carbon technologies could cost developing countries $30 billion per year. The CTF is intended to minimize this cost by financing the development of local markets for clean technology and by financing the cost difference between clean and dirty technologies. As a measure of how important the United States believes the CTF to be, the President's budget requests $2 billion over the next three years for the fund.

5. Multilateral Trade

Finally, India is one of the fastest growing economies in Asia, but nearly 700 million Indians still live on less than $2 per day. The challenge is to extend India's economic gains to the broader population. As India's rural poor become integrated into the global market, the priority is to ensure they too see the benefits inherent in global trade and commerce.

The U.S. regards Doha as an opportunity to attack the scourge of poverty by opening trade flows between all nations in agricultural goods, industrial products, and services. We remain fully committed to an ambitious and comprehensive outcome to the Doha Development Round by the end of the year.

Trade has a compelling record of advancing economic development. The World Bank has estimated that, in the 1990s, per capita real income grew three times faster for developing countries that significantly lowered trade barriers than for other

developing countries that lowered barriers less. The World Bank also estimates that eliminating trade barriers in goods could boost incomes in developing countries by at least $142 billion a year, greatly exceeding the total of G-7 foreign economic assistance of $80 billion last year. And, the World Bank finds that the income gains from trade are enjoyed by people at all income levels, and could lift 65 million people out of poverty by 2015.

We are at a critical juncture in the Doha Round. This spring, we need to see progress on services and agreement on modalities for agriculture and non-agriculture market access if an agreement is to be completed by year's end. To achieve results, a Doha deal must include substantial reduction of applied agriculture and manufacturing tariffs and new liberalization of services.

Financial services, where the Treasury Department has the lead in negotiations, exemplifies a sector where liberalization and improved foreign access can extensively benefit development. This is particularly true for India. Given the potential of open financial sectors to leverage growth and development, it is essential to keep these efforts at the center of the Doha Development Agenda.

The U.S. will provide the necessary leadership, but we can't do it alone. Key advanced developing countries – such as India – are major beneficiaries of the international trading system and must take a leadership role to move the Doha negotiations forward.

Conclusion

This agenda may seem daunting, but these five key issues – promoting infrastructure investment, financial sector liberalization, supporting a bilateral investment framework, investing in clean technology, and supporting multilateral trade – are significant opportunities. They will enable us to enhance our bilateral partnership. They will enable us to foster economic growth. They will enable us to reduce poverty. They will enable us to protect the environment. And they will enable us to promote global economic stability.

By seizing these opportunities, India will achieve its well-deserved position of global leadership. The U.S. and India have made great progress together, and I am confident our partnership will only deepen further as we address these critical issues together in the years to come.

Thank you for your kind attention.

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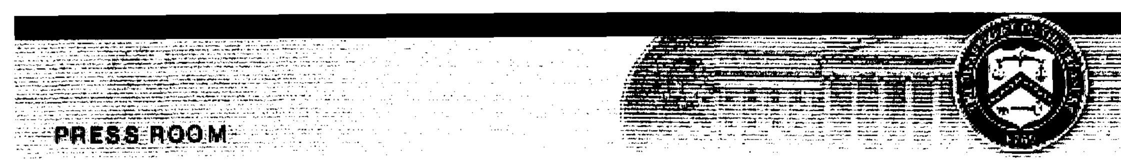


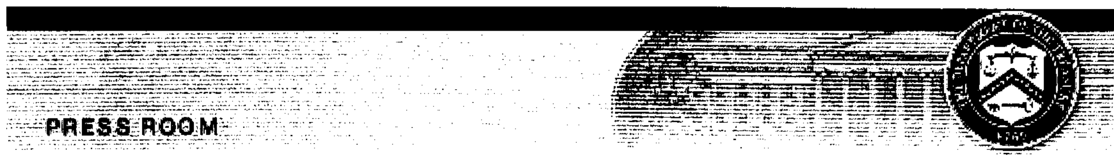
April 24, 2008
HP-941

US Treasury Official to Visit London to Discuss Financial Regulatory Reform

U.S. Treasury Assistant Secretary for Financial Institutions David G. Nason will deliver remarks about Treasury's Blueprint for a Modernized Regulatory Structure in London Tuesday. Assistant Secretary Nason will be the keynote speaker on financial regulatory reform at the Chatham House 2008 City Series.

The following event is open to credentialed media:

Who
Assistant Secretary for Financial Institutions David G. Nason
What
Remarks on Treasury's Blueprint for a Modernized Regulatory Structure
When
Tuesday, April 29, 11:30 a.m. (Local Time)
Where
Bloomberg LP
Citygate House
39-45 Finsbury Square
London
EC2A 1PQ
Note
Members of the press must register with Duncan Newbury at dnewbury@chathamhouse.org.uk.



April 24, 2008
hp-942

**Assistant Secretary for International Affairs Clay Lowery
Testimony Before the Senate Foreign Relations Committee**

"Building on International Debt Relief Initiatives"

Washington – Thank you for the opportunity to discuss the Administration's strong leadership on international debt relief and the new proposals contained in the Jubilee Bill (S.2166).

Debt relief can be a valuable tool to help the poorest, most heavily indebted countries. It helps them re-establish a sound economic footing and reengage with the international community, supporting their efforts to lift people out of poverty. Debt relief can remove a significant barrier to economic growth when external debt levels become so high that they interfere with a country's basic economic sustainability. This is something that plagued many poor countries throughout the 1980s and 1990s. Recognizing the need for strong action, this Administration has been an ardent advocate of and critical leader in international initiatives to maximize the potential of debt relief as a responsible and effective tool of development. The two major debt relief initiatives that this Administration has supported, the Heavily Indebted Poor Country (HIPC) Initiative and the Multilateral Debt Relief Initiative (MDRI), are expected to provide over $110 billion in debt relief to 33 heavily-indebted poor countries. Further, we anticipate that seven additional countries could still qualify under these initiatives.

Many of the goals of the proposed Jubilee Act (S.2166) are laudable. It is clear that all of the countries which are potentially eligible under this bill, the so called "IDA-only countries," face significant development challenges. The Administration shares the goal of increasing economic growth and obtaining greater financial stability in these countries. However, we cannot support this bill based on the answers to the following three key questions.

Is this bill sound policy? In countries where debts are sustainable, other development tools should take precedence over debt relief. We believe that debt relief is not the best development tool for the countries targeted in this bill. The aim of the HIPC initiative was to remove unsustainable debt levels for the most heavily-indebted poor countries, so that these countries could stabilize their economies and focus on growth and poverty reduction. It included requirements for sound economic policies so that debt relief was not simply "throwing good money after bad." For countries that are already able to successfully manage and service their debts, sound debt management can help them to transition gradually toward access to private capital markets. Furthermore, increased private investment and targeted development assistance are more focused ways to address the challenges these low-income countries face.

How will expanded debt relief be financed? Debt relief has a U.S. budgetary cost, just as new development assistance has a U.S. budgetary cost. We continue to face challenges in financing our commitments to existing debt relief initiatives, including in the multilateral development banks, which is why it is so important that Congress enact the President's full request for these programs. The Jubilee Bill represents an unfunded international mandate to fully cancel roughly $75 billion worth of debts owed by the potentially eligible countries to official bilateral and multilateral creditors. As we learned during the financing of MDRI, it is unlikely that we could garner the necessary international support to finance multilateral debt relief with the internal resources of the international financial institutions (IFIs), meaning the U.S. would need to be prepared to make a significant contribution.

Is expansion of debt relief the right priority? Secretary Paulson and other senior

Treasury officials meet regularly with the finance ministers, central bank governors, and private sector and civil society leaders from many of these countries. The priority they most often highlight is the need to spur long-term growth and reduce poverty by attracting investment, building core infrastructure, and strengthening their financial sectors. I would welcome closer collaboration with the Congress on ways in which the United States can support these countries' private sector development agendas.

Current Debt Relief Efforts

This Administration has led international debt relief efforts for the world's most heavily-indebted poor countries. Building on the work of the previous Administration and with strong Congressional support, we have deepened and broadened the Heavily Indebted Poor Countries (HIPC) debt reduction initiative.

In 2005, the Administration, with bipartisan congressional support, initiated and negotiated the landmark Multilateral Debt Relief Initiative (MDRI). MDRI provides 100 percent cancellation of eligible debt obligations owed to the World Bank's International Development Association (IDA), the African Development Bank's African Development Fund, and the IMF, for poor, heavily-indebted countries that complete the HIPC initiative. We have also continued this work, designing an initiative and leading negotiations in cooperation with Brazil to forgive 100 percent of HIPC debts to the Inter-American Development Bank.

As I mentioned earlier, these debt relief initiatives are expected to provide over $110 billion in debt reduction to 33 countries that have already qualified under the HIPC initiative. Further, we anticipate another seven countries could qualify under these initiatives. These two initiatives continue to provide benefits to countries such as Afghanistan, Liberia and Haiti. In 2007, Afghanistan became the thirty-first country to qualify for debt relief under the HIPC initiative. After years of conflict, Liberia is now rejoining the international community. Debt relief for Liberia under HIPC and MDRI, with eventual cancellation of over $4 billion in debts, is an important part of this transition. However, even under these well-established initiatives, the process is not always easy and international support is not always firm. In the case of Liberia – a country whose debts were clearly unsustainable and for which the U.S. provided strong leadership and intense engagement – the international effort to clear its $1.4 billion in arrears to the international financial institutions took over 18 months and almost failed on a number of occasions.

Debt Sustainability

To help ensure that gains from debt relief are not wasted, the Administration has worked through the international financial institutions, such as the World Bank and IMF, to put in place an internationally agreed debt sustainability framework to help guide future lending and borrowing. We are also working through the OECD to operationalize that framework with a set of principles and guidelines that commit export credit agencies to follow sustainable lending practices and consider IMF and World Bank recommendations when extending new export credits to low-income countries. This Administration also led efforts in the multilateral development banks to increase the level of grants for the poorest countries. In 2001, IDA provided less than one percent of its financing for the poorest countries in the form of grants. Today, as a result of U.S.-led efforts, over 40 percent of funds from IDA to these countries are in grants. For instance, the World Bank is providing $82 million in grants to Haiti through the first half of this year. These efforts will help ensure that poor countries will not re-accumulate unsustainable debts in the future.

Mismatch of Tools and Objectives

Debt relief is a valuable tool, but it must be balanced against other policy instruments, such as direct development assistance. It is not always the right response to address a country's development needs. The Jubilee Bill (S.2166) targets a group of countries that face tremendous development challenges. However, debt relief is most appropriate when the debt itself is a barrier to development, as is the case with the countries eligible for the HIPC initiative. This is not the case for the countries targeted in this bill, many of which are experiencing robust growth and reductions in poverty levels. In fact, many of these countries have such manageable debt positions that they are either seeking access to private capital markets – as in the case of Vietnam – or are repaying their debts early – as with Angola and Nigeria.

Of the eight countries that some supporters of the bill have suggested would be immediately eligible, none faces a high risk of debt distress. This means that the immediate impact of the bill, if agreed to internationally and if funded by the U.S. Congress, would be to forgive the debts of countries that are able to service their debts – countries for which debt is a minor issue compared to the challenges they face in tackling issues such as promoting growth. For such countries, targeted development aid and our support for efforts to attract investment are more immediate.

Our experience with HIPC and MDRI has shown that debt relief alone is not enough to address these countries' long-term challenges. For example, Rwanda benefited from $1.8 billion in debt relief under these initiatives, but it is still considered to be at high risk of financial distress. The reason is not that it has borrowed irresponsibly – its debt levels are still low. The reason is that it has a small and vulnerable export base that cannot provide a consistent source of government revenue. The key to supporting a sustainable path for countries such as Rwanda is assistance to directly improve their economic growth potential, not more debt relief.

Countries must also develop and implement effective policy reforms to ensure that savings from debt cancellation – and in fact all development assistance – can be used effectively for poverty reduction efforts. This is why international debt relief initiatives have been conditioned on the adoption of sound macroeconomic policies. Debt relief simply will not have the intended benefits if it is delivered in an environment of macroeconomic instability. Placing blanket restrictions on the types of economic reforms that are appropriate can make it difficult to implement policies tailored to a given country's situation.

Potential Costs of Expanded Debt Relief

There is also the issue of cost. Debt relief must be financed, just as development assistance must be financed, and we should not enter into negotiations without a sense of the costs that could be incurred. The budget impact of pursuing the program described in the bill (S.2166) would be substantial. Expanded debt relief would be a commitment to replace costs over 30 to 40 years, and we need to consider the total, long-term U.S. government exposure to such an initiative.

The Treasury Department estimates that the budget cost to forgive the nominal debt owed to the United States alone, including loan guarantees, by all of the IDA-only countries that do not currently qualify under the HIPC Initiative would be approximately $1 billion. This cost estimate assumes that all IDA countries qualify in FY 2008 and would change depending on the year each country qualified for debt relief. These countries also owe approximately $32 billion in nominal debt to the World Bank and IMF and roughly $15 billion to the major regional development banks. While the bill is not explicit about whether negotiations on expanded debt relief should include comparable debt relief from other bilateral creditors, I note that the total official bilateral debt owed by potentially eligible countries under this bill is approximately $30 billion.

While the bill calls for international financial institutions to fund debt relief from internal resources to the extent possible, the availability of such resources is very likely to be limited. Our recent experience with funding for debt relief under MDRI is a good example of what we are likely to encounter. We began those negotiations in 2004 with a similar goal of seeking no additional donor resources, while providing increased debt relief to HIPC initiative countries from finances of the international financial institutions. However, there was no international support for this proposal. In the end, donors were required to compensate, dollar-for-dollar, for MDRI debt relief at the World Bank and African Development Bank. The U.S. is bearing about 20 percent of the costs of MDRI at the World Bank and about 12 percent at the African Development Bank.

It is uncertain, at best, whether other creditor governments would be willing to agree to additional debt relief of this magnitude, particularly if we are unwilling to provide additional funds. If negotiations for expanded debt relief were to follow our experience with MDRI, the U.S. would need to be prepared to make a significant contribution, likely at the expense of other development assistance priorities.

Continued Financing Needs for Current Initiatives

The United States is far from making good on its commitments to the current debt reduction initiatives – which seek to help the poorest, most heavily-indebted countries. The Administration has continued to request, but has still not received, sufficient appropriations to fully fund U.S. bilateral HIPC debt relief to the Democratic Republic of the Congo. The U.S. also has an outstanding pledge of $75 million to the HIPC Trust Fund, which is needed to support HIPC debt relief at the regional development banks. U.S. support for debt relief under MDRI is funded through our contributions to the IDA and African Development Fund replenishments. However, we have consistently received less than our full request for these replenishments. The result is that, in fiscal year 2008, we anticipate the U.S. government will have over $870 million in arrears to the multilateral development banks, including $385 million to IDA alone. In fact, our arrears request this year is specifically targeted at fulfilling our commitment to MDRI.

Targeting the Correct Priorities

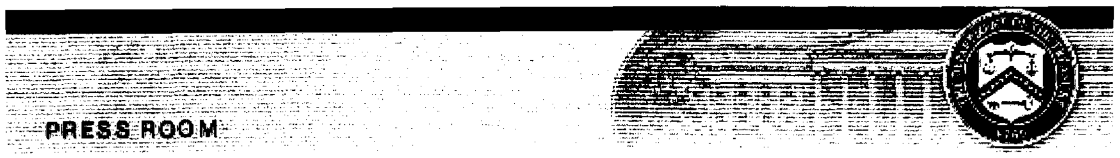
When we meet with developing countries, debt relief appears to be far down the list of their priorities. Indeed many of these countries see strengthening the environment in which the private sector can flourish and drive economic growth as their primary development challenge. This means improving the business climate, meeting infrastructure needs, integrating into the global economy, and strengthening financial sectors.

To underscore what we at Treasury hear from our counterparts in many low-income countries, let me share with you a recent discussion that Secretary Paulson had with the finance ministers from six African countries. One minister noted that his president's top priority was increasing electricity generation. Another spoke eloquently about the costs that poor energy and transport infrastructure impose upon his country's ability to grow and create jobs. And all of the ministers and central bank governors asked Secretary Paulson to work with them to find additional ways to attract foreign investment to their countries. Secretary Paulson wants to find ways to shine a light on this core challenge in these countries. We believe that these issues, rather than debt relief, are the real priorities for spurring growth and poverty reduction in these countries.

Conclusion

Rather than embark on expanded debt relief, the United States should focus on three things. First, it should fulfill its commitments to current debt relief initiatives and meet our other multilateral commitments. Second, it should continue to provide direct development assistance to poor countries through bilateral and multilateral mechanisms aimed at increasing economic growth and reducing poverty. Finally, we need to find ways to work with countries to build their capacity to handle more open trade and investment.

Thank you for your consideration of these issues. I look forward to working with you further to support our current debt relief efforts and to develop the best possible policies in this area. I welcome your questions.



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April 28, 2008
hp-943

Treasury Announces Marketable Borrowing Estimates

Washington- Treasury announced its current estimates of marketable borrowing today for the April – June 2008 and July – September 2008 quarters:

- Over the April – June 2008 quarter, the Treasury expects to pay down $35 billion of marketable debt, assuming an end-of-June cash balance of $45 billion. This pay down estimate is $87 billion lower than announced in January 2008. The decrease in the amount of the pay down, and corresponding increase in borrowing, is primarily due to lower receipts, redemptions of portfolio holdings by the Federal Reserve System, and lower net issuances of State and Local Government Series securities.
- Over the July – September 2008 quarter, the Treasury expects to borrow $112 billion of marketable debt, assuming an end-of-September cash balance of $45 billion.

During the January – March 2008 quarter, Treasury borrowed $244 billion of marketable debt, finishing with a cash balance of $46 billion at the end of March. In January 2008, Treasury announced marketable borrowing of $156 billion, assuming an end-of-March cash balance of $25 billion. The increase in borrowing was primarily the result of lower receipts, redemptions of portfolio holdings by the Federal Reserve System and adjustments to cash balances.

In the past, Treasury has announced marketable borrowing as the total net issuance of marketable Treasury securities to all entities, including the Federal Reserve's System Open Market Account (SOMA). The Federal Reserve has redeemed SOMA holdings in excess of $130 billion since August 2007. In order to more accurately reflect borrowing from private market participants, net SOMA redemptions have not been included in Treasury's marketable borrowing estimates above. The table below details the impact of excluding net SOMA redemptions in the estimates for the current quarter and the actual results for the three previous quarters.

	Jul-Sep 07	Oct-Dec 07	Jan-Mar 08	Apr-Jun 08
Marketable Borrowing (Including SOMA)	105	87	191	-62
SOMA Redemptions	11	39	53	27
Marketable Borrowing (Excluding SOMA)	116	126	244	-35

Additional financing details relating to Treasury's Quarterly Refunding will be released at 9:00 a.m. on Wednesday, April 30.

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REPORTS

- Sources and Uses Reconciliation 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	**Actual**	**35**	**116**	**(31)**	**85**	**50**	**75**
Oct - Dec 2007	**Actual**	**91**	**126**	**(53)**	**73**	**(18)**	**57**
Jan - Mar 2008	**January 28, 2008**	**169**	**156**	**(18)**	**137**	**(32)**	**25**
	Actual	**187**	**244**	**(68)**	**176**	**(11)**	**46**
	Memo: Forecast Revision	18	89	(50)	39	21	21
Apr - Jun 2008	**January 28, 2008**	**(155)**	**(122)**	**(13)**	**(135)**	**20**	**45**
	April 28, 2008	**(83)**	**(35)**	**(49)**	**(84)**	**(1)**	**45**
	Memo: Forecast Revision	72	87	(37)	51	(21)	0
Jul - Sep 2008	**April 28, 2008**	**103**	**112**	**(10)**	**103**	**0**	**45**

April 30, 2008
hp-944

Assistant Secretary for Financial Markets Anthony W. Ryan
May 2008 Quarterly Refunding Statement

Washington, DC--We are offering $21.0 billion of Treasury securities to refund approximately $74.0 billion of privately held securities maturing on May 15 and to pay down approximately $53.0 billion. The securities are:

- A new 10-year note in the amount of $15.0 billion, maturing May 15, 2018;
- A 29 ¾ -year bond in the amount of $6.0 billion, maturing February 15, 2038

These securities will be auctioned on a yield basis at 1:00 p.m. EDT on Wednesday, May 7, and Thursday, May 8, respectively. Both of these auctions will settle on Thursday, May 15. The balance of our financing requirements will be met with weekly bills, monthly 2-year and 5-year notes, the June 10-year note reopening and the July 10-year TIPS offering and 20-year TIPS reopening.

In addition, Treasury will commence issuing a 52-week bill, with the initial announcement on Thursday, May 29 at 11:00 a.m. EDT, the initial auction on Tuesday, June 3 at 1:00 p.m. EDT, and settlement on Thursday, June 5. Treasury will auction this security once every four weeks, concurrently with the 4-week bill, with settlement two days later on Thursday.

Treasury also expects to issue cash management bills in May, June, August, and September. Some of these cash management bills may be longer-dated. The issuance of longer-dated cash management bills is in response to stimulus program payments and other potential seasonal fluctuations in cash balances.

Changes in Borrowing Needs and Treasury's Response

Over the last several months, changes in economic conditions, financial markets, and monetary and fiscal policy have impacted Treasury's marketable borrowing needs. Financial market strains have impacted the real economy, and the nation has experienced lower economic growth, lower receipts, and increased outlays.

As a result, projected marketable borrowing requirements have increased significantly over the last three months, driven by changes in the deficit estimate, a decline in SLGS issuance, and redemption and outright sale activity undertaken by the Federal Reserve in its System Open Market Account (SOMA).

Treasury has responded to the increase in marketable borrowing requirements in its traditional manner and consistent with our comments in the February 2008 quarterly refunding statements. Over the past several months, as borrowing needs have accelerated rapidly, the Treasury has significantly increased issuance sizes of regular bills, the frequency, terms, and issuance sizes of cash management bills, and the issuance sizes of shorter and intermediate-term nominal note offerings.

Given issuance sizes of securities on our current offerings calendar, future borrowing needs for the remainder of fiscal year 2008, as well as deficit projections for fiscal year 2009, we believe it prudent to add an additional maturity point at this time. Treasury will continue to monitor our projected fiscal needs and make adjustments as necessary.

Auction Calendar Addition with Issuance of the 52-week bill

Treasury will commence issuing a 52-week bill, with the initial auction on Tuesday, June 3 at 1:00 p.m. EDT and settlement on Thursday, June 5. The announcement

date for this initial bill will be Thursday, May 29, 2008 at 11:00 a.m. EDT.

In the future, Treasury will announce the size of 52-week bills once every four weeks on the Thursday prior to auction in conjunction with the announcement of sizes of the 13-week and 26-week bills. This security will be auctioned once every four weeks, concurrently with the 4-week bill on Tuesdays at 1:00 p.m. Settlement for the 52-week bill will be, as with all other bills, on Thursday.

The addition of the 52-week bill should help reduce Treasury's reliance on cash management bill issuance.

Financing Needs in Fiscal Year 2008

We anticipate continued increases in bill and nominal coupon issuance over the remainder of fiscal year 2008 to address increases in net marketable borrowing needs associated with the fiscal outlook.

Financing considerations related to the Federal Reserve (SOMA)

While the decisions of the Federal Reserve are independent of the Department, Treasury may also need to alter weekly bill issuance sizes or to issue additional cash management bills to offset cash shortfalls arising from Federal Reserve redemptions and open market sales of Treasury securities. Treasury will adjust such issuance as transparently as possible.

Introduction of the New Treasury Auction System

On April 7, 2008, as part of its Cash-Debt management modernization initiative, Treasury introduced its New Treasury Automated Auction Processing System (NTAAPS). This enhanced auction system significantly upgrades Treasury's auction process by improving system flexibility, reliability, security, analytics and transparency.

Notable improvements include the following:

- Bidders receive immediate system feedback regarding receipt of their bids.
- Award notices are available immediately after auction close. Previously, it took upwards of 20 minutes for successful bidders to receive award notices.
- Treasury publishes preliminary results of the offering amount awarded to non-competitive tenders 15 minutes before auction close.
- An enhanced user experience to provide ease in data entry.
- Robust fail-safes in case of contingency situations.
- $100 minimum denominations of marketable debt instead of $1000 to broaden access to all market participants.

Treasury Repo Market and Private Sector Initiatives

Treasury continues to encourage efforts by the private sector – notably initiatives taken by members of the Securities Industry and Financial Markets Association (SIFMA) and the Treasury Markets Practices Group (TMPG) - to address issues related to the Treasury financing market. The current low interest rate environment potentially leads to an increased likelihood of chronic fails in the Treasury repo market. Such activity is not favorable for Treasury market liquidity.

Treasury strongly believes that the private sector, given its interest in maintaining robust financing markets, should implement initiatives discussed over the past three months in a proactive manner.

In addition, private sector participants should take additional steps from a monitoring and supervisory perspective to ensure that fails do not reach levels that impact financing markets.

Treasury will continue to routinely monitor the Treasury financing markets, and encourage additional steps when necessary.

Please send comments and suggestions on these subjects or others relating to Treasury debt management to debt.management@do.treas.gov.

The next quarterly refunding announcement will take place on Wednesday, July 30, 2008.

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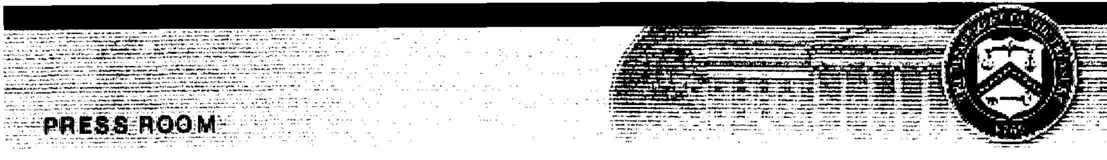

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April 30, 2008
hp-945

Report to The Secretary of the Treasury from The Treasury Borrowing Advisory Committee of the Securities Industry And Financial Markets Association

April 29, 2008

Dear Mr. Secretary:

Since the Committee's previous meeting in late January, credit conditions have remained stringent and the economy has weakened. Overall, Federal Reserve policies have proved effective in forestalling a financial market crisis by effectively eliminating the possibility of another bank failure but concerns remain about the appropriate quoting of money markets rates, term financing and continued proper functioning of the money markets in the absence of these Fed programs. Expectations for economic growth in the first half of 2008 have continued to fall and a number of primary dealers judge the economy currently to be in recession. Housing remains a notable drag through a variety of channels and that weakness now is being augmented by a more cautious approach to spending by businesses and consumers. Forthcoming tax rebates likely will boost consumer spending in the months ahead but that lift will be temporary. On balance, the outlook for the economy will remain uncertain until credit conditions improve and financial intermediation begins to function more smoothly.

Inflation has remained somewhat elevated due to ongoing price increases for food and energy. Slowing economic growth has had a moderating effect on an array of other consumer prices, especially for credit-sensitive goods such as motor vehicles and household durables. Core consumer prices are increasing in a 2% to 2-1/2% range. Chances favor some improvement in these measures amid tight financial conditions, softer home prices and higher unemployment. Nonetheless, rising food and energy costs' possible effect on inflation expectations may sustain concerns about inflationary pressures.

The steady tightening in financial conditions has led the Federal Reserve to lower the federal funds target rate to 2-1/4%. Futures markets anticipate another quarter-point reduction in the policy rate, followed by a period of stability. The shift in investor expectations for the path of monetary policy has contributed to the recent rise in market interest rates and the flattening of the U.S. Treasury yield curve.

The Federal government's budget balance is deteriorating in fiscal year 2008. Weaker economic activity has dampened the pace of revenue collection and lifted growth in economically sensitive spending. A recent survey of primary dealers estimates that the deficit for the 2008 fiscal year ending in September will exceed $400 billion with some economists expecting a deficit of more than $500 billion--a significant deterioration from fiscal 2007's deficit of $163 billion. Economic stimulus measures will complement the forces widening the budget deficit. This year's shortfall may surpass fiscal year 2004 as the largest on record in nominal dollars.

In its first charge to the Committee, the Treasury solicited our advice and recommendations for Treasury issuance over the near and intermediate term given the aforementioned deterioration in the fiscal budget outlook.

As a near-term solution, there was universal agreement on the Committee that the

Treasury should introduce a 52-week bill to its auction schedule. A "year bill" would reduce the Treasury's reliance on large cash management bills and provide sufficient financing to absorb the increased borrowing needs that have grown so quickly over the last year.

There was also universal agreement on the Committee that the Treasury needs to prepare for additional financing needs over a more intermediate term. In fact, several members argued that the current deterioration in the fiscal outlook might be more than temporary and that the risk of further deterioration outweighs the risk of a surprise improvement in the deficit.

Furthermore, additional members again reiterated their concern that this latest "cyclical" deterioration in the fiscal outlook is particularly troublesome as the longer-term "secular" forces of entitlement spending and the aging of the baby boom generation and their effect on the budget deficit are no longer that distant in the future.

Consequently, there was strong agreement on the Committee that the Treasury consider altering its issuance calendar over the intermediate term to account for these forces.

The Committee recommends that the Treasury review its issuance calendar and increase the size and the frequency of existing coupon issuance over the coming quarters in addition to the near-term solution of adding a year bill. Several members noted that the increased reliance on Treasury bills, as the deficit has deteriorated, has shortened the average maturity of the debt, and that steps should be taken to arrest this trend, if not, to purposefully reverse it.

The majority of members believe that the addition of the year bill combined with increases to the size and frequency of existing coupon debt over coming quarters will still not be sufficient to satisfy the increased financing needs of the Treasury over the intermediate and longer term.

Consequently, most members recommended that the Treasury prepare the markets for a re-introduction of a coupon note over the coming quarters. The Committee was somewhat divided as to the maturity of such a note. A 3-year note was suggested by some given its relative ease of issuance, while longer-dated notes were suggested by others who are concerned with the shrinking of the average maturity of the debt as argued above.

In any event, the Committee was in strong agreement that the Treasury cannot view the deterioration in the fiscal deficit as "temporary" and must plan for increased flexibility of bills and notes over coming quarters to ensure a continued effective financing environment.

In the second charge, the Committee was asked to address the prevailing low interest rate environment's potential impact on an increase in systemic fails in the Treasury market. The consequences of such fails would be an impairment of liquidity and an increased cost to Treasury borrowing. Consequently, the Treasury has encouraged market participants to discuss and pursue market-oriented solutions to ease this potential burden.

The discussion was accompanied by a chart that depicted tangible spikes in fail activity during the low rate periods of 2001, 2003 into 2004, and the recent fail rate increases over the past few months, as rates have once again declined precipitously.

The presentation suggested that a number of private sector participants, including the Securities Industry and Financial Markets Association Group (SIFMA) and the Treasury Market Practices Group (TMPG), were encouraging some actionable steps towards dealing with this issue. A few of the Borrowing Committee members actually sit on one or more of these industry groups and suggested that their work was yielding some positive results.

One of these suggestions was in the form of a prompt delivery trading practice or buy-in mechanism. A couple of Committee members suggested that while these measures would enhance clarity and boundaries for market participants, they would

also encourage arbitrage, and increased market activity around these rules or guidelines. However, the notes from the presentation did suggest that there was a broad consensus around encouraging a cash settlement of fails before the 30th day after the fail had occurred.

There was also some discussion of a negative rate repo trading practice, which had some support, due to its ability to allow the marketplace to source securities at a price that would guarantee delivery. SIFMA has formed a task force to study this and related issues.

There was general consensus among committee members that a well-defined series of "Fails Best Practices" outlined by SIFMA and TMPG, which defined such parameters as margining of fails, cash settlement procedures, and initiatives related to pair-offs and security-delivery, would be extremely beneficial.

To supplement this "Best Practices" set of procedures, the Committee was supportive of a Treasury Fails Monitoring Committee that would be comprised of senior funding and cash market participants. This committee would be established to assess market conditions in this arena, make those issues transparent to the broader market, and recommend practices aimed at dealing with the issues if they became outside the bounds of normal market activity.

This Fails Monitoring Committee, alongside of traditional Treasury Department surveillance, and potentially increased Treasury position disclosure (although some suggested that this could have harmful market-effects), should provide for the ability to monitor and influence appropriate market behavior.

The majority of the Committee feels as if subtle activity by the Treasury such as moral suasion, timely reporting of abnormal market activity, and otherwise regular market surveillance, will also help provide for efficient and normal market conditions to exist.

The Committee suggested that continued review and assessment of these issues would be beneficial in the near future, as it would appear that the market will be in for a more sustained low interest rate environment.

In its third charge to the Committee, the Treasury asked for our views of recent initiatives taken by public and private entities to address the problems in the U.S. housing sector.

Committee members were in agreement that the problems in the housing market were significant, and many were concerned that without intervention the problems would grow worse. In fact, housing price data from S&P/Case-Shiller was released hours before our meeting and highlighted that the decline in housing prices is not over but that prices are actually accelerating to the downside. For example, while year-over-year prices were reported to be down almost 13%, prices on a 6-month, 3-month and 1-month basis have declined 21%, 25% and 28% annualized, respectively.

Several members voiced their endorsement for the Frank/Dodd bill that is currently in Congress. One member noted that while none of these bills are perfect, that this proposal is certainly focused on the key problem which is encouraging lenders and borrowers to find an alternative to foreclosure which serves few interests and might in and of itself fuel housing price declines and create additional defaults.

While few members argued against the "intent" of the proposal, several people articulated their concerns that embedded in such proposals are many unintended consequences. One such concern that otherwise able borrowers would be incentivised to default to capture the same benefit as the borrowers targeted by this legislation.

Several members noted that one of the key issues to encourage servicers to modify loans in hopes of preventing default and foreclosures is the legal liability associated with these actions given the disparate interests embedded in a securitized loan. A number of members recommended that Congress indemnify the servicers while at least one other questioned the long-term impact of what is essentially a repudiation of contract law.

In the final section of the charge, the Committee considered the composition of marketable financing for the April-June Quarter to refund the $74.0 billion of privately held notes and bonds maturing May 15, 2008, the Committee recommended a $15 billion 10-year note due May 15, 2018 and a $7 billion reopening of the 30-year bond due February 15, 2038. For the remainder of the quarter, the Committee recommends a $30 billion 2-year note in May and $31 billion 2-note in June, $20 billion 5-year notes in May and June, and a $10 billion re-opening of the 10-year note in June.

For the July-September quarter, the Committee recommended financing as found in the attached table. Relevant figures included three 2-year note issuances monthly, three 5-year note issuances monthly, a 10-year note issuance in August followed by a re-opening in September, a 30-year bond in August, as well as a 10-year TIPs note in July, and a 20-year TIPs re-opening later that same month.

Respectfully submitted,

Keith T. Anderson
Chairman

Rick Rieder
Vice Chairman

REPORTS

- Table Q2 08
- Table Q3 08

US TREASURY FINANCING SCHEDULE FOR 2nd QUARTER 2008
BILLIONS OF DOLLARS

ISSUE	ANNOUNCEMENT DATE	AUCTION DATE	SETTLEMENT DATE	OFFERED AMOUNT 4-WK	OFFERED AMOUNT 3-MO	6-MO	MATURING AMOUNT	NEW MONEY
4-WEEK AND 3&6 MONTH BILLS	3/27	3/31	4/3	18.00	24.00	21.00	65.00	-2.00
	4/3	4/7	4/10	10.00	24.00	21.00	65.00	-10.00
	4/10	4/14	4/17	8.00	22.00	20.00	66.00	-16.00
	4/17	4/21	4/24	8.00	20.00	20.00	61.00	-13.00
	4/24	4/28	5/1	*12.00*	*20.00*	*20.00*	*61.00*	*-9.00*
	5/1	5/5	5/8	*20.00*	*20.00*	*20.00*	*53.00*	*7.00*
	5/8	5/12	5/15	*27.00*	*22.00*	*20.00*	*52.00*	*17.00*
	5/15	5/19	5/22	*30.00*	*25.00*	*23.00*	*52.00*	*26.00*
	5/22	5/27	5/29	*30.00*	*25.00*	*23.00*	*58.00*	*20.00*
	5/29	6/2	6/5	*26.00*	*25.00*	*23.00*	*65.00*	*9.00*
	6/5	6/9	6/12	*20.00*	*25.00*	*23.00*	*72.00*	*-4.00*
	6/12	6/16	6/19	*12.00*	*25.00*	*23.00*	*75.00*	*-15.00*
	6/19	6/23	6/26	*12.00*	*25.00*	*23.00*	*74.00*	*-14.00*
					815.00		*819.00*	*-4.00*
CASH MANAGEMENT BILLS								
5-DAY BILL		4/8	4/10		*25.00*		*25.00*	*0.00*
	Matures 4/15							
60-DAY BILL		2/14	2/15		*0.00*		*30.00*	*-30.00*
	Matures 4/15							
15-DAY BILL		3/31	4/1		*26.00*		*26.00*	*0.00*
	Matures 4/16							
63-DAY BILL		2/13	2/14		*0.00*		*19.00*	*-19.00*
	Matures 4/17							
25-DAY BILL		3/25	3/27		*0.00*		*20.00*	*-20.00*
	Matures 4/21							
6-DAY BILL		4/16	4/22		*20.00*		*20.00*	*0.00*
	Matures 4/22							
35-DAY BILL		5/14	5/15		*40.00*		*40.00*	*0.00*
	Matures 6/19							
120-DAY BILL		5/19	5/20		*30.00*			*30.00*
	Matures 9/17							
11-DAY BILL		6/3	6/5		*25.00*		*25.00*	*0.00*
	Matures 6/16							
								-39.00
COUPONS						CHANGE IN SIZE		
10-Year TIPS-R	4/7	4/10	4/15		6.00			6.00
5-Year TIPS	4/17	4/22	4/30		8.00			
2-Year Note	4/21	4/23	4/30		30.00	2.00		
5-Year Note	4/21	4/24	4/30		19.00	1.00	21.60	35.40
10-Year Note	4/30	5/7	5/15		*15.00*	*2.00*		
30-Year Bond-R	4/30	5/8	5/15		*7.00*	*2.00*	*74.00*	*-52.00*
2-Year Note	5/22	5/28	6/2		*31.00*	*1.00*		
5-year Note	5/22	5/29	6/2		*20.00*	*1.00*	*22.00*	*29.00*
10-Year Note-R	6/9	6/12	6/16		*10.00*			*10.00*
2-Year Note	6/19	6/24	6/30		*31.00*			
5-year Note	6/19	6/26	6/30		*20.00*		*21.10*	*29.90*
					197.00		*138.70*	*58.30*

Estimates are italicized

NET CASH RAISED THIS QUARTER: 15.30

R = Reopening

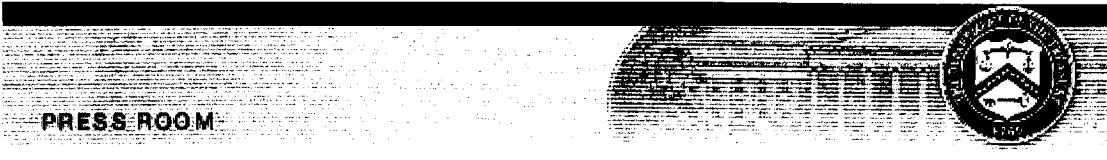
US TREASURY FINANCING SCHEDULE FOR 3rd QUARTER 2008
BILLIONS OF DOLLARS

ISSUE	ANNOUNCEMENT DATE	AUCTION DATE	SETTLEMENT DATE	OFFERED AMOUNT			MATURING AMOUNT	NEW MONEY
				4-WK	3-MO	6-MO		
4-WEEK AND 3&6 MONTH BILLS	6/26	6/30	7/3	*15.00*	*25.00*	*23.00*	*69.00*	*-6.00*
	7/3	7/7	7/10	*15.00*	*25.00*	*23.00*	*62.00*	*1.00*
	7/10	7/14	7/17	*15.00*	*25.00*	*23.00*	*52.00*	*11.00*
	7/17	7/21	7/24	*20.00*	*25.00*	*23.00*	*51.00*	*17.00*
	7/24	7/28	7/31	*12.00*	*25.00*	*23.00*	*56.00*	*4.00*
	7/31	8/4	8/7	*20.00*	*28.00*	*25.00*	*56.00*	*17.00*
	8/7	8/11	8/14	*27.00*	*28.00*	*25.00*	*59.00*	*21.00*
	8/14	8/18	8/21	*30.00*	*28.00*	*25.00*	*67.00*	*16.00*
	8/21	8/25	8/28	*30.00*	*28.00*	*25.00*	*59.00*	*24.00*
	8/28	9/2	9/4	*26.00*	*28.00*	*25.00*	*68.00*	*11.00*
	9/4	9/8	9/11	*20.00*	*26.00*	*23.00*	*74.00*	*-5.00*
	9/11	9/15	9/18	*10.00*	*23.00*	*21.00*	*77.00*	*-23.00*
	9/18	9/22	9/25	*10.00*	*23.00*	*21.00*	*77.00*	*-23.00*
					892.00		*827.00*	*65.00*
CASH MANAGEMENT BILLS								
26-DAY BILL		8/19	8/20		*30.00*		*30.00*	*0.00*
	Matures 9/15							
18-DAY BILL		8/27	8/28		*15.00*		*15.00*	*0.00*
	Matures 9/15							
13-DAY BILL		9/2	9/3		*7.00*		*7.00*	*0.00*
	Matures 9/16							
120-DAY BILL		5/19	5/20		*0.00*		*30.00*	*-30.00*
	Matures 9/17							
								-30.00
COUPONS								
						CHANGE IN SIZE		
10-Year TIPS	7/7	7/10	7/15		*8.00*			*8.00*
20-Year TIPS-R	7/17	7/22	7/31		*7.00*	*1.00*		
2-Year Note	7/21	7/23	7/31		*31.00*	*1.00*		
5-Year Note	7/21	7/24	7/31		*20.00*		*20.00*	*38.00*
10-Year Note	7/30	8/7	8/15		*15.00*			
30-Year Bond	7/30	8/8	8/15		*11.00*	*2.00*	*43.50*	*-17.50*
2-Year Note	8/25	8/27	9/2		*31.00*			
5-year Note	8/25	8/28	9/2		*20.00*		*22.00*	*29.00*
10-Year Note-R	9/8	9/11	9/15		*10.00*		*14.50*	*-4.50*
2-Year Note	9/22	9/24	9/30		*31.00*			
5-year Note	9/22	9/25	9/30		*20.00*		*19.10*	*31.90*
					204.00		*119.10*	*84.90*

Estimates are italicized

NET CASH RAISED THIS QUARTER: 119.90

R = Reopening



April 30, 2008
hp-946

Deputy Assistant Secretary Mark Sobel
Remarks at Conference on U.S. – EU Regulatory Cooperation
U.S. Chamber of Commerce

Washington - Thank you for the invitation to join this panel and discuss U.S.-EU financial market issues ahead of the TEC.

Obviously, the current global financial turmoil and US/EU cooperation is uppermost in people's minds. As noted in the recent G7 statement, the world's major central banks have coordinated their actions to address liquidity pressures in funding markets and disruptions in global financial markets. The Financial Stability Forum (FSF) -- which consists of the G7 countries, Switzerland, the Netherlands, Australia, Hong Kong and Singapore, and also brings together the key standard setting bodies -- put forward a strong consensus-based report with proposals on prudential oversight, transparency and valuation, the role of credit rating agencies, supervisory authorities' responsiveness to risk and robust arrangements for dealing with stress in the financial system.

Several EU members are active participants in the FSF and the European Commission works closely with many standard setting bodies and has itself pursued work in the European context aimed at addressing the turmoil. The substance of this work is closely aligned with that of the FSF as well as U.S. work in the President's Working Group on Financial Markets. These activities underscore that US-EU cooperation in addressing global financial market turmoil is excellent and that this work needs to be anchored not just in transatlantic cooperation but also in the global system.

Let me step back now and put US/EU financial discussions in a broader context. This decade, the EU intensified its efforts to forge an integrated financial market under its Financial Services Action Plan (FSAP). Transformation is already visible, especially at the wholesale level. The EU Markets in Financial Instruments Directive has made for more seamless trading across European platforms. Stock exchanges are being consolidated in Europe and across the Atlantic. Several EU cross-border bank mergers have taken place. All listed European firms use International Financial Reporting Standards (IFRS). Efforts are underway to create more efficient clearance, settlements and payments systems.

In the United States, change is also afoot. Financial markets have evolved significantly reflecting the increased globalization of finance and commerce. Technological change has increased trading efficiency. Cross-border capital flows have picked up and corporate governance has been strengthened.

While financial market regulation is undertaken at the national level, one nation's actions clearly don't stop at the water's edge. This is a reality that the U.S. and EU have confronted. Against that background, in 2002, the informal U.S.-EU Financial Market Regulatory Dialogue (FMRD) began. This dialogue complemented many other critical international processes, for example, in the G-7, Financial Stability Forum, Basel Committee, IOSCO and the like.

Since then, the Dialogue has addressed many topics, including the impact of the FSAP on U.S interests; the effect of U.S. regulatory actions on the EU; how to manage these spillovers; and our common interests in working with emerging markets on financial sector issues. Let me underscore -- this is an "informal dialogue", not a negotiation. Both sides respect the independence of regulatory authorities, recognize that our structures are different and focus on promoting the common objective of facilitating global financial stability and finding practical solutions, if possible.

Much has been achieved. The relationships among the players are extremely cordial and virtual. The nitty-gritty depth of our discussions at times can be mind-numbing. Since many items I will discuss in the rest of my remarks fall in the domain of our regulators, let me be clear that they are independent, I would not presume to speak on their behalf, and my points are solely intended to be factual. To list a few things done since 2002:

- Asset pledge requirements for foreign branches in the U.S. were reduced.
- U.S. firms continued their European operations in the presence of the EU's Financial Conglomerates Directive.
- Accommodations were reached on the impact of Sarbanes-Oxley on Europe.
- European financial rule-making became more transparent and consultation with market participants improved.
- Europe allowed for internalization of stock trading.
- Good discussions were held on the timeline for implementing Basel II, helping to facilitate the smooth management of this issue. Trading book capital charges were included in European legislation.
- Rules were put in place making it easier for foreign companies to terminate SEC registration and reporting requirements when there is little US market interest in their securities.
- In 2005, the SEC and EU began work on a landmark "roadmap" for the United States to accept IFRS statements as a basis for U.S. public listings no later than 2009, and the EU to find US GAAP statements "equivalent" in order to ensure their continued use on European markets without a reverse reconciliation requirement.
- And in early 2007, an active debate emerged on establishing a system of "substituted compliance" for recognition of foreign broker-dealer regimes, or what the G7 Finance Ministers have labeled "mutual recognition of comparable regimes," aimed at facilitating cross-border access by securities exchanges, other trading systems and investment firms, while ensuring high quality investor protection.

With the launch of the Transatlantic Economic Council, the U.S. and EU highlighted the benefits to our economies from promoting greater transatlantic economic integration and seeking to reduce regulatory burdens. Given that some two-thirds of global capital flows take place in the transatlantic space, it was natural that the TEC highlighted financial market issues. Three issues, long in the financial realm, will be in focus.

Accounting Convergence: Following up on the accounting "roadmap" work, in late 2007, the SEC decided to abolish the requirement for reconciliation to US GAAP for foreign companies using IFRS as issued by the International Accounting Standards Board and solicited comment on the possibility of allowing domestic companies to file using IFRS. Noting the report published by the EC Services earlier this month that US GAAP meets the criteria established for recognition as "equivalent" to IFRS, we look forward to a formal decision confirming this finding. We fully expect this to happen this year. It bears underscoring that this work, along with efforts to converge global accounting standards and strengthen international accounting governance, offers the prospect for firms to use one set of financial statements for their global activities, with all of the attendant benefits in terms of reduced costs and greater efficiencies. This is a hugely positive achievement, and the SEC and EU deserve tremendous praise for their hard work in past in bringing these efforts toward fruition.

Mutual Recognition in Securities: Work in this area is proceeding apace. Last year, consultations and roundtables were held with stakeholders to flesh out ideas. In February, Chairman Cox and EU Internal Markets Commissioner McCreevy issued a joint statement on the common willingness of the US and EU to work together on mutual recognition in securities. In late March, the SEC announced actions to further the implementation of the concept of mutual recognition for high-quality regulatory regimes in other countries. It also announced that it would work to develop a process for discussing mutual recognition with the EU, hopefully by mid-2008.

Insurance Issues: Undoubtedly, lively discussions will continue on insurance issues – notably on the implications of U.S. state reinsurance collateral requirements for unlicensed reinsurers and the EU's forthcoming

Solvency II Directive for foreign insurance firms operating in the EU.

The US is open to foreign reinsurers, who account for 85% of the US reinsurance market. On reinsurance collateral, certain European reinsurers operating without licenses in given states take the view that the requirement to hold 100% collateral against gross liabilities is excessively costly and inconsistent with a risk-based regime. High-level discussions have occurred for years on reinsurance collateral, including through the NAIC/EU insurance dialogue, a NAIC dialogue with the European committee of insurance supervisors and the FMRD. Unfortunately, a solution which could be implemented has not been found, though many good ideas have been advanced and work undertaken in good faith to address the matter. Those efforts continue among state insurance commissioners.

On Solvency II, Europe is moving to adopt a new regime, perhaps in 2012, which would provide for consolidated supervision of insurance firms at the financial holding company level and a risk-based approach to capital requirements. Solvency II also provides that foreign firms operating in the EU must be supervised on an "equivalent" basis by their home supervisor or face unspecified measures. Large U.S. insurance firms operating in Europe fear the EU will find the U.S. insurance supervisory regime not equivalent and that they in turn will face uncertainties and higher costs in continuing their European operations. This is a matter requiring intensive discussion.

The Chair specifically asked me to address Treasury's "Blueprint for a Modernized Financial Regulatory Structure" in this context. As Secretary Paulson has said, a state-based regulatory system is burdensome, and it can hinder development of national products and directly impact the competitiveness of U.S. insurers. Also, he has said insurance presents a clear need for regulatory modernization. Certainly in my talks with regulators across the globe, a familiar refrain has been that foreign firms find interacting with many state regulators cumbersome.

Against this background, the Blueprint made two proposals. First, Treasury recommended the establishment of a federal insurance regulatory structure to provide for the creation of an Optional Federal Charter. Second, as an intermediate step, Treasury recommended that Congress create a federal Office of Insurance Oversight within Treasury to establish a federal presence in insurance for international and regulatory issues. These reforms would provide in Treasury's view for more effective, efficient and consistent regulation for national insurers.

Two weeks ago, Congresspersons Kanjorski and Pryce of the House Financial Services Committee introduced legislation to create a federal insurance adviser within Treasury, similar to the intermediate step proposal in the Blueprint. As Assistant Secretary David Nason stated, Treasury welcomes this proposal and it would help the U.S. address international regulatory issues affecting our markets' competitiveness.

Needless to say, these proposals are not yet law and until such time that they are implemented, the current U.S. insurance regulatory structure will remain in place. It is in this context for the period ahead that U.S.-EU international insurance discussions will continue to take place in the various dialogues previously outlined. It is Treasury's strong hope and expectation that all parties will work constructively together in search of practical solutions.

Thank you.

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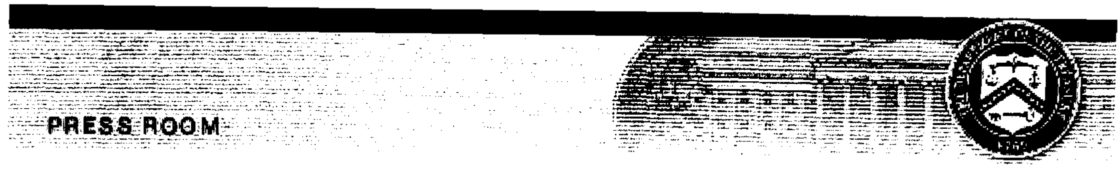


April 30, 2008
hp-947

Report on Foreign Holdings of U.S. Securities at End-June 2007

The final results from the survey of foreign portfolio holdings of U.S. securities at end-June 2007 are released today and posted on the U.S. Treasury web site at (http://www.treas.gov/tic/fpis.html).

This annual survey was undertaken jointly by the U.S. Treasury, the Federal Reserve Bank of New York, and the Board of Governors of the Federal Reserve System. The next survey will be for end-June 2008, and preliminary data are expected to be released by February 27, 2009.

Complementary surveys measuring U.S. holdings of foreign securities are also carried out annually. Data from the most recent survey, reporting on securities held on year-end 2007, are currently being processed. Preliminary results are expected to be reported by August 29, 2008.

Overall Preliminary Results

The survey measured foreign holdings of U.S. securities as of June 30, 2007, to be $9,772 billion, with $3,130 billion held in U.S. equities, $6,007 billion in U.S. long-term debt securities1 (of which $1,472 billion are holdings of asset-backed securities (ABS) 2 and $4,535 billion are holdings of non-ABS securities), and $635 billion held in U.S. short-term debt securities. The previous survey, conducted as of June 30, 2006, measured foreign holdings of $2,430 billion in U.S. equities, $4,733 billion in U.S. long-term debt securities, and $615 billion in short-term U.S. debt securities (see Table 1).

1. Long-term debt securities have an original term-to-maturity of over one year.
2. Asset-backed securities are backed by pools of assets, such as pools of residential home mortgages or credit card receivables, which give the security owners claims against the cash flows generated by the underlying assets. Unlike most other debt securities, these securities generally repay both principal and interest on a regular basis, reducing the principal outstanding with each payment cycle.

Table 1. Foreign holdings of U.S. securities, by type of security, as of recent survey dates

(Billions of dollars)

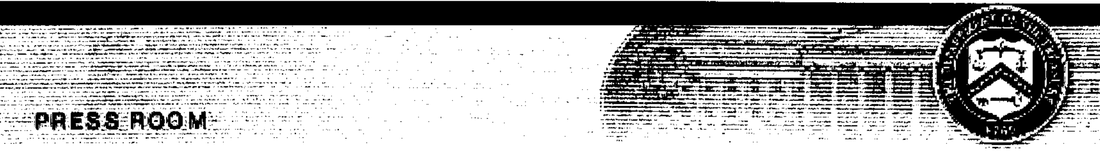
Type of Security	June 30, 2006	June 30, 2007
Long-term Securities	7,162	9,136
Equity	2,430	3,130
Long-term debt	4,733	6,007
Asset-backed	980	1,472
Other	3,753	4,535
Short-term debt securities	615	635
Total	7,778	9,772
Of which: Official	2,301	2,823

Table 2. Foreign holdings of U.S. securities, by country and type of security, for the major investing countries into the U.S., as of June 30, 2007
(Billions of dollars)

	Country or category	Total	Equities	Long-term debt		Short-term
				ABS	Other	debt
1	Japan	1,197	220	133	768	76
2	China (Mainland)1	922	29	217	653	23
3	United Kingdom	921	421	160	316	24
4	Cayman Islands	740	279	236	186	38
5	Luxembourg	703	235	104	320	44
6	Canada	475	347	23	83	22
7	Belgium	396	25	56	313	3
8	Ireland	342	81	75	101	85
9	Switzerland	329	174	41	99	15
10	Netherlands	321	185	64	59	13
11	Middle East Oil Exporters2	308	139	18	107	44
12	Germany	266	100	51	105	11
13	Bermuda	238	90	53	80	15
14	France	221	132	36	48	6
15	Singapore	175	108	13	52	3
16	Australia	165	87	8	62	9
17	Russia	148	0	0	109	39
18	Korea, South	138	5	13	105	15
19	Hong Kong	138	31	24	75	9
20	Taiwan	121	11	27	80	3
21	Norway	109	56	26	22	5
22	British Virgin Islands	108	67	2	32	7
23	Mexico	107	19	2	74	13
24	Brazil	106	1	0	103	2
25	Sweden	99	60	4	32	4
	Country Unknown	214	0	1	211	2
	Rest of the World	762	228	87	342	106
	Total	**9,772**	**3,130**	**1,472**	**4,535**	**635**
	of which: Official	2,823	266	280	2,021	256

1. Excludes Hong Kong, Macau, and Taiwan, which are reported separately.

2. Bahrain, Iran, Iraq, Kuwait, Oman, Qatar, Saudi Arabia, United Arab Emirates.



April 28, 2008
hp-948

Under Secretary for Domestic Finance Robert K. Steel
Remarks before the Society of American Business Editors and Writers
Annual Conference

Baltimore - Thank you for the invitation to be here today. Let me congratulate you on a timely and important conference. To my mind your agenda focuses you on the right set of issues, and it is a privilege for me to be included as one of your speakers.

The Society of American Business Editors and Writers is an important organization, representing more than 3,000 members and setting the highest standards for economic journalism. You play a vital role in our open economy. American citizens – who are both providers and users of capital - rely on accurate and timely information to understand and follow financial markets, and you help distill complicated matters of finance and economics into easily accessible terms. Financial education is an important priority for us at Treasury – and as you may know, April is Financial Literacy Month. We are especially appreciative of the role your organizations play in communicating our message to the American public.

When Secretary Paulson and I arrived at Treasury in 2006, he had a full agenda of global priorities. But on two of his strategic goals – financial preparedness and capital markets competiveness - Domestic Finance has provided leadership.

One of our earliest initiatives was developing protocols for financial preparedness within the President's Working Group on Financial Markets (PWG) – the group chaired by the Secretary of the Treasury that also includes the chairmen of the Federal Reserve Board, the Securities and Exchange Commission and the Commodity Futures Trading Commission. Having spent three decades in financial markets, Secretary Paulson and I understood that periodic market disruptions, many with the potential to impact the real economy, are a reality. While these events are difficult to predict or prevent, we wanted to prepare so as to be ready to take action.

A second early priority for Treasury's Domestic Finance team was enhancing the effectiveness, efficiency and competitiveness of our capital markets. While the U.S. begins from a position of strong financial markets, we undertook a series of initiatives to ensure that our markets remain the world's leader. One of those specific initiatives was a comprehensive review and proposal on modernizing our approach to financial services regulation.

Given recent market challenges, our efforts on both financial preparedness and modernized regulation seem particularly relevant today. This afternoon, I would like to provide an update on our work in each of those two areas, then conclude with some general comments about current conditions and finally take your questions. Let me begin with financial preparedness.

Perspective on Financial Crises

The late MIT economist Charles Kindleberger referred to financial crises as "a hardy perennial" (1) and one recent study documents that market disruptions around the world have occurred regularly for the last eight centuries (2). Secretary Paulson and I understood this firsthand. During the three decades we worked in the financial services industry, we lived through many periods of market disruption, including the savings and loan crisis, the Asian financial turmoil, the collapse of Long Term Capital Management, and the dot.com bubble.

Despite the frequency of such occurrences, even the most talented economists or

financial regulators cannot predict the exact origin, frequency or severity of financial turmoil. For example, very few foresaw the magnitude of bank failures that occurred worldwide during the 1980s. Three thousand U.S. savings and loan associations failed during that decade, costing U.S. taxpayers more than $100 billion. In Japan during roughly the same time period, bank losses resulting from the collapse of a bubble in real estate and asset prices cost Japanese taxpayers an amount totaling more than 25 percent of the country's GDP, a much larger share of the economy than the losses incurred by U.S. banks during the Great Depression (3). Similarly, most economists were surprised by the contagion that resulted from the collapse of asset prices in Thailand in the 1990s, which spread to Malaysia, Indonesia and eventually most of Asia. And in 1995, when only nine percent of Americans used the internet (4), few could have anticipated the mania and subsequent implosion in the stock prices of U.S. information technology and dot.com companies that occurred just a few years later.

As I mentioned, one recent study (by Carmen Reinhart and Kenneth Rogoff) examined eight hundred years worth of financial crises and concluded that, by historical standards, current market conditions are "hardly exceptional" (5). In fact, using the framework to interpret financial crises developed by Hyman Minsky – a scholar of business and credit cycles – one can trace the pro-cyclical impact of both the recent expansion and the subsequent contraction in the supply of credit. Minsky described how strong economic periods fueled optimism among lenders and borrowers. Eventually during a boom, however, what is initially rational enthusiasm turns excessive as both borrowing and lending become increasingly speculative. At some point during the later stages of the speculative boom, buyers become less eager to buy and sellers become more eager to sell. That, Minsky postulated, would develop into a period of "financial distress" (6). This framework certainly seems to capture the issues and challenges of today.

However, the fact that current challenges developed in a way that is not unusual by historical standards should not imply that the specific sources of our current headwinds were any more predictable five or 10 years ago. In fact, if you had taken a survey just 18 months ago, in the wake of the failure of the hedge fund Amaranth, many respondents might have expected the next round of market instability to be connected to the hedge fund industry, when in reality hedge funds have generally remained stable during the current period.

While none of us today can precisely anticipate when or where any future financial disruption might originate, symptoms and warning signs do exist. Just as scientists use seismographs to measure ground movements and anticipate earthquakes, market participants and regulators should continuously gauge markets for any potential alarms. Warning signs require attention, but any government intervention should be considered carefully so as to minimize moral hazard and any undue burdens that would damage the efficiency, effectiveness and competitiveness of our markets.

Periods of financial distress will develop and the frequency of these occurrences has significant implications for public policy. The challenge for policymakers is one of balance. The goal of public policy should be a marketplace that protects and gives confidence to investors and also provides a fair playing field for businesses. Government must ensure safe, stable and efficient functioning markets, while also being prepared to promptly respond to disruptions when they arise and minimize any contagion effect.

Financial Preparedness

With this in mind, in the fall of 2006 Secretary Paulson directed the President's Working Group on Financial Markets (PWG) to focus on financial preparedness.

In the last 20 months, the PWG has significantly enhanced its own protocols and procedures to improve communication and facilitate effective coordination and manage actions and responses in the event of a financial market challenge. These protocols include the ability for PWG member agencies to bring into the discussions a broader array of U.S. financial regulators, and given the global and borderless nature of financial markets, international supervisors depending on the situation. We have tested the protocols and procedures with our international counterparts.

The PWG works in cooperation with two other established groups to coordinate preparedness efforts: the public-sector Financial and Banking Information

Infrastructure Committee (FBIIC); and the private-sector Financial Services Sector Coordinating Council (FSSCC). The FBIIC, chaired by the U.S. Department of the Treasury, is comprised of Federal and State financial regulatory agencies, and has coordinated and improved the resilience and security of the financial infrastructure. The FSSCC is comprised of U.S. exchanges, clearinghouses, financial institutions, financial sector trade associations, and regional coalitions, and has coordinated and improved critical infrastructure protection in the financial services sector.

These organizations have responded collaboratively during challenging periods, and they have also worked during calmer times to prioritize threats and test the financial sector's security and resilience. For example, they recently conducted a sector-wide pandemic flu exercise involving almost 3000 financial organizations in the United States that voluntary tested their plans over three weeks.

This overall commitment to financial preparedness by the PWG proved invaluable when challenges subsequently developed in the summer of 2007.

Policy Response to Current Challenges

Current market challenges, like many others before them, developed over a long period of time as complacency about risk built up over many years. Globally, economic growth was strong, businesses were doing well, earnings were healthy and returns to investors good. As a result, investors continuously looked for new investment opportunities, which created increasing demand for all assets, including housing. As prices were bid up, expected returns declined, and in order to maintain returns, investors sought new and more risky alternatives. Throughout the period, due diligence and risk management practices deteriorated. This overarching scenario affected many different asset classes, including housing. As demand for housing slowed, lending standards were gradually loosened to maintain volume. In 2006, the correction in homebuilding began and house price appreciation began to slow. This exposed underlying weaknesses in the mortgage and credit markets.

What began last summer as concerns in housing and credit markets, raised questions about market liquidity in the autumn, and today is raising uncertainty about the real economy.

The Administration and the independent regulators have responded vigorously to manage and minimize the impact of current challenges on the broader economy. Our goal has been to ease the housing correction, provide an economic stimulus and strengthen market discipline. We are making significant progress on all three of these fronts. Let me elaborate on each.

Housing

The Administration's housing market initiatives seek to prevent avoidable foreclosures and increase the availability of affordable mortgage financing. Our key initiatives include FHA Secure, announced by the President in August, and the HOPE NOW Alliance, launched in October at the encouragement of the Treasury. To date, the Federal Housing Administration (FHA) has refinanced more than 170,000 borrowers into affordable loans, and the Hope Now Alliance announced today that nearly 1.4 million homeowners have been helped through workout plans since the middle of last year. We continue to work with the Hope Now Alliance to gauge progress and evaluate ways for further success.

The stimulus package temporarily allows Fannie Mae and Freddie Mac ("the GSEs") to inject more liquidity into the jumbo mortgage market. This action, in conjunction with the recent capital relief from their regulator and the GSEs' pledges to raise additional capital, will enable them to provide further support to homeowners. The GSEs play an important role in housing finance and these recent actions and commitments should have a positive influence on housing markets.

While we are making significant progress, there is more work to be done. Last summer, the President announced three legislative priorities. One of them – forgiving taxes owed on cancelled mortgage debt – was passed and signed into law in December. We are waiting for Congress to act on the other two – FHA Modernization and GSE reform. These additional tools will help more homeowners.

Let me drill down a bit further into housing issues beyond the headlines. First of all, predatory lending is wrong and should be an area of focus during these housing challenges. We believe independent regulators are taking steps to address this issue. Also important to recognize is the reality that many homes begin the foreclosure process every year, even when housing markets are strong. Between 2001 and 2005, for example, the U.S. annual rate of foreclosure starts averaged approximately 1.7 percent, meaning more than 650,000 homeowners began the foreclosure process each year. While we certainly expect foreclosures to rise this year, we must bear in mind the frictional rate of foreclosure that happens every year.

Additionally, data releases every month create headlines about declining housing sales, starts and prices. Yet, declines are exactly what we should expect during a correction. Similarly, credit standards are improving – also, exactly what we should expect. It takes time to work through the excess inventory – but we are. Housing remains the biggest downside risk to the economy right now, but we are seeing some signs of progress. We are working to limit the impact of the housing downturn on the real economy without impeding the completion of the necessary housing correction.

Finally, let me address a topic that has recently received a lot of attention in the media: some people estimate that approximately 10 million homeowners are "underwater" on their mortgages; that is they owe more money than their home is currently worth. Many have suggested that lenders or taxpayers should make people whole for their investment losses. Let me be clear: a house falling in value does not necessarily change one's ability to afford your monthly mortgage payment. For most Americans, a house is not just an investment, it is their home. It is where they raise their children and live in their communities. We strongly believe people should and will continue paying their mortgages regardless of short-term price fluctuations. If investors choose to walk away because they put no money down and their free option is now worthless, we do not believe taxpayers should be held accountable. We are focused on helping homeowners who want to stay in their homes and have the financial wherewithal to do so.

Economic Stimulus

In addition to mortgage efforts, the Administration has also acted aggressively to support the economy as it weathers the housing correction and financial market challenges. The bi-partisan fiscal stimulus package, signed into law by President Bush on February 13, puts money back into the hands of American households and businesses. The package's $150 billion infusion will support the creation of over half a million additional jobs by year-end.

Just today, we are sending the first payments. And within the next few weeks, millions of Americans will receive their stimulus payment. Professionals at the Treasury Department and the IRS are working overtime to send 130 million projected stimulus payments, while simultaneously fulfilling their normal heightened responsibilities for this time of year, which include processing 138 million individual tax returns and issuing over 100 million regular tax refunds.

Strengthening Market Discipline

While we are focused on housing initiatives and stimulus payments, it is not too early to learn from these recent market challenges. Therefore, U.S. policymakers have also initiated a number of near and medium-term efforts to strengthen market discipline and regulatory practices. On March 13, the members of the President's Working Group issued a comprehensive review of policy issues related to recent financial market turmoil. The PWG recommended measures to reform mortgage origination, strengthen risk management, enhance disclosure and improve market discipline in the securitization process, and reform disclosure and use of credit ratings.

As implemented, these recommendations will change behavior and strengthen our markets through greater risk awareness, enhanced risk management, strong capital positions, prudent regulatory policies, and greater transparency. The PWG has committed to measuring progress by the end of this year, so as to ensure the implementation of these recommendations.

Also, the Treasury Department and key U.S. regulators have come together to speak with one unified voice on hedge funds. If we remember back to the fall of 2006, hedge funds were an area of focus among market participants. It was clear that the status quo was not optimal. The PWG responded in February 2007 by releasing principles and guidelines for private pools of capital to guide market participants and regulators. To complement and further improve the effectiveness of these efforts, last autumn the PWG convened a diverse set of leaders from both the asset management and investment communities to form two committees charged with reviewing and enhancing their respective market practices. These two committees released best practices for hedge fund managers and investors just two weeks ago and we look forward to their implementation in the months ahead.

The Regulatory Blueprint Report: Modernizing Financial Regulation

Progress for the financial system is a function of both market discipline and regulatory effectiveness. Our work to ensure the long-term effectiveness, efficiency and competitiveness of U.S. markets is critical to future economic growth and so it will remain a key area of focus throughout our time at Treasury.

Secretary Paulson kicked off this initiative in the fall of 2006 with a keynote address in New York. In March 2007, Treasury hosted a conference on capital market competitiveness at Georgetown University. Conference participants, who included investor and consumer advocates, academics, public policy experts and business leaders, concluded that our current financial regulatory system could more effectively promote stable and resilient markets and a more competitive financial services industry. So, last year we began work on, among things, a Blueprint for a modernized financial regulatory structure that would be more effective and more appropriate for modern financial markets.

Treasury's Blueprint has generated a great deal of discussion since its release on March 31st, , both in publications like yours as well as among market participants and academics. While some pundits characterized our recommendations as either "more" or "less" regulation, both descriptions are a bit simplistic. The goal of the Blueprint was to envision an optimal structure for financial regulation. This is not about more or less regulation; this is about preparing our financial marketplace to be better positioned to bring benefits to our citizens in the 21st century. We need to modernize our regulatory approach to one that is objectives based, globally oriented and flexible in scope.

Treasury's work began by first articulating the optimal regulatory structure, and then developing short- and intermediate-term recommendations that will help move us toward the ideal structure. Along the way we engaged U.S. and international regulators, market participants, consumer and investor advocates, and academics, and received over 200 comments from the public in response to a notice in the Federal Register. What emerged from our work on the Blueprint is a series of short-term, intermediate-term, and long-term recommendations.

The Blueprint outlined a long-term optimal regulatory structure consisting of three regulators, each with a separate objective: a Market Stability Regulator, a Prudential Regulator, and a Business Conduct Regulator. This new structure, an objectives-based approach, improves on today's functional regulation by creating dedicated regulators to address market challenges. While we considered several different conceptual models of regulation, we believe that an objectives-based approach offers the best potential for enhancing regulation, addressing market failures, and eliminating inconsistencies or duplication by creating regulators with clear missions to provide greater consistency and reduce coverage gaps. Although this optimal model is clearly aspirational and will only be achieved in the long-term, we at Treasury believed it was important to begin a discussion by setting forward our view and then engaging with others. In a similar way, two previous studies in 1984 and 1991 ultimately laid the foundation for many of the changes adopted in the Gramm-Leach-Bliley Act of 1999.

In order to move today's regulatory structure in the direction of the optimal structure, the Blueprint makes a number of short- and intermediate-term recommendations. For example, in the short-term the paper recommends:

- Modernizing the President's Working Group on Financial Markets;
- And creating a new Mortgage Origination Commission to evaluate, rate, and

report on the adequacy of each state's system for licensing and regulation of participants in the mortgage origination process.

In the intermediate-term, the Blueprint recommends taking steps such as:

- Creating a federal charter for systemically-important payment and settlement systems;
- Transitioning from the federal thrift charter to a national bank charter;
- Studying the role of federal regulation of state-chartered banks;
- Creating an Optional Federal Charter for insurance;
- And merging the SEC and the CFTC.

Some may view these recommendations as a response to the circumstances of the day; yet, that is not how they were developed or are intended. This Blueprint addresses complex, long-term issues that should not be decided in the midst of current market strains. Nevertheless, current challenges have highlighted the need to modernize our regulatory structure. We believe these recommendations will help ensure the long-term effectiveness, efficiency and competitiveness of our capital markets.

Conclusion

Let me conclude by again thanking you for the invitation to be here today. It is certainly an interesting time for all of us who focus on the economy, current challenges and the appropriate policy response.

In summary, our first priority is to remain vigilant and minimize the impact of current challenges on the broader economy. By historical standards current market disruptions are not out of the ordinary. Our early focus on enhancing financial preparedness helped equip us to respond appropriately and minimize impacts to the broader economy. In recent months, the Federal Reserve Board has taken strong action and we appreciate their leadership.

We are also working to ease the housing correction and real progress is being made. New data released from Hope Now today indicate that almost 400,000 homeowners have received loan modifications since last summer. In December, we announced a plan to fast-track subprime ARM borrowers who could afford their starter rate into refinancings and loan modifications. Hope Now's data shows that 47 percent of loans scheduled to reset in the first quarter paid in full through a refinancing or sale. Another 14,000 received a modification, of which 64 percent were for 5 years or longer.

To be clear, our objective is not maximizing modifications; rather it is minimizing foreclosures for homeowners who want to stay in their homes and have the financial wherewithal to do so. Hope Now's data shows that less than 1 percent of borrowers who were current at reset have entered foreclosure. The industry is proving it has the ability to help able homeowners avoid foreclosure, and we look forward to continued progress in the near future.

Our economy today has slowed after a period of very strong economic growth. Just last fall, GDP growth in the third quarter was 4.9 percent. Since then energy prices, housing correction, and credit contraction have created substantial economic headwinds. The Administration is focused on easing the housing correction and providing an economic stimulus. We are also focused on longer term improvements, such as enhanced market discipline and modernized regulatory policies.

I am often asked where we are in the recovery process, and my response today is that clear progress has been made. We are seeing many signs of improvement and this progress is encouraging. Certainly, there will be continued challenges in the months ahead. However, we have worked through challenges in the recent past and I have great confidence in the resilience and strength of our economy. As a result of our efforts, I expect our economy to emerge even stronger.

(1) Kindleberger, Charles and Robert Aliber; *Manias, Panics and Crashes: A History of Financial Crises*; (2005).

(2) Reinhart, Carmen and Kenneth Rogoff; "This Time is Different: A Panoramic View of Eight Centuries of Financial Crises"; NBER Working Paper #13882; March, 2008.

(3) Kindleberger, Charles and Robert Aliber; *Manias, Panics and Crashes: A History of Financial Crises*; (2005); pg 2-3.

(4) Harris Interactive Poll, May 2006.

(5) Reinhart, Carmen and Kenneth Rogoff; "This Time is Different: A Panoramic View of Eight Centuries of Financial Crises"; NBER Working Paper #13882; March, 2008.

(6) Kindleberger, Charles and Robert Aliber; *Manias, Panics and Crashes: A History of Financial Crises*; (2005); pg 21-29.

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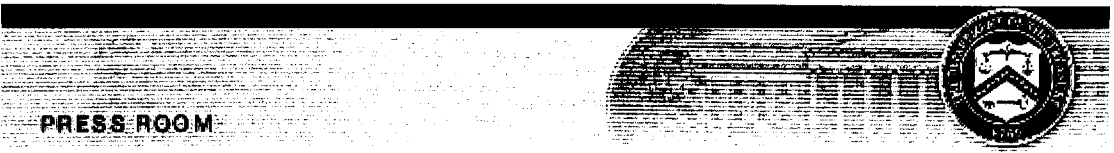

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April 28, 2008
hp-949

Paulson Approves Stimulus Distribution Plan, Payments for American Samoa, Guam, U.S. Virgin Islands, Commonwealth of the Northern Mariana Islands

Washington, DC--Treasury Secretary Henry M. Paulson, Jr. today approved the stimulus distribution plan and payment amount for American Samoa, and payments amounts to Guam, the U.S. Virgin Islands, and the Commonwealth of the Northern Mariana Islands.

As required by the Economic Stimulus Act of 2008, the Secretary of the Treasury had to approve distribution plans for "non-mirror code" territories (Puerto Rico and American Samoa), and payment amounts to territories with "mirror codes" (Guam, U.S. Virgin Islands, and the Commonwealth of the Northern Mariana Islands). Puerto Rico's distribution plan was approved on April 16, 2008.

Copies of the approval letter for the American Samoa plan, as well as payment amount approval letters for the remaining territories are attached.

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REPORTS

- Paulson Letter to American Samoa
- Paulson Letter to Guam
- Paulson Letter to U.S. Virgin Islands
- Paulson Letter to Commonwealth of Northern Mariana Islands

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

SECRETARY OF THE TREASURY

April 28, 2008

The Honorable Togiola T.A. Tulafono
Governor of American Samoa
Office of the Governor
Executive Office Building – Third Floor
P.O. Box 485
Pago Pago, American Samoa 96799

Dear Governor Tulafono:

Thank you for your letter of April 23, 2008, submitting the Distribution Plan for the Recovery Rebates (the Plan) in American Samoa. The Economic Stimulus Act of 2008, P.L. 110-185 (the Act), requires that I approve American Samoa's plan for distributing stimulus payments to residents of American Samoa. The Act also requires that once such a plan is approved, the Treasury Department make a payment to American Samoa in an amount estimated as being equal to the aggregate benefits that would have been provided to residents of American Samoa by reason of the amendments made to the Internal Revenue Code by section 101(c) of the Act if a "mirror code" tax system had been in effect in American Samoa.

In accordance with the Act, I approve the Plan, a copy of which is enclosed. Also, we have estimated the aggregate benefits that would have been provided to residents of American Samoa by reason of section 101(c) of the Act if a mirror code tax system had been in effect in American Samoa at $20.4 million. A payment in this amount will be made by the Treasury Department to American Samoa to fund the prompt distribution of stimulus payments to residents of American Samoa pursuant to the Plan.

Sincerely,

Henry M. Paulson, Jr.

Enclosure

AMERICAN SAMOA
TREASURY DEPARTMENT

2008

DISTRIBUTION PLAN FOR THE

<u>RECOVERY REBATES</u>

Togiola T.A. Tulafono
Governor of American Samo

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1 Introduction

This Plan for the Distribution of Recovery Rebates has been developed by the American Samoa Treasury Department ("ASTD") and approved by the U.S. Secretary of the Treasury, pursuant to the requirements in Section 101(c) of the Economic Stimulus Act of 2008, Pub. L. 110-185 (the "Act"). The Act establishes that in order for American Samoa to be able to receive funds from the U.S. Department of the Treasury for the distribution to its residents of the recovery rebates authorized in the Act, American Samoa must have a plan, approved by the Secretary of the Treasury, under which American Samoa will promptly distribute the recovery rebates to its residents.

Section 101(c) (1)(B) of the Act establishes that the payment to be made by the U.S. Secretary of the Treasury to American Samoa will be "in an amount estimated by the Secretary as being equal to the aggregate benefits that would have been provided to residents of American Samoa by reason of the amendments made by this section if a mirror code tax system had been in effect in such possession." The Act does not prescribe any specific rules as to how the funds are to be distributed to residents of American Samoa. The Act simply states that funds have to be distributed "promptly," keeping in line with the overall economic stimulus purposes of the legislation. It is in the interest of both American Samoa and the U.S. Department of the Treasury that all funds made available to American Samoa be distributed promptly through rebate payments.

American Samoa has adopted as its income tax laws the income tax laws in force in the United States on December 31, 2000. For example, the tax rates, standard deduction, and personal exemption in American Samoa are the same as they were in the U.S. Internal Revenue Code in force on December 31, 2000 (2000 U.S. Code). However, American Samoa has added to the 2000 U.S. Code a minimum income tax of 4 percent of adjusted gross income on individuals. As a result of the similarity between the income tax laws of American Samoa and the United States, American Samoa will generally be able to determine the recovery rebate that its residents would have been eligible to receive by reason of the amendments made by the Act if a mirror code tax system had been in effect in American Samoa. Consequently, this Plan establishes a plan for distribution of the recovery rebates to residents of American Samoa based on the same eligibility requirements as the Act provides for residents of the U.S. mainland, with two minor amendments to reflect the definition of "gross income" and "earned income" in the American Samoa income tax laws.

American Samoa
Treasury Department
Plan for the Distribution – Recovery Rebates

This Plan establishes a procedure for the distribution of advance payment of rebates using information from 2007 income tax returns that were filed in 2008. ASTD will use 2008 income tax returns filed in 2009 to make final rebate payments to eligible individuals. American Samoa will make advance rebate payments for timely filed 2007 tax returns in calendar year 2008 and make final rebate payments for timely filed 2008 tax returns in 2009. American Samoa will resolve disputes with respect to these rebates by December 31, 2010.

All tax references in the Plan are to the American Samoa income tax laws, unless otherwise specified.

2 Definitions

For purposes of recovery rebates, the following definitions apply:

a. Net income tax liability. The term "net income tax liability" means the excess of the taxpayer's individual income tax liability over nonrefundable credits as determined under the American Samoa tax laws with adjustments to reflect the individual income tax rates, personal exemption and standard deduction provided in the Internal Revenue Code of 1986, as amended (IRC).

b. Earned income. The term "earned income" means wages, salaries, tips and other employee compensation included in gross income, the amount of net income from self employment reported on the Form 390 (American Samoa Individual Income Tax Return), and combat zone pay excluded from American Samoa gross income, but reported in a W-2 form filed with the taxpayer's income tax return.

c. Social Security benefit. The term "social security benefit" means any amount received by the individual as a monthly benefit under title II of the Social Security Act or a tier 1 railroad retirement benefit. The term "social security benefit" does not include any benefits as a result of the Supplemental Security Income ("SSI") or Aid to the Aged, Blind and Disabled ("AABD") programs.

d. Veterans benefit. The term "veteran's benefit" means any disability, pension, or survivor's benefit received under chapters 11, 13, or 15 of the title 38 of the United States Code.

e. Joint return. The term "joint return" means a tax return filed with the ASTD by married taxpayers using the "Married living with spouse and filing jointly" filing status as defined in the American Samoa income tax laws.

f. Combat zone pay. The term "combat zone pay" means remuneration for serving in the U.S. Armed Forces in a combat zone, which is any area that the President of the United States designates by Executive Order as an area in which the U.S. Armed Forces are engaging or have engaged in combat.

g. Recovery Rebate. The term "Recovery Rebate" means the sum of the Basic Recovery Rebate (defined in Section 3.3) and Child Recovery Rebate (defined in Section 3.4) for which an individual is eligible.

3 Determination of Eligibility and Amount of Recovery Rebate

3.1 *Eligible Individuals*

Any individual who is a resident of American Samoa, under the American Samoa income tax laws, other than:

a. An estate or trust, or

b. An individual who is eligible to be claimed as a dependent on another American Samoa income tax return or a U.S. income tax return.

3.1.1 *Identification requirement*

To be eligible for the Basic Recovery Rebate, an individual must file a tax return with a valid social security number issued by the Social Security Administration for said individual, the spouse if a joint return is filed, and any children for whom a Child Recovery Rebate will be paid. The absence of valid social security numbers for dependent children will not disqualify an individual from receiving the basic rebate to which he or she is entitled. Anyone filing using an Individual Taxpayer Identification Number will be ineligible for a rebate.

3.2 *Filing obligation*

In order to be eligible to receive a Recovery Rebate, eligible individuals are required to file an individual income tax return for the year they are claiming the Recovery Rebate, even if the individual would not have otherwise had an income tax filing obligation (e.g., certain Social Security benefit recipients).

3.3 *Basic Recovery Rebate*

3.3.1 Amount

The "Basic Recovery Rebate" for an eligible individual is equal to the greater of:

a. Net income tax liability up to $600 ($1,200 for a joint return); or

b. $300 ($600 for a joint return) if the individual satisfies one of the following criteria:

   i. The sum of earned income, social security benefits and veterans benefits is at least $3,000, or

ii. Net income tax liability is greater than zero and gross income is greater than the sum of the standard deduction and personal exemption.

For this purpose, the American Samoa income tax law shall be used to determine the amount of the Basic Recovery Rebate with the following modifications: a taxpayer's income tax liability shall be determined using the tax rates, personal exemption and standard deduction provided in the IRC for the relevant tax year.

3.4 *Child Recovery Rebate*

3.4.1 Eligibility

The Child Recovery Rebate (as defined in section 3.4.2) may be claimed only by an individual eligible to receive a Basic Recovery Rebate greater than zero.

3.4.2 Amount

The "Child Recovery Rebate" is equal to $300 for each qualifying child of the eligible individual.

3.4.3 Qualifying child

For purposes of the Child Recovery Rebate, the term "qualifying child" has the same meaning as the term has in section 24(c) of the IRC.

3.5 *Limitation on Recovery Rebates*

The combined amount of the Basic and Child Recovery Rebates shall be reduced, but not below zero, by five percent of the taxpayer's adjusted gross income as determined under the American Samoa income tax laws that exceeds $75,000 ($150,000 in the case of a joint return).

3.6 *Special Rules*

3.6.1 Exclusion from income

Any payment attributable to Recovery Rebates shall not be taken into account as taxable income.

3.6.2 Joint returns

In the case of an Advance Payment made with respect to a joint return, half of the amount shall be treated as having been made or allowed to each individual filing such return.

3.6.3 Federally funded programs

Any payment attributable to Recovery Rebates shall not be taken into account as resources for the month of receipt and the following two months, for purposes of determining the eligibility of any individual for benefits or assistance, or the amount or extent of benefits or assistance, under any Federal program or any program financed in whole or in part with Federal funds.

3.6.4 Offsets by ASTD for debts to ASTD

The ASTD shall deduct or offset from the Basic and Child Recovery Rebates to an individual any allowable offsets under American Samoa law for tax refunds.

3.6.5 No offsets by taxpayers

Taxpayers shall not deduct any anticipated rebate amounts from their tax liability to the ASTD for any tax year.

3.6.6 Fraud or mistake

If any taxpayer receives a Recovery Rebate from the ASTD based on incorrect information provided by the taxpayer or information omitted by the taxpayer as a result of either fraud or mistake, or if the taxpayer is otherwise not eligible for a rebate paid to him or her by the ASTD, the ASTD may claim such incorrectly paid rebate from the taxpayer through any method available to the ASTD to collect debts from taxpayers, and any amount recovered from the taxpayer, except interests and penalties, shall be deposited in the Recovery Rebate Fund.

4 Advance Payment of Recovery Rebates

4.1 *Determination of Advance Payment*

ASTD shall make a payment to eligible individuals in the amount of the Recovery Rebate (less any applicable offsets) that each individual would have been allowed if the provisions of section 3 were effective for 2007 ("Advance Payment"). The amount of the Advanced Payment will be based on valid 2007 American Samoa individual income tax return information available as of November 30, 2008.

4.2 *Filing Obligation*

In order to be eligible to receive an Advanced Payment, eligible individuals are required to file a 2007 individual income tax return.

4.3 *Timing of Payment*

4.3.1 Timely returns

Advanced Payments based on 2007 individual income tax returns filed on or before April 15, 2008 will be processed for payment by the ASTD between May 1, 2008 (but not before American Samoa receives the payment for the estimated aggregate recovery rebate benefits from the U.S. Department of the Treasury) and July 31, 2008.

4.3.2 Late returns

Advanced Payments based on 2007 individual income tax returns filed after April 15, 2008 but on or before November 30, 2008 will be paid by the ASTD by December 31, 2008. ASTD will not make Advanced Payments for 2007 tax returns filed after November 30, 2008 and will not make any Advanced Payments after December 31, 2008. For 2007 tax returns filed after April 15, 2008, Advanced Payments will be handled on a first come, first serve basis until the balance of the Recovery Rebate Fund is zero.

5 Final Payment of Recovery Rebates

5.1 *Determination of Final Payment Amount*

The ASTD shall make a final payment of Recovery Rebates ("Final Payment") to eligible individuals who file 2008 American Samoa individual income tax returns by October 15, 2009 (or later in the case of eligible military personnel, as described in Section 5.3.2). The Final Payment will be the difference between the Recovery Rebate that each individual would have been allowed if the provisions of Section 3 were effective for the 2008 tax year and the amount the taxpayer was paid as an Advance Payment; however, an eligible individual's Final Payment will be net of any applicable offsets. Individuals who were eligible for a greater Recovery Rebate based on their 2007 information (compared to what they would be eligible for based on their 2008 information) will not be required to return any funds.

5.2 *Filing obligation*

In order to be eligible to receive a Final Payment, eligible individuals are required to file a 2008 individual income tax return on or before October 15, 2009.

5.3 *Timing of Payment*

5.3.1 Timely returns

Final Payments based on 2008 individual income tax returns filed on or before April 15, 2009 will be processed for payment by the ASTD between May 1, 2009 (but not before American Samoa receives the payment for the estimated aggregate recovery rebate benefits from the U.S. Department of the Treasury) and July 31, 2009.

5.3.2 Late returns

Final Payments based on 2008 individual income tax returns filed after April 15, 2009, but on or before October 15, 2009 will be paid by the ASTD between July 1, 2009 and December 31, 2009. The ASTD will not make any Final Payments based on 2008 individual income tax returns filed after October 15, 2009 and will not make any Final Payments after December 31, 2009, except in the case of certain military personnel.

For 2008 tax returns filed after April 15, 2009, Final Payments will be handled on a first come, first serve basis until the balance of the Recovery Rebate Fund is zero.

American Samoa
Treasury Department
Plan for the Distribution – Recovery Rebates

A reserve will be created to pay any rebates that can be claimed by individuals that are permitted to file their 2008 tax returns after October 15, 2009 as provided in the Internal Revenue Code section 7508 and the American Samoa tax laws because they are serving in the military in active duty outside of the United States.

6 Coordination with U.S. Government

6.1 *Dual Filers*

Individuals eligible to receive a Recovery Rebate from the ASTD are not eligible to receive a recovery rebate from the U.S. Department of the Treasury.

6.2 *Information Sharing*

The ASTD will provide the IRS, on a monthly basis, in electronic format, the following information for individuals receiving a Recovery Rebate from ASTD during the previous month:

a. Name of rebate recipient and spouse;

b. Social security number of rebate recipient, spouse and dependants for whom a child credit is claimed;

c. Address of rebate recipient;

d. Amount of recovery rebate and child credit issued;

e. Date of issuance of rebate; and

f. Filing Status of rebate recipient.

ASTD will transmit the monthly reports by the 15th day, following the close of the month.

Any exchange of taxpayer information between ASTD and the IRS will be conducted under the Tax Implementation Agreement Between the United States and American Samoa date January 7, 1988 or as otherwise authorized by law.

7 Recovery Rebate Fund

7.1 *Establishment of Trust Fund*

The Secretary of the ASTD has established a trust fund at the Bank of Hawaii, Pago Pago Branch, herein referred to as the "Recovery Rebate Fund."

a. Amounts received from the U.S. Secretary of the Department of the Treasury to cover the estimated aggregate cost of the Recovery Rebates paid by the ASTD shall be deposited in the Recovery Rebate Fund.

b. The balance of the Recovery Rebate Fund shall be reduced by withdrawals equivalent to payments made by the ASTD of recovery rebates.

c. Overpayments of Recovery Rebates reclaimed by the ASTD shall be deposited in the Recovery Rebate Fund.

d. The Recovery Rebate Fund shall have no authority to borrow.

e. The funds received by the ASTD from the U.S. Department of the Treasury shall be used exclusively for the payment of Recovery Rebates, and not for administrative expenses.

f. Any interest generated by funds in the Recovery Rebate Fund shall not be credited to the Recovery Rebate Fund and may be deposited in a separate account of the ASTD at the Bank of Hawaii. If the funds in the Recovery Rebate Fund are extinguished, however, and there are individuals eligible to receive Recovery Rebates that have not received the amount to which they are entitled under this Plan, the ASTD shall deposit into the Recovery Rebate Fund any interest earned on the amount received from the U.S. Department of the Treasury that would be necessary to pay rebates that cannot otherwise be paid with the funds remaining in the Recovery Rebate Fund.

g. The ASTD shall submit to the U.S. Department of the Treasury quarterly reports indicating the amount of funds in the Recovery Rebate Fund, the amount of funds paid in rebates during such quarter, and the amount of offsets during such quarter. Quarterly reports shall be submitted within 45 days of the end of a quarter. Quarters will be January to March, April to June, July to September and October to December.

7.2 *Return of Unused Amounts*

The remaining balance of the Recovery Rebate Fund less the reserve to pay any rebates that can be claimed by individuals that are permitted to file their 2008 tax returns after October 15, 2009 (as described in Section 5.3.2) shall be returned to the Secretary of the U.S. Department of the Treasury without interest by December 31, 2010. ASTD will certify to the Secretary of the U.S. Department of the Treasury the amount of the reserve needed as of December 31, 2010 to pay rebates to individuals who are permitted to file their 2008 tax returns after October 15, 2009 as provided in the Internal Revenue Code section 7508 and the American Samoa tax laws because they are serving in the military in active duty outside of the United States. Any reserve remaining in the Recovery Rebate Fund on June 30, 2011 shall be returned to the Secretary of the U.S. Department of the Treasury without interest on June 30, 2011.

7.3 *Liability of the United States*

Consistent with Section 101(c) of the Act, the U.S. Department of the Treasury will make one estimated payment to ASTD; U.S. Department of the Treasury will not be liable for any payments or adjustments beyond the single estimated amount. The parties to this agreement recognize that the United States has not waived its sovereign immunity for a suit by either American Samoa or the residents of American Samoa in connection with Recovery Rebates paid or payable to either *American Samoa or its residents.*

8 Claims and Disputes

8.1 *Claims*

Any claim or dispute will be handled by the Tax Office staff of the ASTD. If the claim or dispute cannot be resolved by the Tax Office staff a meeting with the Tax Manager will be granted. If the Tax Manager is unable to resolve the issue, the taxpayer may file an action with the High Court of American Samoa to resolve the dispute. If an additional recovery rebate is claimed and determined to be owed, a second rebate check will be issued by ASTD.

8.2 *Best Effort*

The dates included in this Plan for distribution of Advance Payments and Final Payments are target dates, but given the accelerated schedule for the same, it is understood that there are various circumstances, unforeseen at the time of approval of this Plan that could affect the timing of payments. Accordingly, these dates represent the estimated dates for distribution of rebates based on best efforts as can calculated in advance of this first time ever program. There shall be no liability or claim for interest against the ASTD for failure to meet the target dates established herein.

8.3 *No interest*

No individual shall be entitled to receive any kind of interest by reason of receiving a rebate as a result of a claim or otherwise.

9 Functional Plan for Distribution of Recovery Rebates

The ASTD Tax Office has established an internal team of senior and information technology management officials that are responsible for carrying out the contents of this plan including the following activities:

9.1 *Identification of Eligible Individuals*

The ASTD Tax Office will systemically identify individuals eligible for a recovery rebate based on their 2007 tax return filed in 2008, using its information technology system. The process will include using the applicable tax rates, personal exemption, standard deduction amounts provided in the IRC. Social security and veterans benefit recipients will be included in this process. This systemic identification will be thoroughly tested and validated before initiating the calculation and distribution of advance recovery rebates.

9.2 *Disbursement*

The ASTD Disbursing Office will begin printing and distributing recovery rebate checks within ten (10) days following the date it receives funds (see section 7.1.a) from the U.S. Department of the Treasury.

The ASTD Disbursing Office will begin printing and distributing rebate checks within 10 days following the date it receives funds (see section 7.1.a) from the US Treasury.

Eligible individuals will claim their recovery rebate at the ASTD Disbursing Office and will be required to show some photo identification. Checks are not mailed to American Samoan residents since street addresses are not existent and PO boxes are unreliable.

Most residents of American Samoa who file a 2007 income tax return will be eligible for a recovery rebate. Eligible residents will receive their income tax refund first and afterwards can claim their recovery rebate check.

9.3 *Disbursement Control*

Criteria (e.g., last digit of the Social Security number, last name) will be developed to issue recovery rebate payment on an orderly schedule so to avoid having crowds at the ASTD Disbursing Office every weekday.

10 Outreach Plan

The ASTD Tax Office has communicated with and will continue to communicate with the local media via radio, television, newspaper and its webpage to explain the rebate eligibility and process.

The ASTD Tax Office will issue public communications that outlines the criteria and schedule for refund and rebate check issuance.

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

SECRETARY OF THE TREASURY

April 28, 2008

The Honorable Felix P. Camacho
Governor of Guam
Office of the Governor of Guam
P.O. Box 2950
Hagatna, Guam 96932

Dear Governor Camacho:

Thank you for Acting Governor Cruz's letter of April 25, 2008, submitting the 2008 Guam Economic Stimulus Plan (the Plan). The Economic Stimulus Act of 2008, P.L. 110-185 (the Act), requires that the Treasury Department make a payment to Guam in an amount equal to the loss to Guam by reason of the amendments made by section 101(c) of the Act.

In accordance with the Act, we have estimated the loss to Guam by reason of the Act to be $52.5 million. A payment in this amount will be made by the Treasury Department to Guam to fund the prompt distribution of stimulus payments to residents of Guam pursuant to the Plan.

Sincerely,

Henry M. Paulson, Jr.

DEPARTMENT OF THE TREASURY

WASHINGTON, D.C.

SECRETARY OF THE TREASURY

April 28, 2008

The Honorable John P. de Jongh, Jr.
Governor of the United States Virgin Islands
Office of the Governor
Government House
Charlotte Amalie, VI 00802

Dear Governor de Jongh:

Thank you for your letter of April 24, 2008, submitting the Economic Stimulus Act of 2008 Implementation Plan (the Plan) for the United States Virgin Islands. The Economic Stimulus Act of 2008, P.L. 110-185 (the Act), requires that the Treasury Department make a payment to the United States Virgin Islands in an amount equal to the loss to the United States Virgin Islands by reason of the amendments made by section 101(c) of the Act.

In accordance with the Act, we have estimated the loss to the United States Virgin Islands by reason of the Act to be $41.5 million. A payment in this amount will be made by the Treasury Department to the United States Virgin Islands to fund the prompt distribution of stimulus payments to residents of the United States Virgin Islands pursuant to the Plan.

Sincerely,

Henry M. Paulson, Jr.

PRESS ROOM

April 28, 2008
HP-950

Statement for the Treasury Borrowing Advisory Committee of the Securities Industry and Financial Markets Association

Washington, DC--Economic growth slowed considerably in the first part of 2008, with consumer and business spending affected by the housing downturn, credit market disruption, and the impact of high energy prices. These headwinds are expected to be offset in part by the stimulus payments and investment incentives enacted in February as part of the Economic Stimulus Act of 2008. Even so, the U.S. economy is likely to grow at a rate below trend and the labor market to remain soft throughout the year.

Real GDP grew at an annual rate of just 0.6 percent in the fourth quarter of 2007, and data released so far indicate that growth remained quite sluggish in the first quarter of 2008. The advance estimate of first quarter GDP will be released on April 30.

Household spending has been affected by a weaker job market, declining wealth from housing and equity markets, and rising energy costs. Real personal consumption expenditures were flat in February after having risen only slightly in January. Together with lackluster retail sales in March, it appears likely that consumer spending slowed considerably in the first quarter from the 2.3 percent annual rate posted in the fourth quarter.

Labor market conditions deteriorated in the first quarter after the job market had broadly slowed in the second half of 2007. The unemployment rate reached a 2-1/2-year high of 5.1 percent in March, after averaging 4.6 percent over 2007. Nonfarm payrolls fell by about 77,000 per month on average in the first quarter – the first quarterly decline in payrolls since August 2003.

Housing market indicators point to another large decline in real residential investment in the first quarter, following a drop of 25 percent at an annual rate in the fourth quarter of 2007. Housing starts fell to a 17-year low in March, with starts of single-family homes down by 63 percent from the January 2006 peak. Sales of new single-family homes also fell to a 17-year low in March and existing single-family home sales in March were near the lowest point in the past 10 years. Prices for purchased homes edged up slightly in February according to figures from the Office of Federal Housing Enterprise Oversight (OFHEO), but remained 2.4 percent lower than a year earlier. Other measures such as the Case-Shiller indices indicate as well that home prices are declining in most major U.S. cities. Widespread weakness in the housing data reflects the fact that the U.S. is undergoing a necessary housing correction following years of what were, in retrospect, unsustainable house price increases.

Housing appears likely to subtract a full percentage point or more from growth in 2008 after taking off nearly as much in 2006 and 2007. Inventories of unsold homes are at historically high levels, building permits remain well below starts, and homebuilder optimism is close to an all-time low. Mortgage delinquencies and foreclosures are projected to rise further in 2008; the additional foreclosures will slow the process of working through the inventory overhang and in turn put additional downward pressure on home prices.

Business investment growth appears to have slowed in the first quarter of 2008 from the 6 percent pace in the fourth quarter of last year. Shipments of nondefense capital goods excluding aircraft--a key input into equipment and software spending in the national income and product accounts--rose 1.2 percent in March, partly retracing February's 1.6 percent decline. Private nonresidential construction declined for three consecutive months through February. Tighter credit conditions are likely to affect business spending going forward.

Export growth remains a bright spot in the outlook. Real exports were up 8.4 percent during the four quarters of 2007, the second straight year of more than 8 percent growth. Data for early 2008 suggest that export growth remains strong. Real imports rose by 1 percent over the four quarters of 2007. Nominal data through February suggest that import growth accelerated in the first part of 2008, with much of the increase reflecting the rising value of petroleum imports. The wider trade deficit through February means that net exports are likely to add less to first-quarter real GDP growth than was the case in the second half of 2007, when trade contributed more than 1 percentage point to real GDP growth.

Headline inflation has picked up with energy and food prices, but measures of core inflation remain contained. Overall consumer price inflation reached 4 percent in the twelve months ending in March, up from 2.8 percent a year earlier. Energy prices started to climb rapidly last fall, with the front-month futures price of light sweet crude oil topping the $100 per barrel mark for the first time in February and averaging above $117 per barrel in late April. Food prices are up 4.5 percent over the year ending in March, up from food price inflation of 3.3 percent a year ago. Despite the pickup in headline inflation, core inflation remains within the narrow range that has prevailed over the past four years. The core consumer price index, which excludes food and energy prices, rose 2.4 percent over the year ended in March, compared to 2.5 percent a year ago. Rising inflation eroded the 3.6 percent increase in nominal average hourly earnings and meant that real wage growth turned negative in late 2007, with real wages down by 0.6 percent through the 12 months ending in March.

Economic growth appears to have remained sluggish in the second quarter to date, with the labor market deteriorating further. Initial claims for unemployment insurance have continued to rise, with the four-week average of new claims up to around 370,000 in mid April from an average of 351,000 in the first quarter. Consumer sentiment fell to a 26-year low in April, and homebuilder confidence remained near a record low. Regional measures of manufacturing activity point to broadly flat factory activity in April.

The Economic Stimulus Act of 2008 will provide an important boost to GDP in the second half of the year: more than $150 billion in payments to individuals and business tax relief this year, with the first payments going to consumers this week. These stimulus payments are expected to provide significant support to household and business spending in the middle of the year.

Other policy actions of the Administration have been aimed at helping individual homeowners affected by the housing market downturn. These include measures to help increased numbers of families to refinance their mortgages into fixed-rate products guaranteed by the Federal Housing Administration (FHA); since August, FHA has helped more than 170,000 homeowners refinance. The Administration has also worked with the HOPE NOW Alliance on measures being taken by private lenders to prevent avoidable foreclosures in cases where borrowers have the desire and financial wherewithal to afford their home in a more suitable mortgage product. These efforts have produced meaningful results: HOPE NOW announced in April that about 1.2 million struggling homeowners have received either a loan modification or repayment plan since July 2007 to help them stay in their homes. Preventing avoidable foreclosures limits further increases in the inventory of unsold homes, which would otherwise extend the housing correction. Legislative action on FHA modernization and GSE reform would assist additional homeowners and strengthen the financial sector and thus the overall U.S. economy.

In sum, the economy faces strong headwinds, as the housing correction, high energy prices, and strains in financial markets will continue to weigh on growth through 2008. Tax rebates and investment incentives in the Economic Stimulus Act of 2008 will support consumer and business spending in the middle of the year. A resumption of strong and sustainable growth, however, requires that the U.S. economy work through the corrections in housing and credit markets.

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PRESS ROOM

April 29, 2008
hp-951

Assistant Secretary for Financial Institutions David G. Nason
Remarks on Treasury's Blueprint for a Modernized Regulatory Structure

London - Chairman Julius, thank you for that kind introduction. It is a pleasure to be here for the New Financial Frontiers conference. The Chatham House, as home to the Royal Institute of International Affairs, has served its mission well to foster debate and ideas on important international policy matters for over 80 years. I am honored to be here with this distinguished group of conference speakers and participants and to have the opportunity to contribute to this discussion on financial markets.

I would like to spend my time today in two ways. First, I would like to give an update as to how we see things progressing in the U.S. financial markets. Limiting the impact of the capital market turmoil and housing downturn on the rest of the economy has been and will continue to be our primary focus. Secretary Paulson often says that stable and orderly financial markets are critical to the health of our economy – businesses rely on access to credit in order to invest and create jobs, and families draw on credit markets to finance their homes and daily lives.

Second, I would like to discuss Treasury's recently-released *Blueprint for a Modernized Financial Regulatory Structure*, its approach to addressing long-term challenges with the U.S. regulatory structure and how they connect with current market regulation.

Financial Markets

As we all know, the financial markets stress began last summer. The root causes of the stress are well documented. The turmoil in financial markets was born from a dramatic weakening of underwriting standards for U.S. mortgages, especially subprime mortgages, beginning in late 2004 and extending into early 2007.

The loosening of credit terms in the subprime market was symptomatic of a much broader erosion of market discipline on the standards and terms of loans to households and businesses. Following many years of benign economic conditions and plentiful market liquidity, global investors had become complacent about risks, even in the case of new and increasingly complex financial instruments.

The confluence of many events led to a significant credit contraction and repricing of risk. Sentiment swung hard to risk aversion with perhaps one of the most dramatic series being the events that led to JPMorgan Chase acquiring Bear Stearns.

Our policy makers and central banks have been working diligently to respond. The U.S. Federal Reserve has provided additional liquidity by amending some of its existing policy tools and creating new facilities when needed. The Federal Open Market Committee has lowered the federal funds target rate by 300 basis points since August 2007, to help soften the negative impact of the recent financial market disturbance has on the real economy.

Additionally, the Federal Reserve in coordination with the European Central Bank and Swiss National Bank has provided additional liquidity through a dollar swap facility to help address dollar funding pressures outside of the United States. Other liquidity enhancing measures by the ECB as well as the Bank of England through its recently announced long term debt swap facility have and will continue to help address the acute funding pressures that continue to persist.

As the Federal Reserve helped to resolve the Bear Stearns situation, it

subsequently took a very important and consequential action of instituting a temporary program for providing liquidity to primary dealers. Taking this step in a period of stress recognizes the changed nature of our financial system and the role played by investment banks. Such direct lending from the central bank to non-depository institutions has not occurred in the United States since the 1930s. The Federal Reserve's creativity in the face of new challenges deserves praise, but the circumstances that led the Federal Reserve to modify its lending facilities raises significant policy considerations that we must address.

If we pause and examine where our markets stand today, the story is mixed.

There are certainly some encouraging trends such as the narrowing of both commercial and investment bank credit default swap spreads. Also, financial institution equity prices have stabilized largely as a result of institutions recognizing their losses and raising additional capital. This improves market confidence and allows banks to continue to extend the lending necessary for economic growth.

Our largest institutions have gone to market to raise additional capital. Since December of last year, financial institutions have raised more than $175 billion in capital. Importantly, this investment is helping to facilitate price discovery in markets that are suffering from significant illiquidity. We would like to see smaller institutions raise capital as well.

Of course, some trends are not as encouraging. The interbank financing market is still strained and many securitization markets have not revived in a material fashion.

The Treasury Department has worked to decrease the chances that the current challenges will happen again. Treasury, in conjunction with other regulatory bodies, has developed policy responses to begin to address the ongoing crisis of confidence in our markets.

The President's Working Group on Financial Markets (PWG), led by Secretary Paulson, is composed of the Chairmen of the Federal Reserve, Securities and Exchange Commission (SEC), and the Commodity Futures Trading Commission. The PWG is working closely with the Financial Stability Forum (FSF), composed of regulators, finance ministries, and central banks from the world's largest and most significant economies. The PWG and FSF have proposed sets of separate but consistent ways to address the root causes of current market instability. These are specific ideas to deal with some of these challenges within our current regulatory regimes.

Blueprint for a Modernized Financial Regulatory Structure

In the United States, we are at the beginning of a journey to more fundamental change regarding financial services regulation. Since the focus of the conference is on managing risk and the new financial frontiers, I would like to spend the rest of my time talking about a structure that is better suited to deal with the 21st century financial services markets. Just a few weeks ago Treasury released a *Blueprint for a Modernized Financial Regulatory Structure*, addressing these topics with a series of short, intermediate and long-term recommendations. While this project started more than a year ago, not in response to current market events, there is no question that recent events have transformed these issues from the theoretical to the practical.

For the optimal regulatory structure in our long-term recommendation we started with a blank slate. We thought about the best approach to U.S. financial services regulation. We studied closely regulatory structures in other jurisdictions; we spoke to and reviewed hundreds of comment letters from market participants and regulators worldwide, including our counterparts in the United Kingdom.

After this process, Treasury decided that the optimal regulatory structure would be an objectives-based approach, an approach with individual regulators focused on three key objectives: market stability regulation; prudential regulation, focused on institutions with reliable access to a government backstop or subsidy; and business conduct regulation, focused on consumer protection and disclosure issues.

Our recommendation for a market stability regulator garnered significant interest in

both in the United States and abroad. In Treasury's model, a market stability regulator would address overall conditions of financial market stability that could impact the real economy. This regulator would have authorities to focus market stability regulation in areas where financial markets may not function properly, to provide information to enhance the functioning of financial markets, and to provide authority to take actions should the need arise.

Typically, a market stability role is associated with the central bank. Most central banks have a general responsibility to achieve macroeconomic stability through the formation of monetary policy. In the United States, the Federal Reserve plays this role with the goal of promoting overall macroeconomic stability in terms of output and prices. In normal economic conditions, market stability and macroeconomic stability should go hand in hand. But, as the current conditions in credit markets and other past episodes of financial instability illustrate, the traditional toolbox of monetary policy and the regulatory framework associated with financial institutions might not be well-suited to deal with transmission of financial shocks to the real economy in today's financial markets.

We recommended recasting the role of the Federal Reserve as our market stability regulator to expand its assessment and authority over potential risks in the overall financial system, including correlations and common exposures across financial institutions. This contrasts with its existing regulatory authority that focuses primarily on the health of individual financial institutions. This new responsibility can be referred to as "macro-prudential regulation" and the latter as "micro-prudential regulation".

Undoubtedly, the tasks of the market stability regulator would be difficult. Some have likened it to an impossible task of piercing asset bubbles or having an omnipresent view of risk in the financial system. To be clear, we do not view it in that manner. We do not believe that we can eliminate all future bouts of financial instability.

In a dynamic market economy it is impossible to eliminate instability through regulation. At a fundamental level, the root causes of market instability are difficult to predict, and past history may be a poor predictor of future episodes of instability. Nonetheless, we should not stop trying to understand better and mitigate instability. Yes, the task is difficult, but the task remains.

So exactly what would this new Federal Reserve do? It is interesting to note that this current period in financial market stress has created an important change in vocabulary. For years, public policy makers have struggled with the notion that certain institutions could be deemed "too big to fail". Now, we should consider whether certain firms are "too interconnected to fail".

Interconnectedness occurs in formal markets or in more informal networks of trading in financial instruments. These networks or trading mechanisms are essential to the free movement of capital and efficient disbursement of risk. The network structure is much like an airline hub such as Heathrow Airport, where if everything works as planned, airline passengers and their luggage are efficiently moved from one destination to another. But if a breakdown occurs at just one or two departure gates, the entire interconnected airport can turn into complete disarray.

This is one of the key functions of the market stability regulator – carefully monitoring the interconnectivity embedded in our networks of financial institutions. It is a monitoring of the entire system, making sure that passengers and luggage get to where they are supposed to go, having contingency plans for bad weather, and keeping the air transportation system running even if one airline goes out of business.

Obvious focus points here are counterparty risk exposures – whether they occur through standard credit instruments, credit default swaps, credit insurance, or other means; the operation of market structures – whether established on a formal or informal basis; and general practices that could cause problems for the overall financial network – such as concentrations of asset exposures and overall risk management practices.

At the outset, a goal of this regulator is to attempt to harness market forces. The market stability regulator must have access to detailed information from all types of

financial institutions, including data submissions and the ability to join in or initiate examinations. Second, the market stability regulator should have the authority to require additional disclosure by financial institutions so that market participants can better evaluate their risk profiles. Third, the market stability regulator should also be involved in financial institution regulatory requirements to include a focus on broader market stability perspectives. Finally, the market stability regulator should have the ability to require financial firms to undertake corrective actions to address financial stability problems.

As the market stability regulator collects and analyzes this type of information, it could publish aggregate information to highlight issues and trends associated with potential risk exposure. Such actions, combined with enforcement authority as necessary, would provide a clear signal to market participants and other regulators that the market stability regulator has identified some potential problems that should be addressed. We would expect that this action alone could have an impact on overall behavior.

This process is what some have referred to as "leaning against the wind" in an attempt to prevent broad economic dislocations caused by potential excesses. I would agree, so long as the lean can be calibrated based on the conditions of the storm and the effectiveness of the regulators initial actions.

This would not be an easy task. In addition to the difficulty of determining just where and when to lean against the wind, there could be a tendency of a regulator to lean too heavily simply to avoid blame for any ensuing financial instability. Moreover, regulated entities could push back, alleging regulatory over-reach. But if we clearly understand that this process will not prevent all financial instability and that the dynamic and innovative aspects of financial markets must be preserved, then it is a process worth trying.

The optimal structure in Treasury's Blueprint was an ambitious attempt to recast the debate on regulatory structure for financial institutions and the entire financial system in the United States. As we have acknowledged, change of this magnitude would require considerable debate and time.

Near-Term Steps to Consider

The recent challenges in credit markets illustrates that the world has changed and we need to think continually about what steps can be considered now while broader changes regarding regulatory structure are debated. Fortunately, the Blueprint's analysis is instructive in this regard.

For example, one obvious question is the proper regulatory oversight of investment banks, especially the largest firms- the SEC's consolidated supervisory entities. Right now, the Federal Reserve and the SEC are working constructively together while the primary dealers have access to the Federal Reserve's liquidity facilities. This is appropriate, as the Federal Reserve needs to have information about institutions to which it is lending.

What happens next after that facility eventually closes is a more difficult policy question. We are in the first act of what is a multi-act play. Some decisions seem clear. If firms have permanent access to a government backstop, then these firms need to be regulated in the same way as all other institutions that have access to this backstop. Similarly, as our markets have gotten more inter-connected, it is necessary to have some type of oversight to ensure that broader issues of market stability are considered adequately.

Many other issues still need to be resolved. Some market participants question whether the primary dealers' access to the Federal Reserve's liquidity facilities is truly temporary, which has an impact on behavior. Uncertainty leads some to conclude that these non-banking financial institutions should have the same type of regulation as institutions that have a significant percentage of their liabilities insured by the government.

Others believe the increasing complexity of financial transactions and structure of financial institutions is a logical reason for extending bank-like regulation to additional firms. Greater complexity has not developed in a vacuum. While new financial products and complex risk-hedging strategies provide the benefit of wider

risk dispersion, if market participants cannot evaluate fully the risk profiles of the financial institutions using these products, then it remains unclear that innovation has reduced risk.

If we expand bank-like regulation to a wider range of firms it seems that two outcomes are possible. One outcome could be that innovation and risk-taking decline to levels below what the market would normally allow. This could inhibit overall economic growth and could push market-permitted risk-taking to those firms not swept into broader regulatory reach. Another outcome would be to provide a false sense of security to market participants, potentially leading to less market discipline and even greater complexity and opacity in the future that could lead to even greater financial instability. Both of these outcomes are unattractive. But so is the status quo. Change, in one form or another, is likely to come.

For this reason, the Blueprint advocated for a separation of responsibilities between a regulator looking at the system as a whole and another regulator focused on the health of individual institutions. A bifurcation of regulatory responsibility properly aligns regulatory incentives. A macro-stability regulator should generally not be concerned with the failure of an individual institution. In contrast, especially where the government safety net is at risk, the tendency of a micro-prudential regulator would be to be very concerned with individual institution failures.

If these two functions continue to be combined and the distinction is further blurred, the result could be more overall government support for troubled financial institutions, whether explicit or implicit. This further distorts financial markets and can make the financial system more fragile rather than more stable.

We look forward to further considering the appropriate role of regulation in pursuit of market stability in the coming months. Market stability regulation should reflect a fine balance of addressing areas where the market may not function, allowing for innovation, and harnessing market discipline. It will be difficult to balance these roles, but if we go into this process understanding that we will never fully eliminate market instability, we have a much better chance of establishing a more stable financial system for the future.

Thank you.

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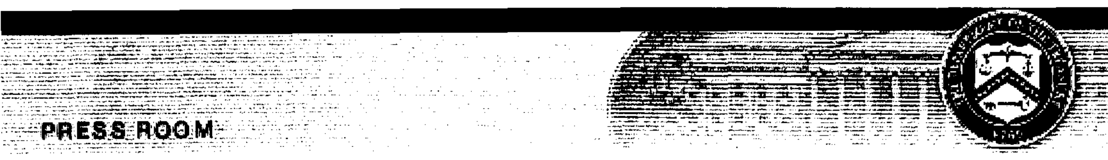

April 29, 2008
hp-952

Assistant Secretary Anthony W. Ryan
to Speak on Capital Markets

Assistant Secretary for Financial Markets Anthony W. Ryan will deliver remarks on Thursday to the Securities Industry and Financial Markets Association (SIFMA) Wall Street to Washington Federal Legislative and Regulatory Conference in Washington. His remarks will focus on the financial markets, and how market participants and regulators are responding to recent challenges.

The following event is open to the media:

WHO Assistant Secretary Anthony W. Ryan

WHAT Remarks on the Capital Markets

WHEN Thursday, May 1, 12:15 p.m. EDT

WHERE SIFMA Wall Street to Washington Federal Legislative and Regulatory Conference
Marriott Metro Center
775 12th Street, NW
Washington, D.C.

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April 29, 2008
hp-953

Treasury Officials to Visit Schools Across U.S. for Annual Teach Children to Save Day

The U.S. Treasury Department and the American Bankers Association Education Foundation once again are partnering today for the 12th annual Teach Children to Save Day. Fourteen Treasury department officials and staff members will volunteer their time to teach America's elementary and high school students the importance of saving.

This is Treasury's fifth year participating in Teach Children to Save Day, when bankers and Department officials connect with students in classrooms and after-school programs to share "real life" lessons about money.

The following events are open to the media:

Anna Escobedo Cabral, U.S. Treasurer
Boys and Girls Club of Burlington
62 Oak Street
Burlington, Vt.
3:30 p.m.

Donna Gambrell, CDFI Director
View Park Preparatory Accelerated Charter Elementary School
3751 W. 54th Street
Los Angeles, Calif.
8:30 a.m., 9:30 a.m. & 10:30 a.m.

Dan Iannicola, Deputy Assistant Secretary for Financial Education
Longbranch Elementary
3723 Franklin Street
Jacksonville, Fla.
1:00 p.m.

Christine McDaniel, Deputy Assistant Secretary for Economic Policy
Chandler Middle School
201 E. Brookland Park Boulevard
Richmond, Va.
10:00 a.m. & 1:00 p.m.

Barry Wides, Deputy Comptroller for Community Affairs, Office of the Comptroller of the Currency
William Hallett School
36-36 10th Street,
Long Island City, N.Y.
10:00 a.m.

Stafford Via, Deputy Executive Secretary
Redbud Run Elementary
250 First Woods Drive
Winchester, Va.
9:30 a.m. & 10:15 a.m.

Stacy Carlson, Speechwriter to the Treasury Secretary
Wagner Jr. High School
1701 W. Chelten Avenue
Philadelphia, Pa.
9:00 a.m. & 10:15 a.m.

Ed Bodensiek, Outreach Office of Financial Education Office Director
Coeur d'Alene High School
5530 N. 4th Street
Coeur d'Alene, Idaho
9:50 a.m.

Skyway Elementary School
6621 Courcelles Parkway
Coeur d'Alene, Idaho
10:50 a.m.

Tom Kurek, Office of Financial Education Program Coordinator
Weymouth High School
1 Wildcat Way
Weymouth, Mass.
11:00 a.m.

Mary Kertz, Special Advisor to Special Envoy for China and the SED
L'Anse Creuse Middle School North
46201 Fairchild
Macomb Township, Mich.
9:30 a.m.

L'Anse Creuse High School North
23700 Twenty-One Mile Road
Macomb, Mich.
11:00 a.m.

Jamie Davenport, Program & Financial Analyst and Erin McKevitt, Compliance Advisor
Running Brook Elementary School
5215 West Running Brook Road
Columbia, Md.
1:40 p.m. & 2:15 p.m.

Neal Carlton, Office of the Treasurer
Ocean Springs Middle School
3600 Hanshaw Road
Ocean Springs, Miss.
9:15 a.m.

Oak Park Elementary School
2230 Government Street
Ocean Springs, Miss.
10:15 a.m.

Lopez Elementary School
140 St. John Street
Biloxi, Miss.
2:00 p.m.

Alise DeLeon, Office of Financial Education Analyst
U.S. Bank, NA
425 Walnut Street
Cincinnati, Ohio
9:00 a.m.

-30-

April 29, 2008
hp-954

President's Council on Financial Literacy Supports Treasury Launch of Financial Access Pilot

Jacksonville, Fla. - The Treasury Department today launched a new initiative to increase financial education and bank and credit union accounts for Americans currently outside of the financial mainstream. The Community Financial Access Pilot will help selected U.S. communities provide low and moderate income people with needed access to financial services. The initiative was recommended by the President's Advisory Council on Financial Literacy.

"Through this pilot, Treasury will work with banks, credit unions, community leaders, and educational providers to target the nearly 10 percent of American households estimated to fall outside the financial mainstream," said Dan Iannicola, Jr., Deputy Assistant Secretary for Financial Education.

Iannicola announced the initiative in Jacksonville, Fla., one of eight communities participating in the new pilot program. The other participating communities include Brownsville, Texas; Cowlitz County, Wash.; Eastern Kentucky; Mississippi Delta, Miss.; Fresno, Calif.; Philadelphia, Pa.; and St. Louis, Mo.

"Having a bank account is a critical part of being able to participate in our vibrant economic system," said Charles Schwab, Chairman of the President's Advisory Council on Financial Literacy. "This pilot will target the low-income families who need access to basic financial services, so they can stop paying outrageous fees just to cash a check or pay a bill. It will also give low-income families access to basic financial education so that they can begin to build a better future."

The number of families using alternative financial service providers is estimated to be as high as 50 million.

Jacksonville, Fla. Mayor John Peyton said, "We're honored to have Jacksonville chosen to participate in this worthwhile new initiative. Our existing efforts, under the leadership of FreshMinistries, recognized in 2005 by the U.S. Treasury for Excellence in Financial Literacy, and its partners RealSense Prosperity Campaign, Individual Development Accounts and Family Foundation will be able to reach more low-to-moderate income families and help them save for the future. Money management is an essential skill for everyone, and an important component of both individual and regional prosperity."

Reverend Dr. Robert V. Lee III, a member of the President's Advisory Council on Financial Literacy and the founder and chairman of FreshMinistries also attended the pilot's national launch in Jacksonville, Florida. Information on the Community Financial Access Pilot is available at www.treas.gov/financialeducation.

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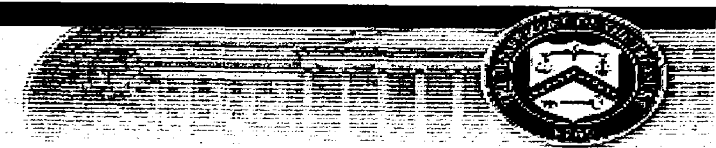


April 30, 2008
2008-4-30-17-6-11-27126

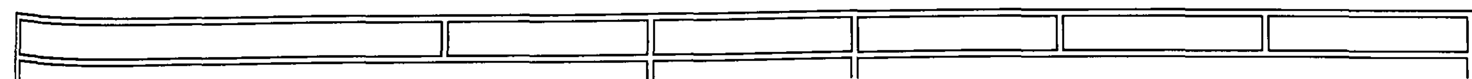
U.S. International Reserve Position

The Treasury Department today released U.S. reserve assets data for the latest week. As indicated in this table, U.S. reserve assets totaled $74,541 million as of the end of that week, compared to $74,782 million as of the end of the prior week.

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

	April 25, 2008		
A. Official reserve assets (in US millions unless otherwise specified)	Euro	Yen	Total
(1) Foreign currency reserves (in convertible foreign currencies)			74,541
(a) Securities	15,591	11,730	27,321
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	15,545	6,591	22,136
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	4,256		
(3) SDRs	9,787		
(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				
(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	

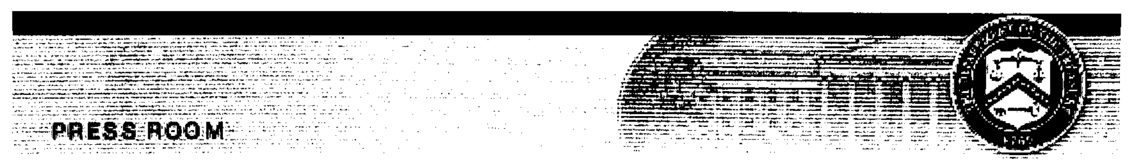
--lent or repoed but not included in Section I	
--borrowed or acquired and included in Section I	
--borrowed or acquired but not included in Section I	
(e) financial derivative assets (net, marked to market)	
--forwards	
--futures	
--swaps	
--options	
--other	
(f) derivatives (forward, futures, or options 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)	74,541
--currencies in SDR basket	74,541
--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.



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May 1, 2008
HP-955

Testimony of Deputy Assistant Secretary for Tax Policy Karen Gilbreath Sowell Before the House Ways and Means Subcommittee on Select Revenue Measures on Tax Incentives for Higher Education

Washington --Mr. Chairman, Ranking Member English, and distinguished Members of the Subcommittee:

Introduction

Thank you for the opportunity to appear before the Subcommittee today to discuss tax incentives for higher education, which currently include more than a dozen credit, deduction, exclusion, and deferral provisions. While my testimony today focuses on tax incentives, I note that there are numerous non-tax governmental and other programs to help make higher education affordable and that figure into an individual's or family's decisions regarding higher education. The principal Federal student financial assistance programs are authorized under Title IV of the Higher Education Act of 1965, as amended, and this year will provide more than $90 billion in grant, loan and work-study assistance to students and their families. The Title IV programs include Federal Pell Grants, which serve low-income undergraduate students, and Federal student loans, both the bank-based Federal Family Education Loan program and the Department of Education's Direct Loan program, which serve undergraduate students and their parents, as well as graduate professional school students. In addition, colleges, universities, non-profit organizations, and the private sector furnish scholarships, tuition programs, and other assistance to students pursuing higher education, which according to the College Board exceeds $35 billion annually.

Education is important to the Administration, and we recognize that there is room for improvement in the tax benefits currently provided through the Internal Revenue Code to encourage higher education. We believe that the goal of providing incentives to make higher education affordable is best achieved by identifying the most efficient ways to address student needs and effectively utilizing those mechanisms. My testimony will focus first on a brief review of current tax incentives for college and other post-secondary education, and then discuss areas for potential improvement.

Over the last several decades, various provisions have been added to the Internal Revenue Code to facilitate savings for, and to incentivize the pursuit of, post-secondary education. Building on these existing provisions, the Administration and Congress have made significant progress during the past seven years to provide tax benefits related to higher education, particularly in helping families save for post-secondary education. Notably, the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) expanded Qualified Tuition Programs, also known as section 529 plans, to permit tax-free distributions from plan accounts to be used for post-secondary education expenses, and to allow private educational institutions (in addition to states) to create section 529 plans. The Pension Protection Act of 2006 made these changes to section 529 of the Internal Revenue Code permanent, which helped eliminate uncertainty with respect to this education savings vehicle. Further, the Administration's Budget for FY 2009 includes a proposal to extend the Saver's Credit to contributions to section 529 plans in order to encourage and assist lower-income families in saving for higher education.

EGTRRA also expanded Coverdell education savings accounts (formerly known as Education IRAs) by raising the annual contribution limit to Coverdell accounts from $500 to $2,000, and increasing the income phase-outs for joint filers. In addition, EGTRRA eliminated the disallowance of qualified distributions from Coverdell accounts or section 529 plans for those taxpayers who claim an education credit.

Notwithstanding these savings programs for those who have the ability and who have sufficient time to save for higher education, students and families who are facing immediate education-related costs must confront a patchwork of education-related tax incentives. Current law tax incentives may take the form of a credit against tax liability, a deduction from gross income, an exclusion from gross income, or a deferral of (or exemption from) tax. A detailed table of all the major tax incentives related to post-secondary education is attached as Table 1.

Set forth below is a brief overview of certain of the significant provisions under current law. Focusing on but a few of the available incentives reveals the complexity of these tax incentives, all of which are aimed at post-secondary education, but which apply to different people, in different circumstances, and for different educational ends. It is important to keep in mind that consideration of tax incentives is only one piece of the financial puzzle. Students pursuing higher education – be they recent high school graduates, high school graduates returning to higher education after entering the job market or raising a family, or professionals interested in pursuing an advanced degree or a different career – also have available to them the panoply of government grant and loan programs, as well as the many forms of non-governmental assistance available from educational institutions, non-profit organizations and the private sector.

Overview of Major Current Law Tax Incentives for Post-Secondary Education

As noted above, current law tax incentives may take the form of a credit, deduction, exclusion, or deferral. Many of these incentives have unique eligibility requirements, different phase-out limits, and various filing requirements. Generally, if an expense would qualify under more than one provision, current law allows only one tax benefit for the particular educational expense.

Credits

In 1997, Congress enacted a pair of tax credits to help families pay for higher education – the Hope Scholarship Credit (Hope Credit) and the Lifetime Learning Credit. In 2008, a taxpayer may claim a Hope Credit for 100 percent of the first $1,200 and 50 percent of the next $1,200 in qualified tuition and related expenses (for a maximum credit of $1,800 per student) for the first two years of college for a student enrolled at least half-time. A taxpayer may claim a Lifetime Learning Credit for 20 percent of up to $10,000 in qualified tuition and related expenses (for a maximum credit of $2,000) per taxpayer for any post-secondary education. Both credits are subject to an adjusted gross income (AGI) phase-out. In 2008, the credits phase out between $48,000 and $58,000 of AGI ($96,000 and $116,000 if married filing jointly). Only one credit may be claimed by each eligible student.

Dependent Related Deductions and Credits

For parents supporting college students, there is an extension of the benefit provided by the personal exemption for full-time students aged 19 through 23. Dependent children over the age of 18 do not qualify as children for the personal exemption unless they remain full-time students (through age 23). In 2008 the personal exemption amount is $3,500.

This favorable treatment of a full-time student aged 19 through 23 as a qualifying child also applies for purposes of the Earned Income Tax Credit (EITC). The EITC is a refundable tax credit for working families with low incomes. The EITC for families with one eligible child phases in over the first $8,580 of earned income for a maximum credit of $2,917. The credit phases out between $15,740 and $33,995 of earned income ($18,740 and $36,995 for joint filers). For families with modest incomes, allowing dependent students to qualify as children for EITC purposes

provides the families supporting the students with a large tax benefit.

Deductions

A deduction may be allowed above-the-line (i.e., without itemization) for up to $2,500 of interest per year on any qualified education loan, subject to an AGI phase-out beginning at $55,000 ($115,000 if married filing jointly). In addition, through 2007, a taxpayer could claim an above-the-line deduction for qualified tuition and related expenses. The maximum amount of the deduction was $4,000 for taxpayers with AGI below $65,000 ($136,000 if married filing jointly), or $2,000 for taxpayers with AGI between $65,000 and $80,000 ($136,000 and $160,000 if married filing jointly) in 2007.

Moreover, deductions may be allowed to taxpayers for work-related education expenses. An employee who itemizes deductions may deduct work-related education expenses as one of a class of miscellaneous itemized deductions subject to a floor of 2 percent of AGI. Similarly, if an employer pays an employee's education expenses and the reimbursement does not take place through an accountable plan, the amount reimbursed is included in the employee's gross income, but the employee may deduct the expenses as a miscellaneous itemized deduction subject to the 2-percent floor.

Exclusions from Income

In addition to any available credits or deductions, any student who receives a qualified scholarship to a degree-granting program (including certain Federal medical training programs) may exclude from gross income amounts used to pay qualified tuition and related expenses, including fees, books, supplies, and required equipment. Under another provision, originally enacted in 1976, a student may exclude from gross income the amount of a loan that is forgiven if the student works for a required period of time in certain professions or locations. For example, after graduating from college, a student might have a loan forgiven if he or she were to become a teacher in an underserved community. Additionally, there is an unlimited exclusion from the gift and generation-skipping transfer tax for tuition paid directly to a school on behalf of a student, resulting in an incentive to make gifts of college tuition

There are also incentives for individuals to continue their education while employed. An employee may exclude employer-provided education expenses (up to $5,250 since 1986) that are part of an Educational Assistance Program (EAP). Under an EAP, there is no requirement that the education be work-related. In addition, like other work-related expense reimbursements, an employee may exclude from gross income employer reimbursements for work-related education made under an accountable plan.

Certain colleges and universities offer tuition-reduction programs to their employees (which can include the employee's spouse or dependent child). Tuition benefits under such programs may be excluded from gross income. Also, certain graduate students employed in teaching or research may exclude tuition reductions from gross income.

Savings Related Deferrals and Exclusions

Traditionally, tax deferral has been afforded to income saved for retirement in an Individual Retirement Arrangement (IRA). Since 1998, an IRA distribution for qualified higher education expenses has been permitted, with penalties waived, although tax attributable to the amounts distributed is still due. The exclusion covers both Traditional and Roth IRAs (effectively without income limits on contributors), encompasses grandchildren as beneficiaries, and extends qualified expenses beyond tuition and required fees to room and board (for students attending college at least half time), books, and supplies.

As noted above, tax deferral on income saved for college expenses has been

available since 1996 through Qualified Tuition Programs, also called section 529 plans. Individuals at all income levels may contribute to a section 529 account or prepaid tuition plan. Contributors may use up to five years of annual gift tax exclusion amounts in advance for a gift-tax-free contribution to a student in a single year (for a total of $60,000 in 2008). There is no limit on the number of permissible student donees per year. Some states permit contributors to deduct a limited amount of contributions for state income tax purposes. Not only does income accumulate tax-free in a section 529 account, but distributions from the account, which include a return of contributions and earnings on those contributions, are also excluded from gross income as long as they are used for qualified higher education expenses.

In 1997, an additional deferral vehicle was created in the form of an Education IRA. Subject to an AGI phase-out, contributors were allowed to contribute in the aggregate up to $500 per year to an Education IRA. As noted above, EGTRRA increased contribution limits to Education IRAs, now named Coverdell Education Savings Accounts, to $2,000. Not only does income accumulate tax-free in a Coverdell account, but distributions from the account, which include a return of contributions and earnings on those contributions, are also excluded from gross income as long as they are used for qualified education expenses, including college expenses.

Since 1988, there also has been a college saving incentive in the form of an exclusion of interest on qualified United States Savings Bonds, provided that the proceeds are used to pay for qualified higher education expenses, subject to an AGI phase-out.

Complexity of Tax Incentives

As reflected in the overview above, the education tax incentives under current law are numerous, often overlapping, and complex. The incentives vary in terms of who may receive benefits, which expenses may be covered, and how large an exclusion, deduction, or credit may be allowed. For example, part-time students may be eligible for the education credits (at least half-time in the case of the Hope Credit) and savings bond interest exclusion. Only full-time students may qualify for the dependent deduction or EITC. Some provisions, like the Hope Credit, are calculated per student, but others, like the Lifetime Learning Credit and the student loan interest deduction, are calculated per taxpayer. Different expenses qualify under different provisions. For example, books, supplies and equipment are qualified expenses for many savings provisions but not for purposes of the credits. Finally, phase-outs with different thresholds apply for purposes of the credits, dependent deduction, student loan interest deduction, Coverdell account contribution, and savings bond interest exclusion.

Consider the following examples and their disparate results. The examples show the value of education benefits available under 2007 law to typical families facing a wide range of circumstances regarding their education expenses.[1] In each example, we calculate the tax benefits that typical families would receive from five tax provisions that may help families with education expenses as in effect for 2007: (a) the Hope Credit, (b) the Lifetime Learning Credit, (c) the tuition deduction (expired December 31, 2007), (d) the dependent exemption, and (e) the EITC. Savings incentives, such as Coverdell accounts and section 529 accounts are not considered.

Because the provisions interact, and because only the EITC is refundable, some families may not have sufficient tax liability to benefit fully from all provisions for which they are eligible. The examples show that total tax benefits vary with the family's specific circumstances: family income, filing status, age of the student, dependent status of the student, whether the student attends part-time, year of study, and their expenses. The families in the examples presented are otherwise typical of families with similar incomes. Of course, the results may vary as the facts vary from the typical family model.

Taxpayers may often be eligible for more than one benefit and only some benefits may be used together. Thus, in many instances, the family must choose among the

various benefits. The first example shows the optimal choice may not be obvious before computing the family's taxes.

Example 1: A Family May Need to Make Many Calculations to Determine the Best Outcome

A family of three (Family A) has an income of $100,000. Their 19-year-old son is a full-time freshman at the local state university. His tuition and fees for the year are $6,000. The family knows that they are eligible for the Hope Credit, the Lifetime Learning Credit, the tuition deduction, and the dependent exemption that the family would not be eligible for if the son were not a full-time student. The family may use no more than one of the following three benefits: the Hope Credit, the Lifetime Learning Credit, or the tuition deduction. The family is in the phase-out range for the education credits.

- Family A could receive $2,005 – from the Hope Credit ($1,555) and the dependent exemption ($850).
- Family A could receive $1,690 – from the Lifetime Learning Credit ($840) and the dependent exemption ($850).
- Family A could receive $1,850 – from the tuition deduction ($1,000) and the dependent exemption ($850).

Note that if this family had additional children with education expenses, the calculation exercise would be even more complicated. For example, the Lifetime Learning Credit provides a maximum of $2,000 per family and thus, may be limited for families whose total tuition expenses exceed $10,000.

The remaining examples calculate the optimal education benefit for a series of taxpayers with different incomes, filing status, and education needs to demonstrate the potential range of results.

Example 2: Individual in Part-time Training Programs – Income Affects Tax Benefits

A single taxpayer attends a training program that costs $1,000. He attends less than half-time, is not in a degree program, and is not in his first two years of post-secondary study.

- If Taxpayer B earns $25,000, B could receive a Lifetime Learning Credit of $200 (the tuition deduction would be worth $150).
- If Taxpayer B earns $50,000, B could receive a tuition deduction worth $250 (the Lifetime Learning Credit would be worth only $140 due to the phase out).

Example 3: Moderate Income Students Working Toward an Associate's Degree – Family Structure Affects Tax Benefits

A student begins work on an associate's degree at the local community college. The student's family has income of $25,000. The student attends at least half-time. Tuition and required fees are $4,000.

- C, a single student who is not dependent on his or her parents, could receive the maximum Hope Credit of $1,650.
- D, a married student who is not a dependent, could receive a Hope Credit or a Lifetime Learning Credit for $750. (D's family does not have sufficient tax liability to benefit from the education credit fully.)
- E, the married parents of a 19-year old living at home and supported by his or her parents, could receive benefits totaling $2,387 from the Hope Credit ($410), the dependent exemption ($340), and the EITC ($1,637).

Example 4a: Students Attending the Local State University – Income Affects Tax Benefits

A college-age student enrolls full-time at the local state university where tuition and fees are $6,000. The student is in his or her first year of study.

- F, a family earning $25,000, would receive $2,387 – from the Hope Credit ($410), the dependent exemption ($340), and the EITC ($1,637).
- G, a family earning $50,000, would receive $2,160 – from the Hope Credit ($1,650) and the dependent exemption ($510).
- H, a family earning $100,000, would receive $2,005 – from the Hope Credit ($1,155) and the dependent exemption ($850).
- I, a family earning $150,000, would receive $1,350 – from the tuition deduction ($500) and the dependent exemption ($850).
- J, a family earning $200,000, would receive $952 – from the dependent exemption.

Example 4b: This example is the same as Example 4a, except that the student is enrolled in his or her third year of study. As a result, the Hope Credit would no longer be available.

- F, a family earning $25,000, would still receive $2,387 – from the Lifetime Learning Credit ($410), the dependent exemption ($340), and the EITC ($1,637).
- G, a family earning $50,000, would receive $1,710 – from the Lifetime Learning Credit ($1,200) and the dependent exemption ($510).
- H, a family earning $100,000, would receive $1,690 – from the Lifetime Learning Credit ($840) and the dependent exemption ($850).
- I, a family earning $150,000, would still receive $1,350 – from the tuition deduction ($500) and the dependent exemption ($850).
- J, a family earning $200,000, would still receive $952 – from the dependent exemption.

Attached as Table 2 are figures that illustrate graphically the tax value of education benefits under 2007 law, taking into account the same five major tax provisions. The figures show the value of the education benefits for typical families by AGI. As in the examples above, the value of these provisions depends on a student's or family's circumstances: the cost of tuition; family income (including whether the family has any income tax liability); whether the student attends college full-time or part-time; filing status; and for the Hope Credit, whether the student is in the first two years of post-secondary education.

The tax savings for a student or family vary significantly with income and tuition level. At the tuition levels paid by most full-time students whose families are eligible for the credits, the Lifetime Learning Credit offers less assistance than the Hope Credit. The Hope Credit, however, is only available to students in their first two years of college. Thus, the tax value associated with a college freshman or sophomore is larger in many cases than the tax value associated with a college junior or senior.

In general, families with incomes under $100,000 in 2007 owing tuition expenses would have maximized their benefits by claiming an education credit; higher income families would have claimed a tuition deduction. As income rises further, the dependent deduction phases out. Families with no income tax liability receive no benefit from the dependent deduction, the tuition deduction, or education credits. However, a college student may qualify a low-income or moderate-income family for the EITC. Large families may lose the benefit of the dependent deduction because they are more likely to be subject to the alternative minimum tax.

Like the family filing a joint return, higher income individuals who file single returns would have maximized their benefits by claiming the tuition deduction, while individuals with incomes under $50,000 would have claimed a credit. A low-income independent student may be eligible for the EITC, but there is no additional education-related benefit from the EITC and thus, the EITC benefit would be the same as for other low-income individuals. Because independent students receive no benefit from the dependent deduction and no education-related benefit from the EITC, the tax value of the benefits associated with an independent student is smaller than the corresponding tax value for a dependent student.

As illustrated in the examples above and the figures in Table 2, the value of various tax incentives attributable to a student may range from a few hundred to a few thousand dollars depending on filing status and AGI. In addition, a claim of one credit or deduction may adversely affect a taxpayer's eligibility for another credit or deduction. From this variety of incentives, a student or parent must discern the optimal combination of tax benefits, which may require many taxpayers to generate alternative complex computations. As in Example 1 above, taxpayers with dependent students who are eligible for a tuition deduction as well as a Hope or Lifetime Learning Credit must run multiple calculations to determine their maximum benefits. Because a qualified expense may not be eligible for more than one benefit, careful recordkeeping is required to ensure both the optimal distribution of expenses and compliance.

Because of the complexity, it may be difficult for a student or parent to determine the value of the tax incentives. In addition, for incentives based on AGI, their value is necessarily retrospective unless the student or parents can predict their income with precision. The more difficult it is to predict the value of the tax benefit accurately, the less effective these benefits are as incentives for the pursuit of a college education.

In addition to the challenges that students face in navigating the myriad education tax incentives to optimize their use, the complexity of these provisions increases the record-keeping and reporting burden on taxpayers, while making it difficult for the IRS to monitor compliance. For example, to claim an education credit, a taxpayer must file a Form 1040 even if he or she otherwise qualifies to file a Form 1040EZ, and the taxpayer must file an IRS Form 8863, a 17-line form with two pages of instructions.

Observations on Simplification

Despite the complexity, because the tax incentives may provide significant value to a family or individual in pursuit of higher education, it appears the various incentives are widely utilized. Table 3 sets forth statistics on the use of the education credits and the tuition deduction based on the most recent IRS data available (for tax year 2005). In the fall of 2005, more than 17 million students were enrolled in college in the United States. As noted in Table 3, a substantial number of these students claimed some combination of the deduction and credits. Overall, in 2005, more than 11.6 million taxpayers claimed an education credit or tuition deduction. Our data cannot capture whether students and families are utilizing the tax incentives optimally, nor what impact, if any, the tax incentives have on decision-making regarding post-secondary education. However, one would anticipate that the complexity would detrimentally affect the efficient utilization and administration of the benefits.

Because the value of a particular tax incentive may not become apparent until the end of the tax year, which may be months after the tuition or other expense was due, and the tax year does not coincide with the academic year, the tax system is not well suited to provide assistance on the "front end" of funding higher education. Generally, tax benefits become available only after year-end (especially in the case of benefits limited by AGI, which is determined at year-end). As a result, the complexity of the current provisions makes it difficult for even a very sophisticated taxpayer to adjust withholding to "advance" the benefit.

In addition, it is important to remember that recent high school graduates do not constitute the only type of person interested in pursuing a college education. Prospective students also include older persons who entered the job market after high school as well as those who have an interest in pursuing an advanced degree or a career different from the one in which they were originally engaged. The provision of different tax incentives for similar higher education expenses may result in the unequal tax treatment of similarly situated taxpayers.

Suggestions have been offered regarding potential simplifications, primarily along three themes. First, it has been suggested that uniform definitions for operative terms such as "qualified higher education expenses" or "qualified tuition and related expenses" and "eligible education institution" be adopted. For example, currently

only tuition may qualify for tuition reduction for college employees and gift tax exclusions; tuition and required fees may qualify for the Hope and Lifetime Learning Credits, tuition deduction, and savings bond interest exclusion; tuition, fees, books, supplies, and equipment may qualify for the scholarship exclusion, employer EAP, and student loan interest deduction; and tuition, fees, books, supplies, equipment (and in the case of a student attending at least half time, room and board) may qualify for penalty-free distributions from IRAs, section 529 accounts, and Coverdell accounts.

A second suggestion has been to conform the phase-out thresholds and ranges and index all amounts for inflation. As noted above, different income thresholds apply to the education credits, dependent deduction, student loan interest deduction, and the different savings provisions.

Third, it has been suggested that the education credits be consolidated along with certain deductions. In particular, the AGI phase-out for the credits could be increased to eliminate the need for the tuition deduction; or a single credit could be designed to cover the same population.

While there is clearly a need to address the complexity concerns arising from the current welter of tax incentives, it is important to remain cognizant that revisions to the tax regime may lead to unintended consequences, and any revision may unsettle taxpayer expectations. Recognizing budgetary constraints, legislative reform of tax incentives will almost invariably result in additional benefits for certain taxpayers and fewer benefits for others. Because of the varying profiles of those who seek the benefits of tax incentives for higher education, it may be challenging to streamline the incentives in a way that would benefit the entire target group. Legislative reform of tax incentives would also need to address transition issues for those students or families who may be planning to rely on relevant provisions under current law.

In contemplating legislative reform of current tax incentives, a good starting point would be to focus on clear, simple ways to help students and their families meet the cost of higher education. While efforts can be made to consolidate and streamline the education tax incentives, to be successful, those efforts should not overlook the non-tax benefits that are available to many students, especially those in low-income and middle-income families, either from Department of Education and other federal and state governmental programs or from private-sector sources.

Thank you Mr. Chairman, Ranking Member English, and distinguished Members of the Subcommittee for the opportunity to participate in today's hearing on this important subject. I would be pleased to respond to your questions.

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[1] The families in these examples have average levels of deductible expenses and no capital gains income. For families eligible for the EITC, all income is from wages.

REPORTS

- Table 1 - Summary of Tax Provisions Related to Higher Education
- Table 2 - The Tax Value of a Student under 2007 Law
- Table 3 - Use of Tax Incentives for Higher Education

Table 1. Summary of Tax Provisions Related to Higher Education

	Provision	Tax Benefit	Qualifying Expenses	Eligible Individuals	Maximum Annual Amount	Income Limits	Eligible Institution
1	**Hope Scholarship Credit (§ 25A)**	Per student credit against tax	Tuition and required fees	Taxpayer, spouse or dependent in 1st or 2nd year of higher education enrolled at least half-time	$1,800: 100% of the first $1,200 and 50% of the next $1,200 (indexed for inflation)	Phase-out begins at $48,000 ($96,000 if joint return) and is pro rata over $10,000 ($20,000 if joint return) (indexed for inflation)	Post-secondary school eligible for Federal student aid
2	**Lifetime Learning Credit (§ 25A)**	Per taxpayer credit against tax	Tuition and required fees	Taxpayer, spouse or dependent in post-secondary or professional education	$2,000: 20% of the 1st $10,000 total across all eligible students in household (not indexed for inflation)	Phase-out begins at $48,000 ($96,000 if joint return) and is pro rata over $10,000 ($20,000 if joint return) (indexed for inflation)	Post-secondary school eligible for Federal student aid
3	**Earned Income Tax Credit for dependent children aged 19 through 23 (§ 32)**	Refundable credit for families with dependent children aged 19 through 23	N/A	Dependent student enrolled full-time for at least 5 months of preceding year	$2,917 for families with a single dependent child	Phase-in complete at $8,580 Phase-out begins at $15,740 ($18,740 if joint return) Phase-out complete at $33,995 ($36,995 if joint return) (indexed for inflation)	Educational organization – any level
4	**Employer-reimbursed educational expenses paid through an accountable plan (§ 62(c))**	Exclusion from gross income	Tuition, required fees, non-academic fees, books, supplies, equipment, room and board, special needs, transportation and travel	Employee	None	None	Educational organization – any level

	Provision	Tax Benefit	Qualifying Expenses	Eligible Individuals	Maximum Annual Amount	Income Limits	Eligible Institution
5	**Traditional and Roth IRAs (§ 72(t)(7))**	Exception from 10% additional tax on early distributions	Tuition, required fees, non-academic fees, books, supplies, equipment, room and board, special needs	Taxpayer, spouse, child or grandchild (enrolled at least half-time for room and board)	None	None	Post-secondary school eligible for Federal student aid
6	**Cancellation of debt (§ 108(f))**	Exclusion from gross income for income from cancellation of certain student loans	N/A	Borrower who works for a certain period of time in certain professions for any of a broad class of employers	None	None	Educational organization – any level
7	**Scholarships and fellowships (§ 117)**	Exclusion from gross income	Tuition, required fees, non-academic fees, books, supplies, equipment	Degree candidate	None	None	Educational organization – any level
8	**Tuition reduction (§ 117(d))**	Exclusion from gross income	Tuition	Employee of college, spouse or dependent; graduate student employed in teaching or research	None	None	Educational organization – college or graduate school
9	**Employer provided education assistance program (EAP) (§ 127)**	Exclusion from gross income	Tuition, required fees, non-academic fees, books, supplies, equipment and special needs	Employee receiving higher education	$5,250 (not indexed for inflation)	Limits on share of benefit that can go to the highly compensated; no individual income limits	Educational organization – any level

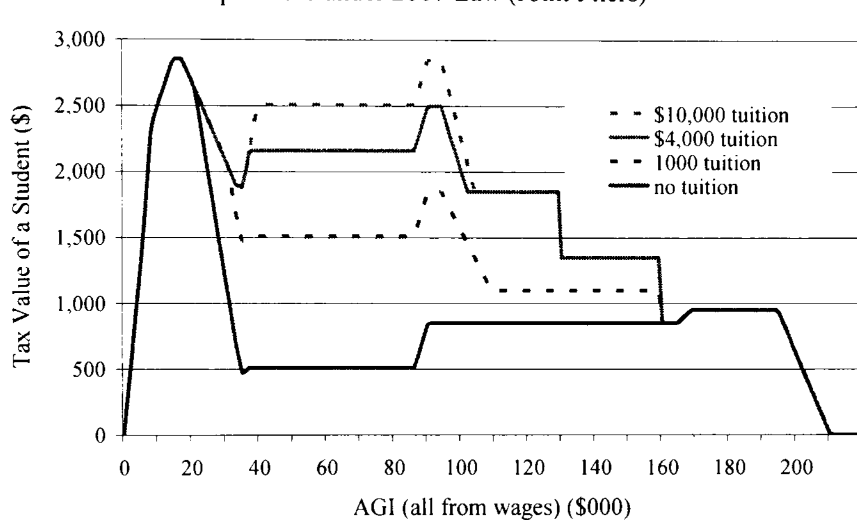
	Provision	Tax Benefit	Qualifying Expenses	Eligible Individuals	Maximum Annual Amount	Income Limits	Eligible Institution
10	**Savings bond interest (§ 135)**	Exclusion from gross income for U.S. savings bond interest	Tuition and required fees	Taxpayer, spouse, or dependent	None	Phase-out $50 per $1000, from $67,100-$82,100 ($100,650-$130,650 if joint return) (indexed for inflation)	Post-secondary school eligible for Federal student aid
11	**Dependent children aged 19 through 23 (§ 152(c)(3))**	Personal exemption deduction for dependent children aged 19 through 23	N/A	Student enrolled full-time for at least 5 months of preceding year	3500 (indexed)	Phase-out begins at $159,950 ($239,950 if joint return) (indexed for inflation)	Educational organization – any level
12	**Business expense deduction (§ 162)**	Itemized deduction	Most business or work related education expenses including transportation and childcare	Taxpayer or spouse	None	Overall limitation on itemized deductions may apply to AGI over $159,950 (indexed for inflation)	Educational organization – any level
13	**Student loan interest (§ 221)**	Above-the-line deduction	Tuition, required fees, non-academic fees, books, supplies, equipment, room and board	Taxpayer paying interest on a qualified education loan incurred on behalf of self, spouse, or dependent	$2,500	Phase-out over $55,000-$70,000 ($115,000-$145,000 if joint return) (indexed for inflation)	Post-secondary school eligible for Federal student aid
14	**Education expenses (§ 222) (effective through 2007)**	Above-the-line deduction	Tuition and required fees	Taxpayer, spouse or dependent receiving higher education	$4,000 or $2,000 subject to income limits	Deduction limited to $4,000 if AGI is less than $65,000 ($130,000 if joint return); and to $2,000 if AGI is less than $80,000 ($160,000 if joint return)	Post-secondary school eligible for Federal student aid

	Provision	Tax Benefit	Qualifying Expenses	Eligible Individuals	Maximum Annual Amount	Income Limits	Eligible Institution
15	**Qualified Tuition Plan (QTP) (§ 529)**	Exclusion from gross income for distributions from QTP accounts	Tuition, required fees, non-academic fees, books, supplies, equipment, room and board, and special needs	Any post-secondary student (enrolled at least half-time for room and board)	None	None	Post-secondary school eligible for Federal student aid
16	**Coverdell Education Savings Account (§ 530)**	Exclusion from gross income for distributions	Tuition, required fees, non-academic fees, books, supplies, equipment, room and board, and special needs	Any student, including primary and secondary (enrolled at least half-time for room and board)	Contributions limited to $2,000 per year, per recipient	Phase-out of eligibility for contributions from $95,000-$110,000 ($190,000-$220,000 if joint return)	Post-secondary school eligible for Federal student aid, or secondary or primary school
17	**Gift tax exclusion (§ 2503(e))**	Exclusion for tuition paid directly to educational institution	Tuition	Any student	None	None	Educational organization any level

Table 2. The Tax Value of a Student under 2007 Law

Figures A through C below illustrate the combined value of five major income tax provisions effective in 2007 – the Hope Credit, the Lifetime Learning Credit, the tuition deduction, the dependent exemption, and the Earned Income Tax Credit (EITC) – to families with different levels of income and different education expenses. Families are otherwise typical of families with similar incomes.[1] The tax value of a student is the difference between the taxpayer's income tax liability and what it would have been if the student had not enrolled in school. The no tuition case corresponds to a full scholarship and reflects the value of the tax benefits of the dependent exemption and the EITC.

Figure A. Tax Value of a Full-Time College Freshman or Sophomore under 2007 Law (Joint Filers)



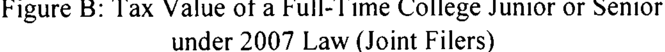
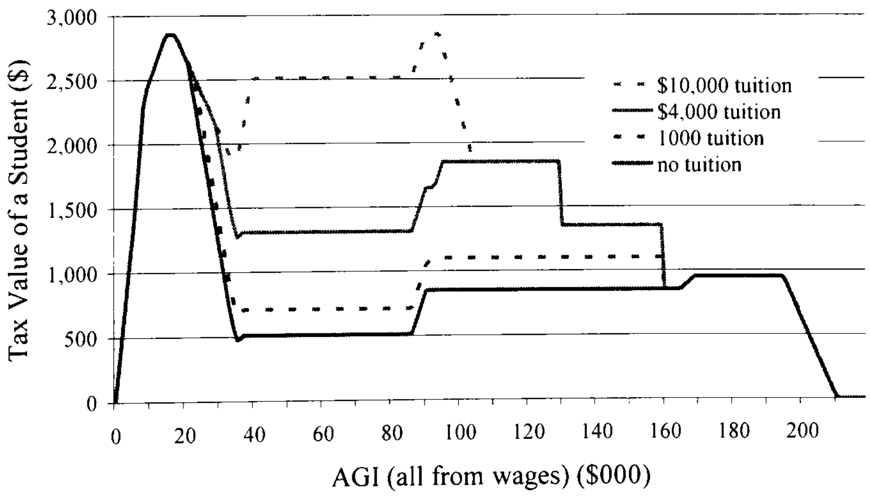


Figure B: Tax Value of a Full-Time College Junior or Senior under 2007 Law (Joint Filers)



[1] The families have average levels of deductible expenses and all income is from wages.

Figure C: Tax Value of an Independent Student Eligible for the Hope Credit under 2007 Law (Single Filers)

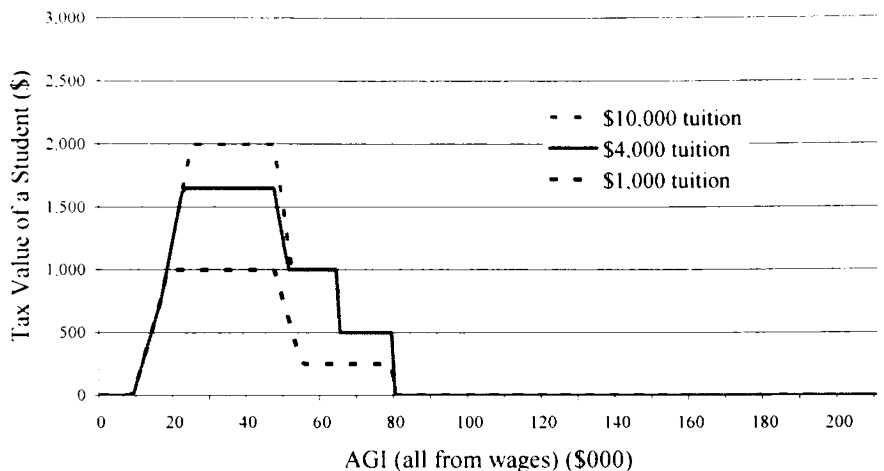


Figure D presents the same information as Figure A, but excludes the benefits of the tuition deduction, which expired on December 31, 2007.

Figure D. Tax Value of a Full-Time College Freshman or Sophomore from Education Credits, Dependent Exemption and EITC (2007 Law, Joint Filers)

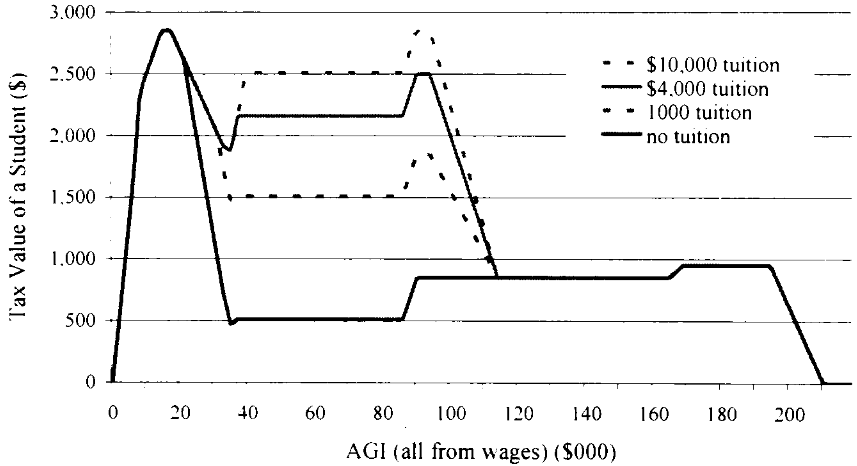


Table 3
Use of Tax Incentives for Higher Education - Tax Year 2005 SOI Data

Education Incentive Claimed		Returns (Thousands)	Dollars (Millions)	Average (Dollars)
Tuition Deduction Only[1]		4,416	10,085	2,284
Hope Credit Only[1]		2,554	2,627	1,029
Lifetime Learning Credit Only[1]		4,011	2,783	694
Any Combination of Above		482	[2]	[2]
	Total	*11,463*		

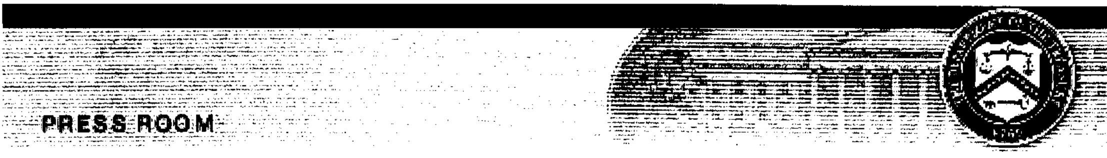
Department of the Treasury
Office of Tax Analysis

May 1, 2008

Notes:

[1] A Hope or Lifetime Learning Credit amount is used to offset individual income tax liability on a dollar-for-dollar basis. In contrast, the tuition deduction is subtracted from the income upon which tax is calculated. Therefore, the value of the deduction to the taxpayer depends on that taxpayer's effective tax rate.

[2] The 482,000 returns that claim more than one type of incentive claim a total of $762 million in tuition deductions and $707 million in education credits.



April 29, 2008
HP-956

Remarks by Assistant Secretary Clay Lowery on Promoting Economic Growth and Investment Through Free Trade Before the Charlotte Economics Club

Washington, DC-- Thank you for inviting me here today to speak about the importance of promoting open investment and free trade. The implications of world trade policies are in the headlines everyday. The benefits of trade are being questioned, the free trade agreement (FTA) for Colombia has been held up by Congress, and finalizing the Doha round has become more complicated as high food prices are exacerbated by export controls. With such varied news coverage of trade, it is easy to lose track of the big picture - free trade will lead to growth for the U.S. and world economy.

In simplistic terms, trade is contentious because trade is not just about the big picture. Trade policy affects the everyday lives of people from the cost of food to how they earn a living. As a result, I do not want to talk to you just as a policymaker with facts, but as a realist, about how trade improves the every day lives of Americans. And the first realistic thing to say is that we need to understand what free trade can and cannot do, and trade promotion must also be accompanied with targeted assistance to help displaced workers find training and new employment.

In this speech, I will begin by talking about the topic of trade and investment in general and what it means for the United States. Then I will look more closely at the benefits of our trade promotion agreements, and then closer still at financial services because of the importance of that sector to North Carolina. Lastly, I will talk about programs to help with the adjustment that comes with freer trade. Because we must face the fact, as my boss, Secretary Paulson says, that the global economy is here to stay.

Benefits of Trade – Exports and Investment

My former boss, former Treasury Secretary Larry Summers, wrote yesterday that it is very difficult to sell the benefits of trade, which is one reason free trade agreements are not more politically popular with the American public. Since I am at the Charlotte Economics Club, however, let me try to discuss trade in the context of how economists and businessmen look at it and then in a way that I hope all North Carolinians see it.

It is easy to understand that free trade is the best way to maximize economic growth, as the market for goods is no longer limited to a country's borders but expands across the globe, creating opportunity. Expanding markets through trade also promotes investment that fuels economic dynamism and innovation, as well as deployment of new technologies that raise productivity, and ultimately our standard of living.

Benefits to North Carolina

What I just said has historically been the view of most economists, though as Secretary Paulson observed – he was surprised that it was with economists that he was having to argue the benefits of free trade more and more. My view is that we should look at the evidence and why not start here in North Carolina. Between 2001 and 2006, North Carolina's exports to the world grew by 30 percent.

I guess one should ask, "what does that mean for the economy and workers here in North Carolina?" My answer would be to point out that that in 1992, trade supported just over 8 percent of jobs in North Carolina. Today, it is nearly 18 percent. Over the last 15 years, trade supported over 60 percent of North Carolina's job growth

and is responsible for more than 600,000 new jobs created in the last decade.

Trade Agreements

Not surprisingly, the primary method for the federal government to assist businesses, workers, and farmers to take advantage of greater trade is to negotiate trade agreements. That is what we have done under President Bush's leadership – negotiating ten new Free Trade Agreements (FTAs) with 15 countries – and our exports to these partners are growing twice as fast as our exports to the rest of the world. And our exports to the whole world are at an all time high, representing 12 percent of GDP, and were responsible for more than a third of U.S. economic growth in 2007.

Exports are a key component of the economic equation, but trade agreements are not solely export focused. They also help spur investment because they set transparent ground rules, give foreign investors rights to establish a local commercial presence, do business, and repatriate earnings, and – let's be frank – establish more of a rule of law in which arbitrary regulation and political risk is diminished. In the United States, we sometimes take these rights for granted as we are a very attractive investment destination, but we need to secure the same rights for American companies investing overseas.

For the United States, attracting international investment fuels our own economic prosperity by bringing new technology and business methods, and providing healthy competition that fosters innovation, productivity gains, lower prices, and greater variety for consumers. Of course, competition and investment can also have negative repercussions in certain industries, as American companies face competition from overseas firms with lower costs of doing business. In the aggregate, however, foreign investment brings jobs. Over 5 million Americans are employed by foreign-owned companies, a third of these jobs are in manufacturing, and foreign-owned companies pay on average 25 percent more than U.S. companies.

Finally, FTAs represent more than just good economic policy. Their strategic importance is enormous. Countries with which the United States has or is pursuing an FTA – Colombia, Panama, and Korea – have demonstrated a commitment to continued U.S. economic engagement, political support, and leadership in this Hemisphere and in Asia. It is very difficult to deny that failure to approve these agreements sends the wrong signal to our friends in Latin America and Korea.

Now, I'm willing to believe that I may not have convinced all of you of the merits and benefits of free trade. Nevertheless, even the most ardent opponent of free trade should agree these FTAs are good for Americans. The fact is we have very low tariffs in the United States, and in many cases give duty-free treatment to other countries – like the Central American countries covered by CAFTA, Colombia, and Peru. First and foremost, a FTA makes these partners cut their tariffs on American goods.

Perhaps the most contentious FTA is the agreement with Colombia, which has met resistance on the Hill despite its clear economic and political benefits to the United States. First, the FTA demonstrates support for Colombia's democratically-elected government, which has made significant progress in combating violence and instability in the face of a long-standing rebel insurgence. Second, the agreement will remove barriers to U.S. services and provide a secure and predictable legal framework for investors. Just as importantly, more than 9,000 U.S. companies export to Colombia, most of which are small and medium-sized firms, and 80 percent of U.S. exports would immediately receive duty-free status.

As one of my colleagues puts it, we already have free trade with Colombia – it just so happens to be one-way free trade. Over 90 percent of goods from Colombia comes into the U.S. duty free. The purpose of this agreement is to make that a "two-way" free trade street, so American goods made by American workers enter Colombia duty free.

I would like to return again to North Carolina to think through free trade agreements. In the first four years (2004-2007) of the U.S.-Chile FTA, North Carolina's exports to Chile increased by 79 percent. Since the North American Free Trade Agreement's (NAFTA) entry into force in 1994, North Carolina's exports to

Canada and Mexico have grown by 150 percent. I have no doubt that the state, which exported $181 million worth of exports in 2007 to Colombia, not to mention almost $550 million in goods to Korea, will equally benefit from free trade agreements which will reduce tariffs on agricultural products and the states' burgeoning chemical manufacturing industry.

Financial Services Industry needs Free Trade

Of course, I cannot come to Charlotte without talking about financial services and trade. Over a quarter of North Carolina's economic growth of 4.2 percent in 2006 was attributable to the financial services industry. In the United States, when one thinks of the financial services industry, one thinks of New York and Charlotte, North Carolina. As the second largest financial city in the United States, Charlotte stands to gain from trade deals that promote services. I can tell you that since Treasury is responsible for the financial services negotiations, we are fighting hard for a good deal in the Doha round – and we have already fought hard in the current FTAs.

As the U.S. economy develops its service industry, it is critical that services are given appropriate treatment. In financial services alone, employment has increased by about a million jobs, or approximately 20 percent, over the last 10 years.

In an increasingly globalized world, FTAs help keep the United States at the cutting edge in financial services as trade opens up new opportunities and spurs innovation in the provision of cross-border services. With respect to cross-border trade, the FTAs ensure that nationals and residents of our partners can purchase financial services cross-border from providers in North Carolina, including portfolio management services to fund managers.

When speaking about trade, there is often little attention on the industries where the United States stands to gain the most, and financial services is one of them. The United States is a world leader in finance and approving the remaining FTAs will only help continue our competitive advantage.

Trade Adjustment Assistance

While trade improves the health of our economy, generating income and opportunities for advancement, the transformation of an economy from one industry to another creates dislocations and anxieties that need to be addressed. Unfortunately, for many workers trade agreements have meant that they need to find new jobs in new industries. For the benefits of trade to be maximized, there needs to be a commitment to ensuring trade works for all Americans, not just those who live in the regions with the next hot industry.

This of course is not easy to do, and making it work depends on the ingenuity and entrepreneurship of the American people. For example, Charlotte did not become a banking town overnight, but the city's leadership, through a combination of measures, saw that there was room for competition and attracted banks by reducing their cost of doing business. It is this kind of strategic thinking that can help mitigate the impact of our increasingly international economy.

Success also depends on support from the government, and the Administration is supporting this through the Trade Adjustment Assistance program. This program helps workers who lose jobs due to increased foreign competition or relocation of work abroad. The program isn't perfect and it could do a better job providing the right incentives. But it is a way to channel resources to people in order to re-train and re-tool for dislocated workers and families.

The Administration supports a reauthorization and reform of trade adjustment assistance so we can help displaced workers learn new skills and find new jobs. But the current design of the program makes it harder for participants to take new jobs for a number of reasons. The income support lasts longer than regular unemployment insurance, but, in order to receive training assistance a worker must remain unemployed. Administrative costs are high, accounting for about 15 percent of total costs. More of the programs benefits should go directly to worker training. Legislation should focus training benefits on workers in industries affected by technological change or international competition, and low-income and unemployed workers without resources to finance their own training, even at relatively low-cost

community colleges.

Conclusion

Let me repeat the single most important fact from this speech: the global economy is here to stay. It is up to us to find a way forward that helps all of us prosper, and to avoid making a scapegoat out of trade or to demagogue the issue. Economic isolationism that would potentially cut the United States off from exporting goods and services would mean fewer jobs, lower incomes, and a lower standard of living. Were we to take the protectionist road, we would find ourselves alone while all the other major world economies continue to grow.

I will close by reaffirming the Administration's commitment to the trade agenda because it is what is best for the United States, and it is what is best for the economic prospects of North Carolina. The benefits of these agreements to exports and investment, including our services industry are high and we collectively need to become more vocal to ensure their realization. As I see more and more protectionism in the news I am worried that we are about to lose an historic opportunity to reap the economic and political benefits of trade through the passage of the remaining trade promotion agreements. This Administration is dedicated to pursuing that course while also enhancing adjustment services and assistance to help build a workforce for the 21st century.

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