THE ANNUAL REPORT OF THE FINANCIAL STABILITY OVERSIGHT COUNCIL

HEARING

BEFORE THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED THIRTEENTH CONGRESS

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THE ANNUAL REPORT OF THE FINANCIAL STABILITY OVERSIGHT COUNCIL

Wednesday, May 22, 2013

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The committee met, pursuant to notice, at 10:05 a.m., in room 2128, Rayburn House Office Building, Hon. Jeb Hensarling [chairman of the committee] presiding.

Members present: Representatives Hensarling, Bachus, Royce, Lucas, Capito, Garrett, Neugebauer, McHenry, Campbell, Bachmann, Pearce, Posey, Fitzpatrick, Luetkemeyer, Huizenga, Duffy, Hurt, Grimm, Stivers, Fincher, Stutzman, Mulvaney, Hultgren, Ross, Pittenger, Wagner, Barr, Rothfus; Waters, Maloney, Velazquez, Watt, Sherman, Meeks, Capuano, McCarthy of New York, Lynch, Scott, Green, Cleaver, Ellison, Perlmutter, Himes, Peters, Carney, Sewell, Foster, Kildee, Murphy, Delaney, Sinema, Beatty, and Heck.

Chairman HENSARLING. The committee will come to order.

Without objection, the Chair is authorized to declare a recess of the committee at any time.

The Chair now recognizes himself for 5 minutes for an opening statement.

This morning, we welcome Treasury Secretary Jacob Lew for his first appearance before the Financial Services Committee. Today, the Secretary is here to present, according to statute, the third annual report of the Financial Stability Oversight Council, or FSOC.

The FSOC is an amalgamation of regulators heading agencies that either helped cause the financial crisis or were largely negligent in preventing it in the first place, notwithstanding they had the regulatory power to do so.

Yet, we know the root cause of the crisis was not deregulation; it was dumb regulation. Federal policy strong-armed, incented institutions to loan money to people to buy homes that ultimately they could not afford. This dramatically eroded historically prudent underwriting standards of the subprime and alt-A mortgages that led to the financial crisis.

More than 70 percent were incented and backed by the Federal Government through Fannie Mae, Freddie Mac, the FHA, and other programs. This speaks for itself.

So in many respects, as we examine FSOC, the regulators that helped precipitate the last crisis are now put in charge of preventing the next. And, according to the U.S. Government Accountability Office (GAO), after 3 years they don't have much to show for it. Just last month, we received testimony from the GAO that FSOC "has still not developed a structure that supports having a systematic or comprehensive process for identifying potential emerging threats."

Yet, FSOC has been granted sweeping new powers within our economy. And this is disconcerting to me. Because as we know, on occasion, regulators may not just be dumb, they may not just be negligent; they may actually be criminal.

Just down the hall, as we speak, the House Oversight and Government Reform Committee is holding a hearing where, according to her attorney of record, top IRS official Lois Lerner is "pleading the Fifth" Amendment for having led an IRS division which trampled upon the First Amendment.

The American people are appalled that the most feared government agency has been permitted to attack their most sacred rights. The American people are appalled at the arrogance of the agency. They are appalled by this abuse of power. And for the last 2½ months, and for the foreseeable future, this agency, the IRS, just like FSOC, reports to you, Mr. Secretary.

And although the IRS is clearly accountable to you, the Consumer Financial Protection Bureau (CFPB), and the Office of Financial Research (OFR), two agencies which are part of FSOC, are not. Neither the Bureau nor the Financial Research Office answers to anyone. A single director who cannot be removed by the President at will heads both.

Spending by both agencies is unaccountable to Congress or the Administration. Neither is bound by the constraints of the government pay scale. And both agencies have subpoena power.

Something else both of these FSOC agencies have in common is that they are engaged in gathering massive, massive amounts of information about private American citizens.

At the same time, the IRS, thanks to its enforcement powers that it gained with Obamacare, is building the largest personal information database the government has ever seen. The CFPB is monitoring how millions of Americans interact with their lenders. And the OFR is working to gather enough information in its computers that would equal all the data held in all the U.S. academic research libraries combined. This is big data for "Big Brother."

As the IRS scandal reminds us, the freedom of every American is endangered when a government agency abuses its power and misuses sensitive information entrusted to it. In light of the recent scandals, this is an appropriate time to remind everyone that our committee maintains on its Web site a confidential way for Americans to report evidence of abuse of power by the Federal agencies under our jurisdiction. We encourage all concerned and informed citizens to use it.

Secretary Lew, we look forward to discussing these issues and many others with you in detail in today's hearing.

At this time, I will now recognize the ranking member for 2 minutes for an opening statement.

The gentlelady is recognized.

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

I am very pleased to welcome Secretary Lew to his first appearance before the Financial Services Committee to deliver the annual report of the Financial Stability Oversight Council, as required by the Dodd-Frank Act.

We are aware of your tremendous responsibilities. We are very pleased that you were confirmed. And many of us look forward to working with you to ensure that you are able to do the best job possible.

As the Council notes in its report, despite some positive developments in 2012, the housing market remains anemic and the foreclosure crisis continues to weigh heavily on our fragile economy.

However, mortgage lenders' poor servicing standards have yielded ongoing court challenges, slowing the process and leaving millions of homeowners in limbo as they contend with the inadequate government programs and mass settlements.

RealtyTrac reported that from January of 2007 to December of 2011, there were more than 4 million completed foreclosures and more than 8.2 million foreclosure starts. And while estimates of future foreclosures range widely, Moody's Analytics recently estimated that foreclosures will strike another 3 million homes in the next 3 or 4 years.

Accordingly, I do hope, Mr. Secretary, that you can discuss with the committee how housing, both legacy issues and perspective reform, factors into this agenda.

Lastly, I am concerned that our financial system remains at risk from delays in implementation of Dodd-Frank and continued industry challenges, both here in Congress and in the courts, to weaken the rules before they have been implemented. While Title VII of Dodd-Frank was designed to increase the transparency of the over-the-counter derivatives market, many of the most critical components remain stalled in rulemaking, challenged in the courts, or obstructed in the Congress.

This slow pace of Title VII rulemakings, combined with delays in implementation of the Volcker Rule, finalization of the living wills, and designation of Systemically Important Financial Institutions (SIFIs) is only made more troubling when considered in the context of the myriad financial scandals, from LIBOR and the money-laundering cases to illegal foreclosures that have occurred since the passage of the Wall Street Reform Act.

For these reasons, I am concerned that our financial system remains fragile, despite substantial improvements since 2008.

I, therefore, look forward to your testimony and insights that you may be able to provide on all of the above matters and what FSOC is currently doing to monitor systemic risk and preserve financial stability.

I yield back the balance of my time.

Chairman HENSARLING. The Chair now recognizes the gentlelady from West Virginia, Mrs. Capito, for 2 minutes.

Mrs. CAPITO. Thank you. I would like to thank the chairman for yielding me time.

And I would like to welcome our witness today.

Like most Americans, I was shocked and dismayed to learn of the IRS' admission on May 10th that they had specifically targeted conservative groups for political reasons.

This witch hunt is an insult to the American people and to the very freedoms that are at the heart of our Nation's democracy. No group, regardless of their political affiliation, should ever be discriminated against because of their political beliefs.

The First Amendment protects the rights of individual Americans and groups to express their views without fear or concern of intimidation.

Not only is Mr. Lew serving as the Secretary of the Treasury, as the IRS' transgressions unfold, he was also the White House Chief of Staff from January 2012 until his confirmation in January 2013.

We need to know more from the Secretary about what steps are being taken to ensure that this breach of trust never happens again. We need to know if further examination is necessary to ensure that this behavior is not occurring in other divisions of the IRS.

And we need to know why and how, as Chief of Staff and Secretary of the Treasury, Mr. Lew did not take immediate steps to bring this un-American action to light?

After all, reports indicate that senior IRS officials have known about these abuses for 2 years, and senior White House officials admitted to learning about them 1 month ago.

Americans deserve the truth. As public servants, we all take an oath to uphold the Constitution. The American people entrust us to be honest stewards of the freedoms and liberties that are at the core of our Nation's democracy.

It is clear that actions taken by the IRS employees and senior officials violated that trust and are counter to this duty.

This is a sad chapter for our Nation's democracy, and it is incumbent upon this Administration to take all appropriate measures to ensure that this type of intimidation and discrimination does not happen again.

I yield back. Thank you.

Chairman HENSARLING. The Chair now recognizes the gentleman from New York, Mr. Meeks, for 2½ minutes.

Mr. MEEKS. Mr. Secretary, I would like to welcome you to your first appearance before this committee. I know that in your testimony before the Senate Banking Committee yesterday, you emphasized making sure that Dodd-Frank implementation is done quickly to provide new protections for consumers, while ensuring we take a well-rounded approach in looking at the system as a whole.

I look forward to your testimony and commend you on the Council's findings regarding Basel III implementation, international coordination, and protecting the Nation's financial system from frequent and varied cyber attacks.

As to community banks and Basel III, I am encouraged by your position on the application of Basel III capital rules to community banks. Often the sole source of mortgage financing, community banks, which were not responsible for bringing the Nation's economy to the brink during the financial crisis, should not be held to the same standards as larger banks and other systemically risky institutions.

I was also pleased to hear during your testimony yesterday that Basel III would be a floor and not a ceiling for the international community.

In my view, the United States should remain a competitive financial market with the necessary safeguards enacted in Dodd-Frank.

And I am interested to hear how the Council will strenthen the core of the nation of financial regulation, both domestically and internationally, not only by pulling up global standards and reducing importing systemic risk into the United States through the effective implementation of Basel III, but also in the cross-border cooperation that is key to implementing the FDIC's Orderly Liquidation Authority (OLA) under Title II of Dodd-Frank.

Now, I want to just briefly talk about the revelations last week in the Treasury's Inspector General's report. The excessive scrutinizing of particular groups by the IRS is certainly wrong. And the IG report findings showing that some employees at the IRS exercised poor judgment in using inappropriate methods to determine if groups qualify for tax-exempt status are troubling.

While these methods are unacceptable and troubling because all individuals and organizations should be treated fairly by the IRS, the report stated that the conduct was not politically motivated.

I commend President Obama and you, Secretary Lew, for taking swift action to restore public confidence in the IRS. And I hope that while the IRS is taking these corrective measures, it does not shy away from curtailing organizations attempting to abuse their tax-exempt status.

I have a specific example in mind when I raise this issue. The IRS 501(c)(3) exemption requires that in order to be tax exempt under Section 501(c)(3) of the Internal Revenue Code, an organization "may not attempt to influence legislation as a substantial part of its activities, and it may not participate in any campaign activity or against any political candidates."

Here, I have a fund-raising letter from a 501(c)(3) organization.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentleman from Alabama, the chairman emeritus, Mr. Bachus, for 1 minute.

Mr. BACHUS. Thank you.

Congratulations on your appointment, Secretary Lew. And thank you for appearing before the committee today.

Secretary Lew, you are obviously familiar with Dodd-Frank, due to your position as the Director of OMB. Now, you are about to confront all of it—the good, the bad and the ugly—as I have said.

One of the common elements in the Democratic and Republican reform proposals that preceded Dodd-Frank was the formation of some type of systemic risk council to help regulators share information and coordinate their actions. These councils differed in their details. And of course, the end result was the Financial Services Oversight Council.

Our expectation throughout the rulemaking and under the statute was that it would be transparent and have accountability, especially considering the high-level nature of the regulators involved.

So it is particularly disturbing to me, especially considering the events in the news over the past few weeks, that the GAO has found that there is a serious lack of transparency at the FSOC. Very little is put down in writing or made available to the public.

And as I noted to Attorney General Holder, when you don't have a record, you don't know the details, and there is no accountability.

So my hope is as Chairman of FSOC, you will work with us to assure more accountability and more transparency.

Thank you.

Chairman HENSARLING. The time of the gentleman has expired. The Chair now recognizes the gentlelady from Alabama, Ms. Sewell, for 1 minute.

Ms. SEWELL. I want to thank Ranking Member Waters and Chairman Hensarling for scheduling this critically important hearing today.

I also would like to welcome Secretary Lew and thank him for his testimony today.

I am very encouraged to find out that since the Council's last annual report, the U.S. financial system has continued to strengthen and make incremental progress.

I am also encouraged to see that many of the stop-gap measures and regulations put into place by Dodd-Frank have succeeded in providing oversight, transparency, and continued liquidity in the marketplace.

However, this report is also very sobering, in that it identifies significant and unresolved risks in the financial marketplace.

This report points to lingering structural vulnerabilities in the wholesale funding markets, continued overdependency on government and agency guarantees in the housing market, and the emerging operational risks to our financial systems posed by increasing cyber attacks, just to name a few.

Our work as Members of Congress is obviously far from done. And we must continue to remain vigilant in providing the necessary guidance and oversight to fully realize the overall objective of Dodd-Frank.

At this time, there may even be commonsense reforms that we must consider, to make technical corrections in order for its purpose to be felt.

I want to applaud the Secretary, as well as administrators at FSOC, for their efforts in providing that transparency.

Chairman HENSARLING. The time of the gentlelady has expired.

The Chair now recognizes the gentleman from Michigan, Mr. Kildee, for 1 minute.

Mr. KILDEE. Thank you, Chairman Hensarling and Ranking Member Waters.

And welcome, Secretary Lew.

Five years after the greatest economic crisis since the Great Depression, home values continue to recover. One way we can improve financial stability, increase property values, and rebuild neighborhoods is by eliminating blight and abandonment in our communities.

Yesterday, I hosted a meeting for Members—including from this committee, Mr. Huizenga and Mr. Peters—with Assistant Secretary Tim Massad to discuss the ongoing importance of demolition in certain housing markets, including places like Flint and Saginaw, Michigan, which I represent.

This issue is not just important to my district, though, but to cities and towns across the country.

Targeted demolition strengthens municipalities and affects their long-term sustainability. Leaving blight and abandonment in buildings and neighborhoods not only hurts homeowners nationwide, but also makes our communities less safe, as vacant, run-down properties often are the sites of crime.

I look forward to your testimony today, and to working with Treasury to continue to identify ways to eliminate blight and abandonment in our communities.

Thank you very much.

Thank you, Mr. Chairman.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentlelady from Ohio, Mrs. Beatty, for what he hopes will be 1 minute.

Mrs. BEATTY. Thank you, Mr. Chairman, and Ranking Member Waters.

And thank you, Secretary Lew, for your testimony today and, more importantly, for your service to this country.

This year's annual FSOC report discusses several different areas of concern that continue to pose ongoing threats to the systemic financial market stability.

And though some are uncontrollable, there are some that I believe can be resolved through the actions of this Congress.

Specifically, the report mentions the U.S. fiscal policy in the absence of bipartisan consensus as an ongoing risk. And since over the last 2 years, unfortunately most of what has been showcased has been our bickering and disregarding the deficit, government spending and raising the debt ceiling—so today, hopefully with your guidance and testimony, we can look at this report seriously and work together to find a common cause.

And thank you very much for being here to help us do that.

Chairman HENSARLING. And thank you very much for coming in under time.

Today, we welcome the Secretary of the Department of the Treasury, the Honorable Jacob J. Lew, who was confirmed by the Senate on February 27th of this year to serve as our Nation's 76th Secretary of the Treasury.

His prior Government service includes tenures at heading up OMB for both the Obama and Clinton Administrations, as well as serving as a Deputy Secretary at the State Department.

In addition to Secretary Lew's public service, he served as the managing director and chief operating officer for two different Citigroup business units, and as an executive vice president and COO of New York University.

No stranger to the halls of Congress, our Secretary has served for 8 years as an adviser to former Speaker Tip O'Neil. Secretary Lew holds degrees from Harvard College, and the Georgetown University Law Center.

Secretary Lew, you will be recognized to give an oral presentation of your testimony. And without objection, your written statement will be made a part of the record.

I wish to inform all Members that we have agreed to release the Secretary at 12:45 p.m. today.

Mr. Secretary, welcome. Please proceed.

STATEMENT OF THE HONORABLE JACOB J. LEW, SECRETARY, U.S. DEPARTMENT OF THE TREASURY

Secretary LEW. Thank you, Mr. Chairman.

I would like to, just at the outset, say that I think all of us are in the same place, that our thoughts and prayers are with those affected by the devastating tornadoes in the Oklahoma City area. It is just a reminder of the terrible ravages that natural disasters can cause. And our hearts and prayers are with the families who are suffering there.

Chairman Hensarling, Ranking Member Waters, members of the committee, thank you for the opportunity to testify today regarding the Financial Stability Oversight Council's 2013 annual report.

Before I address the report, I want to say just a few words about the Treasury Inspector General for Tax Administration's report last week, which showed that some employees at the IRS used outrageous methods to determine if certain groups qualified for tax-exempt status.

As the Inspector General's report indicates, while this conduct was not politically motivated, it was unacceptable and it was inexcusable. Administering the Tax Code without any hint of bias is a solemn obligation that must be carried out with the highest of standards. That is why I moved quickly to take steps to restore confidence in the IRS.

Within 24 hours of the report coming out, I asked for and received the resignation of the acting Commissioner. And within 24 hours, the President appointed a new acting Commissioner, Daniel Werfel. He is a person of high integrity and he has earned the confidence of Democrats and Republicans for his professionalism.

I have directed incoming Acting Commissioner Daniel Werfel, who just starts today, to carry out a thorough review of this conduct, and to take action on three specific things: first, making sure that those who acted inappropriately are held accountable for their actions; second, examining and correcting any failures in the system that allowed this behavior to happen; and third, taking a forward-looking view in determining whether the IRS has systemic problems that need to be addressed.

The acting Commissioner will hit the ground running. He will take actions as needed. And he will report to me on his progress within 30 days. We are going to make sure that nothing like this ever happens again.

I would like to turn now to the Council's annual report. This report represents extensive collaboration among Council members, agencies, and staff. It gives us a chance to provide Congress and the public with the Council's assessment of significant financial, market, and regulatory developments, potential emerging threats to financial stability, and recommendations to strengthen the financial system.

I want to point out that the strength of our financial system depends greatly on the strength of our economy. Now, there is no doubt that we have made significant progress recovering from the worst economic crisis since the Great Depression.

The economy has grown for 15 consecutive quarters. The private sector has been creating jobs for 38 straight months. The housing market is healing. Our deficits are falling at the fastest rate in decades. But there is more to be done. We need to keep our foot on the accelerator. Economic growth and job creation need to be more rapid.

The President has put forward a comprehensive jobs and growth plan. His path forward strengthens the recovery by making needed investments in manufacturing, innovation, infrastructure, and worker training, while taking a balanced approach to restoring our long-term fiscal health. This strategy will not only help grow our economy now and well into the future, it will replace the sequester with sensible deficit reduction measures.

Since the Council's last annual report, our financial system has grown stronger in a number of ways. Capital and liquidity levels for the largest financial institutions have increased. Regulators have taken additional steps towards improving transparency and risk mitigation in derivatives and other markets.

And the implementation of the Dodd-Frank and internal coordination on G20 reform priorities have brought significant progress towards establishing a more resilient and stable financial system, both domestically and globally.

On the topic of Dodd-Frank implementation, the Council and its member agencies continue to put reforms in place. It is important to note that while additional work remains, we are much closer to the end of the process than we are to the beginning.

We have seen a good deal accomplished recently, including: progress on the Council's evaluation of an initial set of nonbank financial companies for potential designation; progress on a new framework for the consolidated supervision of large financial institutions; progress on a new framework for the Orderly Liquidation Authority; progress on implementing provisions related to living wills; progress on reducing risk and increasing transparency in the derivatives markets; and progress on enhancing protections for borrowers and other participants in the mortgage markets.

Despite these positive developments, there are still risks to U.S. financial stability. The Council's report identifies those risks and makes specific recommendations to mitigate them.

For instance, it is our judgment that market participants and regulators need to take steps to reduce vulnerabilities in wholesale funding markets; that government agencies, regulators, and business need to address operational risks posed by technology failures, natural disasters, and cyber attacks; and that reforms are needed to address the reliance on self-reported reference interest rates like LIBOR.

Mr. Chairman, I want to thank the other members of the Financial Stability Oversight Council and all the staff involved with the 2013 annual report for their hard work and dedication. This is an ongoing effort, and we look forward to continuing to work with you, this committee, and Congress to make sure we have a more resilient and stable financial system.

With that, I conclude my opening remarks, and I look forward to answering your questions.

Thank you.

[The prepared statement of Secretary Lew can be found on page 60 of the appendix.]

Chairman HENSARLING. Thank you, Mr. Secretary.

And I would remind all Members, at the direction of the Speaker, that later today during our vote series, there will be a moment of silence for all the victims of the Oklahoma tornadoes, and an opportunity to reflect upon that great tragedy.

The Chair will now recognize himself for 5 minutes for questions.

Mr. Secretary, I am personally not going to spend a whole lot of time with you on discussing who knew what, when, with respect to the IRS scandal, but I would like to say this: I don't know the level of responsibility that you and the President bear for this scandal, but I know it is not zero. And I think the American people would like to hear a little bit more from you and the President that the buck stops here, as opposed to hear no evil, see no evil, and I know nothing, nothing, nothing.

And that may just be a little bit of unsolicited advice. So I am not going to look retrospectively. I am going to look prospectively. I know you have seen the forms that the IRS has sent to American citizens. The IRS now reports to you, Mr. Secretary, and has for the last 2½ months.

So I look through these forms and I find out where the IRS is asking American citizens for all of their activity on Facebook and Twitter, including hard copies of all advertising on social media.

Under your watch, will it be appropriate for IRS agents to ask for this information?

Secretary LEW. Mr. Chairman, I take responsibility for the management of the Treasury Department and for the management oversight of the IRS. There is a difference between general management oversight and the very important line that exists between policy roles and the Administration of the tax system.

For decades, we have had an appropriate line—

Chairman HENSARLING. But Mr. Secretary, the Administration just fired someone. That would seem to indicate there is some control over the policies of the IRS.

So to the extent that you have the ability, and the Administration has the ability to hire and fire the head of the IRS, will it be appropriate for the IRS, going forward, to ask for this information from American citizens?

Secretary LEW. Mr. Chairman, if I could just finish the thought that I was on?

There is a very important distinction between hiring a Commissioner of the IRS and there is one other political appointee at the IRS, the General Counsel. The rest of the IRS—

Chairman HENSARLING. Are you positing an inability—

Secretary LEW. —for appropriate reasons, it is a career agency. And there is involvement on policy matters, but on administration of the tax—

Chairman HENSARLING. So, are you unable to impact the policy?

Secretary LEW. On policy, I will continue, as Secretaries of Treasury have and should, to express views on tax policy—

Chairman HENSARLING. Okay, Mr. Secretary, I get to control the time here. But in your opinion, is it appropriate to ask American citizens about their prayer life, how often they attend prayer meetings and what percentage of time of organizations are spent in prayer groups?

Secretary LEW. Mr. Chairman, I am not familiar with the specific document that you are looking at.

As a general matter, there is the highest regard for the—

Chairman HENSARLING. —release by the IRS—

Secretary LEW. —personal privacy of individuals is very high priority. Protecting of individuals from the kinds of questions that invade their privacy is a very high priority.

Chairman HENSARLING. You have some ability to impact who heads the IRS.

So, in your personal opinion, is it appropriate for the IRS to be asking about the prayer lives of American citizens?

Secretary LEW. Mr. Chairman, it is a hypothetical question, since I am not familiar—

Chairman HENSARLING. It is not hypothetical, Mr. Secretary, to the people who received this application, on penalty of perjury, if they didn't disclose their prayer lives to the IRS.

Secretary LEW. Mr. Chairman, I cannot respond to a form that I haven't had the chance to see. I am happy to get back to you on a specific—

Chairman HENSARLING. Okay, if you would, Mr. Secretary. And after being on the job for 2½ months, and it is one of the biggest scandals that has rocked Washington in years, I would hope in the matter of priorities of the Secretary of Treasury, you would undertake to review this material going forward.

Secretary LEW. Mr. Chairman, I have made clear that it is an extraordinarily high priority, my highest priority to restore confidence in the IRS. That is why we have a new acting Commissioner who is taking over today.

His first job is to find out who is accountable and make sure people are held accountable for any actions that were wrongful. Secondly, he is—

Chairman HENSARLING. Mr. Secretary, regrettably, my time is running out. I assume you will have ample opportunity to speak more about the IRS.

I am actually going to change subjects, which may be pleasant for you. In the FSOC report, on page 13, it states, "The Council recommends that the Treasury, HUD, and FHFA continue to work with Congress and other stakeholders to develop housing reform system."

Mr. Secretary, I have been either the chairman or the vice chairman of this committee for the last 2½ years. And I am unaware of any activities of either HUD or Treasury to work with Congress. I am aware of the White Paper that was released, that has now gathered dust for over 2 years.

So I am not sure who Treasury and HUD has been working with, but it hasn't been this committee. And I see my time has expired.

I would like to have the opportunity to speak to you about this later, to find out if the Administration intends on doing anything with their White Paper besides allowing it to gather dust on housing reform.

The Chair now recognizes the ranking member for 5 minutes.

Ms. WATERS. Thank you very much.

Mr. Secretary, I wanted to talk with you about living wills, but I think it is important, before I deal with public policy that we are all concerned about, that we make some things clear on the record.

As I understand it, the knowledge about the IRS problem was only learned recently by you. Is that correct?

Secretary LEW. That is correct.

Ms. WATERS. And, as I understand it, the President was not told about the problem by his Chief of Staff or anyone else. Is that correct?

Secretary LEW. That is correct. Until it was a public—

Ms. WATERS. I beg your pardon?

Secretary LEW. Until the report was completed, yes.

Ms. WATERS. Okay. And I understand that there is an investigation going on.

Secretary LEW. There are multiple reviews here on the Hill and by the Department of Justice and within the IRS.

Ms. WATERS. And so, the Administration has not in any way said they were not willing to try and find out what was happening in the correct way. Is that correct?

Secretary LEW. Yes. Quite the contrary, we are determined to make sure. The activities that were disclosed by the Inspector General are unacceptable. We have said so in the strongest terms.

We have appointed an acting Commissioner who is going to make sure people are held accountable, who is going to make sure we find out how there was a breakdown in communication and management to permit it, and to look more broadly at the IRS to make sure that nothing like this could ever happen again.

So we are very determined to restore confidence that the IRS is operating without any bias, which is our obligation. And we are committed to doing that.

Ms. WATERS. Again, and my colleague, the chairman of this committee, said that he knows that you and the President must have known something. He said basically that you must have had some information. Would you please take as much time as you want that I have left, because you were interrupted and you did not have time to respond to that.

And if you feel the need to say something else about it, please use my time to do that.

Secretary LEW. Congresswoman, I was informed of the fact that there was an audit under way on March 15th, when I had an initial meeting with the Inspector General.

It was brought to my attention at a very high level, that it was an investigation regarding 501(c)(4) approvals. And I was told that there could be some troubling findings. Then, I did what is an appropriate thing; I did not do anything to get in the way of an independent IG review. That is what agency heads should do. They should give the IG the opportunity to complete their work, and make sure they have access to people and records that they need.

As has been discussed over the last few days, there was some discussion, as is appropriate, between attorneys and other staff at agencies and the White House, for situational awareness.

Now, I want to make clear, the reason that it was not brought to my attention before the report came public, what the facts were—and the reason it was not brought to the President's attention before the Inspector General completed his report is that there was nothing that we should have done to interfere with an Inspector General report.

Just like the IRS should not impose any political influence on the administration of the tax system, agency heads and senior political officials should not exercise any action to interfere with an Inspector General review.

So the first we knew of the facts was when they become public on the Friday before last, in a general way, and then, just last Tuesday, when the actual IG report was delivered.

Within 24 hours of getting the IG report, we took action. We asked for and we got the resignation of the acting Commissioner. And 24 hours after that, the President appointed a new acting Commissioner who starts today, who is going to undertake the task that I described with the three very important parts: accountability; finding out what happened; and making sure it never happens again.

Ms. WATERS. Thank you so very much, Mr. Secretary.

And now, for some public policy.

Secretary LEW. Yes.

Ms. WATERS. What can we do to help get these living wills in, so that we can make sure that we have a process that works in the orderly wind-down that—

Secretary LEW. Congresswoman, we have made great progress in the area of living wills with the largest financial institutions. We now have living wills on file for the very largest institutions.

I think the challenge is now to make sure that we know that those can work. And I think the operational issues are not insignificant.

We are not, hopefully, going to have a test of these any time soon. We are going to need to do the kinds of exercises that make sure that you have confidence in the capital that is available and the structures that are available, so that if there is a crisis, they work.

We are committed to doing that, and the regulatory agencies responsible for the living wills are as well.

Ms. WATERS. I thank you very much, Mr. Secretary. And I look forward to working with you.

I yield back the balance of my time.

Chairman HENSARLING. The Chair now recognizes the gentlelady from West Virginia, Mrs. Capito, for 5 minutes.

Mrs. CAPITO. Thank you.

Thank you, Mr. Secretary,

And you heard my opening statement, so I am going to ask a question regarding the IRS scandal. I think what would be in the best interests of the taxpaying citizens of this country is to know, as you said, that this could never happen again.

How are we going to be able, or the Administration going to be able to convince the American public that being targeted for political beliefs or religious beliefs or lifestyles or whatever—in order for this to put the American mind at ease, which I think is going to be very difficult, you have to come forth with everything.

And so, how do you plan—are you going to issue a report, fire more people? What kind of end-game is there going to be to lay this to rest?

Secretary LEW. Congresswoman, there is nothing more important than restoring the confidence of the American people in the IRS. It is central to the capacity of the IRS to function effectively, which is central to the capacity of our system of government to function effectively.

Mrs. CAPITO. Right.

Secretary LEW. I think that by taking the action that we took last week and bringing in new leadership immediately, we now have a person in place who will very quickly get on with, first, making sure we hold people accountable. That is very important. We have to get the facts and we have to make sure any actions that are taken are based on fact.

Second, the kind of scrutiny that we need to do now has to get at, how did this happen?

Mrs. CAPITO. Right.

Secretary LEW. How could the communications be so bad? How could the management be so loose?

And I can't sit here today and tell you we have completed that. Somebody began today, in whom I have the utmost confidence to get that under way very quickly.

But I think the third piece is really ultimately the answer. We have to look beyond the facts here and ask more broadly, is there something systemic about the management structure of the Internal Revenue Service that needs to be fixed to be able to say with confidence that not just with regard to this area, but more broadly, we have taken the kind of look to be able to say that we can be confident that this won't happen again?

Now, there is all kinds of information people have to provide on a confidential basis to the IRS. We have to protect people's confidentiality.

Mrs. CAPITO. Right.

Secretary LEW. And I think that while most of us would rather not have to file a lot of forms, when you want to get approved as a not-for-profit—

Mrs. CAPITO. But how do people who provide that information, no matter what it is, know it is going to be held in the strictest confidence?

I think the erosion of trust here is tremendous. And I think the best advice I would give to you is that bad news doesn't get better with time. You have to get it out there. And you have to get it out in the strongest, in the most honest way, with the American people.

And so I am going to move to the substance of your appearance here today. I have two questions.

One is, Secretary Geithner, your predecessor, in talking about implementation of Dodd-Frank, he and I had several conversations. And he talked about how we have all this new regulation and we are going to scrape out the old regulation, outdated regulation, outmoded.

And then, when questioned, he really couldn't come up with any outdated or outmoded regulation that he actually was draining from the overpiling of regulation in the financial sector.

Is this an area in which you are interested? Is the FSOC dealing with this?

Because we hear daily, it is not one regulation, it is not two, it is the continuous weight of regulation that is dragging down particularly our community banks and regional banks.

Secretary LEW. Congresswoman, I will tell you that, in general, that is an area of great concern to me. I have not had the time yet, in 2½ months, to go backwards. I am very much committed to making the full implementation of Dodd-Frank happen in as quick a timeframe as possible.

But I will say that when I was OMB Director, we did, for the very first time, take a look back in the overall regulatory system, to ask agencies what do you have on the books that is out of date and that can be eliminated? And we eliminated a whole bunch of regulations across the government. I think it is an exercise that we should not just move forward, we have to look backwards and forwards, both.

Mrs. CAPITO. Right.

Secretary LEW. And I hope we can get Dodd-Frank in place and have the ability to do that.

Getting Dodd-Frank implemented is still a fair amount of work. And getting it done quickly, I think, is a very, very important priority.

Mrs. CAPITO. I hope the next time you come before the committee, you can give me some specifics—

Secretary LEW. Sure.

Mrs. CAPITO. Because I am going to ask you—

Secretary LEW. And I look forward to—

Mrs. CAPITO. —other regulations that you have been able to—

Secretary LEW. It is something I am personally committed to as a general principle.

Mrs. CAPITO. That is good news to me. Thank you.

Lastly, I only have 25 seconds. Basel III is a great—I chair the Financial Institutions Subcommittee. We have, with the ranking member, talked about this quite a bit, the inability of community and small banks to deal with the risk-weighted aspects of Basel III.

Have you considered pushing that back for those institutions? And why are they involved anyway?

And I just ran out of time, so—

Secretary LEW. Mr. Chairman, if I could just take a half a minute to answer the question?

Chairman HENSARLING. A brief moment.

Secretary LEW. I think that it is very important that all of the regulatory agencies take into consideration whether or not there are special issues regarding small and medium-sized institutions. The law, in many regards, has reflected that. And in the review of regulations, the agencies are looking at that as well.

I think that the discussion I have heard in the last few weeks suggesting that maybe Basel III should be repealed or not be used, I worry about that as a principle. Because Basel III is a floor for the world, and we want the world to kind of have a race to the top.

And if we don't keep Basel III as that driver for a race to the top, we face financial—

Chairman HENSARLING. The time of the gentlelady has expired.

The Chair now recognizes the gentlelady from New York, Ms. Velazquez, for 5 minutes.

Ms. VELAZQUEZ. Thank you, Mr. Chairman.

Welcome, Mr. Secretary. I would like to discuss with you another issue that is on the minds of Americans, and that is the state of the economy.

We continue to see improvement in the housing sector, with increased construction activity, more sales and higher prices. As you know, the economic recovery relies heavily on a healthy housing market. In your opinion, could complete privatization of the secondary mortgage market, as some policymakers have proposed, create procyclical conditions where too much credit is available in good times, and too little when there are problems, thus exacerbating downturns?

Secretary LEW. Congresswoman, I think that our challenge as we go through winding down Fannie Mae and Freddie Mac is really in multiple parts. First, we have to make sure taxpayers recover the big investment they made during the financial crisis in those institutions. We are working very hard to do that. They have long-lived assets and it is going to take a while to wind down those institutions.

We also have to be thinking ahead to how do we have a housing market that strikes the right balance, that provides opportunity for homeownership and the economic activity that goes with that, since so much of the construction employment and other employment in our country is related to housing construction, with the prudential considerations that institutions and individuals not be overextended, creating the seeds of some future crisis.

We are working on that. I think it is very important that we have a reduction in the presence of Federal direct and guaranteed loans; that we have an active private capital market for mortgages. And that is our goal as we move forward.

Ms. VELAZQUEZ. Thank you.

Mr. Secretary, some stakeholders have alleged that last year's LIBOR manipulation enriched the largest banks, to the detriment of community and regional banks. As you know, community banks are a significant source of small business lending. And we continue to hear the obstacles that small businesses are facing in accessing capital.

What have Federal regulators done since the LIBOR scandal broke to prevent manipulation of key interest rates that impact the cost of credit for small businesses?

Secretary LEW. Congressman, I think they are kind of separate issues. The manipulation of LIBOR was a terrible abuse of trust, in addition to—the world financial community and participants in it had accepted LIBOR as something that was a market-determined reference rate. And then the manipulation of it was very, very unsettling, in addition to being just very wrong and bad behavior.

Going forward, one of the things the FSOC report makes clear is that we need to work on an international basis with other financial regulators and with market participants to develop an alternative to LIBOR, because there needs to be a broadly accepted market reference rate to take the place of LIBOR, if there is a need to replace it. So that is one area where there is substantial progress being made.

I think in terms of the kind of transmission mechanisms for capital to be made available to small business, that is a very complicated practice. And I think that the tradeoff that I was describing in the area of housing lending, that same tradeoff exists in commercial lending.

There is a need for small and medium-sized enterprises to have access to credit. That means taking some level of risk. Banking does involve some level of risk. We need to make sure that institutions don't take risks that become taxpayer burdens afterwards. Striking that balance correctly so that we can open up the channels of lending to small- and medium-sized enterprises is very important.

Ms. VELAZQUEZ. But we have to also provide a level playing field for those regional and community banks that are really the ones that are lending to small businesses and not put them at a disadvantage.

Secretary LEW. Yes, and as I was indicating before, I have met with small and medium-sized bank representatives. I have shared the concerns they have raised with me with the regulators. I have the very clear understanding that the regulators are sensitive to those concerns. And as they work through the implementation of these rules, things like the Basel III rules, they are working to try and address the legitimate issues that have been raised.

Ms. VELAZQUEZ. Thank you, Mr. Chairman. I yield back.

Chairman HENSARLING. The gentlelady yields back the balance of her time.

The Chair now recognizes the gentleman from New Jersey, Mr. Garrett, for 5 minutes.

Mr. GARRETT. I thank the chairman.

And I too want to get to the seminal issues on financial services, but let me just touch initially on the issue with regard to the IRS.

I must say, first of all, that I found your opening comment on this disingenuous at best, because your initial statement was that as soon as you found about the situation, you were outraged. You found it outrageous conduct. You took immediate action. You made this the top priority. This was going to be your first focus.

And the very first question from the chairman, asking you about documents from your own agency, that are from your agency, that are in the public domain, that have been in the press for literally weeks now—and again, from your agency—your response was that you know nothing about them; you do not know the details; and you would have to get back to us.

If this was really your first priority, if you were going forward trying to solve the situation, not retrospectively but in the future, I would think, sir, that you would know about the basic documents that everyone else in this room knows about.

But that is a rhetorical question. We can judge for ourselves whether you are really trying to fix this for the future, and make it a priority.

Secretary LEW. If I could respond—

Mr. GARRETT. My time is limited. In another hearing room, there is another woman, who is a woman from the IRS, Lois Lerner, formerly from the IRS, who has stated that—I think she has taken the Fifth Amendment. But she has stated that she has done nothing wrong; she had done nothing criminally wrong or did not violate any IRS rules or regulations.

Would you agree with her assessment that she did absolutely nothing wrong, did not violate any rules, regulations, or criminal conduct in any way, shape or form?

Secretary LEW. Congressman, I think it is important that we get to the bottom of the facts—

Mr. GARRETT. Yes or no, do you think she did anything—

Secretary LEW. Congressman, it is not a yes or no, and if I could be permitted to answer your question, I would like to do so.

Mr. GARRETT. Sure.

Secretary LEW. You have asked me a question which—we have a new acting Commissioner who has taken office today—

Mr. GARRETT. Right.

Secretary LEW. —who is beginning today to get to the very bottom of who should be held accountable. I am committed to—I am meeting with him this afternoon. I am not waiting for 30 days to meet with him.

Mr. GARRETT. Good.

Secretary LEW. I didn't wait for 5 minutes after I read the IG report to get on top of it. I got on top of it right away.

Mr. GARRETT. What did you do?

Secretary LEW. What did I do? I got the wheels in motion to get a new IRS Commissioner in there as soon as possible.

Mr. GARRETT. You fired someone immediately here in the case, before you knew whether he did anything criminally wrong, violated any regulation whatsoever. So you are able to make that decision—

Secretary LEW. Congressman, I think that if you are talking about an agency where an IG report makes clear that there was behavior that was totally unacceptable, in order to restore confidence, you begin at the top. We needed a new head of the IRS, which we have as of today. We are going to get to the bottom of it. Anyone who is accountable will be held accountable.

Mr. GARRETT. Okay. So you don't know whether she did anything wrong or—

Secretary LEW. Congressman, I am going to wait to have all the facts. I don't have all the facts. We have to make decisions.

Mr. GARRETT. But you were able to make a decision to fire someone without knowing whether he did anything—

Secretary LEW. I knew the fact that he was the acting Commissioner of an agency that had lost the public trust.

Mr. GARRETT. What position did she have?

Secretary LEW. I think that as the head of an agency, there was a standard that is unique. Frankly, even—

Mr. GARRETT. But do you know what position she has?

Secretary LEW. —even if—

Mr. GARRETT. Do you know what position she has?

Secretary LEW. —even if there is no wrongdoing at the head of the agency, I think it is the right action.

Mr. GARRETT. Do you know what position she held?

Secretary LEW. Yes, I do.

Mr. GARRETT. And it is or was?

Secretary LEW. She is the Deputy Commissioner in this area.

Mr. GARRETT. In this area. So wouldn't she be responsible for this area if she was the head of that area?

Secretary LEW. Congressman, I am not going to go through person by person asking questions that I can't answer right now, and none of us can answer right now. But I am committed, as we have made very clear publicly, that everyone who is accountable will be held accountable.

Mr. GARRETT. Okay. So let us take a look at some of the people that maybe you are responsible for. According to the IG's testimony last week, the IG alerted the IRS and Treasury officials to the investigation in May or June. Have you confirmed that the General Counsel and Deputy Secretary were, in fact, briefed by the Inspector General back in 2012?

Secretary LEW. Congressman, I think that we have made clear that the Deputy Secretary was aware of the fact that an audit was under way. He did not become familiar with the details of it until I did last Tuesday.

Mr. GARRETT. Okay. Do you know whether or not he—this would be Deputy Secretary Wolin, correct?

Secretary LEW. Correct.

Mr. GARRETT. Right. Do you know who, if anyone, he advised about the investigation back at that time?

Secretary LEW. We have over the last few days made clear that there were, as appropriate, conversations among staff where the fact of an investigation was clear. And subsequently in the last few weeks, as draft reports were being either—the facts in them or the reports themselves were available, that there were conversations. But there was no action taken by anyone in the Treasury Department in any way to interfere with the Inspector General's report. And that was the number one goal and responsibility.

Mr. GARRETT. I understand. I understand why you don't want to get involved there. Did he contact the IRS Commissioner and advise him to correct the false testimony that the Commissioner had given to Congress just the month before?

Secretary LEW. Congressman, I told you that there were conversations as appropriate for people who needed to understand that there was an investigation.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentleman from North Carolina, Mr. Watt, for 5 minutes.

Mr. WATT. Thank you, Mr. Chairman.

And I thank Mr. Lew for being here.

Let me turn our attention to FSOC, since I thought that is what this hearing was about, rather than the Internal Revenue Service. I assume the Internal Revenue Service is not on the FSOC. Is that correct?

Secretary LEW. No, it is not.

Mr. WATT. Okay. One of the things that you all have been doing, according to your testimony, is designating some financial institutions as particularly significant to the economy, which results in them being given enhanced scrutiny and some higher standards.

So you have designated some financial institutions. And at the bottom of page 6 of your prepared testimony, you say you have designated 8 financial market utilities. What kinds of utilities are those?

Secretary LEW. It would be utilities like clearinghouses.

Mr. WATT. Okay. And then you also say that you are looking at a number of nonbank financial companies that will be designated. What kinds of institutions are those?

Secretary LEW. Congressman, the identity of the companies has not been publicly noted because in order to go through this process, it requires getting very confidential information from the companies. And it would be inappropriate for me to list the specific entities.

The test that is used, the standard is whether the failure of those companies—the material distress of those companies will be a threat to U.S. financial stability. So the question is, if something were to happen in a nonbank entity that could become a kind of systemic problem. And that is the way the review is structured. It is really the interconnection between the company and the broader state of financial stability.

Mr. WATT. Which actually gets me to the point that I was trying to get to circuitously. A number of people have raised concerns that by designating these entities, we somehow give the impression that they are so important that the government won't allow them to fail. Walk us through, if you would, how we make sure that doesn't end up happening, both statutorily under Dodd-Frank and through the process that the Council is following.

Secretary LEW. The determination is not at all to create the impression that a firm might be too-big-to-fail. It is quite the opposite. It is to ask the question, does a firm need to be regulated in a way so that it won't fail and won't cause that kind of distress to the broader financial stability. The more likely consequence of being designated would not be to get bigger.

I don't think that any designated firm gets any protection by being designated. What they get is a higher level of scrutiny and regulatory oversight by the appropriate regulatory body.

FSOC does not actually take on the regulatory function. If the vote of FSOC is to designate a nonbank, there will be regulatory oversight by the appropriate regulatory body. So in many cases, it will be the Federal Reserve Board, with its regulatory authority over bank and bank-like institutions.

Mr. WATT. And would each one of those significant institutions end up having to do one of those living will scenarios if FSOC designated them as—

Secretary LEW. I think if they are at a size level that would require it. I believe it will be a case-by-case determination, but I would have to get back to you on that.

Mr. WATT. All right.

On page 2 of your testimony, you indicate that reforms are needed in the LIBOR system to address the reliance on voluntary self-regulated and self-reported reference interest rates. Can you tell us what kinds of reforms might be in the contemplation on that front?

Chairman HENSARLING. Briefly if you could, Mr. Secretary?

Secretary LEW. Thank you, Mr. Chairman.

These reference rates are interwoven into millions of financial transactions on a contractual basis. We need to have reference rates that are reliable and not subject to manipulation. And we need, if LIBOR is not in that status at some point, to have an alternative to go to.

And I think that working with the international financial regulatory agencies and working with market participants developing an alternative is critical, because even if you don't ultimately need to move to a different reference rate, there needs to be another reference rate available.

We—

Chairman HENSARLING. The time of the gentleman has expired.

Secretary LEW. Thank you, Mr. Chairman.

Chairman HENSARLING. At this time, without objection, our chairman emeritus is recognized for 1 minute to speak out of order.

Mr. BACHUS. Thank you.

Today, the staff of the House of Representatives loses one of its most valuable staff members. I think we all know and love Warren Tryon, who served as the Deputy Staff Director, a very intelligent, diligent, informed individual.

And in tribute to him and really all the valuable work of our staff, both on committees and our personal staff, I would like Warren to stand up and take a bow.

[applause]

And I appreciate that, Mr. Chairman.

Chairman HENSARLING. And now, the Chair recognizes the chairman emeritus for his 5 minutes.

Mr. BACHUS. Thank you.

Secretary Lew, the GAO and really many press reports and articles have criticized the secrecy of the FSOC. Last week, there was an article in a Washington paper where one gentleman heading up a nonprofit organization with liberal leanings actually said that the FSOC's proceedings make the Politburo look open by comparison. They treat their information as if it were state secrets.

The Council doesn't transcribe its meetings. Is that correct?

Secretary LEW. Minutes are kept.

Mr. BACHUS. Minutes.

Would you commit to transcribing the meetings as the GAO has recommended, and releasing those transcripts, with appropriate redactions, after a certain period of time, as the Fed does?

Secretary LEW. Mr. Chairman, I think that FSOC deals with matters that range from very company-specific, proprietary information to broad—

Mr. BACHUS. And I understand appropriate redactions. The Fed redacts confidential—

Secretary LEW. And I think that for where the FSOC has moved in policy areas, it has tried to be very open in terms of public notice and taking comments. So for example, in the area of the money market rule recommendations to the SEC, they have been open for comment. And many, many—

Mr. BACHUS. I understand comment. But would you commit, at least, to following the same thing that the Fed does about releasing those transcripts?

Secretary LEW. Congressman, I would have to go back and look at that.

Mr. BACHUS. Okay, thank you. Take a look at that. That is all I ask.

The FSOC doesn't keep transcripts and I don't even think they keep minutes of their staff meetings or subcommittee meetings or the committee meetings. That is where most of the work is done. Would you commit to transcribing those proceedings and keeping minutes of those meetings?

Secretary LEW. Congressman, I am not aware of practices where meetings like that are normally transcribed. The challenge of working in these complicated areas involves many, many meetings.

And I am happy to follow up with you on—

Mr. BACHUS. Sure.

Secretary LEW. —the concerns you have about transparency—

Mr. BACHUS. I think most minutes—yes. But as you know, you are chairman. This is one of the most important committees or councils in response to the financial crisis. I think it is important from a historic basis.

Secretary LEW. Congressman, when congressional staff meet to draft important legislation, there aren't minutes of those conversations either.

Mr. BACHUS. Right.

Secretary LEW. So, I think these are complicated questions.

Mr. BACHUS. Sure.

Secretary LEW. I am happy to pursue it with you.

Mr. BACHUS. Take a look at what the GAO recommended—

Secretary LEW. I will take a look—

Mr. BACHUS. —and the statutory language which encourages transparency and see if you can't give us some assurances. Thank you.

Let me ask you this, you have been questioned about this IRS thing. You now know that there was a "Be on the Lookout" list that included Tea Parties, patriot groups, and Project 9/12, which is Glenn Beck's group, and that it was maintained since early 2010.

Now, in 2012, there were quite a number of press reports about this. And it is my understanding that in May, several people at Treasury were briefed. But then, as Chief of Staff of the White House, you were briefed in June and alerted by, I think, Mr. George.

Secretary LEW. My first conversation on this with Russell George was March 15, 2013, after I became Treasury Secretary.

Mr. BACHUS. All right, now are you aware that last Friday, he testified that he briefed you?

Secretary LEW. I think he testified that he briefed me in March 2013.

Mr. BACHUS. Actually, he says—he is talking about May and June 2012: "I alerted Commissioner Shulman on May 30th. I subsequently alerted the General Counsel on June 4th, and subsequently alerted Deputy Secretary Neal Wolin about this matter.

And then upon assumption into the division, I mentioned it to Secretary Lew—"

Secretary LEW. But that was just March 2013. I was confirmed—

Mr. BACHUS. All right.

Secretary LEW. —on February 27th.

I think it is important to note that the fact of the ongoing audit was not a secret. It was publicly posted—

Mr. BACHUS. Sure.

Secretary LEW. —on the Inspector General's Web site in October 2012.

Mr. BACHUS. And it was the subject of numerous newspaper articles back in March—

Secretary LEW. But it was just the fact of the audit being undertaken.

Mr. BACHUS. Specific information that even Democratic legislators had leaned on the Administration to conduct investigations.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentleman from New York, Mr. Meeks.

Mr. MEEKS. Thank you, Mr. Chairman.

First, I just want to finish off where I ended in my opening statement. Because we have to make sure that we tighten up, but I just want to make sure that we don't lose the fact that some people abuse their tax-exempt status. And I stated, I had a specific example in mind.

I talked about not only that a 501(c)(3) exemption requires that to be tax exempt under 501(c)(3) of the Internal Revenue Code, an organization may not attempt to influence legislation as a substantial part of its activities and may not participate in any campaign activity or against any political candidate.

Now, 501(c)(3) is supposed to be more confined than 501(c)(4). And I have a fund-raising letter from a 501(c)(3) organization. I will read a few lines:

"I am writing to ask for your help. We want to finish him off. Let me explain why this is so important. Barack Obama is President. The Democrats control Congress. Your gift would allow us to show that the Empress Pelosi has no clothes. And soon Barack Obama will have to take a stand. Your gift will help us expose the hypocrisy of Obama and his allies in Congress."

Is this letter okay from a 501(c)(3) organization, to send a fund-raising letter like this?

But my point is I hope that in the face of the very real need to prevent any future overreach and targeting by the IRS, we don't lose sight of the important role of the IRS in answering questions like these that are also at the heart of the public trust.

With that, Mr. Secretary, I am going to go to the issue at hand. I just wanted to make sure that—to let people know that the IRS has oversight over this, and it is important for all of the people to make sure that once you get the 501(c)(3) or (c)(4) designation, that they still should oversee those organizations and make sure they don't overstep their bounds.

So, going to FSOC and the issue at hand, as I also stated in my opening, I am encouraged to hear that, while you have stated that there is need to implement Dodd-Frank quickly, you also mention the need to look at the system as a whole by crafting rules that are more tailored to institutions, rather than a one-size-fits-all regime.

So, I am asking, what are your views on and what are your thoughts on bifurcating Basel III in order to make community banks more secure by establishing a simple cap ratio applicable to community banks in order to allow them to operate more effectively for our economy?

Secretary LEW. Congressman, I think that the Basel III rules, which are now being worked on by the Federal Reserve Board, will, in all likelihood, based on public statements made by members of the Fed, reflect the differences in risk in some ways.

So, there are capital surcharges for very large institutions already. I don't know where they are going to set the rates, how they are going to address it, but I think that there are important differences between small and large institutions.

The thing that I think we have to keep in mind is that small and medium-sized banks are not without some element of systemic risk. And we were all focused on the financial crisis of 2008. But in the 1980s, the financial crisis was a savings and loans financial crisis. So, I think we have to look at risk not just as a question of size, but at the characteristics, the activities, and the exposure.

We are very much aware of the fact that community banks play an important role in all of our States and in all of our communities. And I think the law has reflected that. And I think the regulators are attentive to it as they are writing their rules.

Since they haven't completed their rules, it is difficult for me to address exactly how they will be taken into consideration. But I know that there is an effort very much to take it into consideration.

Mr. MEEKS. And also, in yesterday's testimony before the Senate Banking Committee, you mentioned that Basel III would be a floor as opposed to a ceiling. So, how will the implementation of Basel III pull up global standards everywhere, thereby reducing the risk that the United States faces by undercapitalized institutions from around the world?

Secretary LEW. We have made a lot more progress than a lot of other countries since the financial crisis in terms of recapitalizing our financial institutions, in terms of putting liquidation authority and resolution authority in place. There is a lot of work to be done, and our financial stability is connected to the financial well-being of institutions that are regulated in other parts of the world.

It has a lot to do with our ability to address some of these cross-border issues, also. We are not going to lower our standards to some other standard. We are going to have the world's standards at a higher level. And we are working in the G20 and in other bodies to try and bring world standards up. Basel III is a piece of that.

Mr. MEEKS. Thank you.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentleman from Texas, Mr. Neugebauer.

Mr. NEUGEBAUER. I thank you, Mr. Chairman.

Secretary Lew, welcome.

In your previous life as the Chief of Staff for the President, I am sure you are aware that the President was not really fond of the

Citizens United case. In fact, he is quoted as saying, "The Supreme Court reversed a century of law that I believe will open the floodgates for special interests."

You may also be aware that some of the Senate Democratic leaders wrote in 2010, including Financial Services Committee Chairman Baucus and Senator Schumer, a call for the IRS to investigate conservative 501(4) organizations.

At that time, did you or the President think that was a good idea, what the Senator suggested, that the IRS look into those organizations?

Secretary LEW. Congressman, I am not familiar with the Senator's statement at the time, so I can't comment on that.

Mr. NEUGEBAUER. It was a letter that they sent to the IRS. You are not aware of that letter?

Secretary LEW. I couldn't hear you.

Mr. NEUGEBAUER. Excuse me?

Secretary LEW. I couldn't hear you, I'm sorry.

Mr. NEUGEBAUER. It was a letter to the IRS. You are not aware of the letter?

Secretary LEW. As Chief of Staff, I would not get an IRS letter. You know—

Mr. NEUGEBAUER. I think it was fairly well-publicized. I don't think it was a big secret that they had written that letter.

But let me ask you a question. Had you known about the letter, do you think that you and the President would have thought it was a good idea for Members of the Senate or the House to be asking the IRS to investigate or to audit organizations?

Secretary LEW. My position has been, and always will be, that the IRS has to be beyond political reproach. There can be no question of political bias. There can be no question of political motivation. I think organizationally, it has to be set up that way, and in terms of how it is operated, it has to be that way.

That is why we said it is so unacceptable that these practices happen. And there is no disagreement on criticizing the practices that are the subject of these questions.

The question is, how do we fix it? We are committed to fixing it. And there are legitimate questions as to who qualifies for 501(c)(3) and 501(c)(4) status, but it has to be in a politically neutral way. There should be no element of bias in it. I have said that to Democrats. I have said that to Republicans. I said it before this set of facts became open.

Mr. NEUGEBAUER. Thank you, Mr. Secretary. You have said that before, and I agree. And I just would say that I think that America is going to be watching how you handle this, because I think people will define a lot of your service in that capacity.

I want to move on to another question.

As the Secretary of the Treasury, you are obviously governed by our laws, including the SIFI provision as set forth in Dodd-Frank.

You are also one of the three representatives on the Financial Stability Board, which, I understand is about to finalize their designation of what we call GSIs. And given the policy that will be determined by this Board, versus what we are going to do with the SIFIs in this country, many of us are very concerned, particularly that some of our U.S.—or insurance companies could be disadvantaged by this designation, because this is a lot less transparent process than what is going on in the United States.

Can you comment on—what you can assure us that we are not going to disadvantage domestic companies with a process that is going on that is not as transparent?

Secretary LEW. Congressman, as we go through the review of whether or not to make these determinations, we are working with all the firms and understand they will have every opportunity to comment. It will be a process where they have full visibility into what we are doing.

We have worked at the international level to try and have as much, as we can, common approaches. Obviously, it is more complicated in the international setting. It is very important to us in this and in all areas that we strike the right balance of protecting the U.S. economy. And sometimes, that means taking actions that may be higher levels of prudential concern than other countries are taking.

What we are trying to do is convince them to raise their standards. We are trying to level the playing field, because it is in their interest and in our interest for us all to be comparably taking steps to make sure we don't have financial crises.

The questions we are asking for these nonbank institutions really get at their interconnectedness to the broader question of financial stability. So, we are not stepping into the role of being a State insurance Commissioner. We are looking at whether or not there are levels of risk that warrant the designation.

Mr. NEUGEBAUER. I would just say that having different capital requirements for the people who are inside the box versus the people outside the box will cause some competitive disadvantage. Would you agree with that?

Secretary LEW. I think that we need to make sure that we are addressing the statute's requirement that we do the review based on whether or not there is a material risk to financial stability.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentleman from Massachusetts, Mr. Capuano.

Mr. CAPUANO. Thank you, Mr. Secretary, for being here.

And thank you, Mr. Chairman, for having this hearing.

Mr. Secretary, I want to associate myself with the remarks of Mr. Meeks and Mr. Neugebauer. I do agree with them. And I think the only difference overall between our side and their side is that we are willing to give you the benefit of the doubt that you are going to do the right thing, but you know the country is watching. All of us are watching, and you know that. And I have faith that you will do the right thing as we move forward.

It also strikes me as not surprising that, had you not fired someone, today you would be criticized for not having fired someone. It is an interesting little box of cute little tricks to play, but I think it is worth pointing out.

So either way, you were going to lose that argument, or at least be beat up a little bit. And I am not going to participate in that particular one. I will try something else.

Mr. Secretary, I want to talk about what FSOC does, some of the things. Right now, as of today, almost all the money that was given out during the bailout and during the difficult times has been paid back. Almost all the money. The most glaring example of who has not is Fannie and Freddie. My numbers show approximately $187 billion of taxpayer money went to Fannie and Freddie, and none of it has been technically paid back, although $65 billion has been paid. And another $66 billion is about to be paid, which would represent about 70 percent of the overall.

But that money is not allowed to go towards payment of the principal. It is my understanding that Treasury or FSOC could simply change the way that is accounted and allow them to pay off their debt, like everyone else was allowed. Every bank, every private company was allowed to pay off their debt with interest, by the way, and dividends. And I would like to note that every penny that has been paid back, the government has made a very good profit.

I am not suggesting we shouldn't make one on Fannie and Freddie, but I am simply asking that as you move forward, you take a look within your own shop, your shop now, to make sure that we allow Fannie and Freddie, as they pay back, to be credited for that payment.

If that happens it: number one, is the right thing to do; and number two, accepts reality. The reality is, they have paid back almost $130 billion of the money—or are about to do it—that we have loaned them. And I think they should get credit for at least some of that. It is my understanding that that could be done internally in Treasury.

I would like you to take a look at that and get back to us when you can, as to if you can, please do it. If you won't, tell me why. And if you can't, tell me what action we need to take.

Similarly, to the FHA: The FHA right now, as you know, is probably, in this fall, about to have to take what is called a draw on Treasury, even though they have $30-some-odd billion sitting in the bank. And no thoughtful person thinks they are actually going to have to access taxpayer money. The law requires them to do it because they are below a certain percentage of their outstanding numbers.

I think that is ridiculous. I think FHA should be allowed to draw when they need the money, but should not be required to draw when they do not. And I would like you to take—we are filing a bill on that. And at some point, I would like your response and your comments on whether that is a good move or a move that you would like to see amended.

Would you like to go right ahead? I have one more after this. Go ahead, though.

Secretary LEW. I am happy to get back to you, Congressman, on both issues.

I would just say, very briefly, that the treatment of Fannie and Freddie was set up so that all of the profits go to the taxpayers—

Mr. CAPUANO. Yes.

Secretary LEW. —until they are out of conservatorship, until they have discharged all their obligations.

I think that is a very high priority. And I am happy to follow up with you on the other question.

Mr. CAPUANO. But, as it is currently done, they will not be able to get out of conservatorship because they will still owe us $187 billion at any given time. So, that is—

Secretary LEW. On the FHA drawdown, I am also happy to follow up with you. But the economic significance of the difference is probably not as great as the description sounds, if they don't need to draw on it—

And we are following prudent practices in the rules to make sure that FHA is able to continue functioning—

Mr. CAPUANO. I totally agree. I just think that it distracts us from the real discussion of FHA.

The last thing I want to talk about is derivatives. I know you had a discussion on the LIBOR issue. My understanding is the LIBOR issue might involve upwards—it has been reported of a $500 trillion market.

I know that there is an international review going on. I have also read recently about another potential scandal. That is interest rates, but also in the interest rates swaps category, another $400 trillion of a market that may be the exact same thing by the exact same players.

We are talking close to $1 quadrillion worth of a market, which is obscenely ridiculous. I had to look it up; it has 15 zeros. I have never used the term "quadrillion" in public before. I hope to never do it again.

I am not a scientist, so I don't get to count molecules.

That being the case—and I apologize, my time is about up, but I would like to know at some point what FSOC is going to do about these scandals that are brewing.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentleman from California, Mr. Campbell.

Mr. CAMPBELL. Thank you, Mr. Chairman.

I will say "quadrillion," just so that it is a bipartisan term.

Okay. Secretary Lew, getting back to the IRS issue. The IG's audit determined there was targeting. Do you believe it is important to know why that targeting occurred?

Secretary LEW. Congressman, I think it is important to hold accountable everyone who is accountable. That process is under way. We have a new acting Commissioner who is taking over today. That will be his first order of business, to make sure we know who made what decisions, whose behavior warrants—

Mr. CAMPBELL. But shouldn't they know why this occurred? Isn't that a logical question?

Secretary LEW. It is very important, I think, that the IG's report noted there was no evidence of political pressure being brought to bear.

I can tell you I think that there is no—

Mr. CAMPBELL. Okay. Okay. But, Mr. Secretary, the IG, their purpose was to determine whether it existed, not why.

Now, because they didn't present any evidence in that report, does that lead you to conclude that there was no political involvement in this at all?

Secretary LEW. I think, appropriately, we did nothing to interfere with an IG's report. The IG's report came out just 1 week ago.

There are ongoing efforts, with a new Commissioner coming in, to take a review of the personnel involved and to take any necessary—

Mr. CAMPBELL. So we should determine—

Secretary LEW. I think—if I could just finish?

Mr. CAMPBELL. Okay.

Secretary LEW. We have multiple hearings under way. We have the Department of Justice undertaking a review.

So I think that there is an awful lot going on.

Mr. CAMPBELL. Including to determine why?

Secretary LEW. Their review is whether or not there was any criminal activity.

Mr. CAMPBELL. Have you asked them to determine why? Because intent is involved in criminal activity and other things. Correct?

Secretary LEW. I think we have said that it is unacceptable behavior. And those who participated in it will be held accountable.

I think the fact that there is no evidence of any political involvement is very important. But it doesn't make the actions any less—

Mr. CAMPBELL. Just because there is no evidence now doesn't mean there isn't evidence out there we haven't found. Isn't that correct?

Secretary LEW. I think the IG—

Mr. CAMPBELL. Are you trying to find that evidence, if it is out there?

Mr. Secretary, if somebody robs a bank, it is reasonable to conclude that they did it for the money.

Now, you can't assume they did it for the money, but it is reasonable to conclude they did it for the money.

When someone targets organizations entirely of one political bent, it is reasonable to conclude that was the reason for doing it.

Now, not—

Secretary LEW. But—

Mr. CAMPBELL. —you can't assume that—

Secretary LEW. When concerns like this arise—

Mr. CAMPBELL. —finding that out. Shouldn't you, as Treasury Secretary, overseeing the IRS, be trying to find that out?

Secretary LEW. When concerns like this come up, the place you go is to the Inspector General to do an investigation. That is what has happened. That is what is ongoing.

Mr. CAMPBELL. Okay, but now it is out there. It is the IRS, it is within the Department of the Treasury. You are the Secretary of the Treasury. Don't you want to know why these people did this?

Secretary LEW. Congressman, I have said many times and I will repeat: I am committed, and the President is committed to making sure we figure out what happened here, and holding people accountable for wrong behavior, and making sure it never happens again.

So, of course, I care.

But I also believe that it would be inappropriate to stand between an IG and an investigation or, for that matter, to interfere with other investigations, like criminal investigations.

Mr. CAMPBELL. Have you spoken to anybody in the Treasury or IRS about this, since you found out about it, in terms of, why were these people doing this? What were they trying to accomplish here?

Secretary LEW. Congressman, I think that the facts will all—

Mr. CAMPBELL. Have you had any conversations like that?

Simple question.

Secretary LEW. Since this IG report came out, I have had many conversations about what steps we need to take. Step number one was getting the resignation of the Commissioner.

Step number two was getting a new Commissioner. I am going to meet after this hearing with the new Commissioner. I haven't had a chance this morning to do so. But I will meet with him on his first day.

Mr. CAMPBELL. Have you learned anything you can share with us perhaps about the motivations for this?

Secretary LEW. Congressman, I think we all have the same facts in front of us at this point. And we will cooperate with investigations, because we want to know the facts.

What I won't do is I won't put any kind of political intervention in the review of an IG, and I won't put political intervention in the administration of the tax system, because the cure would be worse than the disease there.

Mr. CAMPBELL. That is good. We don't want political intervention now. But we need to find out whether there was political intervention then, because that is significant to—

Secretary LEW. It is also significant that the IG found no evidence of any political pressure. So, we have no evidence. If there becomes evidence, that would be significant. But I can't respond to evidence that has not yet been uncovered. And there will be much time put into figuring out what happened here.

Mr. CAMPBELL. Then, let us uncover it.

Thank you, Mr. Secretary.

I yield back.

Chairman HENSARLING. The Chair now recognizes the gentlelady from New York, Mrs. Maloney, for 5 minutes.

Mrs. MALONEY. I would like to thank the chairman and the ranking member.

And welcome, Secretary Lew, from the great State of New York. And the residents of that great State are very proud of your public service.

Secretary LEW. Thank you.

Mrs. MALONEY. We are very proud of you. Congratulations on your appointment.

In Dodd-Frank, there were a number of regulations that we called upon the agencies to come forward with. Could you bring us up to date on how quickly we are going to get these regulations into effect?

Specifically, I am interested in three areas: the nonbank designation; the Volcker Rule; and the capital rule requirements.

I, for one, do not favor legislating capital rule requirements. I think it is dependent on many changing factors.

But could you comment on the Basel-required capital requirement of roughly 3.5 percent, which fluctuates, but also the new bill that has been put in the Senate, with Mr. Vitter and others that would require a 15 percent capital requirement?

And, again, congratulations on your service.

Secretary LEW. Thank you very much, Congresswoman.

From literally my first day as Treasury Secretary, I have been putting an enormous amount of my time into stepping on the accelerator in the implementation of Dodd-Frank.

I went from my swearing-in to the meeting of the Financial Stability Oversight Council, and chaired my first meeting within an hour of being sworn in.

I have met with—we have had three FSOC meetings. I have met in between that with many of the regulators independently.

I believe that the role of the Treasury Secretary as Chairman of FSOC is to continually keep the pressure on for action. And I have made the case to them, and I have made the case publicly, that we have to measure our progress in weeks and months, not years. We have to get to the end of implementing the regulations.

I think it is important to take that a step back and to remember that one of the reasons for delay was that there was a political fight over repealing Dodd-Frank. We had an industry that was fighting with everything it had to slow down the implementation.

And I think we are beyond that. I think there is now a consensus in the industry and, certainly, from the view of myself and other regulators, that getting Dodd-Frank implemented is a top priority.

I think that will give stability, in terms of knowing what the rules of the road are, and then, like everything else that we do, it will require fine-tuning as we go along.

One of the problems we got into between the Great Depression and 2008 is we went more than half a century without taking a hard look at what we had done. This is going to require constant attention. The financial industry evolves too rapidly to take 50 or 70 years off between taking a hard look at whether the tools we have are effective.

On the nonbank rules, we are hoping to make determinations soon at the FSOC level. On the Volcker Rule, we have five agencies that are working together, I think trying very hard to come out with a common approach, which would be the best way to have clarity in the marketplace, and on capital requirements, the Fed is moving ahead and working toward finalizing regulations.

From statements that have been made by Fed Members in the last few weeks, I think that they are working toward trying to create a system that gets as close as possible to meeting the concerns of small financial institutions, while being able to say that we have ended too-big-to-fail, and we are encouraging them to get to a conclusion as quickly as possible.

Mrs. MALONEY. Specifically on Volcker, I know that the institutions that I have the privilege of representing have already implemented the proprietary rule. They have moved out of their major headquarters, any proprietary trading into a different organization or stopped it completely.

But could you speak a little more on the market-making rule that they are working on, on how do we maintain liquidity in the markets but at the same time have financial stability and safety and soundness?

Secretary LEW. Yes.

Mrs. MALONEY. Many people are very concerned about getting that rule right, in order to keep our competitive edge as a—

Secretary LEW. It is very important to get the rule right, because what looks like the same activity may be a very different activity. If you are a market maker and you need to have an inventory in order to play the role as a market maker, that is very different from taking a bet and buying with proprietor capital, a stake for yourself.

So the rules are going to have to distinguish between the different reasons that financial institutions hold assets. They are working very hard on this. The definitions matter, the coordination amongst the agencies matter, and I will be reconvening those groups to make sure that all five agencies are talking to each other.

Mrs. MALONEY. Thank you. And GSC reform: where do you stand on that? No answer? Okay. My time has expired. Congratulations.

Secretary LEW. Thank you.

Chairman HENSARLING. The Chair would like to yield the witness 10 minutes to speak on the matter—

[laughter]

But he won't. The Chair now recognizes the gentleman from New Mexico, Mr. Pearce, for 5 minutes.

Mr. PEARCE. Thank you, Mr. Chairman.

And thank you, Mr. Secretary, for being here.

When I was in college, I had a professor of statistics who was making the point that I am sure everyone has heard, that if you put an infinite number of chimpanzees in a room with an infinite number of typewriters, they would eventually write the works of Shakespeare.

And you are asking us to believe that you have an infinite number of IRS agents, conducting an infinite number of audits, and they all just happen to be conservatives. That is more preposterous, sir, than my statistics professor.

The fact that I got an email before the story broke from a gentleman in Socorro, New Mexico, who had been singled out and he didn't know why he was singled out for an audit and there was nothing in the audit that said what it was about.

But he noticed a handwritten name on the outside of the folder, and at the end of the interview, after no significant questions on his practices in his business, was asked if he knew that name. He didn't know the name.

On the way home, he said, "By golly, I think that is the guy who went to that meeting 3 years ago." He went to one meeting and he didn't much care for it—the Tea Party hadn't gotten organized, but it was the same guy who eventually who organized the Albuquerque Tea Party—went to one meeting, wrote a small check, maybe $25, and for that, 3 years later, he is picked out, and you want us to believe there are no political overtones. You don't find any political nuances to the situation, sir, and I find that to be an incredible situation.

We are also told, as we have been told in many other scandals of this scandal-ridden Administration that the Administration had no knowledge. Just to run a few fast and furious, the Administration had no knowledge. We had an American border agent killed with rifles that were sent illegally into Mexico, a crime was committed. No one yet has been held accountable.

Jon Corzine took $1.5 billion from segregated accounts in 2011. And I hear you saying things like, "I don't want to get in the way of the investigation." The facts have come out. At what point, sir, are you going to be suspicious that the facts won't come out?

It was 2011, and Mr. Corzine has yet to be charged. And it is a crime to take out money from segregated accounts. We could take a look at the GSA conference, the DOJ tapping of AP phones. Maybe you are willing to talk about the DOJ tapping of Mr. John Rosen's phone and his parents. It was said he is a co-conspirator. A co-conspirator says, "guilty." And I wonder what his parents were accused of.

So we are sitting here, today, understanding that this Administration had no knowledge of any of these circumstances. Not even of Benghazi. And we are to sit here, and take the—I think one of my colleagues said "artful" answers that you give—myself, I don't know.

What I am going to ask about is the war on the poor in which this Administration engaged. In driving interest rates to zero, you are decimating the people who have no political—no financial sophistication. These are people who are 8 times more likely to have money in just bank accounts—the aging, the elderly. They are the people who come out to my town halls and say, "I have lived my life correctly. I bought my home. I have a savings account. I was expecting that I could live on my savings, and now I am having to dip into it, because I get no interest every month."

This Administration continues to have its war on the poor, and the elderly, to the benefit of Wall Street, while you tout you are doing so much for the 99 percent when the case is exactly opposite.

So I don't really have any great impression that you are going to answer any of the questions that come up today. I don't have any great impression that you will stop your war on the poor. Just know that we realize it is going on.

New Mexico's $31,000 with our per capita income. We recognize a war on the poor when we see it.

And I yield back.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentleman from Georgia, Mr. Scott.

Mr. SCOTT. Thank you very much, Mr. Chairman.

Welcome, Secretary Lew. It is good to have you here. I think that you have expressed your concern over this issue. The Administration is concerned over it. And we certainly look forward to you helping to move to a speedy conclusion of this IRS situation, for there is no more penetrating agency, that penetrates into the personal lives of the American people, as the IRS.

And let me say that concern over this investigation goes for Democrats and Republicans as well. This is not a Democratic or Republican issue; this is an American issue. And the American people are expecting us to get to the bottom of it, and not politicize it, not score these political points.

One of the things I do want to mention to you is that yesterday, in the Senate Finance Committee, former Commissioner Shulman mentioned that he knew about this investigation, that there were facts shown to him, but he did not take that information to higher-ups.

The reason I mentioned this is because Mr. Shulman was a Bush Administration appointee, and Mr. Shulman served as the Commissioner of the IRS from May of 2008, I believe, until October of 2012, just 6 months ago.

So my question is that in getting to the facts of this who knew what, when, wouldn't you think since the IRS is a agency of the Treasury Department, that the agency should have brought this to the Treasury Department when he knew of it? Shouldn't he have done so?

Secretary LEW. Congressman, I think that the first line of responsibility here is the IRS Commissioner. The IRS Commissioner is in day-to-day contact with all of the different departments of the IRS, and fixing anything that is wrong in the IRS is a fundamental part of the IRS Commissioner's job. Making sure the system runs well is part of the IRS Commissioner's job.

We are bringing in a new acting Commissioner today, and we are charging him with: first, making sure we find out who is accountable; second, finding out what went wrong; and third, being sure that anything that needs to be fixed is fixed, going forward.

Mr. SCOTT. Right. The point I wanted to make is that—because everybody is looking at where this goes. Does it go all the way up to the President? But it is very important for the record to show that his Commissioner, who was the Commissioner during much of the investigation, knew what was going on, and testified before the Senate Finance Committee yesterday that he did not take it to the higher-ups. That is important.

Let me ask about Basel III, if I may—

Secretary LEW. If I could just say one additional word on that, Congressman.

I think it is important that—I didn't know there was even an audit until March 15th. I didn't know the results until it was final. The President found out about it when the report became public. If there was any sense of political involvement in any way, interfering with this investigation, that would be a real problem.

And it didn't happen. So I think it is a good thing that we didn't know about the investigation that was going on.

Mr. SCOTT. Right. Very good. Let me ask you about Basel III, if I may. What would you say are the likely effects that differences of implementation between the United States and other foreign jurisdictions of the derivative's credit valuation adjustment or the CVA capital requirement might have on American financial institutions and end-users of these derivative products? Do you share the concern of implementing Basel III requirements, and is this an issue that the FCO—OOC is already reviewing?

Secretary LEW. Congressman, we are concerned with Basel III and with other areas of implementation of Dodd-Frank and other financial rules that we both do what we need to do to protect the U.S. economy from the kind of risks that we never want to see again, but also to work with our international partners to where we can harmonize standards and reach a level so there is a competitive level playing field.

We have made good progress in the G20. We are working with our G8 partners. I have already been in many meetings with my counterparts at the finance ministry level and with central bankers. It is going to be a complicated undertaking. We have different legal systems. We have different standards.

The thing that we have to be clear about is that our first obligation is to make sure that we make the U.S. financial system sound. And then, we work with others to bring their standards up.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair recognizes the gentleman from Florida, Mr. Posey.

Mr. POSEY. Thank you, Mr. Chairman.

Mr. Secretary, how long was left on the term of the Commissioner whose resignation you sought?

Secretary LEW. He was an acting Commissioner. His term is until he actually departs; he is a career employee. So there is not a term limit on his time as a career employee.

Mr. POSEY. So had it not been for this event, you expect he would have been Commissioner forever? Is that correct?

Secretary LEW. Under the Vacancy Act, there was a limit in terms of how long you could have the title of acting—

Mr. POSEY. Yes, yes, and how long is remaining on that timetable?

Secretary LEW. Because of the length of time, it was coming up sometime, I think, in June—

Mr. POSEY. Yes—

Secretary LEW. —but the important fact—

Mr. POSEY. I only have 5 minutes—

Secretary LEW. No, I need to answer your question, Congressman—

Mr. POSEY. I have some questions I want to ask you.

Secretary LEW. He would have remained in the position that he had, with all the authority afterwards unless he resigned, which he did.

Mr. POSEY. I read your written testimony, and it says, "The strength of our financial system ultimately depends on the strength of our economy." You talk about the sequester having hurt confidence, which is a key driver of economy.

And I just think everyone knows that spending more money than you make doesn't do anything to inspire confidence either, and proposing budgets that never balance doesn't do anything to inspire confidence either, and in plain English, I think that you might have recommended we try and do the budget process and not level it by C.R.s, and maybe send that message over to the Senate if you ever get to talk to them.

You mentioned that job creation and economic growth have to be a top priority, and next to Obamacare, the biggest impediment to job growth in this country right now seems to be the overuse and overstepping of administrative rules that are killing more jobs than this Administration could ever begin to put in place.

Last year, the Treasury wrote a rule that would require all banking institutions to submit to them the names of all nonresident alien depositors. The Mercatus Center said that could have an impact of over $88 billion, yet the Department of the Treasury never did a cost/benefit analysis, which is required of every agency who writes a rule with an impact of shafting the public for more than $100 million.

Can we count on you to at least do a cost/benefit analysis before that rule takes effect and we have further financial harm to our country?

Secretary LEW. Congressman, I am going to have to get back to you on that specific rule, and I am happy to do so.

Mr. POSEY. How long do you think it will be before you can get back to us, because we would really, really like to stop this thing in its tracks as soon as possible?

Secretary LEW. In 2½ months, I have been involved in a lot of different matters. I haven't worked on that specific matter. So I will take a look at it and get back to you.

Mr. POSEY. Any idea how long it will take you to look at it?

Secretary LEW. I am going to take a look at it, and get back to you, Congressman.

Mr. POSEY. I think in regard to Mr. Pearce's question, and before that Mr. Campbell's from California, you said there is an awful lot you would have to look into to answer Mr. Campbell's questions, but when the gentleman from Georgia, Mr. Scott, asked you, you didn't have any hesitation at all saying that there was no knowledge at the top about what was taking place. How do you make the distinction between the two answers?

Secretary LEW. I know what I know. I know when I heard about this for the first time. I can answer with great confidence on that.

Mr. POSEY. Okay. In answer to Mr. Pearce's question, there is a pattern called: "Admit nothing, deny everything, and blame everybody until it blows over." I think that would be the proper answer to your question, Mr. Pearce.

Mr. Chairman, my time is about up. I yield back.

Chairman HENSARLING. Time has been yielded back.

The Chair now recognizes the gentleman from Texas, Mr. Green.

Mr. GREEN. Thank you, Mr. Chairman. I thank you and the ranking member for the hearing.

I thank the witness for appearing today. And I also thank the witness for making note of those who are victims in Oklahoma. It is important that we not forget. Notwithstanding all of the other things that are on agendas, we should remember what has happened. And I assure you that at the appropriate time, I will cast my vote for aid to the victims in Oklahoma.

I would also like to remind everyone that Dr. King called to our attention that on some questions we have to do that which is neither safe nor politic nor popular. Your not interceding in the audit may not have been safe, may not have been politic, and may not be popular, but it was the right thing to do. And you don't need validation when you are doing the right thing, Mr. Secretary. It was the right thing to do.

Let us move on to page 5 of your testimony or your statement that you have provided. On page 5, you indicate under impacts of fiscal policy that, "To guard against future threats to our economy and financial stability policy makers should avoid using last minute resolutions to fiscal policy matters such as debt ceiling and deficit reduction as a negotiating tactic."

I would like for you to elaborate on this, because as you know, we will again confront debt ceiling and deficit reduction questions. Would you elaborate on how this adversely impacts the economy, given that you have indicated that the economy needs confidence, the consumers need confidence, businesses need confidence? And would you elaborate on how this impacts the confidence factor?

Secretary LEW. I would be happy to, Congressman.

In 2011, we had a series of crisis-driven, deadline-driven negotiations that created a broad sense that there was dysfunction in our government, which undermined confidence in the business community in the United States. It undermined confidence amongst rating agencies. We saw, for the first time, a downgrade of the United States' credit rating, not because of our economic condition, but because of our political condition.

I talk to people around the world in positions of authority, and it makes them very uneasy whether they are in businesses or making financial economic policy decisions, when the United States looks like it is in constant crisis.

I think that if you look at 2012, there was some progress made. We saw less of the brinksmanship in 2012 than we did in 2011. We saw issues getting addressed, and an attempt was being made to avoid having that kind of anxiety, which makes it harder for businesses to invest and harder to get the economy moving.

We have to stay on a path where we do our business or Congress does its business. And on the debt limit, the President has made clear that Congress has the responsibility to raise the debt limit. Every bill that we owe, whether it is interest on a Treasury bill or whether it is a payment for the rent in a building that we lease, it is an obligation of the Federal Government, and for our entire history, the U.S. Government has paid its obligations.

The way to control spending in the future and the way to reduce the deficits in the future, is to make sensible tax and spending policies. It is not to say, we won't pay the bills that we have already obligated. And that is why I think Congress just needs to pass the extension of the debt limit.

Mr. GREEN. Thank you.

Let us move quickly to one additional topic. You talked about how we have to concern ourselves with stability in terms of the Oversight Council. And I would like for you, if you would, to just explain very briefly how important it is to maintain FSOC, given that you have made a comment about too-big-to-fail and how you see too-big-to-fail.

So would you comment please on FSOC and how it will help us to maybe not eliminate but help us to keep taxpayers off the hook on too-big-to-fail issues?

Secretary LEW. Congressman, FSOC is a kind of unique agency or council. It has some areas of direct responsibility, but mostly it is a coordinating role and as Chair it is to pull together the different actors in our quite complicated financial regulatory system to act in a decisive way and a coordinated way.

I think that is very important. These are areas where if you have five regulators going off in five different directions, it could cause massive confusion and a large burden. I think that there is analytic work being done and shared that is very helpful, and I hope that, as Chair, I will play the role to help drive the process towards sensible decision-making in a timely manner.

Mr. GREEN. Thank you, Mr. Chairman.

I yield back.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentleman from Missouri, Mr. Luetkemeyer.

Mr. LUETKEMEYER. Thank you.

Thank you, Mr. Chairman.

Thank you, Mr. Lew.

One of the problems with being on the lower part of the totem pole here is that you wind up with a lot of questions which have already been asked, so let me just go through some things to just kind of clean up a couple of the questions that were brought up in my mind.

One of the things is with regard to the investigation going on with—

Secretary LEW. I apologize, I can't hear you because of the—

Mr. LUETKEMEYER. Okay. There we go.

Okay, one of the questions that I hope that this afternoon when you talk to your new Commissioner and discuss with him this investigation, it is not only to have him investigate what Ms. Lerner and her group were doing with regards to the conservative folks in her tax exempt department, but also the request that was made by lots of folks with regards to the liberal groups and not investigating those.

I have sent you personally about 3,000 documents and a request to investigate one. I sent you a letter last week to also, again, ask for this investigation to take place. That was 3 years ago, and was never given any sort of anything but a stone wall over the last 3 years.

So, I think that this investigation should be broader than just looking at conservative groups. It should be looked at on the lack of action with regards to investigating the liberal groups, and, as the gentlemen from New York said, the oversight that was supposed to be provided with regards to those activities.

One of the questions that came up also with regards to SIFI designation, I know that in discussing a lot of the banking circles the definition is very concerning to them, from the standpoint that a while ago, you made the comment—I think it is in your testimony yesterday also—with regards to size. You also made the comment that perhaps the risk and the activities that they take should also be taken into consideration.

So, do you have a preference in that, if, whenever you start looking at a designation for banks with regards to Systemically Important Financial Institutions whether it should be based on size or whether it should be based on risk of the activities they are engaged in?

Secretary LEW. I think that size is one of the characteristics that suggests risk, but it is certainly not the only one. You can have a large institution that is very well-capitalized and entirely safe. You can have a medium-sized institution that plays a role in the financial marketplace that is far in excess of its size—

Mr. LUETKEMEYER. Right.

Secretary LEW. —and creates more risk. So I think it has to be a balanced approach.

Mr. LUETKEMEYER. I appreciate that, because I think that is the direction that we need to go.

Following up on Chairman Hensarling's question a while ago, with regards to the kinds of questions that the IRS should be able to ask its citizens with regards to compiling their tax returns and investigating their activities, are you intending to go through the types of questions that are on some of these forms to try and winnow out some of these unnecessary and actually very intrusive questions with regards to getting into the private lives of individuals?

Secretary LEW. I think that in terms of the facts that we have seen with regard to this set of determinations on 501(c)(4)s, they clearly went to an unacceptable place, and we have made clear—I have made clear that we need to fix that.

So it is going to be the job of the IRS Commissioner to take the lead on that, but it is something that I will continue to pay attention to, being respectful of the line between Treasury and IRS, not reaching into the administration of the tax system. Because frankly, I do think that would run the risk of politicizing things in a way that it shouldn't.

So there is not—

Mr. LUETKEMEYER. Will you take him this message this afternoon, then, when you talk to him and say this was brought up in our committee today? That the kinds of questions you ask are more than intrusive, that there needs to be a streamlining of this process to get back to your finding out the facts of things—

Secretary LEW. I will share the message, and my own view is we should only ask for the information that is necessary and no more.

Mr. LUETKEMEYER. Okay. Thank you very much on that.

Following up on one other thing that is of concern to me with regards to FSOC, your organization has the responsibility, according to one of its purposes, to respond to emerging threats to the stability of the United States financial system. I fail to see in the report recommendations on things that happened to actually minimize those threats or find a way to keep them from happening in the future.

For instance, regarding the London Whale situation, I fail to see where FSOC promulgated any new rules. With regards to the FED's Q.E. program, I see nothing in there that ever even mentions that. At what point are you going to support winding it down? Are you going to continue to support the quantitative easing program?

My concern is that, and in response to some of your questions on these things, you kept saying, "Well, it needs time to do this and do that." Mr. Secretary, it is kind of like a doctor waiting for the cancer to take over the patient. If we don't start doing something pretty soon on some of these things, it is not going to happen at all.

Secretary LEW. If I could just respond very briefly.

Chairman HENSARLING. Briefly, Mr. Secretary.

Secretary LEW. I think if you look at the report and the recommendations, it identifies the areas that FSOC believes are the areas of greatest risk. It does lay out for the next year the things that we should be looking at. And this will be an evolving list as we go forward.

But take wholesale funding, for example. That is a big risk. There is a lot of activity to be had there. So I think we do go through and identify the big systemic risks and I would be happy to follow up.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair recognizes the gentleman from Minnesota, Mr. Ellison.

Mr. ELLISON. Thank you, Mr. Secretary.

And I also thank the chairman and the ranking member.

Mr. Secretary, I just want to make a comment. First of all, whenever you are dealing with institutions that involve human beings, things go wrong. Something went wrong with this situation. As a person who is probably on the liberal end of the political spectrum, I don't like the idea that somebody—tea party people—got more scrutiny. I just want it even.

But I will say this. The President denounced this. You have publicly disapproved of it. There has been an apology issued, which is shocking to me because you never see that. And I think that somebody ought to at least say there has been an apology and the President has promised to make sure that steps will be put in place to not have it happen again.

I just want to say that because I think the truth is that you can't take the politics out of politics. No doubt somebody is going to try to turn this into some election gold. But I think it should be our interest in this body to make sure that if you are a 501(c)(4) organization, you in fact are a social welfare organization. And if you are not, then you cannot get that exemption.

And there was more scrutiny on some of the tea party groups, but as I read the record in the press, they all got it. Now, that doesn't excuse anything, but it does mean to me that there are groups of various persuasions that are applying for this kind of exemption that shouldn't be getting it because they are not actually social welfare groups and actually are political in nature.

I hope you will make sure that there are no political tests, but in fact that anybody who is actually trying to electioneer shouldn't get get this designation. I just want to say that.

Secretary LEW. Congressman, I totally agree. There should be no bias. There should be an even standard. I am not aware of any bias in favor of groups on the other side. If that were the case, it would be wrong, and there has to be an evenhanded, unbiased system of administering our Tax Code.

Mr. ELLISON. That is right. And I just want to say that you all have said you are going to do something and I trust that you will. Please keep it up.

I have a question of kind of a particular nature. In President Obama's last three budget submissions, the Treasury Department requested Congress to enact legislation to provide permission for State and Federal regulators of money services businesses to share information. Are you aware that has happened?

Secretary LEW. I am generally familiar with it, yes.

Mr. ELLISON. Okay. I ask unanimous concent to enter into the record a Financial Crimes Enforcement Network budget request for Fiscal Years 2013 and 2014, with no objection.

And so last month, Mr. Duffy from Wisconsin, Mr. Paulsen, my good friend from Minnesota who is no longer on the committee, but is on Ways and Means, and I introduced the Money Remittances Improvement Act.

This bill incorporates the request for the President's FinCEN budget. I am eager to see the bill pass. And my hope is that it increases availability of affordable remittances to people in Somalia, because I have a large community from that region. In Minnesota, we have about 33,000 Somali-Americans and they need to send money home to sustain their families.

Of course, we want you to protect the public from people who inappropriately use the money wiring system, but I really do believe that there is no better foreign aid than remittances? And I just hope that Treasury recommendation can recommend the bill and can help streamline the regulatory system.

I just want to add this: Some bankers in my district have told me that the accumulation of regulations makes it expensive for them to facilitate these transactions that they do want to facilitate. U.S. Bank has agreed to try to make a way to do it. But at the end of the day, streamlining and consolidating some auditing would be helpful.

If you could respond?

Chairman HENSARLING. Without objection, the gentleman's materials will be entered into the record.

Mr. ELLISON. Thank you, Mr. Chairman.

Secretary LEW. Congressman, we would very much hope that some form of the provisions we have proposed that are similar to the proposals that you have made are included in legislation. Getting that balance right is very important; making sure that we screen out payments that are for bad purposes, for terrorist finance purposes is critical.

But having a system in place that permits legitimate remittances and an either State or Federal law that ensures that would be very important.

Chairman HENSARLING. The gentleman's time has expired.

The Chair recognizes the gentleman from Wisconsin, Mr. Duffy.

Mr. DUFFY. Thank you, Mr. Chairman.

Mr. Secretary, thank you for being here today.

I have a quick question for you. When did you become aware of the allegations that the IRS is targeting conservative groups? When did you become aware that targeting was going on?

Secretary LEW. Congressman, I have testified several times today on this. I am happy to do it again. I learned the fact of an investigation was under way on March 15th, but I did not know any of the details at that time.

Mr. DUFFY. Mr. Lew—

Secretary LEW. I became familiar with specific details when it became public—

Mr. DUFFY. I want you to answer my question, okay? You are aware that there is a scandal going on right now in Washington about the IRS targeting Americans. You are aware of that scandal?

Secretary LEW. Congressman, I have been testifying on it for 2 days.

Mr. DUFFY. That is right. So in regard to that scandal, when did you become aware that targeting of groups was going on?

Secretary LEW. Congressman, I just answered your question.

Mr. DUFFY. No, you didn't.

Secretary LEW. I am happy—I first saw the report a week ago—

Mr. DUFFY. Hold on a second, Mr. Lew. I am not talking about a report.

When did you become aware in your capacity as a chief or any other capacity, that there was targeting going on of Americans? I am not asking about a report. I am not asking about the IG. When did you become aware that there was targeting of Americans from the IRS?

Secretary LEW. Congressman, I had no fact that I was in possession of until the date—

Mr. DUFFY. I didn't ask you that. When did you become aware that the IRS was targeting Americans? No specific—

Secretary LEW. I was notified on—

Mr. DUFFY. No IG report, when did you become aware—

Secretary LEW. —March 15th that there was an investigation under way. I learned on the Friday before last—

Mr. DUFFY. Mr. Lew, I am not asking you about an investigation.

Secretary LEW. —I learned last Tuesday the IG report recommendation.

Mr. DUFFY. Mr. Lew, I am not asking you about an investigation. I don't care—I know that you found out about the IG investigation on March 15th. Everyone here knows that. That is not my question to you.

My question is: when did you learn that the IRS was targeting different Americans because of political views?

Secretary LEW. Congressman, I had no knowledge until the date that I am describing. People can make all kinds of allegations, but I had knowledge as of the dates that I described.

Mr. DUFFY. So the first time that you heard about any targeting of Americans by the IRS was when you read the IG report? Is that your testimony?

Secretary LEW. Congressman, you asked me—

Mr. DUFFY. Is that your testimony?

Secretary LEW. —you are asking me when I knew. I answered when I knew.

Mr. DUFFY. No, you didn't answer. You did not answer my question. And you know what?

Secretary LEW. I am not sure what you are looking for, Congressman.

Mr. DUFFY. I am asking a very specific question that you dodged, and our President has dodged. If you want to look back at the President's testimony, he received the same question that I just asked you, and what he said was, "Let me answer it specifically. I learned about the IG report on this date."

I am not asking you or the President when you heard about an IG report. I want to know when you learned that the IRS was targeting Americans. When?

Secretary LEW. And I am telling you when the facts were available to me.

Mr. DUFFY. Outside of the IG report? The first time you heard about it was the IG report?

Secretary LEW. I had no facts until—

Mr. DUFFY. I am not asking about facts.

Secretary LEW. What are you asking me?

Mr. DUFFY. I am asking you—

Secretary LEW. I only testify on facts.

Mr. DUFFY. When did you learn that there the IRS was targeting Americans? When did you learn it? I am not asking you about specific facts.

Secretary LEW. I will answer—

Mr. DUFFY. I am not asking about the IG. When did you know that this targeting was going on?

Secretary LEW. You are not going to like my answer, because I learned about it when I learned about it.

Mr. DUFFY. When was that?

Secretary LEW. I did not know there was an investigation—

Mr. DUFFY. I didn't ask you about an investigation.

Secretary LEW. Well, I—what are—I didn't know—

Mr. DUFFY. I am not asking about an investigation.

Ms. WATERS. Mr. Chairman? Mr. Chairman?

Secretary LEW. Congressman, you can ask me a question—

Chairman HENSARLING. The time belongs to the gentleman from Wisconsin.

Ms. WATERS. Mr. Chairman, I would ask that the witness not be badgered.

Mr. DUFFY. I would ask that the witness answer the question.

Secretary LEW. Congressman, I am answering your question.

Mr. DUFFY. No, you are not. You keep saying—you are dodging me, because the bottom line is you knew before the IG report came out that the IRS was targeting Americans—

Secretary LEW. Congressman, I am answering your question.

Mr. DUFFY. —and that is why you are answering the question the way you are—

Secretary LEW. I did not know—

Mr. DUFFY. That is why the President—

Ms. WATERS. Regular order, Mr. Chairman, regular order.

Secretary LEW. I did not know the facts until the dates that I—

Chairman HENSARLING. The time belongs to the gentleman from Wisconsin.

Mr. DUFFY. Let us try it again. When did you learn that the IRS was targeting Americans? When did you learn about—

Secretary LEW. Congressman, I have said so many times that it is unacceptable behavior. That I learned on March 15th that there was an investigation, with no facts. I learned the facts a week ago Friday and then I saw the report last Tuesday.

Mr. DUFFY. America now knows. I reclaim my time.

Secretary LEW. —saw the report on Tuesday.

Mr. DUFFY. I reclaim my time.

It is evident that you knew before March 15th because you keep answering my question, because you don't want to lie to Congress that you knew about an investigation—

Secretary LEW. I did not have any facts until the dates I am telling you of. I don't understand what—

Mr. DUFFY. Answer my question.

Secretary LEW. —I had no facts until—

Mr. DUFFY. I am not asking about facts.

Secretary LEW. What are you asking me about?

Mr. DUFFY. When did you learn—that is my question—when did you learn—give me the date—when did you learn, Mr. Lew, that the IRS was targeting Americans? Give me a date. When did you learn it?

Secretary LEW. Congressman, I learned about this in the dates that I have told you about.

Mr. DUFFY. That Americans were being targeted or an IG report?

Secretary LEW. Congressman, I was not aware of any of these facts until the dates I have told you about.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair recognizes the gentleman from California, Mr. Sherman.

Mr. SHERMAN. Mr. Secretary, take a deep breath. You have earned it.

Secretary LEW. I am fine.

Mr. SHERMAN. I want to focus on a different tax scandal, since that seems to be what we are talking about, and that is our failure to collect taxes from multinational corporations. Apple computer is just an apple on top of the iceberg. It appears as if they have less than 4 percent of their assets, less than 4 percent of their sales, and less than 4 percent of their payroll in the Republic of Ireland but somehow have 65 percent of their profits attributed to the Emerald Island. That is damn effective tax accounting.

One view put forward by the Chamber of Commerce is, hey, we are just never going to be able to tax multinational corporations, U.S. corporations that earn money abroad are just never going to be paying taxes in United States, and we shouldn't even try and just let 'em repatriate their profits, because we do want the profits repatriated.

The other approach—and I don't know if you are familiar with it—is the approach California took for many decades, and that is the worldwide unitary approach. And I wonder if I can count on you and your staff to take a look at that.

You can be hated by the Chamber of Commerce—but you may achieve that on your own—and others, but it is actually a system that they cannot evade and would allow us to collect taxes on the appropriate percentage of worldwide income of all the multinational corporations that do business in the United States. I don't know if you have a comment on that—

Secretary LEW. Congressman, if I could comment just briefly, when we laid out principles of tax reform last year, we tried to address this issue in terms of a conceptual approach. And we see business tax reform as being very important to lower statutory rates and make the United States a more competitive place to have businesses call home.

But it also is a way of addressing this issue, because what we would do is we would put a minimum tax in place so that there is something of a hybrid system that you pay a minimum tax and then you could repatriate with no tax above that if you have paid the minimum tax on your foreign earnings in the first instance.

And we would like to work—there are some other ideas that have been developed. I think, in fact, we have something of a hybrid system now. This would make it a little bit more closer to what you are describing, somewhere in the middle.

Mr. SHERMAN. The worldwide unitary system is completely different, I think, than what you are describing. I hope that you will take a look at it—

Secretary LEW. I am happy to look at the California—

Mr. SHERMAN. And it is a system that California ultimately made optional because we faced such incredible pressure from the worldwide business community. But the Federal Government is a little more influential in world business decisions and this would be a system that would eliminate the 482 audits, would eliminate all the shenanigans, substantially increase—I think the best estimate is $1.2 trillion over the next 10 years. I know you spent a lot of last year focusing on trying to produce $1.2 trillion from many sources over a 10-year period. As to the tax issue—

Secretary LEW. —it is still under way, I might add.

[laughter]

Mr. SHERMAN. I understand.

As to the other tax issue that is being discussed here, I always wanted to be on the Ways and Means Committee and be at a hearing devoted to tax issues, 501(c)(4) secret super PACs can spend unlimited amounts of secret money influencing Federal elections, but they are subject to certain limitations. And I hope that we will enforce those limitations as the law requires, no matter how politically difficult. At the same time, we have to do it, obviously, impartially.

Now, when a ship sinks out of negligence, you might be inclined to fire the admiral of the fleet, but the captain of the ship and even the officer of the deck ought to have some effect on their careers. Do you need additional narrowly crafted legislative tools so that those who are not Presidential appointees at the IRS—which is everybody but two—can face appropriate personnel action for the mistakes made in this case?

Secretary LEW. Congressman, obviously, the rules that govern the treatment of Federal employees are the same for most agencies of government, so it is a broader question than just—

Mr. SHERMAN. Let me just change—only in the IRS do you have a circumstance where many very top managers are civil service, and the question is—

Secretary LEW. I am happy to—

Mr. SHERMAN. —do we need take a look at that?

Secretary LEW. —yes, one of the things that I have asked the new acting Commissioner to do is to look at—question structural organizational issues to see if there are changes we need. I don't want to jump to a conclusion, not having had that review, but I am happy to look at that.

Mr. SHERMAN. Thank you.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair recognizes the gentleman from North Carolina, Mr. McHenry.

Mr. McHENRY. Thank you, Secretary Lew, for your service to our government.

Now, back to the IRS question—we have a few more questions. When you were White House Chief of Staff, I assume you were just as concerned about this then as you are today. Is that fair?

Secretary LEW. What is the "this?"

Mr. McHENRY. I am returning to the scandal within the IRS of the IRS targeting conservative groups. I assume—

Secretary LEW. I wasn't aware of the issue of this investigation or to the facts that we have come to know. So it was not on my radar at the time.

Mr. McHENRY. So you were not aware of the IG audit at that time?

Secretary LEW. No, I learned about the IG audit on March 15, 2013, when I met with—

Mr. McHENRY. Okay. Were you aware of the internal investigation within the IRS prior to that?

Secretary LEW. No, I was not.

Mr. McHENRY. Okay. So as Chief of Staff, did you hear news reports about the IRS targeting conservative groups?

Secretary LEW. I was not aware of any facts at the time—

Mr. McHENRY. No, no, I am asking a separate question than what you are answering, and I have heard the answers you have given prior to that.

So I don't want to talk over you, but I do want to restate the question. At the time you were Chief of Staff, did you read or hear of the allegation that the IRS was targeting conservative groups?

Secretary LEW. I do not recall paying attention to this issue when I was—

Mr. McHENRY. No, no, I understand. Paying attention is one thing—

Secretary LEW. I do not recall any articles that I read on the subject.

Mr. McHENRY. You don't recall—

Secretary LEW. I have no recollection.

Mr. McHENRY. Okay. Okay. So did you—you don't recall anything. So therefore, you couldn't have pursued any allegations?

Secretary LEW. If I don't recall having done it—obviously, one has to have the—

Mr. McHENRY. I am asking this question—

Secretary LEW. If I take your—if I were aware of there being something that was being investigated in this way at the agency, I would have stayed out of it as Chief of Staff.

Mr. McHENRY. Okay, you would have stayed out of it.

Just to be clear, you wouldn't have picked up the phone and called Chicago to say, "By the way, just to put it out there, we are in a Presidential election year. We have a scandal at the IRS, an agency—

Secretary LEW. No, that is not—

Mr. McHENRY. No, no, no, hold on. Let me finish. But you wouldn't have picked up the phone and said, "Hey, guys, you know, this might be a political issue that the President might have to answer in, I don't know, a Presidential campaign debate." This is something which is fairly common, where the Chief of Staff communicates with the campaign, I assume.

So to ask this question is not absurd, sir.

Secretary LEW. But Congressman, if I wasn't aware of it, and I had no conversations at the time, you are creating a narrative that doesn't exist.

Mr. MCHENRY. Okay.

Secretary LEW. I just want you to know.

Mr. MCHENRY. Okay, but you did that on other issues, as a good Chief of Staff? This is not new. I am not trying to catch you on something.

Secretary LEW. Congressman, obviously, as Chief of Staff, you deal with many, many topics with many, many people. But you are asking me about a specific subject—

Mr. MCHENRY. Okay, then, let me just move on—

Secretary LEW. —answer. But if I can just say, though—

Mr. MCHENRY. —and let me ask you this question, okay.

Secretary LEW. —you created a narrative that—

Mr. MCHENRY. My time is limited, sir, okay.

Secretary LEW. Well—

Mr. MCHENRY. Just to get this on the record.

Secretary LEW. In fairness, you should give me at least 30 seconds to respond.

Mr. MCHENRY. Sir, you haven't actually responded to any of these questions in a meaningful way, so 30 seconds won't actually apparently mean anything because you are reciting the same line over and over again.

So while you were Chief of Staff, did anyone at the White House or in the Executive Office of the President ever suggest the IRS or Treasury—that the IRS should focus additional scrutiny on the application of conservative groups?

Secretary LEW. I am—not that I am aware of.

Mr. MCHENRY. Okay. We are just asking these things to certainly understand where things stand.

So while you were Chief of Staff, did anyone in the White House or in the Executive Office of the President meet with or in any way communicate with Members of Congress regarding these letters that Members of Congress sent on the left to say target conservative groups on the right, raising concerns about the targeting of conservative groups?

Secretary LEW. Not that I am aware of.

Mr. MCHENRY. Not that you are aware of.

Okay, so to remind you sir, in March of 2012, the Associated Press and the New York Times ran stories about this allegation. You were then Chief of Staff. And is it your testimony here today that you were never aware of those allegations raised in those two news organizations?

Secretary LEW. I have already testified that I have no recollection of it.

Mr. MCHENRY. No recollection.

Okay, so when Commissioner Shulman of the IRS testified before Congress in March of 2012, and these questions were posed to him, he said, "There has been a lot of press about that." And your testimony today is that as White House Chief of Staff, you didn't know about it.

So the final question I have for you is that—

Secretary LEW. Congressman? Congressman, if you would give me the 30 seconds that I think I deserve to respond. It would be inappropriate—

Mr. MCHENRY. Hold on. I ask unanimous consent that the gentleman have 30 seconds. So understand that Democrats are objecting to their witness.

Chairman HENSARLING. The time of the gentleman has expired, and the Chair will take the liberty of, without objection, offering our witness 30 seconds to comment.

Secretary LEW. Thank you, Mr. Chairman.

Chairman HENSARLING. The gentleman has objected.

The Chair recognizes the gentleman from Massachusetts, Mr. Lynch.

Mr. LYNCH. Mr. Secretary, first of all, thank you for your willingness to come before this committee and help us with our work.

Why don't I yield you 30 seconds and you can finish your answer?

Secretary LEW. Thank you, Congressman.

I think the fundamental issue here is there is separation in the enforcement administration of our tax system so that it is supposed to be insulated from political involvement. It would be inappropriate as White House Chief of Staff, or as Secretary of the Treasury, to try to put any political pressure on our tax system.

I never did, and I never would. And that is why I didn't pay an awful lot of attention to questions of the administration of our tax system, because it wasn't something that I would have intervened in. There is intentionally a separation so that the tax system will not be biased. And I think that what the President has made clear, what I have made clear is that this behavior is unacceptable. We have to find out the facts. We have to take action where people need to be held accountable, and we have to make sure it never happens again.

But, please, let us not get into a world where we start having the White House jump in for the administration of our tax system, because that will be a cure well worse than the disease.

Mr. LYNCH. I thank you.

And in fairness—you know what? I just think that the circumstances here are sort of politicized, anyway, when the IRS has conceded the fact that they did use political terms, such as "tea party" and "patriot." And any group critical of how the government is being run, those were the standards that they were using.

So, I guess the circumstances sort of invites this type of accusation, but I accept and I agree with your answer, Mr. Secretary, again.

I would like to ask you more about what we have been doing in this committee; 2 weeks ago, this committee passed a set of bills amending Title VII of Dodd-Frank. And I believe those provisions significantly undermine the high port reforms to the over-the-counter derivatives market we achieved in Dodd-Frank.

A GOA report earlier this year estimated that the cost of the financial crisis was about $22 trillion, and that the opaque and largely unregulated derivatives market was at the heart of the crisis. And now, not even 5 years after those dark days, we are, in this committee, I believe, planting the seeds for the next crisis.

And before any of the regulations mandated under Dodd-Frank to reform the derivatives markets have been finalized, this committee has passed what are being called "technical fix" bills to prevent those reforms from ever happening.

I read last week that former Chairman Sheila Bair talked about the original push-out provision of Section 7-16. And, Mr. Secretary, I know that you sent a letter prior to this committee's markup of those bills urging us not to advance that legislation, calling it premature, disruptive, and harmful to the implementation of key derivatives reform.

Could you explain to this committee why these bills, in your opinion, are destructive to our economy and to meaningful Wall Street reform?

Secretary LEW. Congressman, I think it is very important for the regulators who have been given authority to implement these revisions and for that process to be completed.

Many of the concerns—some of the concerns that are raised in the legislation actually are going to be addressed, as I understand it, as these rules are forthcoming. Not necessarily all, but the legislation is premature because we haven't yet had the opportunity to complete the process.

In the first 2 years of Dodd-Frank's history, the fight was, should it be repealed, or should it be implemented? It slowed down the implementation process. And then, at the end of 2 years, there were concerns that there was uncertainty because the rules were not yet in place.

Our first responsibility now is to make sure we get all the rules in place, we get that certainty, and I think we are now at a point where the financial industry actually would like us to complete the regulations. They are not in the place they were in fighting for repeal. And we just need to finish the work.

And I am committed with regard to the entire implementation of Dodd-Frank to really keeping the pressure on all of the different parties, as Chairman of FSOC, to keep making progress. And I can't say exactly when the process will be completed, but we are moving, and we are well on our way, and we are going to make a lot more progress this year.

Mr. LYNCH. I seem my time is just about expired. I yield back.

Chairman HENSARLING. The time of the gentleman was about to expire.

The Chair now yields to the gentleman from Michigan, Mr. Huizenga.

Mr. HUIZENGA. I appreciate that, Mr. Chairman.

Chairman Lew, I appreciate you being here. And maybe we can use a slightly different section of your briefing book, or maybe not use the briefing book at all, and discuss a few other issues.

But I do—I was hearing your answer to my colleague about implementation and the uncertainty being out there. And I just have to tell you, I don't buy it.

It is pretty clear that this Administration would veto any attempt that—as much as I might desire eliminating Dodd-Frank and starting over and fixing it a different way, it seems to me that this Administration would be pretty clear on a veto message on that.

And how in the world that would stop you all from implementing the rules—now, I would say that it is probably because this monster is so massive and has so many problems with it that you have realized that you can't go in and implement it the way that it is currently written.

And frankly, 2 weeks ago, we had 9 bills that moved through here. All but one of those were in a bipartisan fashion—fixing derivatives.

Last year, I had a bill signed into law by the President. That was fixing an issue with the CFPB in privacy. We have a myriad of other bills that are going to go in. We had a hearing yesterday on conflict minerals and some of the issues and problems that are there.

These are bipartisan fixes, trying to address this problem. And I will note that you sent a letter opposing all nine of those bills that were passed, and eight of those nine were passed in a bipartisan fashion.

So, how you can blame Congress, or one side of the aisle or the other for a lack of progress seems to be a stretch to me. And you had mentioned on LIBOR—you were asked earlier about LIBOR. And your quote was: "It was a tremendous violation of trust." I think you are sensing a lot of the frustration, not just up here, but in the general public.

There is a feeling and a frustration that there is not trust, and that things have been politicized in the budget process, in the regulatory system. And I have a specific one that just came to light to me, which I thought was interesting.

OMB—and I know you are former—it is not maybe under your current bailiwick, so please give me some insight, if you could, OMB has decided that FASB, GASB, PCAOB, SIPC—all these other regulatory advisors and those kinds of things—they are subject to sequester. Under Section 109 of Sarbanes Oxley, it distinctly says that these are not Federal dollars. These are user fees that are coming in and fees that are paid into these organizations.

And the frustration is that it seems like every time this Administration has come to a fork in the road, and one direction is making some very tough, difficult decisions—I understand it. We are having to do that in our own personal offices.

We are having to do that in our own personal lives. Every business in America that I am aware of is having to make those tough, difficult decisions. But making it work, or politicizing it and trying to make it painful, it seems that this Administration has gone with the painful route.

Shutting down the White House for spring break, FAA—whatever it might be. And just to give you a little sense, that is a sense of frustration. And I know this is sort of an archaic element, and you might not be specifically aware of it, but why the OMB would come in and tell these organizations that they are somehow subject to the sequester just is baffling to me.

Secretary LEW. Congressman, I can't address the specific facts around those decisions, but I do know that OMB has just been calling these issues on a straight basis. But they are—you either do or don't get covered—

Mr. HUIZENGA. I think the real problem is that the—

Secretary LEW. Sequestration was designed to be a bad policy to force Congress to act, so no one should be surprised when it—

Mr. HUIZENGA. Put out by the Obama White House, I might add.

Secretary LEW. It has—it was designed to get Congress to act.

Mr. HUIZENGA. Okay. So, please point out to some of your colleagues Section 109 of Sarbanes Oxley. That would be helpful.

Page 13 of your report, the chairman had talked a little bit about this with the Housing—my background is real estate, construction. I, too, am baffled as to what HUD and FHA—continue to work with Congress and other stakeholders.

There has been radio silence. Other than the White Paper that was talked about, it is been radio silence from this Administration on what we are going to do and what direction we are going to go with our GSEs. And that, in my mind, needs to change. Take 15 seconds if you want to address that and what we are going to do.

Secretary LEW. I don't know that I can do it in 9 seconds, but it is an important subject. We look forward to making progress on it in a bipartisan way.

Mr. HUIZENGA. But how can you claim that you have been working with us when you haven't been?

Saved by the bell. Okay.

Chairman HENSARLING. While the Chair is also curious, the time of the gentleman has expired.

I wish to alert all Members that, in agreement with the Secretary's schedule, I believe we will be able to clear four more Members, and then we will excuse the Secretary.

The gentleman from Colorado, Mr. Perlmutter, is recognized.

Mr. PERLMUTTER. Thank you, Mr. Chairman.

I thank you, Mr. Lew, for being here. You have stayed a lot cooler under fire than I was just a moment ago.

And I want to thank my friend Mr. Lynch for granting you those 30 seconds to explain your position, because I would have given you the 30 seconds. But I think this committee is better than the badgering that I have seen you undertake or you have had to face today.

So, let us just talk—since we have talked so much about 501(c)(4), I think we ought to read what 501(c)(4) says. It says, "An exempt—an organization described in Section C or D of Subsection 401 shall be exempt from taxation under this subtitle"—this is 501—"lest such exemption is denied under Section 502 or 503."

You come down to 4—is says, "Civic leagues or organizations not organized for profit, but operated exclusively for the promotion of social welfare or local associations or employees, a member of membership of which is limited to the employees of a designated person or persons in a particular municipality, and the net earnings of which are devoted exclusively to charitable, educational, or recreational purposes."

So, the IRS has an obligation to look at exemptions that people request. Most people are paying their taxes. Most Americans are out there paying their taxes, but there are certain people who seek exemptions under 501(c)(4). But those have to be scrutinized. They have to be scrutinized impartially, but they have to be scrutinized.

There was an article this week in The Denver Post. It says, "A Colorado conservative group believed to be targeted by the Internal Revenue Service is operating without any tax exempt status and spent more than $1 million last year against Democrats, public records show." I was one of those Democrats who was the recipient of some of the ads, apparently, of this organization.

In an editorial in the Post this weekend by Curtis Hubbard, I want to read one section, "So-called 501(c)(4) social welfare groups have increasingly been putting money into political campaigns. Their spending increased from about $40 million in 2004 to upwards of $150 million in 2008, according to the Center for Responsive Politics. But the real boom came after the Supreme Court's Citizens United ruling in 2010, as the groups' campaign spending soared beyond $300 million in 2012. Much more is believed to have been spent, but the groups are only required to report on spending in the 60 days leading up to the general election and 30 days prior to a primary."

Many 501(c)(4) nonprofit "social welfare" organizations are simply fronts for political operations that provide anonymity to donors, and with anonymity comes a lack of accountability.

So the IRS, in my opinion, whether it is an exemption for this or some other kind of an exemption, has a responsibility on behalf of the taxpayers to look at these things. Do it impartially, obviously, that has been much of what the conversation has been about. But specifically here, when it talks about civic leagues or organizations operated exclusively for the promotion of social welfare, not for political purposes.

So despite all of this tempest that we are in right now, sir, I would ask that the IRS continue in an impartial way to look at these particular exemptions. So, that is just my point on that. I think one of the reasons we are so off on this subject is because since Barack Obama took office, the stock market has doubled, unemployment has dropped, inflation is low, real estate is selling. So let us not talk about those things, let us talk about this—potentially two people in Cincinnati. Let us devote all the time to that.

One of the things that came up last week that particularly disturbs me is a bill the Republicans are pushing which prioritizes the country's debts. The country has, since its inception, paid everything pari passu equally. And now they want to start prioritizing it, which means we are not going to pay somebody.

I hope, Mr. Secretary, that under your watch, we pay everybody pari passu, and I would like you to comment on that bill.

Secretary LEW. I couldn't agree more that there is no distinction between defaulting on one or another obligation. If you are in default, you are in default. And prioritization doesn't solve that problem. You need to extend the debt limit.

Mr. PERLMUTTER. Thank you.

Chairman HENSARLING. The time of the gentleman has expired. The Chair recognizes the gentleman from New York, Mr. Grimm.

Mr. GRIMM. Thank you, Mr. Chairman.

Thank you, Mr. Secretary, for being here today.

It is been a bit contentious and I know it is not an easy day for you. But I am going to start with going back to an unpleasant area, and then I will move on to other substantive issues.

When was the last time you spoke with the four individuals who were testifying in the other committee today—Lois Lerner, Russell George, Neal Wolin, and Doug Shulman?

Secretary LEW. I have never spoken with Lois Lerner. I met with Russell George several weeks ago. And I haven't—Neal Wolin is my Deputy, so I see him every day. And I haven't seen Doug Shulman since sometime before he left the IRS.

Mr. GRIMM. The few conversations that you did have, was any of that about testimony or about the situation—the scandal?

Secretary LEW. I have testified already that Russell George on March 15th informed me that there was an audit under way, so I spoke with him about it then as he reviewed a number of pending matters. He didn't give me the details. He did give me a heads up that it could be troubling, but I didn't know in what way.

I haven't spoken with him. He may have been at a staff meeting after that, but I haven't spoken with him since.

Mr. GRIMM. Thank you. You have clearly testified that you didn't want to get involved in an investigation, and I think that is the proper and prudent policy to have. Stating that, there were people in the White House who knew there was an investigation, there was a problem. There were people in Treasury who knew prior to you and the President finding out.

In retrospect, again not saying that you had to take action, but do you think you should have been notified that there was a problem?

Secretary LEW. Congressman, I really believe that on a matter like this, the general practice that is followed at Treasury is the right one, which is that the Secretary is not brought into the conversation on an IG report until there is a final report. Reports go through changes in degree and direction—

Mr. GRIMM. But even before—if I may, Mr. Secretary—though, but prior to the IG report, wasn't there an internal investigation at the IRS?

Secretary LEW. I am, obviously, while I have been at Treasury, there has not been anything that—

Mr. GRIMM. But I am asking you in general, now that you are the Secretary, what is your policy going to be? In other words, you have a new Commissioner that you spoke about—

Secretary LEW. Yes, we have a new Commissioner, and I will be meeting with the new Commissioner this afternoon.

Mr. GRIMM. Right. So will you be telling your new Commissioner that if something like this arises, you want to be notified?

Secretary LEW. Just to be clear, I think that as a general matter, the Treasury Secretary needs to have visibility into the general management of the IRS. But the Treasury Secretary, for all kinds of appropriate reasons, does not intervene in the administration of the tax system. So there is a fine line there, and I think it is very important to honor that line.

Mr. GRIMM. But I am specifically asking you if there is a problem such as something that arises to this level—this is probably one of the biggest scandals in the history of the IRS—are you going to advise your Commissioner—is it going to be your policy that if there is a major problem going on, you want to be advised of it or not? That doesn't mean you will take action, because maybe for political reasons you would say, just as the attorney general did with Mr. Corzine, he recused himself, but he knew what was going on.

Secretary LEW. Congressman, if in fact either I or the President had known some of these facts earlier, you would be asking me, "What did we do?" It is a very fine line to preserve information and the ability to make sure that there is—

Mr. GRIMM. I agree. But I am asking—because it is such—

Secretary LEW. I think we are going to have to work our way through, in an agency like the IRS that has a delicate balance between being part of Treasury, but an independent, having the right line.

Mr. GRIMM. But with all due respect, you have to still have a policy—

Secretary LEW. And I am going to meet this afternoon with the new acting Commissioner—

Mr. GRIMM. I am just asking you—I am not saying whether it is good or bad, I am just asking you what your policy is going to be now that you have a new Commissioner. In light of what has happened, what will your policy be?

Secretary LEW. My policy will be to hold the IRS accountable and make sure the IRS holds people accountable for their behavior, to make sure that we find out what happened here in terms of the breakdown of the management, of the communication of the IRS to permit it, and we look to see whether there are systemic problems.

On an ongoing basis, I will work with the new Commissioner to make sure that I have visibility into that which is appropriate, but I will stop short of intervening in the Administration of the tax system.

Mr. GRIMM. Again—

Secretary LEW. And that is going to take some—

Mr. GRIMM. —okay, I want to move on, but again, intervention is different than knowledge. I have asked that 3 or 4 times. You just won't answer the question. That is fine. Let is just move on.

Mr. Secretary, I am hearing that the Treasury is thinking about floating variable rate notes. I have a big problem with that. Is that true, first of all, that the Treasury is considering floating variable rate notes?

Secretary LEW. I just wanted to double-check. There is a proposal that is out from I think several weeks ago.

Mr. GRIMM. My time has expired.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair recognizes the gentleman from Delaware, Mr. Carney.

Mr. CARNEY. Thank you, Mr. Chairman. Thank you for having this hearing today.

And thank you, Mr. Secretary, for coming in, and for your answers to the questions.

I am going to try to focus—first, a comment about what you have said. As a former Secretary of Finance at the State level, whose responsibilities or whose jurisdiction included tax administration, I certainly appreciate your kind of hands-off approach to that administration of taxes, and understand why it is necessary for the political appointee at a place like Treasury or where I served.

I would like to ask you a few questions about your role as Chair of the FSOC. And the first one is, we hear a lot, we hear it in this committee, we hear it from folks on the other side of the aisle, and we hear it from people who come in that too-big-to-fail still exists. What would you tell folks who say that?

Secretary LEW. Congressman, I think the challenge we have is to be able to get to the end of the implementation of Dodd-Frank and then answer that question by saying, "too-big-to-fail is over." That is what the policy of Dodd-Frank is. That is our policy in terms of implementing Dodd-Frank.

We are not yet at the finish line. So, I think that there is a challenge if you take a snapshot today and you look ahead. I think if you look at the debate that has taken place over the last number of months, there are different approaches to what additional actions are needed. There is authority in Dodd-Frank to turn a number of dials to different levels in terms of capital requirements, in terms of leverage requirements.

And until that process is complete, it is going to be a little challenging to answer it in the present tense. But I certainly hope the answer, and I intend for the answer to be that too-big-to-fail is over.

Mr. CARNEY. Our former chairman and ranking member, Mr. Frank, would argue that the Orderly Liquidation Authority effectively ends too-big-to-fail.

Secretary LEW. Yes, but it makes it so we don't have the authority to do it.

Mr. CARNEY. Right, right. The second question I would like to ask you, and you have been asked about it a little bit, is about housing finance reform. Your report talks about allowing the GSEs to wind down and to try to encourage and get more private capital into the mortgage market.

A few weeks ago, we had a presentation here in committee by a guy by the name of Jim Millstein, who has worked kind of on the details of that. Treasury has a paper that was presented here in committee about a year or 2 years ago that described at a very high level three options.

Mr. Millstein has put the meat on the bones of what was option number three, kind of a hybrid where there would be a more limited Federal role, a specific guarantee, reinsurance, actually, like the FDIC. Have you seen that proposal? And if you have, what do you think about it?

Secretary LEW. I have seen it, and I have actually asked my staff to do an analysis of it. We are in an ongoing process working through what the next steps should be, and we welcome the contribution to the debate.

Mr. CARNEY. Yes, I would love to see your staff's analysis of that and any concerns and issues that are raised by it. It is very intriguing to me. I have met with Mr. Millstein and his staff. He was here in front of the committee. And it seems to work out, basically that option three that is included in the Treasury White Paper of a couple of years ago.

Secretary LEW. Obviously, the challenge as we go forward is going to be to strike that balance so that we maintain access to mortgages, 30-year mortgages, and we avoid having institutions get back into the place where they fell back on an implied guarantee that created the financial crisis.

Mr. CARNEY. And that was exactly his advice and to be careful, frankly, about the transition from where we are today, where more than 90 percent of mortgages are being federally-insured, which is a really bad situation.

Secretary LEW. Either directly or federally.

Mr. CARNEY. Right, right, right.

Lastly, my first term in the last Congress, I sent a letter that was signed by other Members encouraging Treasury to be a little bit more aggressive with foreclosure prevention programs that you have. In particular, the one that is most effective in our State, the State of Delaware, is HAMP, and our local officials at the State housing authority have used it, and it has been very effective in helping keep people in their homes.

And I would just encourage you do that. I would be happy to resend the letter or talk to your staff about it for a minute, if you would, on your approach to foreclosure prevention.

Secretary LEW. Congressman, I think we have made progress, but we still have a lot more to do. I think that both HAMP and HARP have done a lot of good directly, but they have also indirectly created a set of practices that the private sector has stepped into.

So we have seen six-plus million homeowners be able to refinance or restructure. We have more work to do, and we have to take advantage of this time when interest rates are low to make as much progress as we can for middle-class homeowners.

Mr. CARNEY. Thanks very much. I look forward to hearing more about it.

Chairman HENSARLING. The last Member to be recognized will be the gentleman from Indiana, Mr. Stutzman, who is recognized for 5 minutes.

Mr. STUTZMAN. Thank you, Mr. Chairman.

And thank you, Mr. Lew, for being here today. I do want to just make a statement, then I have another question.

This audit of the IRS started roughly over a year ago. You were the Chief of Staff at the time. I hope that you will give us confidence as we moved through this and as more details come out that, as the leadership of the White House, that if this is one of the biggest scandals that this Administration or the IRS is dealing with, that you should have known about it.

Leadership expects to know about these things, and if you say that you only knew of the facts on March 15th, I hope that you are asking the people below you, "Why didn't I know about this?"

Because I read in a report that you said that you were outraged when you heard of the facts. And if this is the biggest scandal that this Administration is facing, you should be outraged. And I hope that somebody below you is going to face the consequences, because leadership really should step up and find out why you didn't know.

Now, I would like to talk a little bit about what we see on the wall here on the debt clock. Mr. Secretary, on March 13th, the

President said, "We don't have an immediate crisis in terms of debt. In fact, for the next 10 years it is going to be in a sustainable place."

Under President Obama's budget proposal, can you tell me how long it will be until the budget balances?

Secretary LEW. Congressman, I think, as you know, the budget does not balance in a 10-year window. And that is not what he meant when he said a "sustainable place." His budget would bring the deficit as a percentage of GDP and the debt as a percentage of GDP back into a sustainable range.

If anything, we are overachieving on deficit reduction right now, given where we are in terms of the current year and immediate economic needs.

So the goal should not be to balance the budget right now. The goal should be to be on a path where we have a sustainable—

Mr. STUTZMAN. What year should be our goal?

Secretary LEW. I don't think that the year is what is most significant. I think the path we are on is what is most significant.

Mr. STUTZMAN. But for my 11- and 7-year old, when can they expect the Federal Government to balance the budget?

Secretary LEW. I think that the test is, are we building an economy for the future? Are we running our fiscal policy so that we have a deficit and a debt that are sustainable? And are we addressing it in a fair and balanced way?

The President has put together a budget proposal that would do that, and we are looking forward to a bitpartisan—

Mr. STUTZMAN. —are you suggesting we should raise—raise taxes, then, to balance the budget?

Secretary LEW. I think that we should have a fair mix of spending reductions and loophole closing that would give us the ability to, in a fair and balanced way, be on a long-term path to fiscal sustainability.

Mr. STUTZMAN. We have already raised taxes. I want to talk about what, really, I think is holding up the economy, and that is the health care law.

As I talk to folks around northeast Indiana, they consistently say, "I don't have any certainty. I don't know what is going on." And this plays right back into the IRS issue, because the IRS is going to be one of the main agencies of administering the health care law. Is that correct?

Secretary LEW. It is one of many agencies, but HHS is the main agency.

Mr. STUTZMAN. But the IRS is going to be involved.

Do you think that the confidence level of the American people in the IRS, as they administer, as they start to roll out the health care law is going to be increased at all? Is there going to be more skepticism?

Secretary LEW. I have said over and over again that it is a top priority to restore confidence in the IRS. We are committed to doing that. After this hearing today—

Mr. STUTZMAN. Do you know Sarah Hall Ingram?

Secretary LEW. I do not know her, no.

Mr. STUTZMAN. Okay. She was the head of the tax-exempt office during what we understand to be—during the targeting of Americans. And now she is—and I don't know how you don't know her—the head of the health care law—rolling out the health care law. Should you know her?

Secretary LEW. Typically, I deal with Treasury staff, who deal with others in the IRS on policy matters.

If I can just correct the facts that you just described, my understanding—and we—facts matter, we have to make sure the facts are correct, that her responsibilities at the time when awareness of this investigation, these problems, became known, was working on the Affordable Care Act. And—

Mr. STUTZMAN. So you know of her, then?

Secretary LEW. I know of her, of course. Yes.

Mr. STUTZMAN. Okay. All right. So do you think it would be inappropriate for her to continue or to remain in the position she is as now the head of the health care—as the rollout—

Secretary LEW. I just said that facts matter. If the facts are that she was not in the position—taking day-to-day responsibility for this at the time in question, then the question is, is she doing her job on the Affordable Care Act effectively? And I am sure the new acting Commissioner who will take over today will look at that.

Mr. STUTZMAN. I can tell you, the American people are not trusting of this Administration right now.

Chairman HENSARLING. The time of the gentleman has expired.

I would like to thank the Secretary for appearing today, and thank him for his testimony.

The Chair notes that some Members may have additional questions for this witness, which they may wish to submit in writing. Without objection, the hearing record will remain open for 5 legislative days for Members to submit written questions to this witness and to place his responses in the record. Also, without objection, Members will have 5 legislative days to submit extraneous materials to the Chair for inclusion in the record.

Before adjourning, pursuant to the committee's organizing resolution, Mr. Ross is hereby transferred from the Subcommittee on Oversight and Investigations to the Subcommittee on Housing and Insurance.

And pursuant to the committee's organizing resolution, Mr. Rothfus is hereby appointed to serve on the Subcommittee on Oversight and Investigations and the Subcommittee on Financial Institutions and Consumer Credit.

This hearing stands adjourned.

[Whereupon, at 12:55 p.m., the hearing was adjourned.]

A P P E N D I X

May 22, 2013

The Honorable Jacob J. Lew
U.S. Department of the Treasury
Hearing on the Financial Stability Oversight Council Annual Report to Congress
House Committee on Financial Services
May 22, 2013

Chairman Hensarling, Ranking Member Waters, and members of the Committee, thank you for the opportunity to testify today regarding the Financial Stability Oversight Council's (Council) 2013 annual report.

My testimony today will describe the conclusions and recommendations made by the Council in its third annual report. The report represents extensive collaboration among staff of Council members and member agencies to provide Congress and the public with the Council's assessment of significant financial market and regulatory developments, potential emerging threats to financial stability, and recommendations to strengthen the financial system. The annual report is a key way that the Council can share its collective perspective and provide information on its activities to Congress and the public.

Since the Council's last annual report, our financial system has grown stronger in a number of ways:

- Bank capital has increased significantly in terms of both quality and quantity. This substantial amount of additional capital gives these companies a much stronger ability to withstand a future downturn.

- Companies' liquidity and funding profiles have strengthened dramatically as well. As higher liquidity and funding requirements are implemented in the United States and elsewhere, the financial system will be much less vulnerable to the destabilizing runs that we experienced during the crisis.

- Progress on comprehensive reform of the over-the-counter derivatives market has reduced risks in the system, increased transparency, and strengthened investor protections. Collectively, these measures help make financial institutions and the financial system as a whole safer and stronger. In March, mandatory central clearing of certain swap transactions began. More categories of swaps and an expanded universe of financial institutions will be subject to central clearing requirements as the year progresses, reducing risks to the financial system and to the financial institutions engaging in these transactions.

- We are seeing continued strengthening of the equity, fixed income, and housing markets. And implementation of the Dodd-Frank Act and international coordination on G-20 reform priorities have achieved significant progress toward establishing a more resilient and stable financial system, both domestically and globally.

On the topic of Dodd-Frank implementation, the Council and its member agencies continue to steadily put reforms in place. The Council will soon complete its initial evaluation of nonbank financial companies for potential designation, which would lead to supervision by the Federal Reserve Board (Federal Reserve) and enhanced prudential standards. The Council has already designated eight systemically important financial market utilities for similar increased oversight.

The Federal Reserve issued a new framework for the consolidated supervision of large financial institutions in December. The Federal Deposit Insurance Corporation (FDIC) continued to implement the new framework for the orderly liquidation authority. The Federal Reserve and the FDIC are implementing provisions related to living wills by the end of this year. Further, U.S. regulators are continuing to make significant progress on implementing the Basel III accords to set internationally agreed heightened capital and liquidity standards, which are expected to be fully phased in by 2019.

The Securities and Exchange Commission (SEC) and the Commodity Futures Trading Commission (CFTC) continue to fill in the remaining pieces of a new comprehensive oversight framework for derivatives that will reduce risk and increase transparency. The Consumer Financial Protection Bureau finalized new mortgage rules that provide additional protections for borrowers. And the Federal Housing Finance Agency (FHFA) has taken steps to facilitate increased participation by the private sector in the mortgage markets, including the recent announcement of an effort to develop a common securitization platform that will facilitate a more efficient and sustainable housing finance infrastructure.

Despite these positive developments, there are still risks to U.S. financial stability. The Council's report identifies those risks and makes specific recommendations to mitigate them. The Council's 2013 report focuses on seven areas in particular:

- First, market participants and regulatory agencies should take steps to reduce vulnerabilities in wholesale funding markets that can lead to destabilizing fire sales.
- Second, significant reform in the housing finance system is still needed.
- Third, government agencies, regulators, and businesses should take action to address operational risks from internal control and technology failures, natural disasters, and cyber-attacks, which can cause major disruptions to the financial system.
- Fourth, as recent developments with the London Interbank Offered Rate (LIBOR) have demonstrated, reforms are needed to address the reliance on voluntary, self-regulated, and self-reported reference interest rates.
- Fifth, financial institutions and market participants should be cognizant of interest rate risk, particularly given the historically low interest rate environment of the past few years.
- Sixth, long-term fiscal imbalances that have potential economic and financial market impacts should be addressed.

- Finally, regulators need to continue to keep a close eye on potential threats to U.S. financial stability from adverse developments in the global economy.

I would now like to go into each of these areas in more depth.

Key Areas of Focus of the 2013 Annual Report

Wholesale Funding Markets

The Council remains concerned that vulnerabilities in wholesale funding markets could lead to destabilizing fire sales. Specifically, run-risk vulnerabilities related to money market mutual funds (MMFs), which became apparent during the financial crisis, still remain, despite an initial set of reforms implemented in 2010. In November 2012, the Council issued proposed recommendations for public comment to implement structural reforms of MMFs to reduce the likelihood of runs. Council members should also examine whether similar reforms are warranted for other cash management vehicles.

Vulnerabilities to fire sales also remain in the tri-party repo market, particularly with respect to borrowers such as securities broker-dealers. The Council's report recognizes the positive steps that have been taken in the last year to reduce the reliance on discretionary intraday credit, but recommends coordinated efforts by market participants and financial regulatory agencies to address the risks associated with the tri-party repo market, notably by better preparing investors and other market participants to deal with the consequences of the distress or default of a dealer or other large borrower.

Housing Finance Reform

The housing finance system requires significant reform to enhance financial stability and facilitate the proper functioning of residential lending markets. The residential mortgage market still relies heavily on government support, while private mortgage activity remains muted. The Administration has long called for winding down the GSEs as part of comprehensive housing finance reform and remains focused on bringing back private capital into the market. Although progress was made in 2012, including finalization of some key mortgage rules, the completion of additional reforms is needed to add clarity to the market and attract more private capital. Specifically, the Council recommends that the FHFA continue to pursue changes such as a common securitization platform, model legal agreements, improvements to the mortgage recordation and title transfer system, and an improved compensation system for mortgage servicers.

Operational Risks

The Council remains concerned about operational risks stemming from certain types of trading activities, natural disasters, and cybersecurity threats. Trading activity is becoming more dispersed and automated, raising concern among Council members about operational failures. The extremely high speeds at which markets operate can compound the overall impact of even small operational failures. In 2012, equity markets experienced a number of control problems, including those related to the initial public offerings of BATS and Facebook, and losses by Knight Capital. The SEC has moved to strengthen the automated systems of important market participants, and the Council recommends that regulators continue to monitor the adequacy of internal control and corporate governance processes of financial institutions and market utilities.

Additionally, Superstorm Sandy tested the financial infrastructure, including critical financial utilities, demonstrating the need for regulators to assess their policies and guidance in the area of contingency planning. Cybersecurity also continues to be a central concern, with financial institutions subject to frequent and varied cyberattacks. The Council recommends that senior management at financial institutions remain engaged on these issues, improve communication within and between firms, and that government agencies enhance information sharing between the public and private sectors. However, only so much can be done without comprehensive cybersecurity legislation that allows for enhanced information sharing while addressing legitimate privacy and liability concerns. I am hopeful that continued bipartisan engagement will produce legislation that addresses these critical issues.

Reference Interest Rates

Over the past year, the Council has actively monitored developments related to LIBOR and other reference interest rates and their potential impact on financial stability. The combination of a weak governance structure and a small number of actual transactions in the unsecured, interbank lending market underpinning LIBOR reduce market integrity and raise financial stability concerns.

Investigations by regulators and law enforcement agencies across the globe concerning manipulations and false reporting of LIBOR and similar rates have exposed the structural vulnerabilities of these benchmarks, which provide significant incentives for misconduct.

The Council recommends that U.S. regulators cooperate with foreign regulators, international bodies, and market participants to promptly identify alternative interest rate benchmarks that are anchored in observable transactions and are supported by appropriate governance structures, and to develop a plan to transition to new benchmarks. The Council recommends that steps be taken to promote a smooth and orderly transition to alternative benchmarks, with consideration given to issues of stability and to mitigation of short-term market disruptions.

Interest Rate Risk

Yields and volatility in fixed income markets are very low by historical standards, which may be providing incentives for market participants to "reach for yield" by investing in lower-grade credit, investing in longer-maturity assets, or increasing leverage.

Yield-seeking behavior is apparent in several markets. The issuance of high-yield bonds reached a historical high in the fourth quarter of 2012. While underwriting standards remain conservative in many markets, there are some examples of loosening standards. In particular, certain real estate investment trusts, which are highly exposed to a rise in interest rates, have grown considerably in recent years. The report makes specific recommendations to regulators and risk managers of banks, broker-dealers, insurance companies, and pension funds to be vigilant and scrutinize how potential changes in interest rates could adversely affect their risk profiles.

Impacts of Fiscal Policy

The strength of our financial system ultimately depends on the strength of our economy. Over the last several years, political fights over fiscal policy in Washington—including the debt ceiling crisis in 2011 and failure to come to bipartisan agreement on a balanced package to replace the sequester as required by the Budget Control Act—have hurt confidence, which is a key driver of economic activity. The sequester that went into effect earlier this year was intended to be a policy so painful and mutually disagreeable that it would ensure bipartisan action to replace it, but instead, the harsh and indiscriminate across-the-board spending cuts were triggered, creating a self-inflicted drag on economic growth and job creation. According to the non-partisan Congressional Budget Office, sequestration will shave off more than half a percent of economic growth in 2013 and cost as many as 750,000 full-time equivalent jobs. To guard against future threats to our economy and financial stability, policymakers should avoid using last-minute resolutions to fiscal policy matters such as the debt ceiling and deficit reduction as a negotiating tactic.

It is important to note that since 2011 the President and Congress have ultimately been able to come together to enact a series of agreements that have resulted in historic reductions to our budget deficits. Taken in combination, these bipartisan reforms—not counting the effect of sequestration—have locked in more than $2.5 trillion in deficit reduction over the next 10 years, with more than two-thirds of that reduction coming from spending cuts. And today, because of these policies and other factors, the deficit is falling at the fastest rate in decades. Now, while more can and should be done to reduce the risk of long-term fiscal imbalances through sensible measures, shrinking the budget deficit cannot be the only focus of fiscal policy. Job creation and economic growth have to be a top priority.

Global Economic and Financial Developments

Although external financial threats appear to have decreased over the past year, they remain a risk to U.S. financial stability and economic activity. Global demand has slowed and the euro area economy is on course to contract for the second year in a row. In the advanced economies, there is a need to recalibrate the pace of fiscal consolidation to promote economic growth and employment. Fiscal sustainability remains a concern, but is much easier to achieve in a growing economy. The lack of demand rebalancing also remains a risk to the U.S. economy. China, for example has avoided an abrupt slowdown, but concerns persist about its ability to transition away from its export and investment-driven growth model toward increased domestic consumption. Nevertheless, Council members and member agencies will continue to monitor global economic and financial developments to respond to any threats that may arise.

In addition to those seven key areas that the Council has focused on, I would now like to spend a little time describing the Council's work over the last year and the progress that has been made on financial reform.

Activities of the Council

Since its 2012 annual report, the Council has continued to fulfill its core mission. The Council met 12 times in 2012 to discuss and analyze emerging market developments, threats to financial stability, and financial regulatory issues. There were public sessions at three of those meetings. Through regular meetings of the Council and its staff committees, the Council plays an important role in facilitating coordination among federal and state financial regulators.

The Council is working to evaluate nonbank financial companies for potential designation for supervision by the Federal Reserve and enhanced prudential standards. The Council publicly announced that, in September and October 2012, it advanced an initial set of nonbank financial companies to the third and final stage of the evaluation process. The Council discussed its ongoing analysis at its most recent meeting on April 25, and it expects to vote on proposed designations of an initial set of nonbank financial companies in the near term.

The Council is also authorized to issue recommendations to a regulatory agency when financial activities and practices are creating risk for U.S. financial markets. In November 2012, the Council issued for public comment proposed recommendations to the SEC with three alternatives for reform to address the structural vulnerabilities of MMFs. The Council is currently considering the public comments on the proposed recommendations. If the SEC moves forward with meaningful structural reforms of MMFs before the Council completes its process, the Council expects that it would not issue a final recommendation to the SEC. However, if the SEC does not pursue additional reforms that are necessary to address MMFs' structural vulnerabilities, the Council should use its authorities to take action in this area.

Finally, the Council has authority to designate systemically important financial market utilities for enhanced risk-management standards. The Council designated eight systemically important FMUs last summer, and those entities are now subject to increased oversight by the SEC, CFTC, and Federal Reserve.

Progress on Financial Regulatory Reform

The annual report also discusses the significant progress that Council members and member agencies, both individually and collectively, have made implementing Dodd-Frank Act reforms. As a result of these activities, consumers have access to better information about financial products and are benefiting from new protections. Financial markets and companies have become more transparent. And regulators have become better equipped to monitor, mitigate, and respond to threats to the financial system.

Since the Council's 2012 annual report, Dodd-Frank Act implementation included further strengthening of supervision, capital, and risk-management standards for financial institutions and financial market utilities; procedures for stress tests of financial institutions; rulemakings related to the orderly liquidation authority; regulation of the derivatives markets to reduce risk and increase transparency; new standards to protect mortgage borrowers and reduce risks in the mortgage market; and other measures to enhance consumer and investor protection.

Nevertheless, important work remains to complete the implementation of financial reform. The Council, its members, and its member agencies will continue to strengthen coordination of financial regulation both domestically and internationally. In developing and implementing the international financial regulatory reform agenda, the Council members support the development of policies that promote a level playing field, mitigate regulatory arbitrage, and address regulatory gaps primarily through members' engagement with the G-20 and the Financial Stability Board (FSB). In particular, the Council is focused on:

- *Strengthening the regulation of large, complex financial institutions.* The Council supports global efforts led by the FSB, to impose consistent standards on large, complex financial institutions across jurisdictions.

- *Developing an international framework to resolve global financial institutions.* Effective cross-border cooperation will be essential to implementing the FDIC's orderly liquidation authority under Title II of the Dodd-Frank Act. The United States has substantially satisfied the FSB's *Key Attributes of Effective Resolution Regimes for Financial Institutions*, and continues to work with international counterparts to ensure robust resolution coordination.

- *Increasing the transparency and regulation of over-the-counter (OTC) derivatives.* The Council encourages continued development of these reforms, as they are essential to increase transparency and to mitigate risk, including cross border spillovers, that could arise from the OTC derivatives market. The FSB has been critical to facilitating international coordination on this issue.

- *Data resources and analytics.* The Council continues to recommend that improvement in data standards should be a high priority for financial firms as part of their risk management process and for the regulatory community—not just in the United States, but globally. The Council recommends that the Office of Financial Research continue to work with the Council's member agencies to promote data standards for identification of legal entities, financial products, and transactions, and to improve access to standardized, aggregate data by the regulators. The Council also recommends that cross-border exchange of supervisory data among supervisors, regulators, and financial stability authorities continues to be facilitated in a manner that safeguards the confidentiality and privacy of such information.

Conclusion

The actions of the Council and its member agencies have made the financial system more stable and less vulnerable to future economic and financial stress. The Council will continue to focus on the risk areas I have discussed today, while remaining vigilant to new risks, to promote financial stability and strengthen the U.S. financial system.

I want to thank the other members of the Financial Stability Oversight Council, as well as the staff of the members and their agencies, for the work they have done over the past year and their efforts in preparing the 2013 annual report.

We look forward to working with this Committee, and with Congress as a whole, to continue to make progress in creating a more resilient and stable financial system.

Financial Crimes Enforcement Network

FY 2013

President's Budget Submission

2B – Appropriations Language and Explanation of Changes

Appropriations Language	Explanation of Changes
DEPARTMENT OF THE TREASURY FINANCIAL CRIMES ENFORCEMENT NETWORK Federal Funds **SALARIES AND EXPENSES:** For necessary expenses of the Financial Crimes Enforcement Network, including hire of passenger motor vehicles; travel and training expenses[, including for course development,] of non-Federal and foreign government personnel to attend meetings and training concerned with domestic and foreign financial intelligence activities, law enforcement, and financial regulation; not to exceed $14,000 for official reception and representation expenses; and for assistance to Federal law enforcement agencies, with or without reimbursement, [$110,788,000] *$102,407,000*, of which not to exceed $34,335,000 shall remain available until September 30, [2014] *2015*: Provided, that funds appropriated in this account may be used to procure personal services contracts. *(Department of the Treasury Appropriations Act, 2012.)*	

2C – Legislative Proposals

FinCEN is proposing three technical amendments to Titles 31 and 12 that would make improvements in two important areas. The first and second amendments provide authority to rely on examinations conducted by state supervisory agencies for nonbank financial institutions lacking a federal regulator, which would capture most nonbank financial institutions currently subject to Internal Revenue Service (IRS) examination as delegated through a memorandum of understanding (MOU). The third amendment increases information sharing between FinCEN and counterpart anti-money laundering/counter-terrorist financing regulators. Specifically, this amendment provides consistency between how FinCEN shares information in its capacity as a regulator and information sharing that currently exists between federal financial regulators and their foreign counterparts. The specific changes to the amendment language are outlined below.

Sec. 116. Section 5318(a)(1) of Title 31, United States Code (relating to compliance, exemptions, and summons authority), is amended by - (1) Inserting after "appropriate" "federal or (in the case of financial institutions without a federal supervisor) state"; and (2) Inserting after "Service.", "In lieu of delegating such authority to a state supervisory agency, the Secretary is also authorized to rely on examinations conducted by a state supervisory agency of a category of financial institution. The Secretary may only rely on such state examinations if the Secretary determines that under the laws of the state, the category of financial institution is required to comply with this subchapter and regulations prescribed under this subchapter, or the state supervisory agency is authorized to ensure that the category of financial institution complies with this subchapter and regulations prescribed under this subchapter."

Sec. 117. Public Law 91-508, as amended (12 U.S.C. 1958 et seq.) is amended in section 128, by (1) Striking "sections 1730d (1) and" inserting in lieu thereof "section"; (2) Striking "bank supervisory agency, or other"; (3) Inserting after "appropriate" , "federal or (in the case of financial institutions without a federal supervisor) state"; and (4) Inserting after "agency." "In lieu of delegating such responsibility to a state supervisory agency, the Secretary is also authorized to rely on examinations conducted by a state supervisory agency of a category of financial institution. The Secretary may only rely on such state examinations if the Secretary determines that under the laws of the state, the category of financial institution is required to comply with this chapter and section 1829b (and regulations prescribed under this chapter and section 1829b), or the state supervisory agency is authorized to ensure that the category of financial institution complies with this chapter and section 1829b (and regulations prescribed under this chapter and section 1829b)."

Sec. 118. Section 310(b)(2)(E) of Title 31, United States Code (relating to the Financial Crimes Enforcement Network), is amended by inserting after "Federal" the first time that it appears, "and foreign".

Financial Crimes Enforcement Network

FY 2014
President's Budget

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"The Annual Report of the Financial Stability Oversight Council"
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Rep. Keith Ellison (D-MN)

Question 1: Remittances Oversight

In President Obama's last THREE Financial Crimes Enforcement Network budget submissions, the Treasury Department requested Congress provide permission for state and federal regulators of money service businesses to share information.

Why did the Treasury Department include this request?

Mr. Ellison, Mr. Duffy, and Mr. Paulsen introduced The Money Remittances Improvement Act, H.R. 1694. This bill provides the legislative language that FinCEN requested. Does the Administration support this bill?

The Financial Crimes Enforcement Network's ability to formally rely on examinations conducted by state supervisory agencies will greatly improve Bank Secrecy Act compliance and oversight for nonbank financial institutions lacking a federal regulator. Treasury is grateful that H.R. 1694 includes a form of the provisions proposed in the FY 2014 Budget submission, and we look forward to working with you and the bill's cosponsors as the measure makes its way through the legislative process.

Question 2: Internal Revenue Service 501(c)(4) oversight

The IRS staff has the responsibility to screen applicants for social welfare purpose status to ensure they comply with the law, including not primarily engaging in electoral activities.

- **How many 501c4 applications have arrived since the Citizens United Supreme Court decision?**
- **How does this number compare to prior numbers?**
- **How many new staff was the Tax Exempt Office able to hire to cope with the higher number of applications?**
- **How many additional staff would you need to fully ensure that all future applicants are in compliance with the laws governing 501c4 tax status?**

You have asked several specific questions regarding the processing of applications for tax-exempt status by the Internal Revenue Service (IRS). As a general matter, Treasury oversees the IRS with respect to matters of broad management and tax policy. Treasury's longstanding practice, spanning administrations of both political parties, is not to be involved in the details of tax administration and enforcement.

With respect to your specific questions, a series of independent reviews began in the weeks following the release of the TIGTA May 14 report. The purpose of those reviews is to determine exactly what happened at the IRS, and those reviews are ongoing. A number of Congressional oversight committees—including the Senate Committee on Finance, the Senate Permanent

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Subcommittee on Investigations, the House Committee on Ways and Means, and the House Committee on Oversight and Government Reform—have initiated investigations. Those Committees have held several hearings and received a substantial amount of public testimony on some of the very same questions that you raise. Additional hearings are scheduled, and Treasury and the IRS have received and are responding to document requests. In addition to Congress, TIGTA is now conducting a formal investigation of the IRS, and the United States Justice Department is conducting a criminal investigation. Treasury fully supports the ongoing investigations.

Question 3: Financial Stability Oversight Council - housing

I am disappointed to read that banks have paid less than half of the payments they owe homeowners.

- **What can the Treasury Department, HUD, Department of Justice and other agencies do to move these funds more quickly?**
- **What can Congress and the Administration do to help homeowners who are underwater to refinance their mortgages?**
- **Do you agree with former Secretary Timothy Geithner that allowing principal reduction for mortgages held by Fannie Mae and Freddie Mac would be beneficial to taxpayers, communities and the Treasury?**

Treasury supports the effective implementation of the National Mortgage Settlement. While Treasury provided its expertise with respect to aspects of servicer compliance and auditing during the negotiation of the National Mortgage Settlement, we have no authority to monitor the compliance or implementation of this settlement.

The Administration is committed to helping all responsible homeowners have the opportunity to refinance and take advantage of today's low interest rates. The Federal Housing Finance Agency (FHFA) recently extended the Home Affordable Refinance Program by two years to 2015, and Treasury is working with FHFA to make sure all eligible borrowers can take advantage of this program. As you know, the President has called for broad based refinancing to provide access for all borrowers who are current on their payments to refinance without the many barriers currently faced by homeowners including underwater mortgages.

The targeted use of principal reduction can be an important tool to help underwater homeowners achieve affordable mortgage payments. Today, approximately 70 percent of all eligible underwater loans that are modified through the HAMP program also receive some principal reduction.

Whether or not the FHFA permits Fannie Mae and Freddie Mac to undertake principal reduction is up to FHFA. FHFA is the independent regulator and conservator of the GSEs, which up to this point has opposed principal reduction for GSE loans.

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Representative Peter King (R-NY)

Question 1:

In the FSOC Annual Report, the second systemic risk theme was the US housing finance system's heavy reliance on the government, both directly and indirectly through the GSEs. Reports that the Federal Reserve may soon pull back on quantitative easing suggest interest rates could rise again, cooling the housing market and impacting Fannie and Freddie's profitability in conservatorship. Since Treasury unilaterally last August decided to sweep all Fannie and Freddie's profits into its coffers, what is Treasury's plan to ensure that the GSEs will not become a burden once again to the US taxpayers?

A rise in interest rates could result in a decline in new refinance origination volume, which could result in lower guarantee fee income for the GSEs than if rates remained low. However, it is unlikely under the Senior Preferred Stock Purchase Agreements (PSPAs) entered into by Treasury and the GSEs, acting through FHFA, that higher rates would result in the need for additional draws from Treasury.

Treasury is committed to protecting taxpayers from any additional risks posed by the GSEs. In the amendments to the PSPAs entered into by Treasury and the GSEs in August 2012, key changes were made to help achieve better risk management outcomes by the GSEs. These include requiring annual risk management plans from each GSE and an accelerated wind down of their retained portfolios. This should help reduce exposure to interest rate shocks over time. We will continue to engage with the FHFA to highlight the need for the GSEs to appropriately consider the risks to their guarantee business, including the risk associated with potential shifts in home prices as a result of higher interest rates.

Question 2:

What is Treasury doing to build a capitol reserve at Fannie and Freddie to buffer them against interest rate increases or other shocks to the housing market?

It would be more appropriate for FHFA, the conservator of Fannie Mae and Freddie Mac, to answer this question. Treasury has no authority to become involved with GSE accounting considerations, which would include the issue of building capital reserves. However, the August 2012 amendment of the PSPAs includes a modest, temporary Capital Reserve Amount of $3.0 billion in 2013 that will decrease by $600 million per annum until it reaches zero in 2018. Inclusion of this buffer helps to protect the taxpayer from having to inject more capital into the GSEs due to quarterly losses that are driven by swings in earnings as result of mark-to-market volatility. The Reserve will fall over time in conjunction with the reduction in the GSEs investment portfolios, which historically have been the key drivers in earnings swings.

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Question 3:

Do you think GSE reform will help remove Fannie and Freddie as a systemic risk concern of FSOC?

Comprehensive reform of the housing finance system, including the GSEs, is an important priority of this Administration and was a specific area of focus in the FSOC's 2013 annual report. We need to fix the fundamental flaws of the previous system to create a stable and more lasting housing finance system that better serves borrowers and renters, and better protects the system against future stress. Any future system must also protect taxpayers and financial stability, promote private capital taking on more mortgage credit risk in a responsible way, and meet the needs of our nation's rental population. At the same time, we must preserve access to credit for American families, including long-term, fixed-rate mortgages, and better target government support for low- and moderate-income Americans, including the development of affordable rental options. Our housing finance system must also include stronger and clearer consumer protections and must establish a level playing field for all participating institutions. If GSE reform achieves these goals, the FSOC's systemic risk concern regarding the GSEs could be alleviated.

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Congressman Steve Stivers (R-OH)

Question 1:

In a May 14th letter from the House Committee on Ways and Means to you, it requested any communication between the White House and the Internal Revenue Service (IRS) be transmitted to that committee by May 21st about the targeting of conservative groups for tax-exempt status. That deadline and request was not met.

Will you send to this committee any and all communications between the IRS and any current or former Treasury official regarding the revelation that IRS employees targeted conservative groups for tax-exempt status?

I did not receive a May 14 letter from the House Committee on Ways and Means requesting documents. The House Ways and Means Committee did send a detailed document request to the Internal Revenue Service (IRS) on May 14. We understand that the IRS has begun producing documents in response to this and other Congressional requests.