FINANCIAL SERVICES AND GENERAL GOVERNMENT APPROPRIATIONS FOR 2017

HEARINGS

BEFORE A

SUBCOMMITTEE OF THE

COMMITTEE ON APPROPRIATIONS

HOUSE OF REPRESENTATIVES

ONE HUNDRED FOURTEENTH CONGRESS

SECOND SESSION

SUBCOMMITTEE ON FINANCIAL SERVICES AND GENERAL GOVERNMENT

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FINANCIAL SERVICES AND GENERAL GOVERNMENT APPROPRIATIONS FOR 2017

THURSDAY, FEBRUARY 11, 2016.

INTERNAL REVENUE SERVICE

WITNESS

HON. JOHN KOSKINEN, COMMISSIONER, INTERNAL REVENUE SERVICE

Mr. CRENSHAW. Well, good morning, everyone. The hearing will come to order.

This is the subcommittee's first hearing of the year. So welcome to all our returning members. Glad to have you back. And always appreciate your attention to these important issues that we face here in the subcommittee.

Today we are going to hear from the Internal Revenue Service Commissioner, John Koskinen.

Welcome, Commissioner. We appreciate you taking the time to be with us today, and especially since the budget was released so recently. Thank you for being here.

As a matter of housekeeping, we are going to follow the 5-minute rule that we did last year. Members are going to be recognized in order of seniority, those that were here when the meeting started, and the latecomers will be recognized in order of their arrival, and we will go back and forth from side to side. And if everyone will try to keep their questions and comments to 5 minutes, then everybody will have a chance to be heard.

Now, over the past 5 years, the IRS budget request, in my view, has been a little bit unrealistic, a little bit excessive, because it has averaged $1.6 billion, or 14 percent, above the last year's enacted level. And the IRS hasn't received either a dollar or a percentage increase of that magnitude over the past 20 years, so history would not seem to be in your favor.

Now, this year's request is not quite as excessive. For 2017, the IRS is requesting $12.3 billion. That is $1 billion, or a 9.3 percent increase, over last year. However, less than 20 percent of the budget increase is for taxpayer services, strengthening cybersecurity, and eliminating identity theft. This committee believes that these three activities should be a top priority of the IRS and they should be funded accordingly.

In addition, the budget before us today removes some of the good government provisions that cure what we believe ails the IRS, such as reviewing the appropriateness of the videos that are made, complying with the Federal Records Act, guarding against excessive conference spending, upholding the confidentiality of taxpayer in-

formation, and prohibiting the targeting of taxpayers based on their ideological beliefs.

Now, Commissioner, last year, we asked you to show Congress and all Americans that it is no longer going to be business as usual at the IRS. So sometimes it is hard for us to take seriously this budget request when the IRS again asks for an unrealistically high amount that doesn't make customer service a priority and fails to adopt some of the good government reforms that we added on this committee last year.

Moreover, the IRS has fallen short of its mission to provide top-quality tax services and fairness to all. For far too long, too many calls into the IRS are either abandoned, they are dropped, or they are met with a busy signal. Inexcusably, the last tax season, only 37 percent of all the calls were answered by IRS. Telephone wait times just about tripled since 2010, and the inventory of tax-related identity theft cases rose nearly 150 percent since 2014.

So for the past 2 years, I have asked this agency to make customer service a priority. And each year we learn that customer service diminishes. Now, you may argue it is because the IRS budget has been cut, and I might argue that it is because the IRS chooses to spend its funds on other areas, like the Affordable Care Act, bonuses, and conferences. But nevertheless, Congress included $290 million in the omnibus for the IRS to answer the phone, to improve fraud detection, and cybersecurity, and we expect to see results.

Recent cyber attacks on the Federal Government and private businesses have all of us worried about identity theft, especially when it comes to filing taxes. Later today the Oversight and Government Reform Committee is going to hold a hearing with your chief technology officer on last week's IRS hardware failure and the destruction of an IRS hard drive despite a court preservation order to preserve its contents.

Now, I look forward to hearing from you today on how the agency is providing taxpayers with both privacy and assistance.

Along the lines of fairness, public confidence in the IRS was deeply betrayed when it came to light that the IRS was using inappropriate criteria for selecting tax-exempt applications for extra scrutiny. And so the omnibus took a major step toward restoring public confidence in the IRS by including a new provision that prohibits the IRS from using its funds to revise regulations for the 501(c)(4) organizations.

This committee would also caution the IRS against wading into further controversy, such as when you proposed draft regulations that would put charities or 501(c)(3) organizations in the position of collecting and reporting Social Security numbers of their donors to the IRS. Members of this committee, other members, including myself, questioned the need for this, and we are glad to see the IRS formally withdraw the proposed rule. We don't want to see the IRS take any steps backwards.

Now, with the budget release this past Tuesday, I look forward to hearing from you how the 2017 plan is going to modernize and transform your organization into one that is more customer service oriented, which stresses integrity and fairness to all. From what I have been able to observe, past funding cuts have clearly motivated

the IRS to deliver more service online and increase automation, and every organization ought to constantly strive for greater efficiency. But these changes are meaningless without objective measures to evaluate their effectiveness.

So I would encourage you to report back quantifiable results to the committee and to members to accommodate taxpayers. We want to make sure that you also deal with folks that maybe aren't as technologically advanced as others.

But let me close on a positive note, Commissioner. Let me thank you for your personal dedication to the success of the ABLE Act. Some of you all know that was the major reform to individuals with disabilities, first time in 25 years, allows individuals with disabilities, autism, Down syndrome, to set up a tax-free savings account as long as they use those proceeds for qualified expenses. And that is going to give peace of mind to a lot of families. It is going to allow individuals with disabilities to achieve their full potential.

And right now, 37 States have enacted some sort of ABLE Act legislation. I am happy to report that my home State, Florida, has a State mandate to have it up and running by July 1 of this year, and it wouldn't have happened without your commitment and the commitment of the IRS to get those regulations out, make them understandable, simple. So we thank you for that, on behalf of millions of individuals with disabilities around the country. Thank you for that.

So now, I want to turn to Mr. Serrano for any opening statement he might make.

Mr. SERRANO. Thank you, Mr. Chairman. And I thank you for your cooperation and your support of all members of the committee. I am one who believes that, notwithstanding the omnibus situation that we always have at the end of the year, it is not this committee that causes that. Although, it is this committee where some members—not on this committee—would like to put so many riders on the bill that make it difficult then for the bill on the floor and otherwise. But maybe this year we can convince them that they want to go home earlier and it is better not to have riders on it.

This is our first subcommittee hearing of the year, and I look forward to working with you once again. We have a number of important hearings planned, including with some folks who our friends on the Budget Committee don't feel like meeting with. So I look forward to moving forward with our process.

Today, I would like also to welcome our Commissioner back before the subcommittee. He took over the helm of the Internal Revenue Service during a very difficult time in the agency's history, and I believe he has done a strong job of righting the ship and making sure that the employees there are focused on their mission.

That said, there is only so much the Commissioner can do without sufficient resources, and that is where this subcommittee comes in. While we were able to increase funding for the IRS by $290 million above the fiscal year 2015 level, compared to the deep cuts suffered by the agency in previous years, this increase is insufficient.

Last year, numerous nonpartisan reports—from the Taxpayer Advocate to the Treasury Inspector General for Tax Administration to the Center on Budget and Policy Priorities—noted the negative

impact that budget cuts have had on taxpayer services and dollars collected.

The omnibus funding increase was a downpayment on the necessary investments needed for the IRS to succeed, and I believe that more investment is needed to help reverse these declines.

That is why I support the fiscal year 2017 budget request proposed by the President. It includes a significant increase over last year's level and is spread across several initiatives, from improving taxpayer service to the continued implementation of the Affordable Care Act.

Much of this increase is devoted to the core mission of the agency: helping ensure that Americans can file their taxes in a timely and accurate manner and ensuring that those who attempt to cheat the Federal Government are caught and punished. In my view, much of this increase should be acceptable to both sides of the aisle.

Last year, we reached consensus that the IRS needed further investment in order to collect the revenue owed to our country and to ensure that everyone plays by the same rules. I hope we follow the same bipartisanship spirit this year.

Before I conclude, I do want to express my concern over language that was added to the surface transportation bill, the FAST Act, last year requiring the IRS to use private debt collection agencies. We have seen in the past that this is a waste of taxpayer money and that requiring private entities to take on essential government function leads to confusion and abuse.

I strongly opposed these efforts in the past, and it is my expectation that no private debt collection program should take place without sufficient safeguards in place. And if those safeguards cannot be found, then I expect the program will not move forward.

I hope you will be able to discuss this issue and we will all be able to discuss this issue in more detail today.

And I must say, Mr. Chairman, in closing that we have had this discussion before in this committee, both under your chairmanship, my chairmanship, and at other times, Mrs. Emerson, and the consensus throughout the years has been that these debt collectors in many cases abuse and mistreat people rather than collect the debt they are supposed to collect. So it is something we should be very careful about when we deal with it.

Commissioner, welcome back, and I look forward to your testimony.

Thank you, Mr. Chairman.

Mr. CRENSHAW. Thank you, Mr. Serrano.

I would like to now recognize Mr. Rogers, who is chairman of the full committee, for any opening statement he might like to make.

Chairman ROGERS. Mr. Chairman, thank you for recognizing me.

Mr. Commissioner, welcome back to the committee.

Since fiscal year 2011, this committee has pared back IRS' astronomically high budget requests on a bipartisan basis. This is largely a result of this committee's concerted effort to reduce discretionary spending government-wide, justifiable concern over the implementation of ObamaCare and the Foreign Account Tax Compliance Act, and multiple objectionable management decisions at the agency; for example, targeting certain groups based on their ideo-

logical beliefs and destroying documents. It is therefore surprising to see that the fiscal year 2017 budget request is $12.3 billion, a 9.3 percent increase over the enacted level of 2016.

There are a number of issues with this request that you have made of us. Three in particular stand out.

First, the bipartisan budget agreement does not allow for a discretionary cap adjustment for the IRS. As you know, this would require a statutory change outside the jurisdiction of this committee, a legislative change that has been rejected by both the House and Senate Budget Committees for the previous 5 years.

If the activities funded by the discretionary cap adjustment are important to the administration, then you ought to operate within the amount allowed under the Bipartisan Budget Agreement. The IRS needs to prioritize spending like every other Federal agency.

Second, this Congress has repeatedly rejected additional funding for the implementation of ObamaCare. I am concerned, as are my colleagues, that the IRS, through CMS, made billions in payments to insurance companies without the approval of Congress.

The courts, of course, will be the final arbiter of that issue, but I can say without doubt at this time that this committee has never appropriated a single penny to permit the administration to make any Section 1402 offset program payments.

Finally, I am disappointed that the IRS requests to eliminate the three administrative provisions that have been enacted on a bipartisan basis for several years. Since the IRS targeting and spending scandals, appropriation bills have included prohibitions against targeting U.S. citizens for exercising their First Amendment rights, targeting groups for regulatory scrutiny based on their ideological beliefs, and making videos without advance approval. We are dealing with the taxpayers' money, and these provisions lay out what most people would consider commonsense policies.

Mr. Commissioner, we are glad to have you with us today. This committee takes seriously our role in overseeing the budget and policies of the IRS, and I appreciate your continued engagement with us.

This is the first hearing of this subcommittee for the year. It is also the first hearing of the entire committee for the year. We will have over 100 of these types of hearings among the 12 subcommittees, trying to oversee the spending of the Federal Government and trying to cut waste, fraud, and abuse, as we go.

So, Mr. Commissioner, thank you for being here.

I yield back.

Mr. CRENSHAW. Thank you.

Commissioner, I would like to now recognize you. If you could keep your oral presentation to about 5 minutes, that will give us more time for questions. And your entire statement will be included in the record. So the floor is yours.

Mr. KOSKINEN. Thank you. I will do my best.

Chairman Rogers, Chairman Crenshaw, Ranking Member Serrano, members of the subcommittee, thank you for the opportunity to discuss the IRS budget and current operations.

I want to begin by thanking you for the $290 million in additional funding for fiscal year 2016. These funds were specifically designated for improving taxpayer service, strengthening cyberse-

curity, and expanding our efforts against identity theft. It is the first time in 6 years the IRS has received significant additional funding. It is a major step in the right direction, and I can assure the Congress and this committee we will use these resources wisely and efficiently.

But the IRS is still under significant financial constraints. Even with the additional $290 million, our budget for 2016 is still about $900 million below where it was in 2010. As a result, we have had no choice but to continue the exception-only hiring policy that began in fiscal year 2011, that leaves us unable to replace most employees we lose through the year through attrition. In fact, we expect the IRS workforce to continue to shrink by another 2,000 to 3,000 full-time employees this year, for a total loss of more than 17,000 employees since 2010.

We recognize the importance of spending taxpayer dollars wisely, and we will continue working to find efficiencies in our operations. But a fact that often gets overlooked is the U.S. is much more efficient in its tax collection than most other countries. The average OECD member country spends $8.87 to collect $1,000 of revenue, while the U.S. spends only $4.70, about half. And so, I believe, it is important to understand that we already are one of the most efficient tax administrations in the world.

The IRS is also continuing to strengthen our operations as we move forward. In that regard, we have addressed a number of management problems that developed in the past, including all of the issues that Chairman Crenshaw mentioned. We have dealt with all of those. Those problems are not going to recur again.

And in particular, in the tax-exempt area, of concern to all of us, we welcomed the Senate Finance Committee's bipartisan report issued in August. And in addition to having accepted all of the IG's recommendations made 3 years ago in its report, we accepted, and have virtually completed, the implementation of all of the recommendations of the Senate Finance Committee bipartisan report, including the recommendations in the majority report and the recommendations in the minority report.

In developing our funding request for fiscal year 2017, we felt it was important to be as specific as possible in describing our priorities and the cost of each one. So while the President's 2017 budget for the IRS requests a total increase of about a billion dollars, we have broken that down into 15 separate initiatives. We believe this will give Congress a good sense of how we intend to spend any increase in funding we might receive.

And, I think equally important, we are prepared to be held accountable for achieving the goals related to each initiative. Let me briefly highlight some of the major areas covered by these initiatives.

First, taxpayer service. The additional funding will help us improve service delivered through traditional channels, and allow us to continue modernizing the services we offer, to help transform the taxpayer experience.

Second, stolen identity refund fraud. The additional funding will allow us to keep investing in resources and tools to stay ahead of criminals who continue to become more sophisticated in stealing identities and filing false refunds.

Third, our core enforcement programs. With this additional funding, we would, for example, be able to increase audits and collections. This increase is critical because the ongoing decline in enforcement activities we have seen in the last several years has translated into, literally, billions of dollars of lost revenue for the government.

Fourth, the Affordable Care Act. We have no choice but to implement it. It is a statutory mandate, and we must continue to invest in IT infrastructure to support implementation of the ACA's most tax-related provisions. I would point out that for the past 4 years, the IRS has received almost no funding for this implementation, and we have had to use over $1 billion of resources needed for other critical IT functions in order to meet our statutory obligations under the ACA.

And fifth, electronic records management. Although we have been making progress in preserving and protecting emails and other electronic records, we need to continue making improvements so we can respond faster and completely to legal and congressional inquiries, as well as FOIA requests.

While providing adequate funding in these and other areas is critical, Congress can also help us by passing legislation to improve tax administration. In that regard, the President's 2017 budget request contains a number of legislative proposals I would urge Congress to approve.

They include renewing streamlined critical pay authority, allowing us to expand the matching program for taxpayer identification numbers, granting us authority to require minimum qualifications for paid tax preparers, and expanding the electronic filing requirements for businesses.

This concludes my statement, Mr. Chairman. I would be happy to answer any questions you have.

[The information follows:]

WRITTEN TESTIMONY OF
JOHN A. KOSKINEN
COMMISSIONER
INTERNAL REVENUE SERVICE
BEFORE THE
HOUSE APPROPRIATIONS COMMITTEE
SUBCOMMITTEE ON FINANCIAL SERVICES AND GENERAL GOVERNMENT
ON IRS BUDGET AND CURRENT OPERATIONS
FEBRUARY 11, 2016

INTRODUCTION

Chairman Crenshaw, Ranking Member Serrano and Members of the Subcommittee, thank you for the opportunity to discuss the IRS's budget and current operations.

Let me begin by expressing my appreciation to Congress, including the members of this Committee, for approving $290 million in additional funding for the IRS for Fiscal Year (FY) 2016, to improve service to taxpayers, strengthen cybersecurity and expand our ability to address identity theft. This brings the total IRS budget for FY 2016 to $11.2 billion. It is an important development for the IRS and for taxpayers, and is the first time in six years that the agency has received significant additional funding. It is a major step in the right direction, and I can assure the Congress that we will use these resources wisely and efficiently.

Even with this additional funding, however, the IRS is still under significant financial constraints. This is illustrated by the fact that the IRS appropriation remains $911 million below the FY 2010 enacted level and that the $290 million increase is less than half the amount that had been requested for FY 2016 in the three critical areas mentioned above. In addition, the IRS must absorb mandated cost increases and inflation during FY 2016 that are greater than the additional funding provided.

As a result, we will need to continue the exception-only hiring policy that began in FY 2011, leaving us unable to replace most employees we lose this year through attrition. In fact, we expect the IRS workforce to continue to shrink by another 2,000 to 3,000 full-time employees during FY 2016, equaling a loss of over 17,000 since FY 2010.

While this decline in our workforce has been occurring, the number of individual returns filed grew by more than 10 million (or nearly 7 percent), from 153 million in 2010 to 163 million in 2015. Further increasing our workload, the IRS during this period has had to implement a number of significant legislative mandates,

nearly all of which came with no additional funding. These include: the Affordable Care Act (ACA); the Foreign Account Tax Compliance Act (FATCA); the Achieving a Better Life Experience (ABLE) Act, which includes a new certification requirement for professional employer organizations; and reauthorization of the Health Coverage Tax Credit (HCTC). In FY 2016, several additional legislative mandates were put in place that carried no implementation funding with which to execute them – for example, new passport restrictions, a private debt-collection program and a registration requirement for newly created 501(c)(4) organizations. We have had to defer hundreds of millions of dollars worth of important information technology (IT) projects and improvements since FY 2014 in order to meet our statutory requirements to implement the ACA.

Against this backdrop, a fact that often gets overlooked is that the U.S. is much more efficient in its tax collection operations than most other countries. According to statistics compiled by the Organization for Economic Cooperation and Development (OECD), the average OECD member country spends $8.87 to collect $1,000 of revenue, while the U.S. spends only $4.70. The tax administrations of Germany, France, the United Kingdom, Canada and Australia each spend twice as much as the IRS to collect a dollar of revenue. So while the IRS will continue to look for efficiencies in our operations, it is important to understand that we are one of the most efficient tax administrators in the world.

We continue to recognize the importance of spending taxpayer dollars wisely and working to strengthen our operations as we move forward. In that regard, the IRS has addressed a number of management problems that had developed in the past. Actions taken to solve these problems have in some cases been in place for several years. For example, spending on conferences has been reduced by 80 percent since 2010. In order to achieve this, since 2012, any division planning to spend more than $20,000 on a conference is required to obtain prior approval from the IRS Commissioner. Any proposed conference expense over $50,000 must also be approved by the Secretary of the Treasury or his designee. With regard to videos, any IRS division seeking to make a video must receive prior approval from an executive review board the agency created in 2013 for this purpose. As for performance awards, the IRS no longer pays such awards to IRS employees who are disciplined for serious misconduct issues or who have willfully failed to pay their taxes. In addition, processes are in place to ensure the IRS does not rehire former employees who had significant conduct or performance problems during prior employment with the agency.

In the tax-exempt area, the IRS has acted on all of the recommendations made by the Treasury Inspector General for Tax Administration (TIGTA) in his May 2013 report describing the use of improper criteria in reviewing applications for tax-exempt status under section 501(c)(4).The changes we made in response to those recommendations include: eliminating the use of inappropriate criteria; implementing improved and expanded training for employees; expediting the processing of section 501(c)(4) applications; and establishing a new process for

documenting the reasons why applications are chosen for further review, with appropriate oversight of the entire process.

In addition, the Department of the Treasury and the IRS followed TIGTA's remaining recommendation and began the process of drafting guidance on how to measure social welfare and non-social welfare activities of section 501(c)(4) organizations. In light of language in the appropriations legislation for FY 2016, the IRS halted work on those proposed regulations.

Along with responding to TIGTA's May 2013 report, the IRS also has been working to address the recommendations by the Senate Finance Committee in its report issued last August. As we advised the Finance Committee in October, the IRS accepted all of the recommendations in the report that are within our control – those that did not involve tax policy matters or legislative action. They include 15 of the report's 18 bipartisan recommendations and also six of the recommendations in the separate sections prepared by the Majority and Minority. Moreover, I am pleased to report that the IRS has substantially completed action on all of these recommendations.

PLANNING FOR THE FUTURE OF THE TAXPAYER EXPERIENCE

Within our tight budget constraints, the IRS has also continued to analyze and develop plans for improving how the agency can fulfill its mission in the future, especially in delivering service to taxpayers and, along with that, maintaining a robust compliance program. Our goal is to improve and expand taxpayer services for all taxpayers, no matter what their circumstances.

In requesting adequate resources to allow the IRS to improve taxpayer service, it is important to point out that our goal is not to fund today's staff functions at historically high levels. We need to be, and are, looking forward to a new, improved way of doing business that involves a more robust online taxpayer experience. This is driven, in part, by business imperatives; when it costs between $40 and $60 to interact with a taxpayer in person, and less than $1 to interact online, we must reexamine how we provide the best possible taxpayer experience, in response to taxpayer expectations and demands.

The improvements we are planning are a natural outgrowth of modernizations made to our business systems over many years. These include the development and implementation of the Customer Account Data Engine 2 (CADE2), which allowed the IRS to migrate to daily processing and posting of individual taxpayer accounts, enabling faster refunds for more taxpayers, more timely account updates and faster issuance of taxpayer notices. Another advance put in place several years ago was Modernized e-File (MeF), which processes tax returns electronically in real time, rather than in several batches a day. MeF has reduced

turnaround time, and allows acknowledgments to be sent much more quickly to those who transmitted the returns.

After years of study, and in response to taxpayer demand, the IRS has also worked to improve our website, IRS.gov, and to provide more web-based tools and services. These include the "Where's My Refund?" electronic tracking tool, which was used nearly 235 million times in FY 2015, and the IRS2Go smartphone application. In FY 2015, there were more than 2.3 million downloads of the application.

With regard to compliance programs, an excellent example of actions the IRS has taken to improve interactions with taxpayers involves our Large Business and International (LB&I) division. LB&I recently restructured its operations to center around issues, rather than organizations, which will focus resources to better meet taxpayers' evolving needs in a global environment.

An important change in the compliance area has been the development and phase-in of the Return Review Program (RRP), which delivers an integrated and unified system that enhances IRS capabilities to detect, resolve, and prevent criminal and civil tax non-compliance. Continued investment in the RRP will allow the IRS to retire the legacy Electronic Fraud Detection System (EFDS), and save between $10 million and $15 million a year.

Going forward, the IRS intends to further improve compliance programs through investment in an Enterprise Case Management (ECM) system, which will address the need to modernize, upgrade, and consolidate over 100 aging IRS case management systems. A unified case management environment will yield efficiencies by implementing standard case management functions, providing visibility across all types of tax transactions and improving data accessibility and usability.

Even with the improvements we have made and continue to make, we are at the point where we believe the taxpayer experience needs to be taken to a new level. Building on improvements made and new applications provided over the past 10 years, our goal is to increase the availability and quality of self-service interactions, which will give taxpayers the ability to take care of their tax obligations in a fast, secure, and convenient manner.

As I have discussed in numerous Congressional appearances and speeches, the idea is that taxpayers would have an account with the IRS where they, or their preparers, could log in securely, get all the information about their account, and interact with the IRS as needed. Most things that taxpayers need to do to fulfill their obligations could be done virtually, and there would be much less need for in-person help, either by waiting in line at an IRS assistance center or calling the IRS.

As we improve the online experience, we understand the responsibility we have to serve the needs of all taxpayers, whatever their age, income, or station in life. We recognize there will always be taxpayers who do not have access to the digital economy, or who simply prefer not to conduct their transactions with the IRS online. The IRS remains committed to providing the services these taxpayers need. For example, while the IRS will continue to offer more web-based services, taxpayers will still be able to call our toll-free help lines or obtain in-person assistance if that is their preferred method of receiving service from the IRS.

A good example of our commitment to serving all taxpayers, whether or not they participate in the digital economy, involves the return filing process. While the number of taxpayers who e-filed their income tax returns exceeded 85 percent last year and is expected to do so again this year, millions of people still choose to file paper returns. The IRS will not leave any taxpayer behind as we move into the future and will continue to offer taxpayers who prefer filing on paper the option to do so.

In moving toward the future of taxpayer service, it is also important to note that actions the IRS takes to help taxpayers increasingly will have a positive impact in the enforcement area, and will in turn help improve voluntary compliance. An excellent example of such an action is the Early Interaction Initiative we launched last December to help employers.

Under this initiative, the IRS seeks to identify employers who appear to be falling behind on their interim employment tax payments before they file their annual employment tax returns. The IRS will offer helpful information and guidance through contacts such as letters and automated phone messages. In the past, the first attempt by the IRS to contact an employer having payment difficulties often did not occur until much later in the process, after unpaid tax obligations were already beginning to mount. This initiative is designed to help employers stay in compliance and avoid needless interest and penalty charges. You could call this initiative a form of improved taxpayer service, or a more efficient enforcement activity. We believe that it is both.

This initiative illustrates why I believe it is important to view taxpayer service and enforcement as two sides of the same coin. While the IRS collects $50 billion to $60 billion a year as a result of our enforcement operations, those numbers pale in comparison to the more than $3 trillion that is collected each year as a result of taxpayers voluntarily fulfilling their tax obligations. That is why we continue to be extremely concerned about the decline in both taxpayer service and enforcement as a result of the continued cuts in IRS funding. These declines threaten to undercut the basic voluntary compliance fabric of our tax system. If you consider that a one-percent drop in the compliance rate translates into a revenue loss of approximately $30 billion a year, or $300 billion over the ten year budget window often used, then declining voluntary tax compliance results in a cut to the funds the government needs to operate.

THE ADMINISTRATION'S FY 2017 BUDGET REQUEST

In preparing the FY 2017 budget request, the IRS's senior leadership recognized the need to prioritize funding of key activities that help support enhanced digital service delivery discussed earlier in this testimony, while preserving the agency's core mission functions. As a result, the IRS established a new investment process and created six key strategic themes that outline how the agency will execute tax administration to meet the needs of taxpayers in the future. IRS leadership set priorities for new investments based on how those investments align with these themes:

- Facilitating voluntary compliance by empowering taxpayers with secure innovative tools and support;
- Understanding non-compliant taxpayer behavior and developing approaches to deter and change it;
- Leveraging and collaborating with external stakeholders;
- Cultivating a well-equipped, diverse skilled workforce;
- Selecting highest-value work using data analytics and a robust feedback loop; and
- Driving more agility, efficiency and effectiveness in IRS operations.

Following from these themes, the Administration's FY 2017 budget request includes a number of initiatives that provide the building blocks to move the IRS into the future. These initiatives represent a large portion of the increased funding requested in the IRS budget for FY 2017. They are as follows:

Additional funding to improve taxpayer service: $48 million. Under this initiative, the IRS will work both to improve taxpayer service delivered through traditional channels and continue modernizing the services we offer in order to help transform the taxpayer experience.

The additional staffing funded by these resources by itself will deliver phone level of service (LOS) for the full year on our toll-free helplines at 53 percent; if the President's Budget is enacted in full, the IRS will be able to combine this funding with additional resources through user fees to achieve a 70 percent LOS throughout the year. It is worth noting, however, that we expect to have the lowest user fee balance available for carryover into FY 2017 since FY 2008, meaning that we will not have that contingency available to boost service if other needs are not sufficiently funded.

In terms of modernizing the taxpayer experience, the additional funding will allow the IRS to continue moving toward the development of: secure online taxpayer accounts; secure online digital communications between the taxpayer and the IRS; and new web-based self-service products and more interactive capabilities to existing products, so that taxpayers would potentially be able to, for example,

securely authenticate their identity, view and print tax records online, pay outstanding debts, enter into installment agreements, establish powers of attorney, and get tax law information.

Taken together, these improvements will ultimately allow taxpayers to resolve more issues online, leaving our employees more time to support the transactions that are best completed by phone or in person.

Additional funding to continue implementing the Affordable Care Act: $153 million. The additional funding provided by this initiative, above current resources, will allow the IRS to develop advanced technology infrastructure and applications support and to modify existing IRS tax administration systems, so the agency can continue implementing the tax-related provisions of the ACA.

For example, the funds will improve the IRS's ability to: validate taxpayer claims for the premium tax credit; collect penalties, taxes and fees related to the ACA provisions that the IRS administers; and administer the individual shared responsibility provision. The additional funding also supports administration of the new reporting requirement for health coverage providers, as well as the employer shared responsibility provision, both of which took effect in 2015.

To further illustrate the importance of funding this initiative, I would note that over the last several years the IRS has had to divert resources from other critical functions, including taxpayer services and IT, and expend user fees to fund ACA implementation. In particular, these diversions have depleted user fees and made it difficult to use those fees to help fund core mission activities and other unfunded legislative mandates.

Additional funding to leverage new technologies to advance the IRS mission: $53 million. Under this initiative, the IRS will continue using new technologies to develop critical IT systems needed to support the IRS's taxpayer service and enforcement programs. This includes making improvements to such systems as CADE2 and MeF. The IRS will also be able to provide the necessary IT infrastructure to support efforts to improve the online taxpayer experience, including the infrastructure portions of secure digital communications and more interactive capabilities to existing web-based self-service products.

Another major component of this initiative is the implementation of the Event Driven Architecture (EDA) framework, which is designed to improve return processing by allowing the IRS to process and share data internally from returns more easily. Through the use of EDA, for example, returns with minor errors can be addressed at the time of filing. Implementation of EDA is a prerequisite for a number of planned improvements to the online taxpayer experience, including immediately notifying taxpayers of errors on a return as soon as it is filed, and allowing taxpayers to self-correct return errors through an online tool.

Additional funding to help prevent stolen identity refund fraud and reduce improper payments: $90 million. The IRS has made significant progress in combatting stolen identity refund fraud over the last several years, though it has been a challenge to find the resources for investments in this area because of the ongoing cuts to our budget. We therefore appreciate the additional funding Congress approved for FY 2016 for cybersecurity and identity theft.

Nonetheless, the IRS needs to continue investing in resources and tools to stay ahead of criminals. The additional funding requested under this initiative will allow the IRS to invest in the additional staffing and technology to continue improving our efforts to: detect and prevent refund fraud related to identity theft; assist identity theft victims; and apprehend the criminals who perpetrate these crimes.

With this additional staffing, the IRS will be able to, for example: resolve taxpayer cases of tax-related identity theft more quickly, and expand the capacity of the IRS's Identity Protection Specialized Unit (IPSU) to handle additional cases; expand the IRS External Leads program, through which the IRS works in cooperation with financial institutions, state agencies and other external sources to recover fraudulent refunds; and do a better job of detecting prisoner refund fraud through the use of Prisoner Update Processing System (PUPS) data.

Technology investments under this initiative will allow the IRS to make a number of other improvements, including: reducing the use of Social Security Numbers (SSN) on IRS mailings to taxpayers; establishing a centralized fraud repository within the IRS to expand the agency's ability to identify significant tax cases and streamline and standardize the fraud referral process; and accelerating IRS access to employment tax data from the Social Security Administration (SSA).

Additional funding to improve electronic enterprise records management: $19 million. The additional funding provided under this initiative will allow the IRS to continue its efforts to manage official records more effectively through the implementation of new systems to maintain unified records of IRS policy, program and project development, and to create a unified searchable archive of IRS e-mails to avoid redundant archiving. By making these improvements, the IRS will be able to respond in a timelier manner to legal and Congressional inquiries and requests under the Freedom of Information Act (FOIA). These improvements, which will be phased in over several years, will allow the IRS to more easily comply with various recordkeeping requirements under the Federal Records Act.

The investment-related increases I have just described must be viewed in the context of the overall budget request for the agency. The President's FY 2017 Budget provides $12.3 billion for the IRS, an increase of $878.5 million in investments and an additional $167 million in funding for inflation for a total of $1.045 billion over the FY 2016 level. This amount includes $11.8 billion in base

discretionary resources and an additional proposed $514.7 million program integrity cap adjustment to support program integrity efforts aimed at restoring enforcement of current tax laws to acceptable levels and to help reduce the tax gap, which is the difference between taxes owed and taxes paid on a timely basis. This multi-year effort is expected to generate $64 billion in additional revenue over the next ten years at a cost of $18 billion over that 10-year period, thereby reducing the deficit by $46 billion.

Enactment of the program integrity cap adjustment proposal would facilitate funding for several initiatives, including the following:

Additional funding to strengthen enforcement programs: $399 million. This set of initiatives allows for investment to strengthen core enforcement programs to help the IRS improve the resolution of non-compliance with fairness and integrity. Budget cuts over the last several years have led to rising case inventories and call volumes, preventing the IRS from bringing into compliance taxpayers who fail to pay their tax debt, and reducing individual audit coverage to levels below 0.8 percent.

With this additional funding, the IRS will be able to: increase collection and audit coverage; conduct compliance activities related to FATCA; pursue employment tax noncompliance and abusive tax schemes; increase investigations of transnational organized crime; and develop a digital version of the Form 990, *Return of Organization Exempt from Income Tax*.

The investments made through this initiative will, for example allow us to: handle more than 30,000 additional collection cases; close more than 32,000 additional individual audits; expand the Automated Underreporter (AUR) program to process more than 400,000 additional cases; and implement a quality review program for penalty and interest.

Additional funding to maintain the integrity of revenue financial systems: $10 million. The current revenue financial systems do not use commercial software, so the IRS is reliant on internal resources to maintain them. This investment will merge multiple financial systems into one repository to ensure the integrity of the IRS's financial data and make necessary changes to ensure that systems comply with accounting standards and requirements. This will automate reconciliations of the IRS ledger systems and assist in the gathering of data to respond to audits by TIGTA and the Government Accountability Office (GAO). Savings and efficiencies will be achieved in future years through the reduction or elimination of the resources required to maintain the multiple systems supporting operational decision making and the financial audit. This will close a material weakness.

Additional funding for operations and maintenance of deployed Business Systems Modernization (BSM) projects: $92 million. The IRS receives

funding for major IT modernization projects through the BSM appropriation, but BSM funds can only be used for developing new systems. Once development is completed, regular operations and maintenance begins, and the IRS is required to pay for this maintenance through its Operations Support appropriation. Since 2013, the IRS has incurred more than $95.5 million in unfunded increased annual requirements to its Operations Support appropriation as a result of BSM systems deployments. The additional funding requested partially restores the Operations Support base so that the funding will not have to be redirected from other areas to pay for the operation of deployed BSM projects. Resources will fund additional staff, hardware and software, and contractual services for these deployed systems.

LEGISLATIVE PROPOSALS TO IMPROVE TAX ADMINISTRATION

The IRS appreciates the actions taken by Congress last year to approve legislation designed to improve tax administration. These measures include: accelerated filing dates for information returns; allowing SSNs to be masked on W2 forms and other information returns; creating a safe harbor for minor errors on information returns; and expanding the due diligence requirements for paid tax return preparers.

The President's FY 2017 Budget contains several additional legislative proposals that would further improve tax administration and enhance IRS operations. They include:

Streamlined critical pay authority. The IRS Restructuring and Reform Act of 1998 increased the IRS's ability to recruit and retain a small number of key executive-level staff by providing the agency with streamlined critical pay authority. This allowed the IRS, with approval from Treasury, to hire well-qualified individuals to fill positions deemed critical to the agency's success in areas such as international tax, IT, cybersecurity, online services and analytics support. This authority, which ran effectively for 14 years, expired at the end of FY 2013. The loss of streamlined critical pay authority has created major challenges to our ability to retain employees with the necessary high-caliber expertise in the areas mentioned above. In fact, there are only 10 IT senior executives and leaders hired under this authority remaining at the IRS and we anticipate there will be no staff left under critical pay authority by next year. The President's FY 2017 Budget proposes reinstating this authority.

Authority to expand the Taxpayer Identification Number (TIN) matching program. The IRS operates a voluntary program under which entities that issue payments subject to backup withholding can confirm with the IRS that the name and TIN of the person receiving the payment match the name and TIN on file with the IRS. Although IRS code section 6103 generally prohibits the IRS from disclosing taxpayer data, the agency is permitted to disclose this information to

payors under authority of section 3406. But this authority only covers instances where payments are subject to backup withholding. The proposal would broaden the agency's authority to cover any situation where a person is required to provide the TIN of another person to the IRS.

Correction procedures for specific errors. The IRS has authority in limited circumstances to identify certain computation mistakes or other irregularities on returns and automatically adjust the return for a taxpayer. At various times, Congress has expanded this limited authority on a case-by-case basis to cover specific, newly enacted tax code amendments. The IRS would be able to significantly improve tax administration – including reducing improper payments and cutting down on the need for costly audits – if Congress were to enact the proposal in the President's Budget that replaces the existing authorities that specify specific tax code amendments with authority to correct specific errors instead. This would allow the IRS to fix errors where the IRS has reliable information that a taxpayer has an error on his/her return. Thus, for example, the IRS could use data from completed state tax return audits to adjust information on the federal return.

Authority to require minimum qualifications for return preparers. The proposal would provide the agency with explicit authority to require all paid preparers to have a minimum knowledge of the tax code. Requiring all paid preparers to keep up with changes in the Code would help promote high quality services from tax return preparers, improve voluntary compliance, and foster taxpayer confidence in the fairness of the tax system. It would thereby help the IRS to focus resources on the truly fraudulent returns.

Expanded electronic filing requirements for businesses. The proposal would require all corporations and partnerships with $10 million or more in assets to file their tax returns electronically. In addition, regardless of asset size, corporations with more than 10 shareholders and partnerships with more than 10 partners would be required to file electronically. Paid tax return preparers who expect to prepare more than 10 corporate income tax returns or partnership returns annually would be required to file these returns electronically. Additionally, all tax-exempt organizations required to file Form 990 series returns would be required to file electronically.

Chairman Crenshaw, Ranking Member Serrano and Members of the Subcommittee, this concludes my statement. I would be happy to take your questions.

Mr. CRENSHAW. Well, thank you very much.

And let me start with a couple of questions. You know, you mentioned your goals. We have talked about the fact that $290 million of additional appropriations came to you for those three areas: customer service, fraud detection, and better dealing with cybersecurity. And you outlined how you plan to use that in the sense of having some broad goals.

Let's begin by telling us specifically what do you plan to do. Because one of the things, it is great to have goals, but they need to be implemented. And tell us specifically how are you going to deal with customer service. Are people going to still wait on the telephone? How are you going to deal with that?

How are you going to implement that goal of making sure that you are detecting fraud, taxpayer fraud? Because right now, customer service is at an all-time low and tax fraud is rising every year. Give us a couple of specific ways that you are going to try to implement those goals in those three areas.

Mr. KOSKINEN. I am delighted to explain. We have given this Committee a detailed spending plan, but our goal is your goal, and that is not only to spend the money, but see the results. As I have said all along, you ought to be able to tell what you get for what you pay.

In taxpayer service, we will spend, of the $290 million, about $178 million specifically to improve taxpayer service.

Mr. CRENSHAW. How are you going to do that?

Mr. KOSKINEN. And we are going to do that, by hiring up to 1,000 new temporary and seasonal people. We hire several thousand every year, 8,000 to 10,000, to staff the call centers, to staff our walk-in centers, to deal with all the correspondence. It takes us a little while to get them hired, but already the results are in. We have about 25 million returns already filed, and the level of taxpayer service has already gone up.

Our goal for the filing season is to have taxpayer service move from the 37 percent, 40 percent area into the low 60 percent area. It won't be where we think it needs to be, because the $290 million was out of a request, last year, for an additional $700 million in those three areas.

Part of the reason we have more requests for additional funding for taxpayer service in the 2017 budget is that we think the level of service ought to be at 80 percent; 80 percent of people ought to get through, inside 2 to 5 minutes, to somebody they need to talk to.

Specifically, the thousand people, the additional adjustment of resources, will allow us this year, we think, to have a taxpayer level of service in the low 60 percent. Our goal would be to try to get to 70 percent. But if we have the additional funding in 2017, we could get to 80 percent.

Mr. CRENSHAW. Twenty percent of that new money was going to go for customer service, right?

Mr. KOSKINEN. Virtually half of it now. Of the $290 million, $178 million.

Mr. CRENSHAW. That is good. So that is a big priority, right?

Mr. KOSKINEN. Yes. Well over half of the money will be on taxpayer service.

Mr. CRENSHAW. Tell us about——

Mr. KOSKINEN. Cybersecurity.

Mr. CRENSHAW. And before that, just identity theft.

Mr. KOSKINEN. Identity theft. As I have said in my testimony, we called together, almost a year ago, the CEOs of the major tax preparers, the software developers, the payroll providers, as well as the State tax administrators. And I told them when they came together—it was the first time we had ever had that kind of a summit—that the goal was not for me to tell them what to do, or the IRS to tell them what to do. The goal was to create a true partnership, because we cannot deal with identity theft, any one of those groups, by ourselves. We need to actually work in concert with the private sector, with the States.

And we have had remarkable success. We have virtually the entire tax ecosystem, as it were, working with us to share information, to spot suspicious patterns of refund filing. We have also worked with them to establish minimum standards of authentication. When taxpayers use their services, as one of the CEOs said, "You need—the IRS—to set a standard." And I said: I am happy to set that standard, as long as you define it so it works for you.

The net result of that is that we have 20 different data elements that we now have, that we didn't have before. We are sharing information on a regular basis. We have been able to actually move forward in such a way that the private sector leaders move from requesting, to almost demanding, that we make the partnership permanent, because it has been so effective for them, for the States, and us.

Mr. CRENSHAW. How much did we lose—do you know the latest number—in terms of tax identity theft? One time there was like $9 billion. What is that number today?

Mr. KOSKINEN. In 2013, the GAO number in review with us was about $5 billion. We think we have it down, but it is still a significant number. We think this year—we already see—we have been able, thanks to having found some money ourselves, to get our filters to work better. Part of the way we caught the attack that took place in the last couple weeks was improved detection capacity.

And what we would do with the $95 million we are devoting to cybersecurity, out of the $290 million, and we have specific additional resources we are providing that we will share with you, is we hope we will be able to finally begin to catch up with, if not get ahead of, the criminals.

One of the ways we measure that is the percentage of suspicious returns and refunds we are able to stop. We already have stopped 300,000 suspicious returns just in the front end of this filing season, many of which we would not have been able to stop before. So it is the IT monitoring. It is being able to segregate our systems to be able to determine what is going on.

In the most recent attack, as we stopped one attack, we could watch it moving. As I said yesterday, one of the things people don't realize is we are all in this battle, and that is why I brought the private sector in. We get pinged or probed a million times a day, a number that is hard and mind-boggling to think of.

We are dealing with increasingly sophisticated organized crime syndicates around the world, attacking not only us, but attacking

private sector companies and banks. Banks in the financial sectors are part of the security summit that we have put together, and we are working with them regularly.

Mr. CRENSHAW. Great. Well, thank you for that.

Let me go now to Mr. Serrano.

Thank you, sir.

Mr. SERRANO. Thank you, Mr. Chairman.

We know that we were able to agree on an increase last year for the IRS, and that was a good thing. I hope we can continue it. But there are many people who still feel that it is 19 percent below the fiscal year 2010 funding level.

So my question is, what do you believe the long-term impacts of these cuts the IRS has experienced since 2010 will be? And how does your request for this year begin to repair the damage done by these cuts?

Mr. KOSKINEN. We have tried to explain that, ultimately, the government functions on voluntary tax compliance. We collect over $3 trillion a year, the vast majority of it voluntarily.

People participate voluntarily, first, because they think the system is fair. So one of the advantages of the Foreign Account Tax Compliance Act isn't just the money we will collect, it is that the person in Des Moines or Ashland, Kentucky, when they write their check, will feel rich people aren't getting away with something, hiding their money in Switzerland. That is no longer possible.

People also do it because they know we have information. And while we try to work very hard with taxpayers trying to be compliant, if you are trying to cut corners or cheat, they know if we have got the information, we are not going to be pleased with that, and we will track you down.

Taxpayer service is an element of compliance. In other words, I have always thought enforcement and taxpayer services are two sides of the compliance coin. So we need to provide appropriate taxpayer service. We need to make it as easy as possible for people to figure out what to do if they owe, and how to pay it. We need to be able to do that, for those who wish, online. Most people don't want to call us. They would like to get the information and just file.

On the other hand, enforcement is important. It is not so much the $50 billion to $60 billion we collect with the enforcement funding, although that is significant money, obviously; it is that, again, people feel that, if I didn't pay, somebody would come and collect. And therefore, if the enforcement activities begin to decline, and people over the water cooler at their country clubs are saying, "Well, you know, I did this and nobody called me" or I got away with that, it is corrosive to compliance.

Simply leading into this year, we have 5,000 fewer revenue agents, officers, and criminal investigators. At the end of this year, we will have 6,500 fewer. The fewer people we have, the fewer audits we do. The audit coverage rate has gone from 1.1 percent to 0.6 percent.

So we estimate on the numbers—and again, we are happy to share those performance measures—that, it is costing the government $4 billion to $5 billion lost every year. And I guess it is the

audits and the cases that we cannot pursue because we do not have enough people to do that.

We lose money on the one hand, but we also undercut—at some point risk undercutting—the voluntary compliance system if people think that the enforcement mechanism in the IRS is being constrained, underfunded, and no longer effective.

Mr. SERRANO. Let me ask you something. I have been here a bunch of years, and so have these other gentlemen, except for those two guys over there, the young ones. On one hand, you present a picture that I believe in, an agency that does its work and gets respect from most of the American people. And yet you have some Members of Congress, a large number, who have always seen the IRS as a problem. If they could get rid of it, I don't know who would collect the taxes, but they would be very happy.

Briefly, because I know my time is running out, why do you think the difference of opinion? Obviously, it would be easy to say it is a political statement. But there is no real political gain in saying let's not collect taxes, although nobody wants to pay taxes. So why the difference?

Mr. KOSKINEN. I think, around the world, tax collectors are not the world's most popular group. Many people ask me: Why did you take this job?

It is important, I think, ultimately for people to understand tax collection is a critical function of government. Not only do we collect 93 percent of the money that funds the programs everyone else supports, but we deal with virtually every American. We, in the last year, had 150 million individuals file tax returns.

And that is why I agree with the Chairman: taxpayer service is a critical issue. It is why I was as concerned, more concerned probably, than most people about the relatively abysmal level of service last year. Taxpayers deserve, and need to be able to get, service properly. When you call us, you should be able to get through, you should be able to get somebody knowledgeable, well-trained, able to answer your question.

As Justice Holmes said a long time ago, taxes are the price we pay for democracy. Basically, without the funding, the government can't function, whether it is defense, whether it is Social Security, whatever it is.

We have an obligation. I take Chairman Rogers' point and Chairman Crenshaw's point, that we have an obligation, not only to provide effective service and appropriate service and appropriate collection activities, but we have an obligation for taxpayers to feel they are going to get treated fairly. That it doesn't matter who they voted for, what party they belong to, what organization they support.

And as I have said, people need to understand—because even with the low coverage rate we will still do a million audits this year—they need to understand when they hear from us, it is because of something in their return. And if somebody else had that same issue, subject to resource constraints, they would hear from us as well.

One of the things I have taken on, and I think the concerns have been appropriate, it is critical for us to ensure that we restore whatever trust has been lost in the ability of this agency to func-

tion as a tax administration agency, without any agendas beyond that, treating everyone fairly.

Most importantly, one of the things I have been trying to stress is, we spend a phenomenal amount of time trying to help taxpayers. I know we have an image of, well, you know, we knock on the door, we are chasing you for money. We spend a phenomenal amount of time on assistance.

And as I have said, if you are trying to be compliant, you don't have to call somebody on late night TV to deal with us. You can call us. We will try to figure out. If you are having trouble making a payment, we have online installment agreements, we have offers in compromise. Our goal is to have people be compliant when they are trying to be compliant.

Mr. CRENSHAW. Thank you.

Mr. SERRANO. Thank you.

Mr. CRENSHAW. Mr. Rogers.

Chairman ROGERS. Thank you, Mr. Chairman.

A recently released GAO study on the 2015 tax filing season highlights just how bad customer service has become at the IRS. That report found that roughly only one-third of taxpayers who called the IRS for assistance had their calls answered. One-third. Two-thirds did not get an answer. The report also showed that call wait times have more than tripled in just the last 5 years.

Because of multiple poor management decisions at IRS, the budget has been either cut or held flat since 2010. Blame for long phone wait times and the decline in customer service is often placed on these budget cuts. However, nothing in the Financial Services appropriations bill explicitly reduces funding for customer service. To the contrary, funding for customer services was increased in fiscal year 2014 and fiscal year 2016.

Under your leadership at IRS, funding has been prioritized for implementation of ObamaCare and the Foreign Account Tax Compliance Act, and your customers, the U.S. taxpayers, have paid the price.

Since our committee has increased funding specifically for taxpayer services in recent years, how do you explain the continuing decline in customer service, which you, yourself, have admitted as abysmal?

Mr. KOSKINEN. I testified 2 years ago, shortly after I became the IRS Commissioner, and noted, in fact, at my confirmation hearing 2½ years ago, this agency does statutory mandates. The chairman has talked about our efforts. With no funding, we have a number of statutory mandates. Unfunded or not, we do them. We have taken the ABLE Act seriously. We take all of the statutory mandates seriously, including private debt collection. When the Congress gives us a requirement, we do it. It is the highest priority.

So Congress, as I noted in my testimony, has underfunded us for the Affordable Care Act. That does not remove the statutory mandate we have to implement the act. We have to implement the Foreign Account Tax Compliance Act. We have no choice.

So when no funding is provided for those, we have to find the funding somewhere else. And as I said 2 years ago, at the continued level of underfunding, the things that were going to suffer

were going to be enforcement, taxpayer service, and, ultimately, information technology.

The $900 million that we did not get for information technology, for funding the unfunded mandates, had to come from other IT projects. We do not replace and install every patch that we get. We get thousands of security patches and upgrades. They all take time and money and effort. We have to prioritize, which we can do——

Chairman ROGERS. But have you taken money from customer services to do these other?

Mr. KOSKINEN. No. We have actually, if you look at it, the only thing we have taken from customer service from last year is we have spent fewer user fees there. We have never been fully funded in the last 3 or 4 years for customer service. We have been using our user fees, which normally would help us with unfunded mandates, to support taxpayer service. Last year we provided user fees to taxpayer service, but we did not have enough user fees, as in prior years. We had to spend them elsewhere.

Chairman ROGERS. Stay on track here with me a minute.

Mr. KOSKINEN. Pardon?

Chairman ROGERS. Stay on track here a minute.

Mr. KOSKINEN. I am saying, we spent——

Chairman ROGERS. No, no, no. Let me ask you a question.

Mr. KOSKINEN. Good.

Chairman ROGERS. We increased customer services funding in fiscal year 2014 and for 2016. Nothing in this bill, these bills, reduced funding for customer service. If service is so bad, as GAO says it is, and we have funded customer service, you say that you have had to use moneys from all over to fund these other mandates, our question is, the mandate we want you to have is to serve the public, and you are not doing that, according to GAO.

Mr. KOSKINEN. We share that goal. The budget process, when you look only at the appropriation, ignores—and we have drawn this to the attention to your staff as well as the Committee—that we have $250 million to $300 million of user fees we collect every year historically. I am sorry, we have $250 million to $300 million——

Chairman ROGERS. Go ahead.

Mr. KOSKINEN. We have $250 million to $300 million of user fees that historically have been used for unfunded mandates, other expenditures. Because the appropriation for taxpayer service has not been fulsome, we have historically devoted a lot of those user fees to taxpayer service.

The appropriated amount, you are exactly right, went up by several million dollars. But what we were not able to do last year was put the same amount of user fees into taxpayer services. We ended up spending $100 million less of user fees—and we made that very clear, your staff understands that—on taxpayer service, because those user fees had to be spent to fill the other holes in our budget.

We have the same problem this year. At the end of this year, our balance of user fees will be at the lowest level in the last 15 or 20 years.

Chairman ROGERS. But how can you defend yourself against GAO's determination that only one-third of taxpayers who called

the IRS even got their call answered? Only a third of them. Two-thirds never got an answer.

Mr. KOSKINEN. That is right, and one of the reasons we appreciate the Congress' additional funding this year. And we are spending the vast majority of it, over half of it, on taxpayer services. We couldn't agree more.

Two years ago, when our level of service was at a higher level, I noted that if the budget continued to be cut, we were going to see lower enforcement, lower taxpayer service, and threats to IT.

So the Committee's actions, and the Congress' action, by giving us the $290 million, I think, is a significant step forward. As I say, we expect taxpayer service to be significantly better this year. It won't be at the level we want it to be because the funding of $290 million doesn't fill all of the gaps that the $700 million in additional requests last year, for those three areas, would have done. But it will be noticeably different.

I think Chairman Crenshaw is right. If you give us the money, we should be able to show you the results. And my hope is, as taxpayer service gets better this year, the Committee will understand, if more money is provided there, and we don't take it out of someplace else, the service level will ultimately get to a point that 80 percent of people will get through in less than 5 minutes.

It is the goal. We used to be able to do that. Before the budget cuts there were days in the mid-2000s when that was the level.

But I couldn't agree with you more, and we agree with the GAO. We have, ourselves, been noting, as you note, and describing it as unacceptable to continue to run at that level of taxpayer service.

Chairman ROGERS. Well, the report also showed that call wait times have more than tripled——

Mr. KOSKINEN. Exactly.

Chairman ROGERS [continuing]. In the last 5 years. Tripled.

Mr. KOSKINEN. And in the last 5 years, the budget has gone down every year.

Chairman ROGERS. And we have increased your funding for customer services.

Mr. KOSKINEN. I have told you. We have spent, the year before that, $150 million to $200 million in user fees on taxpayer service, because it is a priority. Last year, with the additional significant budget cuts, we could not do that. We could only put $50 million of user fees in. So taxpayer service last year, the funding went down by $100 million because of the budget cuts.

But I would stress, we totally agree with you. It is unfair to taxpayers. It is not the way the government ought to operate.

And the wait times are as bad as the so-called courtesy disconnects. You should be able, when you call us, to get through in less than 5 minutes. We won't quite meet the 5-minute deadline this year because, again, we don't have the resources. The increase is significant, but not sufficient. But you will see a noticeable improvement. The Practitioner Priority Line will be better for the first time in several years.

It is a high priority for us. I couldn't agree with you more.

Chairman ROGERS. Well, we want to see the statistics to see whether it is coming or going, better or worse.

Mr. KOSKINEN. If it doesn't go, you have a legitimate point, we should be held accountable. If we are going to spend $178 million of taxpayer dollars on taxpayer services, the services should significantly improve, and we are happy to track that with you.

Chairman ROGERS. Would you be able to give this subcommittee a status report on how you are doing with that in, say, a couple of months?

Mr. KOSKINEN. I could give you a status report right now. As I say, we have had——

Chairman ROGERS. I am interested in how you are going to change things.

Mr. KOSKINEN. No, no, the status report. The number I have is 25 million returns have been filed, all but a million of them electronically. And while we are still at the front end, the level of service has gone up to 71 percent. So 71 percent of people, as a result of our ability, thanks to your funding, have moved in.

Now, we won't be able to sustain that because we are about to get far more calls the rest of the filing season. But our goal, and we said that in our plan to you, we should be held, measured to, during the filing season this year, going from that 37, 40 percent to the low 60s. Our level of service for the filing season should be 62 percent.

For the year—because we had 3 months before we got the bill and were running at a really crummy level—our expectation is that we will be in the 47 to 50 percent rate, which is significantly better than the 37 percent.

Chairman ROGERS. Well, what I want to know, and I want you to report to us on April 15——

Mr. KOSKINEN. I will be here.

Chairman ROGERS [continuing] I want you to report to us on the percentage of people whose calls get through.

Mr. KOSKINEN. Yes.

Chairman ROGERS. And how much you have reduced the wait times for those who call.

Mr. KOSKINEN. Those are exactly the right measures, and I will be happy to report those.

[The information follows:]

2016 IRS TOLL-FREE TELEPHONE DATA

CALENDAR YEAR (CY) FILING SEASON WEEK ENDING		FS 2016 Week	FS 2015 Week	FS 2016 Weekly Cum	FS 2015 Weekly Cum
January 23, 2016	LOS	78.6%	55.0%	74.2%	54.5%
	ASA	8 Min 57 Sec	28 Min 38 Sec	10 Min 30 Sec	29 Min 55 Sec
January 30, 2016	LOS	79.1%	44.0%	75.8%	51.0%
	ASA	7 Min 32 Sec	30 Min 59 Sec	9 Min 31 Sec	30 Min 13 Sec
February 6, 2016	LOS	76.0%	34.0%	75.9%	45.4%
	ASA	7 Min 31 Sec	28 Min 30 Sec	8 Min 53 Sec	29 Min 48 Sec
February 13, 2016	LOS	76.7%	36.5%	76.1%	43.0%
	ASA	8 Min 10 Sec	22 Min 8 Sec	8 Min 42 Sec	28 Min 2 Sec
February 20, 2016	LOS	67.4%	31.3%	74.4%	40.5%
	ASA	11 Min 36 Sec	16 Min 41 Sec	9 Min 13 Sec	26 Min 6 Sec
February 27, 2016	LOS	65.4%	33.0%	72.8%	39.1%
	ASA	11 Min 33 Sec	19 Min 46 Sec	9 Min 36 Sec	25 Min 7 Sec
March 5, 2016	LOS	72.8%	34.2%	72.8%	38.5%
	ASA	9 Min 20 Sec	21 Min 15 Sec	9 Min 34 Sec	24 Min 38 Sec
March 12, 2016	LOS	79.4%	34.8%	74.7%	38.0%
	ASA	6 Min 40 Sec	20 Min 22 Sec	9 Min 13 Sec	24 Min 9 Sec
March 19, 2016	LOS	74.2%	35.6%	74.7%	37.8%
	ASA	10 Min 7 Sec	20 Min 16 Sec	9 Min 19 Sec	23 Min 47 Sec
March 26, 2016	LOS	67.2%	34.6%	74.0%	37.5%
	ASA	14 Min 40 Sec	20 Min 40 Sec	9 Min 44 Sec	23 Min 30 Sec
April 2, 2016	LOS	69.1%	38.7%	73.7%	37.6%
	ASA	14 Min 1 Sec	22 Min 27 Sec	10 Min 3 Sec	23 Min 25 Sec
April 9, 2016	LOS				
	ASA				
April 16, 2016	LOS				
	ASA				

Definitions:

1. Level of Service (LOS) is the relative success rate of taxpayers who call for IRS services seeking assistance from a Customer Service Representative.
2. Average Speed of Answer (ASA) is the average number of minutes and seconds customers wait in an assistor queue before receiving service.

Chairman ROGERS. Gotcha. Thank you.

Mr. CRENSHAW. Thank you, Mr. Chairman.

And, Commissioner, you hear this over and over again from this committee, you get $11 billion, and you have got a lot of things to do, just like we all have got a lot of things to do, and it is all about priority. And what the message is, it seems like the most important priority ought to be customer service. And I think the criticism is, from time to time, money goes to other places that don't seem to be as important as customer service.

So I think you are getting the message that we would say—sometimes people say: Well, the way the Federal Government works is when they cut their budgets, they find the place that creates more pain to the average citizen and then everybody thinks they need more money.

So I think you got the message that we just want you to make sure that you make this a priority. That is all we have got to say.

Mr. Bishop.

Mr. SERRANO. Mr. Chairman, I noticed that you said he gets $11 billion. That is what he is asking for.

Mr. CRENSHAW. No, he is asking for $12 billion.

Mr. SERRANO. Oh, okay. Just checking to see if you were committing yourself to the $11 billion.

Mr. CRENSHAW. No, that is last year.

Mr. KOSKINEN. You are very careful.

Mr. CRENSHAW. Mr. Bishop, please.

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

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

I have been listening to this discussion, but I know that your fiscal year 2017 budget request proposes to restore more than $807 million in cuts to the IRS that have occurred over the past few years. The cuts, once counting for inflation, currently fund your agency at levels comparable to 1998, I am told.

You have indicated that personnel accounts for nearly 75 percent of your budget and that these cuts have contributed to the loss of 13,000 people due to normal attrition, reduction in forces, and agency hiring freezes. This loss has translated into fewer personnel conducting audits, which you have said, and tax enforcement, fewer employees answering the phones to respond to taxpayer inquiries, longer wait times.

As a result, you have indicated that we have suffered a degradation of taxpayer services and a loss of billions of dollars in enforcement revenue. I am told that for the 2006 tax year, that there was a $450 billion gross tax gap. That is the difference between taxes owed and taxes voluntarily paid on time. That would be a substantial contribution toward reduction of the deficit and also providing the additional resources that the Internal Revenue Service needs to collect the money that is needed to fund the government.

It seems to me that the cuts over the past 5 years have really worked to sort of cut off your nose to spite your face, in terms of being able to fund our government.

And so while customer service is vitally important—and I hear it from my constituents day in and day out when they have to deal with the IRS and can't get through—if you get this restoration, are you going to be able to collect that money, to decrease that $450

billion gross tax gap, so that the government gets what it is entitled to get under existing law without raising tax rates, what is actually owed?

Mr. KOSKINEN. Perhaps a way to put this in context for everyone is the President's request for 2017 would get us to the level—forget about inflation—where we were 7 years ago, 2010. I don't think there is any other major agency of the government that presently is asking, in 2017, simply to be restored to 2010's level.

Since 2010, we have 10 million more taxpayers. We have the aforementioned Affordable Care Act, Foreign Account Tax Compliance Act, the Health Coverage Tax Credit, private debt collection act, and other unfunded mandates we are dealing with, with a budget that is not anywhere near where we were 6 years ago, in 2010. The 2017 billion extra would take us back to where we were in 2010.

So over 7 years, we would have been held flat. And yet, in the meantime, if we can get that program integrity cap money, the enforcement revenues, net of the expenses over a 10-year period in the budget, are projected to generate, to the government, a net of $46 billion more revenue, far exceeding the billion dollars that is in that budget, and would be every year.

So, again, I would stress when we talk about this budget, it is another billion dollars, that would take us back to where we were in 2010.

I would also stress, again, we need to be efficient. We need to consolidate our space, we need to make sure that we are not printing anything more than we have to, that we are using our people efficiently.

But you have to understand, France, Germany, England, Canada, and Australia all spend twice as much as we do to collect their revenues. We are already far more efficient as a tax collection agency than anyone else.

I agree we should be as efficient as we can be. But the image that somehow $11 billion, or even $12 billion, is a lot of money and we must be able to do everything with it doesn't correspond with the reality. It is clear to us taxpayer service is a priority, but statutory mandates are also a priority. Running the filing season every year is a priority.

Mr. BISHOP. Mr. Koskinen, I have got 24 seconds left.

Mr. KOSKINEN. Sorry.

Mr. BISHOP. Bottom line is that Congress has required and the population increases has required that you do more with less. And that has contributed and is a contributing factor, I would take it, to the fact that customer service is poor and we have got that tax deficit, that tax gap.

Mr. KOSKINEN. That is correct. And we are doing, as I said, much more with much less. There is a limit to what you can do with less, and we are well beyond that limit.

Mr. BISHOP. Thank you, sir. My time has expired.

Mr. KOSKINEN. Thank you. Sorry to use so much of your time.

Mr. CRENSHAW. Thank you very much.

Let's go now to Mr. Graves.

Mr. GRAVES. Commissioner, good morning. I hear your arguments, and I want to applaud you for doing more with less. I re-

mind the committee that we are nearly $20 trillion in debt. Over the last 6 years, we have been able to cut nearly $200 billion from discretionary spending, but there is more to do. But I understand your request. I do.

And so just to go back to last year, we had a conversation about fraud, and my memory, if it is correct, is that around $5.8 billion was reported in fraudulent tax refunds being sent to criminals and not to the taxpayers that were owed them. That is about half of your budget request.

And so the easiest way to get to your budget request would probably be to continue your efforts to eliminate that fraud. I think that would help all of us.

And so I want to thank you for the summit that you had and bringing all the stakeholders in. It sounds like it was very productive. I would like to learn more about that, and hopefully we will hear a little bit more about that today.

But it sounded like it was more about the individual preparers that had been defrauded through identity theft or some other mechanism—that seemed to be the focus. Was there any type of focus on fraud related to the electronic identification numbers, the filing identification numbers the industry uses for authentication purposes, to check and make sure that there is not fraud occurring from the non-individual filing perspective?

Mr. KOSKINEN. No. We are dealing with very sophisticated criminals. One of our concerns is, as we get better at dealing with individual fraud, and particularly with the Congress' approval for us to get W–2s earlier so we can match data, we now have criminals forming false corporations and creating false W–2s that look like they are real W–2s. So there is a business fraud issue.

One of the issues we talked about, again, with our partners is, as we get better at detecting fraud, the next place criminals go is to the tax preparers. So there will be more and more private sector companies in the tax system who are being attacked, because if you can get into a preparer's system, you then have all of that information and you can file false refunds.

The goal of all of this activity, as far as we are concerned, as opposed to whatever they are doing with everything else they have got, is to file false returns and get false refunds. We think that by being able to share this information in real time, because of investments we made we have improved. It used to be our filters could be adjusted once a year. We have a very antiquated system. We can now adjust those filters in real time. We can adjust them as a result of the information we get from preparers, from States.

The issues we have had with the recent bot attack, we have immediately been able to share, thanks to the partnership, all of those Social Security numbers with State revenue agencies around the country. We have been able to share all of those with all of our private sector partners.

So we think it is going to be a more formidable battle——

Mr. GRAVES. So you have ability to verify and authenticate the EFIN of these preparers?

Mr. KOSKINEN. One of the issues we have is, again, looking at authentication for every way people get into our system. We are satisfied on the installment agreements, for instance, if you are try-

ing to pay us, it is unlikely you are a criminal. The criminals don't pay us, they try to get the money.

On the other hand, we are looking at everybody who has access to our system—preparers, mortgage companies, others—because they are all vehicles and venues that if we can stop people here, they will simply come in other ways.

I would stress the bottom line is, we are making progress. We will never end this battle. The criminal syndicates we are dealing well are too well funded, too creative, and too desperate. Somebody asked me: When will you be done? And I said: The minute you think you are done is when you are going to be done. You can never think that you are finished.

So we have spent a lot of time—and the funding you have given us will improve that—trying to make sure that, to the extent we can, we are getting ahead of it.

What we would do with the additional funding in the 2017 budget is be proactive. Thus far, even with our partners, up until recently, we have been reactive. There is a probe here, and we push back. We find a problem here, and we solve it.

We have a potential, and, again, with this partnership, with all of their security people, to come together and actually start to get ahead of the game. Instead of responding to where the attacks are coming from, beginning to protect ourselves against where we think the next attacks will come from.

Mr. GRAVES. All right. And as I close, Mr. Chairman, let me just point out that the industry is lawfully doing what they are expected to do, and that is filing returns to the best of their ability.

Mr. KOSKINEN. Right.

Mr. GRAVES. And so, as we said last year, and I believe the Commissioner supports this, we don't need to put undue regulations on an industry that is clearly trying to assist the Commissioner and the agency, and are doing as much as they can do with the information that is being provided to them. It is up to the agency to determine and verify the validity of the data being received.

And then lastly, let me point out, it is nice to hear for the record that we have one agency that is just trying to get back to a 2010 funding level, and that demonstrates the good work of this committee and what we have been doing over the last couple years and how tough it has been.

But thanks for doing more with less.

Mr. KOSKINEN. Happy to hear that.

And I would just stress, your point, in our work with the private sector, as I have told them, it is a partnership. So we are not telling them to do anything. What we are doing is jointly figuring out, OK, what can we do together.

So when they said, well, they need a standard, obviously, because they don't want to have a competitive disadvantage if it is a little harder to get into one than the other, and as I have said, it has been our approach, OK, we will work with you on developing it. But it will be their standard. And I think that is why it has been such a productive relationship.

Mr. CRENSHAW. Thank you.

Mr. Quigley.

Mr. QUIGLEY. Thank you, Mr. Chairman.

Thank you, Commissioner.

The phone scammers, I have heard the tapes actually played of people posing as IRS agents and scaring the hell out of people when they call them and tell them: If you don't do this right now or wire money to us to pay these back taxes, someone will be knocking at your door, you will be arrested. A real horror story in my district, in my State, and I know you know across the country.

I would love to hear what you are doing about that, but particularly because as we go forward with private sector collectors, the possibilities that people believe that these people are real become more evident and I think it actually complicates that problem.

Mr. KOSKINEN. I have been dismayed by the persistence of the scam. For the last 2 years, every press conference I have done, I have mentioned we put out a Dirty Dozen every year. The highest priority has been to warn people against phone scams. Basically, 2 years ago when I started I said: If you are surprised to be hearing from us, you are probably not hearing from us, because we don't call you first. We actually send you letters. You will get several communications from us before you get a call. We work with the IG. We have been working on criminal prosecutions of people we catch.

What is concerning to me is I get news clips every day, and virtually every day there are very good news reports warning people, whether it is on television or print news media, across the country. And it is amazing the number of people who still get that call and they just say: Well, I am going to have to deal with it. A lot of times they are older people. A lot of times they are immigrants.

One of the things we are trying to get people to understand is, if you hear from the IRS, we will never threaten you. We will never tell you that you are going to go to jail the next day, you are going to lose your house. We will never tell you to make a payment to a debit card or to a bank account.

We are committed, and I am personally committed, that on the private debt collection, we are going to do everything we can to make it work. I don't want anybody to think we are slow-rolling it.

Mr. QUIGLEY. Excuse me, how will they differentiate themselves, besides the precorrespondence?

Mr. KOSKINEN. The big challenge we have is that—we are designing the program and the training—we will send a letter to the taxpayer saying: We have turned your account over to a specific company. Part of the contractual relationship is the company will then send a letter to the taxpayer saying: We have been given your account by the IRS and you will be hearing from us.

That, we think, will help. It won't solve the problem. We are then trying to get ahead of the world. We know the criminals will now try to figure out how do they send letters that look a lot like our letters, use the same letterheads, say the same thing. So we are going to work.

We have a bidders conference coming up at the end of this month, again, with the private sector, to say: "Okay, we have got this problem. We didn't have it the last two times we tried private debt collectors. How can we jointly figure out how to deal with that problem?" Because it won't do them any good if they call and get hung up on because people say these are more scammers.

Again, I don't think we are going to have the only answer, and we are going to work with the potential contractors. One of the big issues will be how can we buffer their work from all of the efforts we are all making to try to get people not to respond to the phone scams.

Mr. QUIGLEY. You state the obvious. Hopefully, the letters will differentiate themselves: We are not going to call you and threaten you, we are not going to call you and demand you debit right away, we are not going to call. It has got to go into those specifics.

Mr. KOSKINEN. Yes. And we are trying in our public relations campaign to tell people just that.

The bottom line is, if we can just get the public to understand, "If you are going to pay your taxes, you write the check to the U.S. Treasury and you mail it," and get people not to go down to the bank and make a debit card deposit today, not to make it to somebody's bank account. And nobody is under the threat of, if they don't do it, in 24 hours something terrible is going to happen.

Mr. QUIGLEY. Thank you.

I yield back.

Mr. CRENSHAW. Thank you.

Mr. Yoder.

Mr. YODER. Thank you, Mr. Chairman.

Commissioner, good to have you this morning. Thanks for your testimony.

I noted the very interesting dialogue that you have had this morning with members about how to collect the taxes that are due and owed, and how complex that is, and how challenging that is. Certainly Chairman Rogers made very clear his frustration that we all have with customer service and challenges that I think you recognize are a problem well and you have stated you are working on.

You made a statement that really resonated with me, which was you said we will never win this battle, that it is sort of a never-ending problem, and you just have to do as good as you can.

And I think the reason we are having this problem and why we will never win this battle is because we are looking at it the wrong way. You are looking at it, and this committee looks at it, from a revenue solution answer, and I think the problem is within the Tax Code itself and the tax system we have set up in America.

With 70,000 pages, the complexities that exist, Americans are frustrated with the Tax Code. There are people that don't pay their taxes, that find loopholes. And most Americans want to see a Tax Code that is flatter and fairer, in both political parties.

Maybe one of the things that unifies the country is that they want to see what happens if the IRS changes. And I think that makes your job very difficult. And I don't think there is enough money we can throw at the problem. The problem is changing the way we do business at the IRS, changing our Tax Code.

And I note that you spend $11 billion. You would like a billion dollars more. I am sure you would be willing to spend even more than that, if we would give it to you, because you would try to use it to collect more taxes.

Americans spend more than that. I mean, by some estimates they spend $37 billion annually complying with the Tax Code. So you are spending $11 billion and Americans are spending 3.24 bil-

lion hours complying, and that adds up to 369,000 years annually. And just think about a country when we are trying to create jobs, we are trying to create opportunity, that would not be the country that our Founders designed that they would expect that this is where we would be.

And if you look at the changes we have made to the Tax Code with ObamaCare additions and the various laws that get passed in this country every year, that has added up to a point where you have got a J curve in terms of just dramatic increase in responsibilities we have placed on you to the point where your point is we will never win this battle. And I think it is precisely because we are going about the battle the wrong way.

If we had a simpler and fairer Tax Code, you would get higher compliance rates, people would know where their tax revenue is going, and they ultimately would be more willing to comply themselves, and your collection efforts would be less costly.

So that brings me to some of the things we can do immediately that might help bring about some of those changes. One of the things my constituents hate more than anything is fraud, waste, and abuse in government. Nobody likes that.

And I bring our attention back to the earned income tax credit issue that we have discussed before. And I would highlight again for the committee the roughly 25 percent error rate, which is astounding. I don't know that there are very many government programs that have that high of a fraud or error rate, to the tune of maybe $15 billion to $20 billion annually. We spend $30 billion researching cures at the NIH, every disease known to man, we are spending $30 billion, and we are wasting $15 billion to $20 billion on paying earned income tax credits to people that don't deserve them.

So it is particularly concerning. And I would just like to ask, I guess, where we are on that issue, what progress we are making, and in particular, what solutions Congress can bring or you can bring towards resolving this? Can you highlight any disparities, in particular, of improper payments made by self-preparers versus third-party providers? And do you believe that you need additional authority granted by Congress to impose due diligence penalties on self-preparers in addition to enforcement and audit powers that you have now?

Mr. KOSKINEN. I am going to try to get all that done in a 1 minute and 20 seconds.

Mr. YODER. Fair enough.

Mr. KOSKINEN. But let me start by saying, as I have testified from the start, this is one of the major challenges we have. It is a program a lot of people support. Most people seem to support it. It is for the working poor. And the error rates, and the amount of money going improperly just need to be fixed.

We appreciated your responding to our request to get W–2s earlier. Next year, we will get them in January. As a result of our partnership, we have volunteers who have provided us with 20 million W–2s already this year, and that allows us to double-check, when somebody files, their income, to the extent W–2 income is reported. Next year, also the Congress has said that refunds will be

held until February 15 to give us more time to check, and that will be helpful.

[CLERK'S NOTE. In the above paragraph, the IRS is referring to section 201 of the PATH Act, which was enacted as part of the Consolidated Appropriations Act for 2016 (P.L. 114–113). More specifically, 201(a) (earlier W–2s) and 201(b) (delayed EITC refunds).]

The corollary to that, what we need, is to have what we are now calling, because we are trying to keep it narrow, "correction procedures for specific errors." For instance, we are going to work with Social Security to get their identification when people report that they have reported to us the wrong Social Security earnings for the EITC.

When we see an error like that, that is from a reliable database, we can't make the change. We actually have to audit that person. We have to send them letters. We already do over 400,000 EITC audits. So it is clear we can't just audit our way out of the problem.

If we have the ability, as we have in some instances to correct math errors, when we have a reliable database, to make the change, taxpayer can still say, "Hey, you know, I have got a concern." They have the right to come in and disagree. But if we can make those changes without having to audit, we think we could cut down improper payments significantly.

One of the reasons we are talking about, and requesting, the ability to require minimum standards for preparers is not to create a regulatory regime. We had the program before. People know what it would look like, since we did it 4 or 5 years ago. It simply requires some minimum testing of preparers so that they know something about the Tax Code.

A significant number of errors are made in good faith. The statute is very complicated. So if somebody wanted to simplify the statute, that might be OK too. But it is basically preparers, if they have had no training or education, having a difficult time tracking their way through it. So that is what we have in mind for the minimum standards.

We won't drive crooks out of business. There are criminals—a small, very small percent of preparers—who are, in fact, advertising: Come with us, we will get you a big refund. Those people we prosecute as we go.

But if we could get the W–2s earlier, the correction procedure for specific errors would go away. We think the W–2s by themselves will help us make a dent in this problem as we go forward.

To address the question of the due diligence, we have been running pilots, we have been looking at it. Preparers have due diligence questions. The questions are helpful. We have built them into the software. We are working again with the software providers and the preparers to try to figure out what is the reasonable level of due diligence they should have.

Their point is, in the preparers that are preparing—back to the minimum standards—EITC returns, they have a very high error rate. What is also happening, though, is as we get more focused on preparers, then marginal preparers prepare the return and don't sign it. So it looks like it is self-prepared, but it has actually been prepared by a preparer. So we are trying to warn people don't do that, because you may lose your refund if it is a crook.

One of the things we are doing, as actually the Omnibus bill suggested—maybe even required, but I thought it was a good suggestion. I pulled together everybody in the IRS that knows anything about this. They suggested a kind of a summit on EITC.

And we are going to do that. We are going to bring preparers, we are going to bring recipients, we will bring people from outside the government, as well as inside the government, to try to sit down, and, again, not tell people what to do, but to try to say: "Okay, what is the common view here as to what needs to be done?" If there are statutory changes in the program that would help, we would get back to you.

We know on the enforcement side, if we have the things I have just talked about, particularly the correction procedure, that would help.

We have this duality. We have to make sure everybody eligible knows about EITC, like the ABLE Act. We say, "here is your program," and at the same time we are trying to make sure people get the right amount.

So we will hold that summit, which may turn out to be a series of meetings, and get back to you on that as well. I had four or five things that I was worried about when I started. This was one of the five.

Mr. YODER. Thanks, Commissioner.

Mr. CRENSHAW. Thank you.

Just a quick question. You mentioned that identity theft costs $5 billion or $6 billion a year. What are the latest numbers on how much the earned income tax credit error rate costs?

Mr. KOSKINEN. The earned income tax credit fluctuates. The error rate has always been in the 22 to 25 percent error. It goes up and down each year.

Mr. CRENSHAW. What is that in real numbers? At one time it was $19 billion. Do you know what is the latest?

Mr. KOSKINEN. I don't remember it being high, but the number has floated again, depending on which year it is, between $14 billion and $17 billion. Whatever it is, it is a number—well, again it is like everything. We will never get it to zero, because it is complicated and people will file——

Mr. CRENSHAW. That is a lot of money.

Mr. KOSKINEN. We ought to be able to get it under $10 billion. I mean, you could say $5 billion to $7 billion. If we could just get it under $10 billion.

Mr. CRENSHAW. It would be nice.

Mr. Rigell.

Mr. RIGELL. Thank you, Mr. Chairman.

And, Commissioner, thank you for being here today and for your testimony.

It has been my experience here in 5 years of service in the House that so often in these hearings it is not too surprising that Republicans, we really focus on really reducing spending, and often times my Democratic colleagues are making the case for the other side of things.

Just for the business background, when I try to assess and work through that, because I am a fiscal conservative and I am deeply, deeply troubled by us being $19 trillion in debt, I think really it

is a fundamental threat to our country. And we are all in this together, Republicans, Democrats, those who are fed up with both parties. From coast to coast, we are all in this together.

So as it relates to the IRS, an evaluation of the request that you have made and just some of the comments that have already been made today, I try to look at this, as best I can, from an objective standpoint and trying to assess performance, and indeed your performance. That is part of what we do here.

So performance over time is something that I always look for in evaluating a business unit or something like that. It is difficult for me to at least easily—I know you would be very good to come by and explain this to me. I have met with you privately before and you have always been responsive.

That said, if you could incorporate into your summaries, at least I would ask for performance over time, that is the efficiency numbers that you are using, the cost per thousand collected. And also, because I know that it is not just cost per thousand that we are looking for and that you should be evaluated on, but also, and importantly, the quality on a range of different metrics there.

So with all that said, is your cost per thousand, according to your own data, is it increasing, decreasing, or staying the same?

Mr. KOSKINEN. At this point, we have become more efficient. Not to overstate it, but we really are, by far, the most efficient tax administration in the world.

We do think, and we measure it, and we are happy to share those measures, on taxpayer service, for instance, as we have had more taxpayers and less funding, we have had a decline in performance. And it is of concern to all of us, and it is an appropriate measure.

Over time we just look at it in gross. We are spending a billion dollars less than we did 6 years ago, even with the increase, and we are processing 10 million more taxpayers. So, obviously, we are processing significantly more taxpayers with less funding. There is a problem, at some point, in terms of at what point do you lose effectiveness.

Mr. RIGELL. Well, let's talk about that just for a moment. I remember from my econ class a long, long time ago, when marginal costs and marginal revenue are equal, you have maximized profit.

Now, let me say right up front, I know this is not a business, we are not in the profit business. But this idea of optimizing the right amount of tax collection, not more than is owed, but not less than is owed, that is the optimum.

So does your budget reflect, are you saying, could you make the argument that if you got the budget request that you had asked for, that that is the optimum? I mean, that is, if you start to spend more than that, you are going to actually maybe collect less than it cost you to collect it?

Mr. KOSKINEN. I don't know where that curve will go. I can guarantee you, as I said earlier, just with the funding in the program integrity cap—and I understand that is always an issue as to where it fits in this budget—but just for the increased enforcement arm over time, our estimate is the net gain to the government would be $46 billion.

So you are right. We are not a business, but we have a business-like aspect to us because we are the accounts receivable, the collection arm of the business. If you are in a business, we are the revenue generator, and then you have the expenditures and all of the programs, wherever you are going to spend them.

So part of my concern is that, as I said, I spent 20 years in the private sector running large, troubled businesses. I never met anybody who said: I think I will starve my revenue arm to see how they do.

But on the other hand, your point is, everybody looks at them and says: But I want that revenue arm to be efficient. I am not just going to throw money at it.

Mr. RIGELL. There you go.

Now, I have got about 30 seconds, and let me just close with this. I just wanted to share with my Democratic colleagues, the ranking member and others, every line of our budget needs to be given scrutiny, and including the IRS. And this is just part of being prudent and doing right by the taxpayer, all of us.

But what is driving our fiscal situation overwhelmingly is our failure collectively to responsibly reform mandatory spending. And I just want to close with that, because that is really what has got to be done. I know it is outside the scope of this hearing, but we have got as an institution to address that thoughtfully, because that essentially is what is driving us in our fiscal situation.

Thank you for your service, and thank you for your testimony today.

I thank the chairman, as well, and I yield back.

Mr. CRENSHAW. Thank you, sir.

Mr. Amodei.

Mr. AMODEI. Thanks, Mr. Chairman.

Good morning, Commissioner.

Mr. KOSKINEN. Good morning.

Mr. AMODEI. To the extent that Mr. Crenshaw is going to endeavor to manage my 5 minutes, please don't be offended if I endeavor to manage the time you take in your answers.

I want to talk to you about a specific instance, and the issue is process related. And we have heard a lot about taxpayer service, and I am gratified by that.

Taxpayer gets a designation for alternative energy purposes that says he is an alternative fuel refiner. It turns out he files under that, it is wrong, for whatever reason, you don't qualify for that. Receives advice from the IRS that you are an alternative fuel blender.

OK. Goes forward under that. New IRS agent: Oops, you are not one of those either. Refund, blah, blah, blah, blah, blah.

Goes into your appeals process, fast track mediation, mediates, IRS folks on the other side, come to an agreement, don't know what the agreement was. And your folks on the other side of the mediation say: Hey, we are not in power to sign off on this.

So the mediator calls the person who is and gets an affirmative: We will do that deal. OK, whatever it was. Then they get a call back the next week saying, from somebody else above, whoever he talked to on the phone: We are not doing that deal.

And so I am sitting here in the face of things like it is a critical function of the government, taxpayer service is a critical function. Now, these aren't folks who are trying to run away from you. They are embracing your system and your dispute resolution system. They are entitled to knowledgeable, well-trained, able to provide effective and appropriate service. You can call us, not some late night talk show person, have people compliant when they are trying to be compliant, treat them fairly.

It is no news to anybody in here you are a Yale-trained lawyer, and I respect that. I know that is probably the only school you could get into with your minimal educational requirements. But don't worry, I couldn't even get in there, so you are doing better than me.

But I look at all this stuff and I say: Hey, I am not expecting your folks to be perfect, they make mistakes. And maybe if it was just one of these things in a single case it would be like, well—and I don't know if you have been briefed on it, because your folks have been into my office at one point in time a while back.

But I am sitting here in terms of basic fairness, in the context of all this stuff where we are talking about we want people to reach out to us, we want to provide the best possible service. And I am not saying, therefore, they shouldn't have to pay the tax or they shouldn't have to do this or that.

But the process of a system where people have embraced your system at every point they could, thought that they went through your fast track mediation program, not yours, but the Service's, and they come away with not the first disappointment in terms of, oh, you are really not that, but the second one says: Oh, by the way, that deal we did, we have decided we are not doing that, even though you had somebody who ostensibly was in the course and scope of their employment in the appeals process that said we will do that.

It is something that deeply troubles me in terms of those folks who are coming to you for resolution as opposed to those who we have been talking about that are trying to scam you, run away from you, cheat you, lie, and steal.

So I say all that to say this: I would really appreciate, and my request is, since we are not going to accomplish it during our little 5-minute speed dating session here, I would like the appropriate folks from your office—I don't know if it is still under litigation or not, although I can tell you the company was 28 employees when this all started and now I think there are 4, because it is a business thing and those decisions had consequences—I need somebody to come in and say: Listen, Taxpayer Bill of Rights, Code of Federal Regulations, Administrative Procedure Act, are we exempt from something where if we say we are going to saw off on something in mediation, that it is really like, well, don't take that to the bank yet, because it came as a complete shock not only to these folks, but to the mediator who had never seen it before.

And so I want to hear what the other side of the story is a little bit. But in terms of general process moving forward beyond this case, it is like, hey, if I am coming to you and trying to be compliant and you guys have made mistakes, then we still need to go forward, tax law still needs to be enforced.

But there ought to be a lane for, OK, let's figure out how he get to where we need to get here short of, hey, sorry we made a mistake, but that doesn't change it, you have got fines, penalties, and blah, blah, because you weren't really entitled to be treated that way. Oh, and by the way, the appeals process really isn't going to help you, even though you thought you had a deal.

Will you please come by and see me? I am not a high maintenance guy. You have only been by twice in 5 years. I don't abuse you. If I say please?

Mr. KOSKINEN. As you can imagine, our golden rule is: "The Commissioner does not get involved in any individual case." We can't talk about cases publicly. We are delighted to talk about it with you. But the Commissioners basically, historically, have not gotten involved in individual cases. But I take the point. I think the point you raise——

Mr. AMODEI. The point is a process point. I am not asking you to come talk about this case. I want to know the process that says that is OK.

Mr. KOSKINEN. The process, I am happy to come talk to you about. I am happy to because the process is designed to be fair, it is designed to work with people who are trying to be compliant. We do, literally, millions of installment agreements and other agreements.

When the system doesn't function appropriately there are lanes for appeals. We have a Taxpayer Advocate, who I strongly support, who can do that. There are ways.

But, again, people ought not to have to go through the maze to the extent we can avoid it. We ought to be able to come to closure.

Mr. AMODEI. So is that a yes, your folks will be by?

Mr. KOSKINEN. Yes, I will come, I will be happy to come by.

Mr. AMODEI. Thank you very much.

Thank you, Mr. Chairman.

Mr. KOSKINEN. But just for the record, I would note, we will be talking about process, not a particular case, because I can't talk about a case.

Mr. AMODEI. Absolutely.

Mr. KOSKINEN. Fine.

Mr. CRENSHAW. And, Mr. Amodei, if you would like another 5-minute speed date, if you just sit quietly for a couple of minutes you will have that opportunity. So we will have another round.

Just what I would like to know is, I mentioned in my opening statement that you had this hardware failure, and I think that there is a hearing today on that. Tell us a little about how that happened. I think there was a destruction of one of the hard drives. Plus the problem, I guess, the breakdown. How did that happen? And how does that affect folks that are filing their tax returns?

Mr. KOSKINEN. This is when we went down for 24 hours.

Mr. CRENSHAW. And then the destruction of that hard drive.

Mr. KOSKINEN. Two separate issues.

Mr. CRENSHAW. OK.

Mr. KOSKINEN. So the first is the systems failure. We do our processing in Martinsburg, West Virginia, and then we have a backup site, alternate site that we go back and forth to, in Memphis. We have redundancies within those systems.

This was a hardware failure and we are still working with the vendors to figure out exactly why, but a simple voltage regulator failed. There is a backup voltage regulator. When they were fixing the first voltage regulator, the outside contractor, the backup failed again.

We normally would have, if the system were going to be down for any period of time, moved to Memphis, which we do about every 6 months or so just so we have a disaster recovery. But that doesn't automatically take up. It takes us 24 to 36 hours to get that system up.

We decided, and it turned out to be right, that we could get the system back up inside of the 24 hours, so it would go faster and we would be more secure in terms of not losing data going back up in Martinsburg.

So the hardware has fixed, the system is up. It happened, again, about 3 years ago in a different mechanical failure. It reminds all of us filing season is simple if you are just filing and it all goes well, and last year we didn't have any of these issues. But we are running a complicated system to process and collect the data on 150 million taxpayers, and we are always at risk that some part of the system, just like your computer, is going to one day decide, "Okay, I am just not going to function again." That is why we have the backups in Martinsburg.

Part of the reason, when people say, "Well, gee, you have a big system," is because we have to have the backup. If we had a lightning strike, a fire, whatever it was in Martinsburg, we have to be able to continue processing. So we have a redundant system with people sitting in Memphis and it moves back and forth for that reason.

But we were delighted that we were able to be down less than 24 hours and that we were able to get back up and that there was no corruption of the data. It was a hardware failure. The system just stopped. So you are worried about——

Mr. CRENSHAW. There was no corruption of the data and it just kind of slows things down for——

Mr. KOSKINEN. So we basically were down for a little less than 24 hours.

Mr. CRENSHAW. Just put you behind that.

Mr. KOSKINEN. And so it turns out for taxpayers, the submitters are able to just simply hold—we have 17 transmitters that collect all of this—and they just hold the returns until we are open again. So most taxpayers, of the 25 million filing, never saw anything. They just filed. For all they knew, the system had gone through in that 24 hours.

Mr. CRENSHAW. How about the destruction of that hard drive? Evidently there was an order to preserve the contents.

Mr. KOSKINEN. I would first note it wasn't a court order. It was part of a FOIA issue in a major case we have that got a lot of visibility. We had a FOIA case filed. So we, on our own, put out what is called a litigation hold. We said, OK, everything related to this FOIA request we need to preserve. It is part of major litigation. So, the FOIA was a kind of an end run. Can we get stuff in discovery out of FOIA that we won't get directly through the court?

The hard drive in question belonged to an employee who had left in the summer of 2014, the end of July. The FOIA request was filed and the litigation hold was put in place in the end of the year.

What happened was that we have 3,000, 3,500 people leaving every year. When they leave we clean their computers. They have to turn everything in, and then to protect taxpayer data as a general matter, if there is nothing else going on, we clean those hard drives and computers and then recycle them, or destroy them if they are old. And we collect those.

In this case, the computer and the hard drive were separated. The hard drive was designated, along with a lot of others, to, in fact, be recycled and destroyed.

As luck would have it, in October, it went to the holding area where they are all collected. When the litigation hold went on, it went on to all existing employees. It didn't go to this hard drive, which was on the way to being recycled.

Fortunately, we had, in another FOIA case, taken the data off that hard drive. So we have the data, but we didn't discover that. We advised the court in the major litigation that in the FOIA case, it appeared we had lost that data because the Justice Department, whoever handled it, felt, and we agreed, that we ought to let them know.

But we kept investigating and pursuing it and then discovered that we had, in another case, pulled the data off the hard drive. So as has been said, as a guy said, I would rather be lucky than good.

What we decided to do is have me simply issue an order we are not going to sanitize, as it is called, or wipe any hard drive. We have been saving all of our disaster recovery backup tapes for the last 3 years. So they are there. And if need be, we could go into those to get data, if we hadn't found the data otherwise.

But we decided that, while we are trying to fix the system so we don't rely on getting data off hard drives, we are going to save every hard drive. And beyond that, what we are going to do as people leave, is we will copy the data off that hard drive into an electronic area. And if there is a litigation hold, we will actually now, instead of just sending notification to the employees, send it to their managers. And the managers, when an employee leaves, will have to check: "Have you checked to see if there is a litigation hold?" So, we will have a belts and spenders approach, I hope, going forward.

By the end of this year, we hope that we will be able to be in a situation where all of the data off every hard drive as people leave will be collected into, in effect, an electronic area.

One of the requests in the 2017 budget is for $17 million to $19 million to allow us to have a modernized e-discovery system. When you ask for data, instead of this clunky system we use now which takes forever, we would be able to go into that database, pull all of the relevant documents, and give them to you virtually overnight as we go.

But in the meantime, nobody is wiping anything, or collecting the data off of it and saving it, and we have made even more complicated responses to a litigation hold. So while we didn't lose this data, it did seem to me that we just can't afford that question while

we are moving to kind of a modern document recovery and retention system. I just don't want to hear anymore of these: It got stuck in——

Mr. CRENSHAW. In a minute, I would like you to talk more about this whole modernization. You just hear over and over again that somehow IRS needs to kind of transform itself, modernize itself. A lot of that has to do with technology. We will save that for a minute.

But Mr. Serrano, and then Mr. Amodei after that.

Mr. SERRANO. Thank you.

Well, that is the first thing I wanted to talk about, the IRS "future state" plan. The concern that some people have is that you may be making or your agency may be making these decisions based on false assumptions—one, for instance, that the budgets will remain in place, and that is a battle we have every day.

And secondly, that you will be, and I am not trying to be sarcastic, you will be the first agency in the history of the U.S. Government to be up to date on technology. It seems that we have never had that. Ever since I got on Appropriations we have been—had dealt with fiscal year 2000, where the world was going to come to an end; didn't come to an end. But still every month it seems an agency is falling behind on its IT.

So what are you doing to prepare for the fact that what you are dealing with now in terms of your plan may be obsolete by tomorrow?

Mr. KOSKINEN. Well, IT presents that challenge. That as you go forward, if you just stand still you are falling farther behind because the IT is getting more modernized. We now talk about cloud storage and a lot of things nobody thought of 5 or 7 years ago.

We are, as I say, not at that level of risk in the sense that we are not trying to go to the moon. We are just trying to catch up where financial institutions are now, and then evolve with them in terms of the taxpayer experience.

So the budget issue is always appropriate. People need to make sure we are spending the money appropriately. We need to make sure we are spending the money appropriately. But, again, as shown, if we can move, in response to taxpayers' requests, to more and more information online, make it more available to them, it will free up our call centers and our Taxpayer Assistance Centers to people who want to be there.

The "Where is My Refund?" application is a good example. Last year, 235 million hits were made on that app online. It allows you to figure out the status of your refund. We don't have 235 million taxpayers. As I keep saying, some people just love to push the button. But this year already we have had 95 million hits.

Now, even if that is only 10 million or 20 million taxpayers, in the old days they used to call to find out, "Where is my refund? I filed my return. What has happened?" So we moved all of those calls online.

Now, if we don't get funding going forward the app—except for our concern about operation and maintenance—the app will be there. And so the more people we can move online, the more efficient we will become, the better the taxpayer service will become.

What is at risk in terms of future budgeting—and we hope to present this committee with more details about what the line of sight over the next 3 to 5 years will look like with particular building blocks and how much they cost—is simply that we will go slower than we would like. So, for instance, the apps that are up about online installment agreements, online payment agreements, online payments, all are building toward taxpayers being able to have an online, secure account with us. If we stopped today, we would have apps that work for limited applications, but people would still have to call us for other issues.

It is important to recognize two things about this. One is there will always be taxpayers who aren't comfortable with the digital economy, or basically don't want to use it. I always use my mother-in-law, until she hears me. For years we didn't try to get her to do email. She refuses. She wants to talk to somebody. She picks up the phone.

Last year, 86 percent of people filed electronically, which meant 14 percent, over 20 million taxpayers, gave us paper returns. And as far as we are concerned, if that is what they want to do, that is fine.

So in the future, there will be people who could use the app who will call us, and that is fine. What we are trying to do is get people off the phone who didn't want to be there in the first place.

But your point about it in terms of upkeep is we have two challenges, and the committee knows this. The committee has been very good about our modernization program, and we have made significant progress as a result of the funding provided by Congress. And we give you reports about that, and I am trying to make the reports more readable, so as you see what you are buying.

Once we get a system up and running, we have to sustain it. Our operations and maintenance budget has not necessarily grown with that. Our budget for 2017 asks for $95 million for maintenance of all of these systems. So when we get a hardware failure like the 24-hour shutdown, we have the systems to fix it, and hopefully we modernize enough that we have fewer of those breakdowns as we go forward.

It is a package. It is complicated. The system is complicated. IT is complicated. What we are trying to do with this "future state" is not look at it from the standpoint of the IRS, look at it from the standpoint of taxpayers, again, taxpayer service. How do we make the taxpayer experience as improved and as efficient as we can for them, recognizing we don't want to leave anybody behind, so if they don't want to participate in the online digital stuff, that is fine? But I think that helps.

And then, if we can, for the Committee, be clear about exactly—and that is where we started in this budget, trying to be very specific about the initiative so you could see what you are getting for what you pay for. My goal is that then we could have performance measures, you could look at it every year and say: How are we doing? You put in that system.

One of the systems we put in this year, for instance, allows us to monitor our system better, which is how we caught the bot attack, which in previous years we never would have caught.

So we need to be in an ongoing dialogue with you about specifically what are we buying, and why, and what is going to make a difference.

Mr. CRENSHAW. Thank you.

Now for another speed date from Mr. Amodei. Take your time.

Mr. KOSKINEN. I would like the record to note I didn't use any of his last 5 minutes.

Mr. CRENSHAW. That is right. And he can have some of my next 5 minutes if he wants them.

Mr. AMODEI. Thanks for the generosity on both gentlemen's parts. And I am sure that if I don't already, I will soon regret referring to the phrase as speed dating in 5 minutes. Nonetheless, I will stand by it.

Commissioner, in the highway trust fund provision that was passed last year, there were some things in there which strengthened your ability to collect tax debt. And I believe one of the provisions was, hey, we want you to do some stuff within 90 days, and we want you to look at using private collection folks, they are already approved by the Treasury. And I am looking at something here that says last month you said you didn't think you would meet the deadline for implementing that program, and I guess that deadline refers to the 90 days.

Mr. KOSKINEN. Right.

Mr. AMODEI. So I am looking through your statement talking about all the initiatives in terms of Treasury-approved folks, that sort of thing, although it is not clear to me that that was part of it, but I think some people assumed it was. And you are talking about additional funding to strengthen enforcement programs and the ability to handle 30,000 more addition debt collection cases.

I guess my first question is, I am assuming you are not going to meet the 90 days, when do you expect to meet that if that assumption is correct? And what do you attribute the delay to?

Mr. KOSKINEN. Let's work backward. The delay is that, even just in a standard procurement, 90 days would be the shortest time in which we could do it, if we had a program up and running and it was simply a question of buying off the schedule.

So my commitment is within that 90 days, to give Congress a timeline as to when we are going to implement the private debt collection. As I said earlier, my goal is to make sure we do everything we can to make it work well, including dealing with the phone scams issue.

We have a bidders conference scheduled this month which will be within the 90 days, again to get their participation with us in designing this program. We have to set up an IT system from scratch, again an unfunded mandate. We just keep collecting these. We have to design an IT system to take the cases that, under the statute, go to debt collectors, send those to the debt collectors, make sure they have a secure system to protect the taxpayer data.

They then have to process those cases, have a secure way of giving us back the information case by case as to what happened to it so we can monitor and collect that, monitor their performance, and be able to report on how it runs.

So our goal, although the timeline is still being finalized, and I do want to get it back to the Congress in the 90 days, is we will

have a bidders conference now. Our goal is to have the procurement done and the program designed, with all of the training that goes into it for the debt collectors, so that they know exactly how this is going to work, the development of the protections for taxpayers, the letters. Our goal would be to have that procurement done before the year is out. But we will have that timeline, we will get it to you.

My concern is, I don't want to put it together quickly and then have it be a problem, and then people say: "Well, you really knew that was going to be a problem and that is your way of killing the program." I have no intention of killing the program. If we can make it work, my view is that would be fine. But it is complicated because you are taking people and having them perform quasi-government functions. You have got to make sure the data is protected. You have got to make sure that they are trained appropriately, and that we have an agreement with them this is, in fact, what they are going to go do.

Mr. AMODEI. So use of the language already used by the Department of Treasury, which I assume would have some of those same concerns since you are collecting on behalf of the government, really wasn't helpful to you.

Mr. KOSKINEN. No, no. It is very helpful to us. We are going to use that. The bidders coming to that conference are the people on that list. It is very helpful to us. It would take us much longer if we had to go to the broader GSA list. That list has four companies, the GSA list has 63.

So it was very helpful. The focus is there. The reason we can have this bidders conference and get going is because you made it easier.

Mr. AMODEI. In the remaining minute of our speed date, how would you describe this in terms of your priorities for how you are transitioning the Service? And I will tell you the context, to be fair. It is like when I look at this thing that says, hey, we get more money, we can process 30,000 more collection cases, I am assuming that that is an in-house thing, not a private debt collection thing.

Mr. KOSKINEN. Exactly.

Mr. AMODEI. So the question comes, how would you describe this as one of your priorities in terms of compliance?

Mr. KOSKINEN. Like all statutory mandates, it is a high priority. The highest priorities we have, we have got to run filing season, because that is $3 trillion we collect. The next highest priority is to implement statutory mandates. And we do those as quickly as we can.

Again, since I have been here we have accumulated a number of statutory mandates; none of them have come with any funding. That doesn't give us an excuse for not doing it. It may slow us down in some places. But we have an obligation to do them. We have an obligation to make them work, and we have an obligation to keep you advised as to what the timeline is and how the program is going.

Mr. AMODEI. Thank you.

Thank you, Mr. Chairman. Since it is a school night, I yield back. I will be dating no further.

Mr. CRENSHAW. You are on a roll. You want to keep going?

Mr. KOSKINEN. And I am not taking that as a sign of rejection that he gave up on the relationship here.

Mr. AMODEI. Since I have never had anybody say, "I wish you would have talked longer," I think I will stick with that.

Mr. CRENSHAW. Thank you very much.

Just real quick, how much money, how much revenue did we collect last year?

Mr. KOSKINEN. We collected a little over $3 trillion. $3.1 trillion. I think is the number.

Mr. CRENSHAW. When is the last time we collected $3 trillion?

Mr. KOSKINEN. I think we probably collected, the year before, $3 trillion. Basically it grows incrementally.

Mr. CRENSHAW. So would you say this last year that you collected more than you had ever collected before?

Mr. KOSKINEN. I think our collections from our enforcement activity, with the revenue agents, are starting to go down. But as a general matter, the compliance rate continues and our collection rate, overall compliance rate, goes steady.

My concern is, a decline of 1 percent in that compliance rate is going to cost us $30 billion a year, so that we have to worry about taxpayer service, we have to worry about enforcement. Because the number that we collect on our enforcement activity, the $50 billion to $60 billion, is real money. But what it is doing is reinforcing voluntary compliance.

The number I have tried to get everybody to focus on is, what is the compliance rate? And if it starts to decline, the numbers you are talking about dwarf everything else we have talked about here today.

Mr. CRENSHAW. The enforcement collections, do they go up and down?

Mr. KOSKINEN. We do a lot of enforcement collections by just our automatic collection process. We automatically find mistakes in returns and we communicate with people by paper, as I said. We send out 200 million notices a year. So the vast amount of our collection is done that way, and that stays fairly steady.

Our problem is, to the extent people write back and disagree, then we have an audit. And our limited ability to audit starts to run down, and that is where the decline in revenue agents and officers, which we are now tracking separately, goes down.

Somebody asked about revenues. Say the average revenue agent generates between $1.5 million and $1.8 million a year. So on the incremental basis it is why we say, if we could restore the agents and officers, we can guarantee you we would give you more money back, by far, than you gave us for that purpose.

But otherwise the voluntary compliance system has continued running appropriately and effectively. My concern is, I just don't want to do anything that jeopardizes that.

Mr. CRENSHAW. I would just encourage you, this is like priorities in terms of customer service. I mean, you know where the revenue comes from, and I would think those, you would want to make that a priority. If you only have so much money, you have to decide where you are going to spend it.

Mr. KOSKINEN. We do that.

Mr. CRENSHAW. And I think you are doing that to a certain extent. But that really is the bottom line on any kind of agency.

I am bothered sometimes when I hear you say: Well, if we just had a little more money we would have collected more revenue. If you listen to GAO, they will tell you: You give us an extra dollar and we will save you $69. And I always say: What if we gave you a trillion dollars, would you save $69 trillion? And I know you are not saying that, but just keep that in mind.

Mr. KOSKINEN. I agree.

Mr. CRENSHAW. We collect more revenue with less dollars, but make sure we are spending our money in the right places to keep that collection going.

Mr. KOSKINEN. And the advantage of having this discussion in the face of 6 years of decline, until this year, is that we can track the number of cases, collection cases we are not pursuing where we know there is money owed. So it is not the theoretical. "There is an unlimited amount of money out there." There is not an unlimited amount of money. The tax gap, actually, you couldn't collect all of that.

But at this point you can talk to the heads of our Criminal Investigators or Wage and Investment, Small Business people, and they will tell you, without revenue agents and officers, the rate of examination is going down. But more importantly, as we have collection cases, we are just going after fewer of them.

I have talked to over 20,000 IRS employees personally. And when you talk to them, their concern is that—the revenue agents particularly—is that they know the money is there and they just don't have the time and the people to get it. And as we shrink—and we will shrink more this year—there is going to be less of that.

I am not saying we would have collected a billion billions, but we have committed that if you funded the enforcement, we would get you $46 billion net over the next 10 years.

Mr. CRENSHAW. I understand that. I would just encourage you to, if you know that is there, then you ought to find money in other places. That seems to be an important function, and if you do that more efficiently you will get the money.

Mr. KOSKINEN. Well, yes, but you have to understand, on enforcement, the easiest thing to do we would just take rich people and big spenders, because that is where the biggest differentials are. The minute we don't provide audits across the entire income spectrum, preparers are very smart and they have large numbers of clients, they can see, because they know which clients they are hearing from, they will notice. And the minute we are not providing oversight, even though it is at a lower rate, in a particular area of the economic range, that is where you are going to see the next frauds. And the bulk of money is collected from the bulk of people in the middle of the bubble.

Mr. CRENSHAW. I just want to encourage you to make that a priority. You have a lot of money, you spend it in a lot of different places, and I know everything is important, but some are more important.

Mr. KOSKINEN. I would say we don't have a lot of money. We have a lot of money from the standpoint of any individual. In terms

of how the operation of the agency goes, we do not have a lot of money. We have $900 million less than we had 6 years ago.

Mr. CRENSHAW. And you are collecting more revenue.

Mr. KOSKINEN. Right. Our customer service has not been good and we are losing $5 billion a year on the revenue we know is out there.

Mr. CRENSHAW. But it is more than you had 5 years ago.

Mr. KOSKINEN. And the $900 million, as always, nobody has ever disagreed, costs you about four to five times as much in lost revenue.

I think it is appropriate to look at performance, and we are a businesslike operation with the accounts receivable of the government. And so to underfund the accounts receivable, when you know there are accounts out there you should be collecting, doesn't seem to me to be the most sensible way to run the business.

Mr. CRENSHAW. No, but I guess you could argue, if you collect more revenue with less money, then maybe if you had even less money you would collect even more revenue. But I think there are other factors, we all agree, that go into that.

Mr. KOSKINEN. And I guess my bottom line—because I only have another one of these years and then I am going to run out of my tenure—my bottom line concern is that when we have undercut the effectiveness of the Agency, you won't see it immediately, we won't see a 1 percent decline.

Mr. CRENSHAW. We don't want to see that happen. I am with you 100 percent.

Mr. KOSKINEN. OK, but we are getting very close to the edge, if we are not over it.

Mr. CRENSHAW. OK. Mr. Serrano has a parting comment.

Mr. SERRANO. There is the temptation to say that if we are collecting more money, then the President Obama economy is strong. But I won't do that. You will tell me it is just that taxes are higher and we will get into that back and forth.

Quick statement, and then you could comment on it if you wish. It is not in the form of a question. But I am still not convinced, I have never been convinced, about the private debt collectors. I don't like them. It makes me nervous. And I know it can be abused. These folks get a bounty. A bounty means that you go hard to make sure you collect and how you treat people.

I am one of those Members of Congress, and there are more than we think, it is just that they don't say it out loud, who has great respect for government employees, government workers. I have great respect, for instance, for the people who sit behind us.

If the American people knew the average age of the people who run Congress behind the scenes, behind the work that we do, they would be very grateful and know that the country—the last time I looked the country is still the greatest country on Earth, and there are a lot of young people involved in running it on a daily basis, at least running the Senate and the House.

But I worry, and I hope that as time goes on and this begins to be developed that you keep us informed on whether or not I was wrong or I was right on the fact that there will be abuse, and that it is better to have people who are on the payroll now, people who have been around a while, collecting that debt, rather than having

people who don't have the government as their sense or center point, but rather just collecting the dollars.

And that is my statement. If it's a question and you want to comment on it, it is up to you.

Mr. KOSKINEN. It is an important statement. It has been controversial. We have tried private debt collection a couple times in the past, and it hasn't turned out to be efficient or effective.

It is not our role to second-guess that decision. And that is why I want to make it clear we are committed. It is a statutory mandate. We should take this program. We are committed to doing everything we can to make it work. We want to protect taxpayers. We want to make sure that we don't build in problems for them, which is one of the reasons I can't just go out and say, "Go collect debt," because I have a lot of things we have to do around it.

But we really do want to make sure that we do everything we can to make it work, because it needs a fair shake. And we are documenting with the IG, as well, all of the steps we are taking. We have tried to learn from what happened before, and if there were issues that we could have improved on the last couple times, I said we need to do that.

Because if it works, that would be fine and we would have a fair choice at it. If it doesn't work, we will have done everything we can to make it work, and then everybody will be able to decide, OK, we had a fair test of it, we worked hard, and it didn't work.

Our goal is to make it work. We recognize the issues around it. But the Congress has said you should do this, and our response to what the Congress tells us to do is we do everything we can to do it as quickly as we can.

Mr. CRENSHAW. Thank you.

Mr. Amodei, do you have anything further?

Mr. AMODEI. Thank you, Mr. Chairman. I guess I am going to be staying out past my curfew today.

I appreciate the comments of my colleague who is the ranking member in that. There are a couple of things going on here where you are, although some days I am sure you feel like it, are not held to a perfection standard. Government employees make mistakes from time to time.

So to hold this thing, I am not sure that is what is being attempted, but to hold the concept of this statutory mandate, which was signed by the President, so for anybody with a C or above, in government it is like, well, that kind of makes it the law of the land at the moment. To hold that to a perfection standard, I can tell you right now, you are going to be disappointed, because there are human beings involved. That is like holding Members of Congress to a perfection standard, members of executive agencies to a perfection standard, and all that.

But in the context of the testimony that I believe is absolutely accurate from the Commissioner, that we have a very large amount of money that is due to the government, legitimately, that, quite frankly, isn't collected, to explore this as a possibility, and especially with your testimony, Mr. Commissioner, that we want to try to give it every fair chance and do it right, so we are going to report back within the 90 days or whatever, it is like OK. And if it fails, then that is fine.

But I think sweeping generalizations in terms of it can only be done by your employees or it should never be done in another context are things that, quite frankly, aren't open. If it falls on its face, then that will become evident. I appreciate the fact that you want to cover yourself, to say we put all the gas in the tank it could hold and it didn't get there, or if it does get there it is like, OK, this is part of it.

But to take a tool that is in the box and not try to use it and leave it in the box, I think is one of the reasons that gets us all criticism in government, whether it is the executive branch or the legislative branch.

So I look forward to hearing what you folks have done in 90 days with those already-working-for-the-government folks and then how the program proceeds. And, hopefully, you will pick folks that don't make as many mistakes as those of us in government do, and that will be a rousing success. And if they do make as many mistakes as those of us in government, then we will deal with what comes.

Thank you. I yield back.

Mr. SERRANO. Mr. Chairman, if I may?

Mr. CRENSHAW. Yes.

Mr. SERRANO. Because the gentleman made a very interesting point.

Your comment would be perfect if we had never tried this before. We have tried it and it hasn't worked. The experience has not been a good experience.

And that is my concern, that there are some people heck bent on making this part of how government collects money. And the experience we have had in the past was not good. We had complaints about people being harassed, we had complaints about people going to the door really as, I hate to say it, as bounty hunters.

So I just have a certain respect for people who understand what the parameters of their behavior are in government. But I understand your point, and your point would be extremely well taken if we have never tried this before.

Mr. CRENSHAW. Maybe it will work this time.

But we thank you for being here today, for your time, and are really encouraged to hear some of the efforts you are making in terms of customer service, in terms of modernization. It is a tough job. But we thank you for your service, and we thank you for your testimony today.

This hearing is adjourned.

Financial Services and General Government Subcommittee Hearing on the Internal Revenue Service Budget QFRs

Chairman Ander Crenshaw

ABLE Act

On December 19, 2014, Congress passed the Stephen Beck, Jr., Achieving a Better Life Experience (ABLE) Act of 2014, adding section 529A to the Code to enable states to create qualified ABLE programs for people with disabilities. On June 19, 2015, the IRS published proposed regulations implementing the provision. As stated on Treasury's Statement of Regulation Priorities for 2016, Treasury and the IRS intend to finalize the regulations during the 2016 fiscal year, taking into account all comments received.

1. Does the IRS still anticipate publishing final regulations during fiscal year 2016?

IRS response: Yes, final regulations under section 529A enacted by the ABLE Act are included in the 2015-2016 published guidance plan and we anticipate publishing the final regulations during fiscal year 2016.

2. How has the IRS worked with the Social Security Administration on coordination of implementation of ABLE programs?

IRS response: The IRS has coordinated with the Social Security Administration (SSA) on the implementation of ABLE 529A accounts since February 2015. Early in the planning process, the IRS worked closely with SSA on the development of the codes used to identify the designated beneficiary's category of disability. The category information is reported to the IRS by ABLE programs on Form 5498-QA (ABLE Account Contribution Information).

Upon release of the proposed regulations for 529A, the IRS met with both SSA and the Centers for Medicare and Medicaid Services (CMS) to discuss the status of the guidance each organization was preparing to support ABLE program implementation by the States, and to coordinate timelines and information sharing procedures across the three organizations.

The IRS provided copies of written comments submitted by the public on the proposed 529A regulations to SSA and CMS, and both organizations were invited to attend the October 14, 2015, IRS public hearing on the proposed regulations. Immediately following the hearing, all three organizations met to discuss the comments received from the public and how best to address stakeholder feedback.

Since October 2015, the IRS, SSA, and CMS have conducted monthly coordination calls. These calls support effective communication and coordination across the three organizations so that the States have the information and guidance necessary to

implement ABLE programs. The coordination calls will continue until all three organizations have published the final regulations, rules, and guidance related to ABLE 529A implementation.

The IRS "Future State" Plan

3. Regarding the IRS's "Future State," what is the IRSs' timeline for soliciting input?

IRS response: We are continuously soliciting input both internally and externally and, as we are developing related future state plans, we will further our efforts to gain taxpayer and tax industry perspectives. We also are working with numerous stakeholder advisory groups established for the express purpose of getting the taxpayer and tax professional perspective. These groups include the Internal Revenue Service Advisory Council (IRSAC), the Information Return Program Advisory Council (IRPAC), the Tax Executive Institute (TEI), and the Electronic Tax Administration Advisory Council (ETAAC) . We continue to gain insights through our periodic surveys of taxpayers about their service channel interactions, preferences, behaviors, and experiences with us in service or enforcement transactions. Additionally, we are continuing briefings with Congressional committees with IRS jurisdiction, along with other key stakeholders as the Future State vision development progresses. We are actively informing both employees and taxpayers about the Future State with continuous updates to our Intranet site and external website (www.irs.gov) and welcome feedback. As you may know, the National Taxpayer Advocate is hosting public forums on the Future State, which will also afford additional insight and reaction to the Future State.

4. How does the IRS plan to engage and seek input from the American taxpayers and tax preparer community? Within the IRS' "Future State" the IRS plans to reduce telephone and face-to-face services.

IRS response: Beyond the answer to Question 3 above, please know our objective is to provide better, not less, service to all taxpayers, including taxpayers interacting with us by phone or face-to-face. Our future state will enable those taxpayers who choose to interact with us online to do so, effectively easing the traffic on the phones and walk-in offices and thereby allowing us to better serve the taxpayers that use those channels more quickly. Additional funding provided to the IRS this year has also allowed us to improve telephone level of service to 72 percent so far this filing season, as of April 23, 2016. IRS.gov has been accessed more than 326 million times so far this filing season, which is nearly 5 percent more than last year.

5. When does the IRS plan to reduce telephone and face-to-face services?

IRS response: The IRS is committed to serving taxpayers on the service channel they choose, and does not plan to reduce services. We recognize, however, that many taxpayers increasingly want to interact with us online for some transactions, so we are making as many services as possible available through that medium. Ultimately, once a secure online tax account is available, those taxpayers who prefer to conduct their

business online may also be able to resolve tax account issues. Other taxpayers who are more comfortable interacting by phone or in-person will be able to get through to IRS assisters faster as well as those taxpayers who have more complicated issues that require a dialoguerather than simply information about how to resolve an issue.

6. What type of online accounts does the IRS seek to create for taxpayers to be able to obtain information and interact with the IRS?

IRS response: The IRS has partnered with the US Digital Service to develop a state-of-the-art authentication solution and beta testing of taxpayer accounts with secure access is scheduled to begin in staged releases during fiscal year 2016. This will include the ability for taxpayers to view their balance due, make payments, view payments, and access tax transcripts.

Tax accounts will ultimately be available in a secure online manner for each type of taxpayer—individual, business, tax exempt, etc.—for the authenticated taxpayer as well as those individuals whom the taxpayer has authorized access, such as a tax professional or a family member with a power of attorney. The development of such taxpayer accounts will be done in a measured, and iterative manner, taking into account the complexities of different types of taxpayers. Many of today's online offerings, such as Where's My Refund, as well as others being developed, could be addressed through an online account. We are also launching a test of secure electronic document transfer between IRS employees and taxpayers, which could substantially reduce the time now taken in mailing documents back-and-forth.

7. How much has the IRS spent to create these online accounts?

IRS response: As described in question 6 above, the envisioned online account will be developed and deployed in a measured, iterative manner over multiple years and the cost is determined in a similar iterative manner. From the end of FY2014 through the first quarter of FY2016, the IRS IT organization has spent approximately $17 million establishing contracts to support the Online Account effort. The funding includes development and testing for the online account features, enhancement of e-authentication capabilities to support Online Account and other future Web Applications, and the Web Applications Program Management Office to oversee development and testing of the currently planned Online Account features and future Web Applications' capabilities. Additionally, we have used approximately $3 million in labor for all IRS team members supporting Online Account. The FY 2017 President's Budget requests a funding increase of $5.1 million and 9 FTE to support Online Account development , which is in addition to base resources (plus inflation) currently dedicated to this critical effort.

IRS Security Summit

Each year many taxpayers file their taxes to find that someone else has already used their stolen identity to fraudulently claim a refund. The IRS recently held a Security Summit to address fraudulent refunds and how to address this problem.

8. Are there plans to hold another Summit? Who will participate?

IRS response: The work begun at the Security Summit last spring is ongoing and the Summit partners will meet again after the filing season to review 2016 activities and work on plans for 2017. The Summit partners include representatives from the tax software industry, electronic refund payment processors, state tax administrators, financial services and tax professionals, and other industry leaders.

In the FY16 Omnibus, the Committee asked Treasury's Office of Tax Policy (OTP) and the IRS Office of Research, Analysis and Statistics to conduct a data-driven analysis to improve EITC compliance in collaboration with the tax preparation community and submit a report to the House and Senate Appropriations Committees, not later than June 2016.

9. Have OTP and IRS started preparing the report? Has an organizational meeting occurred? If so, does the Department expect to meet the June deadline?

IRS response: The IRS Office of Research, Analysis & Statistics and Treasury's Office of Tax Policy (OTP) have met and are collaborating on the report. At this time, we have not identified any barriers to providing a report on our efforts to conduct such analysis by the June deadline.

Electronic Filing Identification Authentication

10. What is the IRS' concerns surrounding increased Electronic Filing Identification Number (EFIN) fraud?

IRS response: An EFIN allows a preparer to become an authorized IRS e-file provider. Preparers must submit an application and undergo a screening process. EFINs allow for the successful transmission of millions of electronically filed tax returns. The IRS validates a person before assigning an EFIN through a suitability process, which includes checking professional credentials, reviewing fingerprint cards, and checking tax account indicators related to identity theft. The IRS monitors closely for signs that an EFIN has been shared, stolen, or sold, and deactivates EFINs as necessary.

11. How does the IRS plan to keep up with criminals and cyber criminals who steal tax preparers' electronic filing indemnification number?

IRS response: Since 2012, the IRS has been using a system to detect when EFINs are used by individuals not associated with the owner of the EFIN. When fraud is discovered, the compromised EFIN is deactivated and a new EFIN is generated to the true owner.

12. Will the IRS be automating this process?

IRS response: The suitability, assignment, and detection processes all take advantage of automated tools.

13. How does the IRS verify and authenticate an EFIN upon receiving a return?

IRS response: When the IRS receives a return filed electronically, the system matches the EFIN against the IRS's record of valid EFINs. A return submitted using an invalid EFIN is immediately rejected and the return is not processed.

14. What has the Commission done to ensure that bad actors don't steal professionals EFIN?

IRS response: The IRS communicates the importance of safeguarding an EFIN through meetings with software developers and transmitters, e-mail alerts, monthly industry discussions, and news releases. The IRS also uses its publications and IRS.gov to discuss identity theft and the importance of safeguarding an EFIN. Continued and expanded collaboration with industry through the Security Summit is helping the IRS to develop new tools and procedures to safeguard EFINs and combat identity theft.

Refund Fraud Information Sharing and Assessment Center

The IRS' Security Summit report plans to look at establishing an Information Sharing and Assessment Center to help break down government barriers that unintentionally get in the way of stopping tax refund fraud and taking a more proactive approach to refund fraud.

15. Is the IRS currently developing this center and when can we expect to see some results?

IRS response: Consistent with Executive Order 13961, Promoting Private Sector Cybersecurity Information Sharing, the IRS is assessing the feasibility for development and implementation of an Information Sharing & Analysis Center (ISAC). The ISAC will be designed to centralize, standardize, and enhance data compilation and analysis in order to facilitate the sharing of actionable data and information within the legal parameters of Internal Revenue Code section 6103. The IRS is currently working with a Federally Funded Research and Development Center to study current processes, develop attributes, and recommend a best process for establishing a permanent ISAC as early as filing season 2017.

16. What resources have the IRS committed to this center?

IRS response: The creation of this Center is being funded in FY 2016 using $1.7 million of the $290 million provided by the Congress this fiscal year. We thank the Congress for funding this critical capability that will continue to reap benefits in our fight against identity theft and fraud well into the future. In addition to the robust, enterprise-wide identity theft prevention and anti-fraud program currently in existence, the IRS is using the additional funds to operate pilots, assess the existing fraud evaluation and information

sharing processes, and to develop an all-inclusive ISAC for purposes of timely sharing information and data related to cyber-threat assessments and identity theft refund fraud.

IRS Determination Letter Program

The IRS plays a key role in the continuation of defined benefit plans, not just through its rulemaking process, but through its regular issuance of determination letters that provide certainty as to the qualified status of the plan.

IRS Announcement 2015-19 states effective January 1, 2017, with some exceptions, it will no longer provide determination letters to plan sponsors, instead assuming that plans will use one size fits all, prototype plans.

17. If the IRS eliminates the determination letter program for all plans, how will the IRS provide pension plans that have the most significant need for the assurance that determination letters previously provided? Please explain why this would or would not be viable.

IRS response: As set forth in Announcement 2015-19, the IRS will continue to offer determination letters to new retirement plans, so that employers adopting new plans may be assured that the plans are compliant, as well as to terminating retirement plans. At other times, such as when a plan is amended, determination letters may be available, under specified limited circumstances identified by the IRS and Treasury, taking into account IRS resources, current inventory of work, and public comments, especially when amendments concern new products or provisions as a result of any new developments. In addition, Notice 2016-03 provided that as of January 4, 2016, determination letters for individually designed plans will no longer have expiration dates and that expiration dates in letters issued earlier will no longer be effective so that plan sponsors may rely on those letters for specific plan terms until those plan terms or any related statutory requirements change. Announcement 2015-19 also requested comments on all the various issues raised by the modifications to the IRS determination letter program, and stakeholders have submitted many thoughtful comments that the IRS continues to consider. Initial efforts to facilitate compliance have also included an expansion of the preapproved retirement plan programs to include more types of retirement plans. Using these plans, employers have access to a variety of plans to fit their needs and may obtain the assurance of a determination letter. In addition, the IRS continues to explore how the Employee Plans Compliance Resolution System (EPCRS), a highly successful program permitting retirement plan sponsors to correct noncompliant plans in the least burdensome manner while still protecting participant interests, may best be adapted to reflect the changes in the determination letter program.

18. How has the IRS considered ways to make it easier for plan sponsors to comply with the qualified plan document requirements?

IRS response: The IRS is exploring many avenues to make it easier for plan sponsors to comply with the qualified plan document requirements. As expressed in question 17 above, one avenue is to increase the breadth of the preapproved plan programs. In this vein, the IRS recently published guidance intended to facilitate sponsors moving from individually-designed plans to preapproved plans, and will continue to look for other ways to lower the obstacles for such changes. The IRS is also engaging stakeholders in discussions and otherwise considering how to most effectively address statutory and other changes that result in required plan amendments, such as reexamining the remedial amendment period during which plans may operate in compliance while waiting to make written plan amendments, expanding and clarifying the use of incorporation by reference to minimize the need for certain amendments, and expanding the publication of model plan amendments and other related guidance.

Addressing Fraud and Filing Errors in Refundable Credit Programs

In the FY16 Omnibus, Congress asked Treasury to review tax forms and instructions as well as paid preparer due diligence requirements in an effort to reduce intentional fraud and unintentional filing errors in refundable credit programs.

19. What has the IRS done with respect to the requirement to address fraud and filing errors in refundable credit programs?

IRS response: The IRS prevents $3 billion in questionable Earned Income Tax Credit (EITC) claims from being paid each year through its identity-theft and fraud prevention enforcement programs. In addition, the IRS protects between $3 and $4 billion in total revenue each year through additional EITC-related taxpayer compliance activities. The IRS also addresses paid preparer error through its EITC return preparer strategy that protects $465 million in EITC and Child Tax Credit claims. This year the IRS has expanded its compliance efforts around the Child Tax Credit and the American Opportunity Tax Credit, conducting additional examinations and mailing additional letters to encourage self-correction.

The IRS plans to hold an EITC Summit with EITC partners to obtain new ideas and cooperative efforts moving forward. We plan to kick off the summit in May. Towards the end of this summer, we plan on issuing a report containing the findings and suggestions on how to improve participation and compliance. However, without additional authorities granted to us by Congress, our ability to reduce payment errors in benefit programs administered through the tax system remains extremely challenging. The IRS continues to work with the Department of the Treasury, which supports other legislative changes beyond those recently provided in the Consolidated Appropriations Act of 2016 that will help us improve compliance and reduce overclaims related to refundable credits. For example, IRS currently identifies more suspicious EITC claims than we have audit resources to address. We believe that if Congress were to provide the IRS with authority to correct more errors during processing (correctable error authority), we would be able

to adjust additional improper EITC claims without the need to conduct a full audit of the taxpayer's return. Also, enactment of proposals to require minimum education standards for paid tax preparers, would provide taxpayers with improved preparer choices and the IRS with more accurate EITC returns. Finally, approval of the increased IRS funding in the President's FY 2017 Budget proposal would allow us to expand our enforcement efforts to address improper EITC payments and fraud.

20. Can the concept of "preparer due diligence" be easily applied to individual taxpayers who complete their own returns?

IRS response: The concept of "preparer due diligence" is not easily applied to individual taxpayers who prepare their own returns. Taxpayers must already attest, under penalties of perjury, that the information on their return is correct and complete. In contrast, preparers, who have no knowledge of their own about the taxpayer, are required to be diligent in preparing returns that are consistent with information obtained from the taxpayer. Due diligence requirements apply to preparers to show that they interacted appropriately with the taxpayer and did not ignore the implications of information furnished to or known by the preparer.

21. Would requiring forms or procedures to be identical across methods of tax preparation increase filing burden unnecessarily? Would it make it more difficult to customize questions and information to specific groups and to react quickly to new compliance threats?

IRS response: When possible, changes to forms and procedures should be tested and based on evidence that they will improve compliance or reduce burden. Requiring forms or procedures to be identical across methods may increase filing burden unnecessarily, and such a requirement would reduce our ability to react quickly to new compliance threats by customizing questions and information to specific groups. Also, the purpose of the specific questions that are required of paid preparers is to help preparers understand what the due diligence requirements are and to provide a uniform tool for determining that the requirements have been met. The IRS is currently reviewing the existing EITC preparer due diligence checklist and, in accordance with recent legislation concerning procedures to reduce improper payments, will be reporting its findings later this year. We are also testing questions for Schedule EIC, with a goal of increasing compliance without reducing participation or greatly increasing taxpayer or preparer burden.

TUESDAY, FEBRUARY 23, 2016.

OFFICE OF MANAGEMENT AND BUDGET

WITNESS

HON. SHAUN DONOVAN, DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET

Mr. CRENSHAW. Well, good afternoon, everybody.

This hearing will come to order.

Today, we will hear from the OMB Director, Shaun Donovan, who has the dubious distinction of submitting for the first time in our Nation's history a $4 trillion budget.

This record level of spending corresponds with a record level of revenue; however, it still isn't enough to balance the budget. So another $600 billion is added to the Federal debt, which, in gross terms, now exceeds $20 trillion for the first time. It took 233 years to incur the first $10 trillion in debt, and it took only 8 short years to incur the next $10 trillion in debt.

Now, the only way to retire the Federal debt is for spending as a percentage of GDP to be lower than its historical average and for revenue as a percentage of GDP to be higher than its historical revenue. The budget before us, however, projects that both spending and revenue as a percentage of GDP will remain above their historical average through 2026. In other words, this budget is a permanent source of debt.

As a percentage of GDP, gross debt hovers around 105 percent. Now, that is a level that has not been seen or tolerated since the end of World War II. And I think we would all be a little afraid if the country became acclimated to this level of debt.

So make no mistake, it is an economic burden that threatens the living standards of future generations. As such, I am disappointed that the administration's final budget request to Congress did not propose any substantive entitlement reforms to prevent any further intergenerational inequity, let alone not one substantial entitlement reform in the last 8 years. Back in 2000, there was talk about retiring the Federal debt by 2013, and now the Federal debt has eclipsed our GDP.

Now, the Office of Management and Budget has the great responsibility of constructing a budget that reflects the President's vision for our country. And because of this responsibility, I believe OMB has an even greater responsibility to be judicious and deliberate with its own budget request. And so, today, I hope not only to have an informative discussion about OMB's appropriations request but also to dive into some of the important policies and assumptions included in the President's overall request.

For fiscal year 2017, OMB is requesting a 6-percent increase over last year's level. That is just a little bit under $101 million. In ad-

dition, the budget requests a significant increase for OMB's IT account, at 17 percent over last year.

Now, I appreciate the strides the administration has made to improve the use of IT resources all across the government to increase efficiency, to reduce waste, and identify savings. However, at a time where our Nation is incurring significant debt for generations to come, I think OMB should be exercising even greater fiscal restraint.

And may I remind the Director that when the President first took office in 2008 OMB received $78 million. Therefore, I believe your agency, again, has a greater duty to lead by example and to live within the means of your own budget.

I would also like to discuss the role OMB has in strengthening Federal cybersecurity and the steps the Federal Government is taking to prevent the kind of IT failure we saw with the breaches of OPM's background security and personnel database. More and more, we are seeing threats to our national security via cyber attacks on our networks and operating systems. OMB's role in guiding and coordinating cyber policy is very, very important.

Today, I hope we can talk about the Department of Labor's proposed fiduciary standard rule. As you know, last month, the Department of Labor submitted its rule to redefine fiduciary standards to OMB for its mandatory review. I will have some questions about this because OMB has the critical task of reviewing all the Federal regulations to ensure all proposed regulations keep pace with modern technology, promote the changing needs of society, and avoid duplicative and inconsistent policies.

I believe the Department of Labor's rule will significantly harm low- and middle-income investors seeking financial advice regarding their retirement and will cause unintended consequences to many Americans' IRA accounts by limiting their access to investment advice provided to many small account holders. At a time when many Americans lack adequate retirement savings, we should be empowering families to save more for retirement by preserving access to all forms of affordable investment advice.

And, finally, I want to talk some today about the administration's inadequate proposal to fund the Army Corps of Engineers. I am very disappointed the administration chose to ignore the importance of our Nation's ports and waterways. As we move toward larger post-Panamax ships, ensuring that ports are dredged deep enough to handle these larger ships is essential to secure America's place in a global competitive market.

For instance, in Jacksonville, Florida, my home district, JAXPORT, our local port, is a major economic driver in the community. JAXPORT supports more than 132,000 jobs and has an economic impact of about $27 billion in the northeast Florida region. And, unfortunately, the President's budget not only cut the Army Corps of Engineers' funding by 22 percent, but it doesn't fund a single new deep draft navigation project.

In order to modernize our Federal navigation channels, we need a budget that reflects the needs of our Nation's ports. And so I am hoping to hear from you, Director, today on why the administration woefully underfunded the Army Corps of Engineers and about the

decision to fund only one new start project in the 2017 budget request.

But, again, I want to thank you, Director Donovan, for taking the time to be with us today, and I look forward to your testimony.

And now I would like to turn to the ranking member, Mr. Serrano, for any opening remarks he might have.

Mr. SERRANO. Thank you, Mr. Chairman.

I want you to know that you just cost me a dollar. I bet someone that you would say something positive about the budget, and I didn't hear it. Maybe I skipped it.

Mr. CRENSHAW. Yeah, I said something nice about the IT stuff.

Mr. SERRANO. Yes, you did. Yes, you did.

Thank you, Chairman Crenshaw. I would like to join you in welcoming Shaun Donovan, Director of the Office of Management and Budget, to this hearing.

Today's hearing serves a dual purpose: We will of course discuss OMB's specific budget request for this year and delve into the new initiatives that will help coordinate government-wide responses to pressing issues. But we will also delve into the budget request as a whole and how OMB has helped to put together a coherent and cohesive product that reflects our Nation's values and addresses its needs.

That secondary role is especially important for this year's context, because this year our majority colleagues on the Budget Committee have taken the unprecedented step of refusing to invite Director Donovan to testify on the administration's budget. I think that decision is unwise at best.

With that in mind, I want to commend Chairman Crenshaw for his decision to hold a hearing today. I think it speaks well of the Appropriations Committee's more bipartisan nature. Although we may have differences of opinion about what our policy priorities should be, I am glad to know that the chairman believes that we should hear all sides of the debate.

And I am very serious and sincere about that, Mr. Chairman.

And I think it is especially necessary to hear what Director Donovan has to say about the fiscal year 2017 budget.

So I believe that the President's request, prepared with your counsel, creates a strategic plan that strengthens our economy and invests in working families by improving access to early and higher education as well as affordable health care, investing in our infrastructure, and partnering with local communities and businesses to create good-paying jobs and affordable housing. I commend OMB for your role in these efforts.

There is also much to discuss in OMB's request, as well, which totals $100.7 million in fiscal year 2017. This includes a relatively small increase of $5.7 million to help ensure you have the personnel and the tools necessary to meet these numerous responsibilities.

It is important to note that, out of the requested increase, $2.4 million are for unavoidable costs, such as salary increases, higher rental costs, and IT contractor support. The other $3.3 million would help OMB restore a portion of previous staff cuts at a time when OMB has taken on numerous new responsibilities mandated by Congress. OMB's current staffing levels are 7 percent below

2010 levels and would still be 5 percent below 2010 levels even if OMB receives its full 2017 funding request. We need to make sure that OMB has the resources necessary to do its job.

I am also interested in hearing about the implementation of the Cybersecurity National Action Plan and OMB's role in developing and coordinating Federal IT cybersecurity strategy and policy. I hope we will have a chance to discuss all these issues in further detail today.

Thank you for your service and for appearing before this subcommittee. I look forward to hearing about your priorities for 2017.

And I thank you, Mr. Chairman.

Mr. CRENSHAW. Thank you.

I would like now to yield to Mr. Rogers, who is the chairman of the full committee, for any opening statement he might like to make.

Chairman ROGERS. Thank you, Mr. Chairman.

Director Donovan, we are pleased to have you with us to discuss the President's fiscal year 2017 request for OMB as well as some recurring themes in the overall request.

This marks the eighth and final budget request under the Obama administration, which you have been a part of from the very beginning. While we may not agree on everything, I have enjoyed working with you over the years and appreciate your service to the country.

For fiscal year 2017, as has been said, you have requested $100.7 million, which is about $5.7 million over fiscal year 2016. These additional funds are proposed to hire more staff, raise pay and benefits, and for increases in rental and IT costs.

As you know, we are in very tight fiscal times, so any request for additional dollars is met with extra scrutiny in this committee. That is our job.

Your relatively small agency plays a critical role in overseeing the administration of the entire executive branch, and it is important that this committee assess the strength of the President's budget request as a whole.

As you are aware, in December, Congress and the President came to an agreement that set budget caps for fiscal year 2016 and 2017. So I am disappointed, not surprised, that this year's budget request seeks at every turn to circumvent the terms and the spirit of that agreement.

Year after year, this committee has rejected the administration's attempts to evade statutory discretionary spending caps by proposing new and unrealistic programs on the mandatory side of the ledger. And yet, here again, this budget, which you helped draft, shifts tens of billions of dollars from discretionary funding over to mandatory.

If we were to blindly follow the President down this path, by 2020 our country would spend more money on interest payments on the national debt than we would on protecting and defending our Nation. Instead of proposing real solutions to help get our Nation's fiscal house in order, the President has chosen only to exacerbate the problem.

And while I have sadly come to expect the budget request to be a political document, this year I am especially disappointed in two proposals in particular.

First, despite bipartisan efforts in the past several years to increase funding for medical research, this budget opts instead to politicize the issue, proposing the $1 billion Cancer MoonShot through mandatory spending, outside the terms of the balanced budget agreement and outside the scope of this committee's jurisdiction.

The same goes for the proposal related to our Nation's deadly opioid epidemic. Our country loses over 100 lives a day to heroin and prescription drug overdoses. That is over 100 families every day that lose a son, a daughter, a father due to this tragic scourge.

And don't mishear me. I have enjoyed working in a bipartisan fashion with the administration, with a number of dedicated individuals to curb the tide of abuse, to help save those lives and those families. I believe we have made some real progress, and I do not question their commitment.

However, when we receive a $1 billion proposal in mandatory funding to address this pressing problem, I do have to question the sincerity and seriousness of the request. It is unquestionable that funding for NIH and for treatment and law enforcement to fight against drug abuse are important, admirable goals that we all share on a bipartisan basis. But here we have to make tough choices and prioritize, and this budget request is completely devoid of that leadership. Again, I am not surprised, but I am truly disappointed.

And let's move on now to the global Zika virus emergency. The committee has received the President's supplemental appropriations request for Zika. We are reviewing it carefully. But I am disappointed you didn't take our committee's recommendation to use unobligated Ebola and other disease funds for the immediate response to Zika, which we offered to backfill as needed in the fiscal year 2017 bills.

I think you will eventually regret that decision. The supplemental you have requested will take time, will probably get mired in controversy, and will likely attract many requests for additional emergency funding.

We gave you a quick and easy path. You have chosen a much more difficult one that will only slow the response to Zika. And I am sorry you didn't take our advice and our permission to use those funds for Ebola and the other diseases for this immediate pending problem with Zika.

I look forward to discussing these issues with you further during the question-and-answer part of the hearing, and I want to thank you for being here and for your work.

I yield back.

Mr. CRENSHAW. Thank you.

And now, Director Donovan, we will turn to you for your testimony. If you could keep it in the 5-minute range, that will allow more time for questions. And your full statement will be made part of the record. So the floor is yours.

Mr. DONOVAN. Thank you.

Chairman Rogers, thank you for joining us today.

Chairman Crenshaw, Ranking Member Serrano, and all the members of the subcommittee, thank you for the opportunity to present the President's 2017 budget request for the Office of Management and Budget.

I want to first thank this subcommittee and the full committee for its work on the 2016 omnibus and the Bipartisan Budget Act of 2015. Together, we came together to avoid harmful sequestration cuts and enacted a spending bill that provided critical funding for both our defense and nondefense priorities.

The President's 2017 budget builds off the achievements we secured for 2016 and adheres to the funding levels authorized in the BBA. And we look forward to working with Congress to continue the progress we have made in moving the appropriations process back to regular order.

I also want to thank you for your support of OMB. Over the last 3 years, you have provided OMB with resources to halt the furloughs and staffing losses that threatened our ability to maintain the high standard of quality that we hold ourselves to and that Congress rightly expects from OMB. Restoring capacity allows us to deliver more value for taxpayers through improved program management, smarter regulations, and more identified opportunities for savings.

Under the President's leadership, we have turned around our economy and created 14 million jobs; the unemployment rate has fallen below 5 percent for the first time in almost 8 years; nearly 18 million people have gained health coverage as the ACA has taken effect; and we have dramatically cut our deficit by almost three-quarters.

The President's 2017 budget will help continue this economic and fiscal progress. It shows that investments in growth and opportunity are compatible with putting the Nation's finances on a strong and sustainable path. And it lifts sequestration in future years so that we continue to invest in our economic future and our national security and replaces the savings by closing tax loopholes, reforming tax expenditures, and with smart spending reforms.

The budget shows that the President and our administration remain focused on meeting our greatest challenges not only for the year ahead but for decades to come, making critical investments that will accelerate the pace of innovation, give everyone a fair shot at opportunity and economic security, and advance our national security and global leadership.

The President's request for OMB is $100.7 million, which will be used to support the staff we brought on board in 2015 to address our historically low staffing levels, as well as enable us to hire an additional 10 full-time equivalents. Our 2017 request supports the staffing levels we need to more effectively oversee program management and funding, including identifying opportunities for budgetary savings across more than 100 agencies and departments throughout the Federal Government.

OMB's request will also enable us to continue to play a central role in executing the President's management agenda. The additional resources will let OMB ramp up promising efforts and build on progress in a number of key areas. But I would like to specifi-

cally highlight our investments in supporting smarter IT delivery and stronger cybersecurity across government.

OMB is requesting $35 million for Information Technology Oversight and Reform, or ITOR, to support the use of data, analytics, and digital services to improve the effectiveness and security of government services.

The requested resources will help scale up particularly promising efforts like the U.S. Digital Service, which has already saved agencies millions of dollars and assisted with many of our toughest digital challenges. The 2017 request expands the central USDS team at OMB to work on additional projects and supports standing up Digital Service teams at 25 agencies across the government.

The ITOR fund also supports OMB's work on enhancing Federal cybersecurity. Strengthening the cybersecurity of Federal networks, systems, and data is one of the most important challenges we face as a Nation. To address these challenges, the President created a Cybersecurity National Action Plan that takes near-term actions and puts in place a long-term strategy to enhance cybersecurity awareness and protections. OMB will use ITOR resources to work with Federal agencies to implement these actions and to support timely and effective responses to cyber incidents.

Our efforts to help deliver a smarter, more innovative, and more accountable government extend to our regulatory responsibilities as well. The administration is committed to an approach to regulation that promises economic growth, competitiveness, and innovation, while protecting the health, welfare, and safety of Americans.

We continue to make significant progress on the retrospective review of existing regulations, eliminating and streamlining regulations to reduce burden and cost. Since 2010, agency retrospective reviews have detailed hundreds of initiatives that will reduce costs, saving more than $22 billion in the near term.

The responsibilities I have described here are in addition to our work with agencies to prepare and execute the Federal budget. And while some people think only about OMB's efforts on behalf of the President's budget, members of this subcommittee know that OMB works with Congress every day to provide information and analysis and to respond to contingencies and unforeseen circumstances.

I want to close by thanking you again for the opportunity to testify today. It is a particular honor for me to serve at OMB, given the critical role it plays and the talented individuals who work there.

Supporting OMB and the work we do to make government perform better for the American public will continue to be a smart and necessary investment, and I look forward to continuing to work closely with this subcommittee to that end.

Thank you. I look forward to your questions.

[The information follows:]

TESTIMONY OF
SHAUN L. DONOVAN
DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET

BEFORE THE
APPROPRIATIONS SUBCOMMITTEE ON
FINANCIAL SERVICES AND GENERAL GOVERNMENT
U.S. HOUSE OF REPRESENTATIVES

February 23, 2016

Mr. Chairman, Ranking Member Serrano, Members of the Subcommittee, thank you for welcoming me here today and for giving me the opportunity to present the President's Fiscal Year (FY) 2017 Budget request for the Office of Management and Budget (OMB).

Before discussing the President's request for OMB, I want to thank this Subcommittee for its work on the Consolidated Appropriations Act of 2016 and the Bipartisan Budget Act of 2015 (BBA). Together, we enacted a spending bill that will help grow the economy and benefit the middle class, and moved the appropriations process back towards regular order and away from manufactured crises. We look forward to working together to continue this regular order for FY 2017.

I am particularly grateful for this Subcommittee's support of OMB, which has allowed us to partially reverse the staffing losses that had threatened the agency's ability to maintain the high standard of quality that the Congress rightfully expects from OMB. Since early 2014, when staffing levels reached an all-time low, OMB has made a concerted effort to attract more of the high-performing civil servants that allow us to deliver more value for taxpayers through improved program management, high-quality analysis, and by identifying more opportunities for efficiencies and budgetary savings.

These additional resources and staffing at OMB have helped facilitate our work on the BBA, FY 2016 appropriations, and the submission of the President's FY 2017 Budget, which adheres to the funding levels authorized in the BBA and builds on the investments made in the Consolidated Appropriations Act of 2016. Formulating a Budget that is in line with bipartisan legislation is an important step in moving the Budget process back towards regular order.

The investments made possible by the BBA will help expand the economic progress we have achieved over the last seven years. The two-year period ending January 2016 marked the strongest two years of job growth since 2000. Businesses have added more than 14 million jobs over 71 straight months of private-sector jobs growth, the longest streak on record. The unemployment rate has fallen to 4.9 percent—dropping 1.7 percentage points since the end of 2013, one of the sharpest declines over the last 30 years.

The 2017 Budget continues this progress. It shows that investments in growth and opportunity are compatible with putting the Nation's finances on a strong and sustainable path. We are proud that the President's Budget meets the key tests of fiscal sustainability—reducing deficits to below three percent of GDP in the budget window, stabilizing debt as a share of the economy, and putting debt on a declining path through 2025—while making investments in innovation, opportunity, and national security.

The FY 2017 Office of Management and Budget Request

As you know, OMB plays a pivotal part in executing the President's budget, management, regulatory, and legislative agenda and ensuring that the Federal government works at its best on behalf of those it serves. OMB works with and across agencies to improve management and create a government that is more effective, efficient, and supports continued economic growth. In coordinating the review of Federal regulations, OMB focuses on protecting our health, safety and environment while promoting economic growth, job creation, and innovation. Through its role in helping develop, manage, and oversee agency budgets and its support of the appropriations process, OMB helps execute on the Administration's fiscal goals and key priorities. And we work to be a trusted and respected source of information for our counterparts in the Administration and for Congress, as well as for the public, as evidenced by the high-quality analysis conducted by OMB's excellent staff.

The President's FY 2017 Budget request for OMB is $100.7 million and 500 FTE. This funding level is necessary to support the staff we brought on board in 2015 to address our historically low staffing levels, as well as to enable us to hire an additional 10 full-time equivalents (FTE) as we continue to recover from those low staffing levels. Despite our recent gains in hiring, OMB's current staffing levels remain roughly 7 percent below where they were in 2010, while our responsibilities are growing, including new activities related to:

- Improving the Federal permitting and environmental review process for major infrastructure projects as envisioned in the bipartisan Fixing America's Surface Transportation (FAST) Act;
- Meeting new financial reporting requirements associated with the Digital Accountability and Transparency Act (DATA Act);
- Scoring legislation for PAYGO and publishing the PAYGO scorecard;
- Calculating sequestrable amounts for mandatory programs and issuing discretionary sequestration reports under the Budget Control Act;
- Coordinating the development and quarterly OMB reviews of Cross-Agency Priority Goals as well as establishing and maintaining a central Performance.gov site;
- Working with the Department of Defense and other agencies to modernize personnel security;
- Implementing the Federal Information Technology Acquisition Reform Act (FITARA);
- Implementing the remaining provisions of the recently enacted FAST Act; and
- Overseeing and coordinating intellectual property enforcement.

To fulfill our mission and perform the highest quality work, OMB made a concerted effort in 2015 to bring staffing levels back up to the pre-sequester level, resulting in a net increase of 57 staff. OMB's success is ultimately dependent on our ability to attract and support high-quality, dedicated people. Restoring our staffing levels is a necessary precondition for successfully carrying out our mission and conducting the activities that Congress has charged us with. Unfortunately, our 2016 appropriation was not sufficient to support these essential staffing increases, so we will have to make use of one-time savings to cover personnel costs. Our 2017 request includes the amount needed to support our 2016 staffing levels, plus 10 additional staff that will allow OMB to more effectively oversee program management and funding, including identifying opportunities for budgetary savings across more than 100 agencies and departments throughout the Federal government.

With our request, OMB would still be 5 percent below its 2010 FTE level.

In addition, $32.5 million and 112 FTEs are requested for the Information Technology Oversight and Reform Fund, which is further described below.

Creating a 21st Century Government

The President is committed to driving lasting change in how Government works—change that makes a significant, tangible, and positive difference in the economy and the lives of the American people. The President's Management Agenda focuses on four pillars: effectiveness—delivering world-class customer service to citizens and businesses; efficiency—enhancing productivity and achieving cost savings across the Government; economic growth—opening Government-funded data and research to the public to spur innovation, entrepreneurship, economic growth, and job opportunities; and people and culture—unlocking the full potential of today's Federal workforce and building the workforce needed for tomorrow.

The Administration is executing the President's Management Agenda through Cross-Agency Priority (CAP) Goals, which were introduced by this Administration to improve coordination across multiple agencies to help drive performance on key priorities and issues. Performance for each CAP goal is regularly tracked throughout the year and goal teams are held accountable for results, which are updated quarterly on Performance.gov. In addition to the Management Agenda, the Budget also supports the President's plan to reorganize the Federal Government so that it does more for less, and is best positioned to assist businesses and entrepreneurs in the global economy.

OMB's request will enable it to continue to play a key role in executing on the President's Management Agenda in order to make government work better for taxpayers. The additional resources will let OMB ramp up promising efforts and build on progress in a number of key areas, including:

Smarter IT Delivery: To keep pace with the innovation and user experiences that the public expects, the Administration has embarked on a comprehensive effort—the Smarter IT Delivery Agenda—to fundamentally improve the way that the Government delivers technology services to the public. This agenda is focused on recruiting top technologists and entrepreneurs to work within agencies on the highest priority projects, leveraging the best processes to increase oversight and accountability for IT spending, and ramping up Government contracting with innovative companies. This effort builds off the success of the U.S. Digital Service (USDS), a unit of innovators, entrepreneurs, and engineers that the Administration launched as a pilot in 2014. This team of America's best digital experts has worked in collaboration with Federal agencies to implement streamlined and effective digital technology practices on the Nation's highest priority programs.

In addition, we continue to invest in PortfolioStat, a data-based review of agency IT portfolios that has helped the Government achieve more than $3.5 billion in savings, while ensuring agencies are efficiently using taxpayer dollars to deliver effective and innovative solutions to the public.

Building on the support Congress provided in FY 2016, we are requesting $35 million for Information Technology Oversight and Reform (ITOR) to support integrated, efficient, secure, and effective uses of information technology in the Federal Government. The requested resources will help institutionalize modern systems design and development principles and invest in scaling up particularly promising efforts like the USDS. USDS efforts have included helping on top national priorities like the College Scorecard. Working alongside the Department of Education and 18F, USDS launched the new College Scorecard with the Department of Education to give students, parents, and their advisors the clearest,

most accessible, and most reliable national data on college cost, graduation, debt, and post-college earnings. This new College Scorecard provides students and families with information on college performance that can help them identify colleges that are serving students of all backgrounds well and providing a quality and affordable education. It empowers Americans to search for colleges based on what matters most to them and allows them to compare the value offered by different colleges to help improve their decision. Within the first month, the College Scorecard had over one million users, more than 10 times the users its predecessor had in a year. Over a dozen other organizations have used the Scorecard data to launch new tools to support students in their college search and application processes. In addition, this past September, a team of visual and user experience designers at USDS and 18F created the U.S. Web Design Standards. These standards set a new bar for simplicity across U.S. government websites, and they aim to make government tools more consistently built and more easily accessible to everyday people.

The 2017 request expands the central USDS team at OMB to support standing up Digital Service teams at 25 agencies across the government. The OMB USDS team will also continue to help coordinate cross-agency technology initiatives while serving as a resource for the small, high-impact agency teams that will tackle the most high-priority challenges faced at individual agencies. OMB will also use ITOR funding for training current Federal IT professionals to scale modern development practices across the workforce, to provide accountability to ensure agencies see results, and to recruit more highly skilled digital service experts and engineers into government. Additional ITOR funding will also help OMB work with agencies to ensure continued success in implementing the Federal Information Technology Acquisition Reform Act (FITARA), which is designed up deliver better value to taxpayers by improving federal IT acquisitions.

Cybersecurity. The ITOR fund also supports OMB's work on enhancing Federal cybersecurity. Strengthening the cybersecurity of Federal networks, systems, and data is one of the most important challenges we face as a Nation. As cyber risks have grown in severity over recent years, the Administration has executed a comprehensive strategy to address cybersecurity across the Nation. Building upon the Administration's broader efforts to enhance cybersecurity, in 2015 OMB in coordination with the National Security Council, the Department of Homeland Security, the Department of Commerce, as well as other departments and agencies, executed a series of actions to bolster Federal cybersecurity and secure Federal information systems through the Cybersecurity Sprint and Cybersecurity Strategy and Implementation Plan (CSIP). In 2015, these actions and others led to areas of significant progress across the Federal Government. For example, Federal civilian agencies have nearly doubled their use of strong authentication for all users from 42 percent to 81 percent. Challenges still remain, and the Federal Government has identified three primary challenges – outdated technology, fragmented governance, and workforce gaps. To address these challenges and continue moving the needle on cybersecurity, the President has set forth a Cybersecurity National Action Plan that takes near-term actions and puts in place a long-term strategy to enhance cybersecurity awareness and protections, protect privacy, ensure public safety and economic and national security, and empower Americans to take better control of their digital security. OMB will use ITOR resources to work with Federal agencies to implement these actions and to support responses to cyber incidents, where OMB plays a central coordinating role to ensure agencies are taking appropriate actions to effectively respond to cyber events and address any deficiencies in their cybersecurity programs.

Buying Better. OMB has also been centrally involved in efforts to simplify Federal contracting, streamline purchases, and expand shared services to make government more cost effective. For example, the Administration is shifting its approach to purchasing through the adoption of a Category Management model where the Administration will "buy as one" by creating common categories of products and services across Government. Through the application of best commercial practices as well as the collection and sharing of key performance information, we are improving how we acquire and manage common products and services to ensure that agencies get a more competitive price and better performance. This new model will allow our acquisition workforce to focus their time and energy on critical mission-specific procurement. Just one month after OMB issued a new category management policy on laptops and desktops that included standard configurations, several vendors dropped their prices for the standard configurations by 50 percent. Through this new way of buying agencies have already saved or avoided costs of $1.5 billion. By the end of 2019, we aim to save at least $10.5 billion on IT through category management and PortfolioStat in the areas of hardware, software, telecommunications, outsourcing and data center consolidation. As we scale this effort, it will lead to even more significant savings in the future. For instance, in the United Kingdom, the government was able to realize savings of roughly 10 percent from its adoption of category management practices and the Federal Government is the single largest buyer in the world with annual spending on goods and services close to $450 billion.

Using data to get better results. OMB has also been essential to efforts to establish cost and quality benchmarks in human resources, finance, acquisition, IT, and real property, allowing agencies to compare performance with peer agencies and the government-wide average and pursue efficiencies. Launched in 2014, this initiative allows agencies to see how their bureaus compare against each other, how they perform peer-to-peer, and their individual agency impacts on Government-wide averages. In 2015, in conjunction with GSA we expanded the Benchmarking program to include customer satisfaction metrics and created "FedStat" – a comprehensive review of agency management using the benchmarking data, agency strategic reviews, Agency Priority Goals and other data. As part of this initiative, OMB met with agencies to identify potential areas for improvement, discuss shared challenges across the Government, and explore opportunities to pursue cross-agency solutions—including policies, processes, and leading practices of excellence for broader application across program administration and management. These data-driven reviews led to a number of tangible improvements— such as how agencies may benefit from shared services or strategies for addressing common hiring and recruitment challenges—that can improve the effectiveness and efficiency of individual agencies and the Government as a whole.

OMB also plays a key role in helping work across agencies to deliver results for the American people. The Administration uses Cross-Agency Priority (CAP) Goals to deliver a more integrated approach to tackle a challenge, helping break down organizational barriers to achieve better performance and results than one agency can achieve on its own. For example, DOD and the Department of Veterans Affairs (VA) have partnered to improve veterans mental health. Through this collaboration, last year over 11,000 individuals participated in 144 VA medical center-hosted Mental Health Summits across the Nation in order to identify unmet needs and increase awareness of community-based programs and services for organizations supporting veterans and their families. Newly available data also shows that, for those servicemembers completing a Post-Deployment Health Reassessment in 2013 who screened positive for posttraumatic stress disorder (PTSD), depression, or alcohol abuse and received a referral to mental

health specialty, or behavioral health in primary care, 55 percent received care at VAs or DOD (2013), up from 46 percent in 2011, and nearing the target of 56 percent by 2016.

The CAP Goals are part of the performance improvement framework developed with Congress through the Government Performance and Results Act (GPRA) and the GPRA Modernization Act. Each CAP Goal has senior level Goal Leaders and publishes quarterly progress updates on Performance.gov. Agencies have also used the Priority Goal process to drive performance improvements. For example, HUD and VA have reduced the total number of homeless veterans; the Department of Justice has improved the protection of the most vulnerable within society, including victims and survivors of human trafficking, and the Small Business Administration has helped increase small business access to capital by adding new lenders to its flagship lending program. We appreciate this committee's support in granting authority in FY 2016 for OMB, with prior notification to Congress, to transfer up to $15 million from agency budgets to support these cross-cutting management initiatives. This institutionalizes a capability to fund cross-agency efforts and provides a powerful tool to turn management reform ideas into real and lasting results for the American people.

Cost-Effective, Evidence-Based Regulation. Our efforts to help deliver a smarter, more innovative, and more accountable government for the American people extends to our regulatory responsibilities. OMB is responsible for reviewing significant rulemakings and ensuring that our regulatory system is both cost-effective and evidence-based. The Administration is committed to an approach to regulation that promotes economic growth, competitiveness, and innovation while protecting the health, welfare, and safety of Americans, now and into the future.

The Administration continues to make significant progress on the President's unprecedented prioritization of the retrospective review of existing regulations. OMB is focused on rooting out regulations that are unnecessary or overly burdensome and streamlining, modifying, or repealing those regulations to reduce burdens and costs. Since 2010, the publicly released agency retrospective reviews have detailed hundreds of initiatives that will reduce costs, simplify the regulatory system, and eliminate redundancy and inconsistency. This effort has already produced completed actions that will save more than $22 billion in regulatory costs in the near term, with more savings to come. This work will continue to be a major focus for OMB.

By promoting health, safety and welfare, as well as reducing long run costs to the American economy, the net benefits of regulations issued through the sixth fiscal year of this Administration were about $215 billion when factoring lives saved and injuries prevented.

All of the responsibilities and efforts described above are in addition to our work with agencies to prepare the President's Budget and execute Federal budgetary policies, and our work with Congress. While some people think only about OMB's efforts on behalf of the President's Budget, OMB plays an important role as a steward of taxpayer dollars, working closely with agencies to ensure that Federal programs and services are well-implemented, cost-effective, and high-quality. Members of this subcommittee know that OMB also works with Congress every day to provide information and analysis, and in order to help respond to contingencies and unforeseen circumstances. Last year, OMB worked with Congress on the development, enactment and implementation of a supplemental appropriation to address the outbreak of Ebola, and is currently working with Congress on a package that would respond to the outbreak of the Zika virus. Our FY 2017 Budget includes a number of proposals that we look

forward to working with Congress on in the year ahead, including new investments in cancer research, funds to ensure that those struggling with opioid addiction can get treatment, and an expansion of tax credits that support work and reduce poverty for workers without kids at home.

I want to close by thanking you again for the opportunity to testify on OMB's FY 2017 Budget request. Supporting OMB and the work we do to make government perform better for the American public will continue to be a smart and necessary investment. I look forward to continuing to work closely with Congress and this Subcommittee as we continue to move toward regular order. Thank you and I would be glad to take your questions.

Mr. CRENSHAW. Well, thank you.

Let me ask you about your budget request of a little over $100 million. You got an increase last year. You are asking for a 6-percent increase this year.

As I understand it, your role is to say to the agencies what you ought to be asking money for and not spending yourself. I mean, you oversee the overall budget, and that is why I said earlier I think you have a particular responsibility in terms of fiscal restraint.

I know when I was chairman of the Legislative Branch Subcommittee of this full committee, I cut the Members' office accounts by 10 percent. It was a tough decision, but I thought we ought to lead by example. And if you look over the last 5 years, the budget of the House of Representatives has gone down by 16 percent.

And so when you ask for a 6-percent increase, I look at the request, and I think last year part of that increase was going to go for 25 new staffers and now, for 2017, another 10 new staff positions. Can you tell me how many of the 25 from last year's appropriation have been hired?

Mr. DONOVAN. We have fully hired to the staffing levels that you have provided in prior years.

And I think it is important to recognize, there is a significant piece of this—of the $5.7 million increase, $2.4 million will go just to inflationary increases that we have, whether staff, benefits, rent, those types of things.

I think it is critical for us to execute the additional responsibilities that we have been given, many of them by statute. I was very pleased that we reached a bipartisan agreement in the transportation bill last year, for example, to step up our efforts to streamline infrastructure permitting across the country. I think a very strong bipartisan effort there. We are bringing on some new staff to implement that effort. That is a good example.

Mr. CRENSHAW. So the 25 that we funded last year, they have all been hired?

Mr. DONOVAN. That is correct.

Mr. CRENSHAW. Okay.

Mr. DONOVAN. That is correct.

Mr. CRENSHAW. And then you need 10 more for next year, and you have roles for them to play.

Mr. DONOVAN. Absolutely. And, again, the DATA Act is another good example, a bipartisan effort that we need to bring on staff for. And, obviously, cybersecurity is an area where I think we can all agree.

I think one of the most important points I can make about this is that I think in all of these different areas we can demonstrate that the staff that we are bringing on are achieving substantial savings across the Federal Government, whether it is the Digital Service——

Mr. CRENSHAW. I gotcha.

Mr. DONOVAN [continuing]. Which is saving hundreds of millions of dollars——

Mr. CRENSHAW. You hired that first 25 pretty quick. And, you know, if you have the money to do it, you did it, and that is good.

Mr. DONOVAN. We have saved $3.5 billion in IT acquisition costs through the reforms that we have made. So the leverage on these staff, we think—and it is important that we show you the return on investment for those staff.

Mr. CRENSHAW. Gotcha.

Let me ask you a quick question about some of the work you do when you oversee all the different regulations that come before you. And, in particular, I mentioned in my opening statement the Department of Labor and the fiduciary standard.

As you know, we had this conversation last year, I believe the SEC, which we oversee and fund here, has the primary responsibility to look at our economy and make sure that things are safe and stable. And it seems like they would be the appropriate people to make a rule or regulation about fiduciary standards. In fact, when we asked Mary Jo White at the hearing, she said they are working on a rule to do that.

It seems like the Department of Labor has kind of just ignored everybody's input to say, you know, let's not duplicate, let's not make things overlap, and yet they just keep going, and keep going. They have heard from the Department of Treasury, they have heard from the different appropriators, different subcommittees, full committees.

And I guess the question is, if they are just going to kind of keep moving—then they come to you, and you have to ultimately review that. And my understanding is that you are going to expedite that review, and there might be a final rule sometime in April.

And so the question becomes, do you sit down and do a comprehensive cost-benefit analysis to make sure that—we all want to help investors. We all understand that with the stock market there are certain risks involved. So we want to help, but we don't want to help in a way that cuts off people's access to investment advice.

So before you kind of finalize that rule, do you do a cost-benefit analysis?

Mr. DONOVAN. Absolutely.

And let me just say at the outset, we do have, as you just noted, this rule under review at this point. So I am limited in what I can say on the specifics of the rule. But, generally speaking, it is one of our most important duties to ensure that cost-benefit analysis is done correctly and effectively, and we take the time necessary to ensure that that is done.

Also one of our most important duties is to ensure that there is interagency review of regulations. In this case, it is the Department of Labor's statutory authorities that they are putting into effect through the rule, but one of our jobs is to make sure that there is a strong interagency review of these rules before they are finalized.

Mr. CRENSHAW. So can you assure us that there is not going to be duplication or inconsistencies if you have a rule by the SEC and a rule by Department of Labor?

Mr. DONOVAN. What I can assure you is that we are going to do everything we can to minimize those. SEC is obviously an independent agency, so, while we consult with them, we don't have direct oversight over their rulemaking. But I can assure you that we will do everything we can to ensure that coordination.

Mr. CRENSHAW. And how do you go about making sure this proposed rule isn't going to have unintended consequences, and actually limit people's access, not adversely affect particularly some of the low- and middle-income Americans? How do you go about the process to make that determination?

Mr. DONOVAN. Well, one of the critical things that we do—and this is through an open, transparent process of meetings and comments that come into rules. I believe there were thousands of comments that were received and evaluated, hundreds of meetings that took place in the review of the rule. And so that is, obviously, the best possible way to have an open, transparent process that makes sure that concerns about any particular rule are incorporated.

Mr. CRENSHAW. And I guess you know there have been a lot of concerns—anytime you have a comment period, some people like it, some people don't—but there have been a lot of concerns raised, and not on a partisan basis, kind of across the board, people are just concerned that you don't overdo the regulation to really harm the people you are trying to help. So I just hope that you will continue to keep that in mind.

And, again, when we have the SEC Chairman before us, we will ask her how she's doing on her rule. Because, again, we don't want to see the inconsistencies, duplication that just create even more confusion.

Mr. DONOVAN. Well, again, I am not going to comment directly on the rule. I will say that Secretary Perez has made clear they are doing everything they can to streamline and simplify the rule while still maintaining the bedrock principle of a fair standard of protection for investors.

Mr. CRENSHAW. Can you tell us whether or not you are expediting the rule and when the final rule might be available? Or is that something you are not supposed to comment on?

Mr. DONOVAN. Even if I could tell you, I wouldn't know exactly when we would be finished here. What I can tell you is we are giving it a full interagency review, as I described.

Mr. CRENSHAW. Thank you very much.

Mr. Serrano.

Mr. SERRANO. Thank you, Mr. Chairman.

You have touched on it somewhat, but I want you to expand on it. You know, we have been in a certain kind of mood in the last few years—actually, more than a few years—of cutting, cutting, cutting the budget. And some Members feel that if we cut the budget, that is fine; that is what we were elected to do. But some of us feel that what made our country great was investing in our country also, investing in infrastructure, investing in education.

So how does the President's budget deal with those issues? And is it possible, do you think, at all in this climate—and I know this is more a political question than anything else—for any President to make Congress happy in terms of investing and at the same time not making them totally angry on spending?

Mr. DONOVAN. Well, I think you have hit on a core issue that we grappled with in the budget. But I will say that I think what we really did here was to build on a bipartisan precedent that we have seen now twice, with the Murray-Ryan agreement and then with the Bipartisan Budget Act last year. And that is basically to recog-

nize that sequestration, which I would really describe, in many cases, as mindless austerity, cutting just simply straight across the budget without reflecting, really, which are the critical investments—that, on a bipartisan basis, we came together last year to invest more on the discretionary side of the budget, but we offset it with both revenue increases and smart spending cuts on the mandatory side of the budget.

And that is exactly the model that we have been taking up in the President's budget. Not only are we living within the caps that were part of that budget deal, which provide substantial relief on the discretionary side for critical investments, many of which you described, but we also achieved $2.9 trillion in deficit reduction over the 10-year window through taking a look at where we can close loopholes on the tax side, where we can make smart spending reductions. We have $375 billion in healthcare savings over the 10-year window.

So we really think that is the right model, and it is a model that has been bipartisan that we have followed.

But what we can't do is continue to cut the very things that will help us make the investments that are going to grow our economy, whether it is the research and development that is so critical to keeping our innovation edge that we have over other countries, whether it is investing from the very youngest age in our kids, like we did with Head Start in the bipartisan agreement last year and we continue this year in our budget, in education and training and so many other areas that are critical to our short-term but also our long-term success.

Mr. SERRANO. I am glad that we are discussing that approach, Mr. Chairman, because one of my concerns and the way I always say it is, you know, somewhere right now in this country, in many places, there is a man and a woman somewhere in a lab, or a couple of men and women in a lab, in white coats working either on the next Velcro or perhaps finding a cure for cancer or the common cold. And we sometimes feel, it looks to me, like we are willing to even cut those areas, you know, that make us grow.

Do you think we are reaching at all that dangerous point? Or do you think that the bipartisan agreements we have had or some of the changing in tone that we have seen at times in the last couple years, which some people forget about—it hasn't all been rancor and discord at times—that we can get to a point where we don't jeopardize the investments we have to make in the future of the country?

Mr. DONOVAN. Well, I am hopeful, if we can not continue the model that we had of 3 or 4 years ago, between shutdown and the other manufactured crises that really hurt our economy, hurt confidence of individual families across the country and our businesses, but follow the model we had last fall, I think we really can make progress on these issues.

Because I think there is broad recognition that discretionary spending is not where our fiscal challenges are, that, actually, we are investing too little on the discretionary side, even with the substantial increase that we got in this budget deal, which we lived by in our budget, and that, really, where our fiscal challenges are are more on the revenue and on the mandatory side of the budget,

particularly around health care. And that is something that we have made a lot of progress on, bringing down our healthcare costs.

Mr. SERRANO. Mr. Chairman, one quick question. And this is a question that I run the risk that anybody under 30 in the audience will leave here shaking their head and saying, "How dumb can he be?"

But can we reach a point where the IT equipment we buy doesn't become obsolete 6 months later? Is that our ability to purchase improperly, or is it just that technology changes so quickly that we can't keep up?

Mr. DONOVAN. Well, no——

Mr. SERRANO. Because it seems that all the years I have been on Appropriations—I mean, there was the fiscal year 2000 where we thought we were going to all die and the country was going to go down the drain. But since then, one of the issues is how we pour money at times—pour money, honestly—you're hearing a Democrat say that—into IT and then, a year later, the department or that agency is saying it is obsolete.

Mr. DONOVAN. Yeah.

Mr. SERRANO. Is there any way to deal with that?

Mr. DONOVAN. Part of this is, clearly, the technology changes quickly. But the fact is, historically, the government has taken an approach that dramatically exacerbated that problem. A lot of this is in how we procure information technology, whether that is the individual devices that we use or how we procure software services.

And so two critical things that we are doing that we are making a great deal of progress on: One is we are moving aggressively to what we call category management. Instead of having literally thousands of different contracts across the Federal Government for laptops, for desktops, for handheld devices, we are going to a very small number of government-wide contracts.

As we started to implement that late last year in IT and particularly in devices, we saw a 50-percent decline in prices very quickly. How can that be, you say? Because, for example, right now, if you were going to bid on a contract, you have to look at potentially thousands of different contracts in different agencies with many, many different types of configurations. Instead, if we go to saying simply, let's choose three, four, five different configurations of a desktop or a laptop and make that the standard, we can actually dramatically improve the efficiency for the contractors themselves of doing business with us and bring the prices down. And we have started to see that.

On software procurement, which is a little more complicated, we have moved to what we call an agile system. It basically used to be that we would buy giant IT systems all at once, kind of in a big bang, and, by the time you get 4 years down the road, realize you are above budget, behind schedule, it is too late to be able to make changes and adjustments. Instead, what we are doing is buying, just like the private sector does, much more incrementally. And that is also really starting to make a difference.

I saw this, frankly, at HUD. When I came in, I had a giant financial services project that was above budget, behind schedule. And I came to OMB—this is the role that OMB can play. I came to OMB; they said, you know what, Treasury has actually got a sys-

tem that is very similar. And so we moved to what we call shared services where HUD now does all its financial transactions through its system at Treasury. Much more cost-effective.

And so those are the kind of techniques that, even if technology changes quickly, it allows us to be much more agile and responsive to keep up with those changes.

Mr. SERRANO. Thank you.

Thank you, Mr. Chairman.

Mr. CRENSHAW. Just real quick, do you have a number, like, how much money the Federal Government spends every year across the board on IT?

Mr. DONOVAN. Roughly $90 billion.

Mr. CRENSHAW. That is all?

Mr. Rogers.

Chairman ROGERS. Mr. Director, let's talk about debt. We owe over $19 trillion, growing uncontrollably, several trillions of it during this administration.

People out there are frightened, frustrated, mad, misunderstanding what is happening. And when I try to tell them, look, we have cut discretionary spending in the last 5 years by over $175 billion, and yet the debt continues to zoom. Why? Because of mandatory spending, entitlement spending—out of control.

When I first came here, we appropriated two-thirds of Federal spending. Today it is one-third. Two-thirds is now mandatory, automatic. If you qualify for a certain program, the money comes out of the Treasury. It doesn't go through this committee. We have no oversight.

If we continue at this pace, as I said in my opening statement, soon the debt interest is going to exceed what we spend for national defense, among other things. So it is a real crisis, in my judgment.

Of the $4 trillion in Federal spending that is going to take place next year, we are only appropriating $100 billion, and it is out of control. And yet this budget that the administration is proposing would increase mandatory funding by some $60 billion, either currently funded under discretionary or new money that should be funded as discretionary.

[CLERK'S NOTE.—Chairman Rogers corrects the $100 billion as $1 trillion later in the record.]

Knowing that we have a mandatory spending problem that is crowding everything else out, the President chooses to ignore that problem and, frankly, only make it worse. He plans to pay for much of this new funding through imaginary fees and taxes that obviously aren't going to happen.

With the President having been in office now over 7 years, we still haven't seen a credible plan to tackle this out-of-control entitlement spending and debt. He has almost 11 months left in office. Can we see any hope that he will make a good-faith effort with the Congress to help strengthen and preserve critical entitlement programs and yet have some kind of a check on the rapid growth of the entitlement sector?

Mr. DONOVAN. So, Chairman, let me begin by agreeing with your fundamental premise that discretionary spending is actually a place that we have cut and I think cut too far, and that was the

basis of the bipartisan deal we reached last year. And I want to thank you for your leadership on getting to, I thought, a very effective compromise on the omnibus at the end of last year.

Where I want to disagree with you is that, in fact, since the President has come into office, we have made substantial progress not just on our short-run deficits, which are down by roughly 75 percent—we have had the fastest sustained deficit reduction since the end of World War II—but we have also made substantial progress on our medium- and long-run deficit and debt as well.

And the reason for that is because healthcare spending, as you know, is the single most important challenge that we have on the mandatory spending side. It outweighs all other programs. And, in fact, that is one of the reasons why the President immediately, on coming into office, focused on this issue. And since he came into office, we have actually seen the slowest healthcare cost growth in 50 years.

And, in fact, if you just take 1 year, the year 2020, since the Affordable Care Act was passed, CBO—these are not our numbers—CBO projects that we are going to spend $185 billion less in 2020 on Medicare and Medicaid combined.

So we have made real progress. And what we are proposing in our budget is to continue that progress. We have $375 billion of further healthcare savings that we are proposing. And as we saw with the doc fix legislation that got done about a year ago, we think there are many areas where we can make bipartisan progress to make further progress on those entitlements.

But I would also say that the President believes that we need to take a balanced approach. And the fact is we have wasteful spending on the Tax Code side of our budget as well and that we need to aggressively look at those areas as well. And our budget does that.

But even with the added $2.9 trillion of deficit reduction that we achieve in this budget, if you add that to the $4.5 trillion of deficit reduction that we have achieved since 2011, even if his budget was enacted tomorrow, we would still have more than 50 percent of the deficit reduction of that $7.4 trillion that comes from spending cuts.

So we think we have a real record of looking hard not just at the discretionary side but the mandatory side. But we also need to look at the tax side.

Mr. ROGERS. What was the amount of debt when he took office?

Mr. DONOVAN. As a share of the economy and the projections——

Mr. ROGERS. No, as a real number.

Mr. DONOVAN. I don't have those numbers in front of me. But, again, the right way to look at this problem——

Mr. ROGERS. It was only about $14 trillion. Now it is over $19 trillion.

Mr. DONOVAN. Well, what I——

Mr. ROGERS. How can you say that you have cut the debt?

Mr. DONOVAN. What I can say is that, as a share of the economy, we have brought down the deficits dramatically. If you look at our budget proposal, it would take the critical step of stabilizing and then bringing down our debt as a share of our economy. That is the critical test that economists apply to it.

And I will say, compared to the current status quo, we achieved that $2.9 trillion of deficit reduction in our budget, which achieves that key fiscal goal.

Mr. ROGERS. Let me make a correction. I think I said a moment ago something wrong, when I said that of the $4 trillion we are going to spend next year, I said $100 billion. It is $1 trillion of that is what we appropriate.

The rest is mandatory and growing out of control. And yet your budget proposes roughly $60 billion more mandatory spending from discretionary. It should be going the other way.

Mr. DONOVAN. Expected mandatory spending has gone down substantially since the President came into office, primarily because of the healthcare savings that we have achieved. The projections of debt and deficits today——

Mr. ROGERS. How did we get from a debt of $14 trillion when he took office to over $19 trillion now? That is not a reduction; that is a huge increase.

Mr. DONOVAN. Not compared to the expectations when he came into office. If you look at CBO's numbers when the President came into office, we have substantially reduced expected deficit and debt.

Mr. ROGERS. Can you take expectations to the bank?

Mr. DONOVAN. All I can do and all the President can do is make changes, propose changes, working with Congress, that change our path, our fiscal path.

Mr. ROGERS. The bottom——

Mr. DONOVAN. And we have done a substantial amount to improve the fiscal path of this country, particularly through reductions in healthcare spending, since the President came into office.

Mr. ROGERS. But in spite of all of that, the debt has gone up dramatically since the President came into office.

Mr. DONOVAN. The President inherited deficits that were at almost 10 percent of our economy, and he has brought them down to well below 3 percent. That is the fastest deficit reduction we have seen since World War II.

Mr. ROGERS. Well, bottom line, bottom line, the public doesn't understand cutting expectations. The public sees that we owe $19 trillion and growing like a weed, all the while the administration adds more mandatory spending to the debt so that the appropriations process, the people's way of oversight, is thwarted. Because mandatories, as you well know, rely upon formulas and qualifications for programs that automatically come out of the Treasury without it being appropriated. And that is where I think we are on a real, real bad track.

Mr. DONOVAN. Well, Mr. Chairman, where I think we can agree is exactly the leadership you and the committee provided last year, that finding ways to reduce mandatory spending in smart ways, which was part of the budget agreement that was reached last year, is the right way to go while we continue to make the critical investments on the discretionary side that we need.

Mr. ROGERS. Thank you.

Mr. CRENSHAW. Thank you.

We have been joined by the ranking member of the full committee, Mrs. Lowey. And so I am going to recognize her to either

make an opening statement and/or ask a question or a combination thereof.

Mrs. LOWEY. Well, my good friend the chairman is so very generous. I really appreciate your welcome here to this distinguished committee. And I appreciate you and my good friend Mr. Serrano holding this important hearing.

And I would like to join you in welcoming Director Donovan. Thank you for being here today.

And thank you for your gracious welcome, Mr. Chairman.

Mr. SERRANO. I can't take all this.

Mrs. LOWEY. Welcome.

Mr. DONOVAN. Thank you.

Mrs. LOWEY. With the 2-year bipartisan agreement we reached at the end of last year and Speaker Ryan's focus on regular order, most of us were optimistic that this year's appropriations process would be smoother than the prior years'.

Yet Speaker Ryan, I understand, is entertaining cutting entitlements through appropriation bills instead of through authorizing committees. And Budget Committee Republicans broke with decorum and did not invite you to testify on the President's budget request. This is very surprising to me.

At this time, it is unclear whether House Republicans will even offer a budget of their own. At least the Appropriations Committee is doing its job, and I am very happy to work with the chairman in doing the job. And I am glad to have you here today.

Mr. DONOVAN. Thank you.

Mrs. LOWEY. Director Donovan, do you know the last time a sitting OMB Director was not asked to testify before the Budget Committee?

Mr. DONOVAN. To my knowledge, Ranking Member, that has never happened before since the Budget Committees were created.

And I will say, despite any personal feelings, I think the most important issue is that I was disappointed because we did make—and I said this before you arrived, and I want to compliment you directly for the bipartisan work, both on the bipartisan budget agreement and on the omnibus in December. But it felt like we made a lot of progress toward reestablishing regular order in doing that and creating this 2-year framework and getting a good agreement, a good compromise last year. And I was disappointed that I wasn't able to testify. My hope is that we can continue the progress toward regular order as we go forward.

Mrs. LOWEY. And I know because Chairman Rogers and I would like to have regular order and move forward with regular order.

So, Mr. Donovan, Mr. Director, had you been invited to testify before the Budget Committee, are there particular areas of Federal investment that would spur the economy, enhance our national security, provide groundbreaking biomedical breakthroughs that you would have discussed? If so, I am happy to let you speak to those investments now.

Mr. DONOVAN. Thank you.

I would really highlight three key areas, and these were areas that the President highlighted as major challenges for the country going forward.

First, we have to invest to maintain our leadership as the most innovative economy on Earth. And one particular area that he highlighted was the investment in renewable energy. R&D for that is a critical place where we can put people to work, grow the jobs of the future. But an area that I know is near and dear to your heart, as well, is on biomedical research and a substantial increase in investment that we are proposing as part of the Cancer Moonshot, along with a range of other areas of investment as well.

The second big area is where we need to invest to grow opportunity to give everybody a fair shot in the country. One of the most important advances I think we won in the omnibus was a major increase in Head Start to get kids started at the very earliest stages. Our budget proposes more than a $400 million increase there, which would take us to more than half of Head Start children in full day, full year programs around the country, which has been shown to be a critical advance.

But also a great bipartisan victory in replacing the No Child Left Behind Act. And I think there is a significant set of places that we could invest, and that the budget does, on the education side, on training and apprenticeships.

One other area that I would point out to really try to modernize the safety net that we have for workers is our wage insurance proposal as part of a broader effort to modernize unemployment insurance around the country. We think that is a critical area where we could make bipartisan progress, encourage people to get back to work even more quickly.

So those are two, and then the third is national security. The budget invests more than $2 billion in additional resources to take the fight to ISIL; substantial increases to make sure that our European partners are reassured that we are going to stand in the way of Russia's aggressive actions in Europe and beyond. Third, the cybersecurity proposal that we have already started to talk about is a major national security threat that we need to do more on, and the budget proposes a more-than-one-third increase, $19 billion in total, for our fight to improve cybersecurity.

Mrs. LOWEY. In looking at President Obama's final budget proposal, I see that it would reduce the Federal deficit to $503 billion in fiscal year 2017, down from the current fiscal year.

In fact, since 2009, under President Obama's leadership, Federal deficits have fallen by nearly three-quarters, the most rapid sustained deficit reduction just after World War II. The annual deficit in 2015 fell to 2.5 percent of the gross domestic product, the lowest level since 2007 and well below the average of the last 40 years.

You have mentioned that the budget stays within last year's budget agreement and, as a result, has caused some tough choices. Can you describe the effect of some of these choices on the discretionary side of the budget?

Mr. DONOVAN. Absolutely.

So the structure of the bipartisan budget agreement relieved about 90 percent of sequester on the nondefense side of the budget but only about 60 percent in 2017. So 90 percent in 2016; about 60 percent in 2017. Essentially, discretionary funding is about flat in our budget from 2016.

And what that means is, as you well know, if you look at areas like veterans health care where there are inflationary increases that happen each year, Section 8 vouchers I am very familiar with, and a range of other programs where simply serving the same number of people requires an inflationary increase, what that means is, when you have flat funding, you are going to have much more pressure on other discretionary accounts.

And so there are a range of areas where we had to make tough decisions, whether it is in low-income heating assistance, the LIHEAP program; CDBG; State-paid leave assistance. There are a number of areas where we would have wanted to do more, but, through the compromise that was reached, we decided that we should honor the deal that was reached last year and stick to those caps despite those tough choices.

Mrs. LOWEY. Thank you, Mr. Chairman.

Mr. CRENSHAW. Thank you.

Mrs. LOWEY. I appreciate your time.

Mr. CRENSHAW. Now we will turn to Mr. Womack.

Mr. WOMACK. Thank you.

I want to pick up—before I go to a couple of my prepared questions, I want to go back and pick up on Chairman Rogers' discussion on the mandatory side.

So, since we didn't have a presentation, Director Donovan, before the Budget Committee, on which I proudly serve, maybe we could go back and just revisit some numbers in response to his questions.

One, what does the gross Federal debt of the U.S. Government balloon to in the 10-year window?

Mr. DONOVAN. Actually, it declines from about 76 percent of GDP down to——

Mr. WOMACK. So let me stop you. Just a minute.

Mr. DONOVAN. It declines from——

Mr. WOMACK. I have very limited time. I have very limited time, Director.

So only in Washington and only from the Office of Management and Budget could we see the gross Federal debt go from $19 trillion today to—and let me help you with the number; it is fresh on my mind—even with $3 trillion worth of tax increases, $26 trillion in the 10-year window. Now, forget the percentage of the economy. In many respects, that is kind of a fairytale around here. But only here can we go from $19 trillion in gross Federal debt to $26 trillion and somebody in this administration talk about how it is going down.

So let me ask you this. What is the net interest on the debt based on the projections of interest rates, if there is such a thing, over the 10-year window? Today it is, in round numbers, $225 billion or $230 billion a year. So what does it go to in the 10-year window, Mr. Director?

Mr. DONOVAN. I don't have those numbers in front of me.

Mr. WOMACK. Well, let me help you with the number. Even with tax increases, it balloons to more than $700 billion a year.

What do we spend on national defense? With OCO——

Mr. CRENSHAW. About $600 billion.

Mr. WOMACK. $500-and-some-odd billion, plus some OCO money. So let's just round it to $600 billion.

In the budget that was presented to this Congress by this President, we were going to take the net interest on the debt from an alarming rate of $225 billion or $230 billion today to nearly $800 billion in the 10-year window. And if you take out tax increases, it is nearly a trillion dollars of interest.

How can you sit here with a straight face and tell this committee in response to questions about what we know to be the true drivers of the deficits and the debt in this country—mandatory spending—that this President has done anything but lead on how we are going to get our arms around this phenomenon? How can you sit here and say that?

Mr. DONOVAN. Congressman, you don't have to take my word for it. If you look at CBO's numbers, if you look at the broad——

Mr. WOMACK. These are CBO's numbers I am looking at.

Mr. DONOVAN. And CBO's numbers will show you that, relative to where we were 4 or 5 years ago, they will tell you we expect to spend $185 billion less on Medicare and Medicaid in 2020 than we did just 4 or 5 years ago. Relative to current law, our budget shows $2.9 trillion of deficit reduction.

And so we are making real progress on the most important driver of mandatory spending. We have the lowest healthcare cost growth than we have had in 50 years. And that is why, despite the politics around the Affordable Care Act, the President focused on health care as one of the most important drivers, if not the most important, of our mandatory challenges. And we have made real progress on that front.

Mr. WOMACK. All right. I am glad you mentioned health care, because I agree with you that it is the principal driver of the deficits and the debt as we now know it.

So at about what year—and I know you have looked at these numbers. At about what year, based on 18 percent of GDP in average revenues—that is about what we see, 18, plus or minus—at what year is there no money left for discretionary spending at all, no money at all for this committee to appropriate? At what year does that happen because mandatory programs consume all of it?

Mr. DONOVAN. Congressman, one of the things that we all have to recognize——

Mr. WOMACK. What year?

Mr. DONOVAN [continuing]. Leave aside the politics——

Mr. WOMACK. What year?

Mr. DONOVAN [continuing]. Is that we have a demographic challenge in this country, with the retirement of the baby boomers, that is going to require us to pay attention to these mandatory challenges but also to look at the revenue side. If we want to keep our promises to seniors, we are going to have to look not just at mandatory spending but also to close tax loopholes, to look at wasteful spending on the tax side of the ledger as well.

Mr. WOMACK. I know that the President wants to raise a lot of taxes. What I find incomprehensible as a Member of Congress—because I sat with my colleagues on the floor of that House when the President gave his State of the Union address and talked for 70 minutes, and not one time did he dedicate any leadership from that podium on what we are going to try to do to get our arms around the mandatory spending that is bankrupting this country.

That is the kind of leadership that I think we should expect out of the President, and that is leadership that I think is lacking in the budget proposal.

Mr. DONOVAN. What I can certainly tell you is he showed a lot of leadership in pushing healthcare reform that is accelerating the cost reductions that we have seen. It is universally recognized, as you have just agreed, that healthcare spending is the most important driver of the costs on those sides, and we have made remarkable progress in the last 4 to 5 years.

So I think it is a completely unfair characterization that we have not focused on entitlements. And, in fact, we have made remarkable progress compared to any benchmark when the President came——

Mr. WOMACK. We are probably not going to agree on that one. And I yield back my time.

Mr. CRENSHAW. Thank you.

We will have time for another round of questions, but now let's turn to Mr. Quigley.

Mr. QUIGLEY. Thank you, Mr. Chairman.

Mr. Chairman, I can't help it. I wasn't going to get into this, but let me put this on a different picture and put it in the proper perspective. Simpson-Bowles, I believe, really only had one major vote on the House side, and that was Cooper-LaTourette, as I recall, and I was one of 38 Members of the House to vote for that. So the debt, the deficit, these are things that I am concerned about and put my vote on the line toward that end.

But let me just put the perspective, I think, what you are trying to get to is, as you relate to the deficit as it relates to GDP, I think what you are saying is, if a household of $25,000 annual income has $5,000 in debt, that is a whole lot different, a debt of $5,000, than it is a $50,000 income a year, correct? Is this what you are alluding to?

Mr. DONOVAN. This is the way we look at mortgages, we look at personal finances: What share of people's income do they dedicate toward their debt? And that is exactly the way we look at it for the economy.

Mr. QUIGLEY. And one last point on this. I am sure you don't have this—able to answer now, but since people are asking you for specific numbers—and if you don't have it, maybe you can get it to us. The total debt we have right now, could you tell us what percentage of that debt comes from the Iraq war and the tax cuts that came with it at the same time?

Mr. DONOVAN. I don't have an exact number. What I can tell you is a sizable portion when the President came into office. I would also say——

Mr. QUIGLEY. I would like to know what percentage is——

Mr. DONOVAN. Well, that we have reduced spending in OCO, in the war account, by over $100 billion a year since the President came into office because he was able to keep his promises to end the ground wars in Iraq and Afghanistan.

Mr. QUIGLEY. And I appreciate that. But at some point if you would get to us the raw numbers——

Mr. DONOVAN. Absolutely.

[The information follows:]

DEBT IMPACT OF THE IRAQ WAR AND 2001/2003 TAX CUTS

OMB does not separately track the comulative impact of individual legislative action on debt. However, the cumulative effects of the 2001 and 2003 tax cuts, along with spending for Iraq war and related activities, are clearly substantial. The Congressioal Budget Office maintained a cumulative tally of the changes in its January 2001 projection of a surplus of $5.6 trillion surplus over the 10-year period 2002–2011 (see *https://www.cbo.gov/sites/default/files/112th-congress-2011-2012/reports/06-07-ChangesSince2001Baseline/pdf).*

Mr. QUIGLEY [continuing]. Of how much we owe now, how much of that—now and as time goes on, what percentage of that will be from the expenses of invading Iraq and completing that war and the tax cuts that went. Because what I recall, in World War II we went to war and we recognized that wars are expensive and we raised taxes.

On a less pleasant note, let me talk about something locally in Illinois. Flooding is a regional issue. In the Chicagoland area, it is a bipartisan issue. I talk to my Republican colleagues and those that serve with me in the region.

One of the big solutions to that was the McCook reservoirs, supported on a bipartisan basis. Got funded from the administration for 3 straight years. We are concerned about spending money; had a three-to-one benefit-cost ratio, not just Chicago but 36 suburbs. Would have had 1.5 million structures, 5 million people. And the amount of damage we already had before these were completed is staggering.

Unfortunately, Assistant Secretary of the Army (civil works) Ms. Darcy omitted this in the 2017 funding for stage 2 under the extraordinary mistaken belief that stage 2 is related to water pollution control instead of the fact that it is for flood control, fully authorized and documented in the Corps' system as such. The project is being recommended by the Corps for flood protection.

At some point, as Senator Durbin and I have been talking about, but, again, on a bipartisan basis, we need your help to try to include these resources in the fiscal year 2017 workplan for the Corps of Engineers in that area.

Mr. DONOVAN. Well, I understand your concern about this. We did include——

Mr. QUIGLEY. Concern is you stubbed your toe. This is a broken foot.

Mr. DONOVAN. I am sorry if I understated it.

Mr. QUIGLEY. Yeah.

Mr. DONOVAN. But we did include $5 million in the 2016 workplan, which is part of a substantial contribution we made to completing phase 1. I am glad that we are able to keep that commitment to the first phase, but I understand that you are focused on how we get phase 2 funded.

Mr. QUIGLEY. Right. So this will be one of many conversations, and more and more animated, because, with all due respect, we need your help to try to find a way to put these resources in the workplan for the Corps of Engineers. And I believe that Ms. Darcy will be around Friday, and we will have an animated conversation with her at that time, as well.

But the fact is we need your help. Funding the first 3 years and then leaving it hanging there isn't particularly helpful.

Mr. DONOVAN. Understood.

Mr. QUIGLEY. Thank you.

Mr. CRENSHAW. Thank you.

Mr. Graves.

Mr. GRAVES. Mr. Donovan, good to see you.

Mr. DONOVAN. And you.

Mr. GRAVES. I am going to change topics briefly for a moment, but, first, I am excited to hear the enthusiastic support of the President's budget by Mr. Quigley and the ranking member. I hope to see them introduce that and put their name on it and cosponsor it and advocate for it and debate it on the floor so we can see where all Members of the House stand on that budget.

But thinking about the President's budget, thinking about Mr. Womack's comments and the chairman's comments, the American people and particularly those in the 14th District of Georgia are just mad. They are frustrated. They do not trust this government. They do not trust in any kind of responsibility for financial management, for reducing the debt. They hear the comments, such as yours just now, of, "oh, well, the debt's going to go down over time in relation to something else," when, actually, the number is going up over time. They see that. They know that.

And it is that frustration you are seeing all throughout the country right now in the Presidential election. And, quite frankly, I am glad that they are expressing this frustration and this anger because I am hoping somebody will listen. And we are soon to find out who is going to be listening.

But an area they know they can control and they know they can manage is their own personal finances. They don't think anybody can do anything with this place up here, and, for the most part, I think they are right. But someplace where they do have direct control and access is their own personal finances, their own debt reduction, their own savings for retirement.

And that leads me to the fiduciary rule that you and I spoke of last year, and you mentioned it briefly today, about the economic analysis. And I know the terms you used earlier today were the same as last year, in that you cannot speak directly on the rule because the rule is being evaluated.

But as to the economic analysis, has there been one completed, a cost-benefit analysis? And if so, what did it indicate?

Mr. DONOVAN. So the cost-benefit analysis is obviously completed as part of finalization of a rule. So we do not have a final cost-benefit analysis that I can speak to.

What I can say is that the Council of Economic Advisers looked at this issue more broadly and identified that consumers lose about $17 billion a year over bad advice on investment products. So there clearly is a major impact directly to families, the families that you are talking about, from bad advice.

Mr. GRAVES. So the $17 billion, I believe that is the far end of the scale. It is a very wide range—it is an extremely wide range of numbers.

Is that an analysis that you are basing your economic analysis off of? Or is yours an independent analysis taking into consideration potentially other analyses that may disagree with the $17 billion or the $8 billion number?

Mr. DONOVAN. Again, I can't speak directly to OIRA's because we have not completed the rulemaking. But, generally speaking, we look at a broad range of sources of information, not just the Council of Economic Advisers.

Mr. GRAVES. Speaking of the one you did reference, so I assume you have knowledge of it, that $17 billion of savings, how is it achieved? How does a consumer achieve a savings?

Mr. DONOVAN. Actually, I think it was a cost. And so the savings would be achieved if a consumer is protected from getting bad advice or gets better advice.

Mr. GRAVES. How, though? The mechanism of their—you say it's a cost. So if they don't incur that cost, I am going to suggest it is a savings. How are they saving $17 billion, specifically?

Mr. DONOVAN. If I understand the question, it would be through getting advice that would allow them to make better investment decisions.

Mr. GRAVES. Is the assumption that there would be the same number of investors post-fiduciary-rule versus pre-fiduciary-rule in that analysis?

Mr. DONOVAN. I guess I would want to look back at that analysis before I answer that question. I am not sure.

Mr. GRAVES. I understand.

Well, my concern—and I will close, Mr. Chairman—is that, while this rule may have some intention, we don't know whether it is good, or not, intention. It has some intention.

The question truly should be how does this impact the overall consumer, who in my district is working hard every day just to try to slog through this economy that the President, in previous spending and irresponsibility, has created for them to struggle through, with their families.

But they want to get ahead. They want a fair shot. They want to be able to save. They want to be able to invest. My concern is that this rule is a barrier to them, that instead of being able to save a little money and meet with somebody in their town that they know, that they go to church with, that they shop with, that they see locally that offers them advice, now they are going to be pushed more towards an interface that is impersonal, and maybe it is a computer interface, Internet interface, whatever it might be, but something that is less accessible, which creates a deterrent, which creates less savings and less preparation for retirement.

So I would be very interested in the analysis and whether or not it makes the assumption that you will have the same, if not more, investors in the future after the rule, or will you have less investors. Because it is going to be one of those options there.

So thank you, Mr. Chairman.

Mr. CRENSHAW. I think what he is asking is what areas of the market failure led the administration to propose this rule. I mean, if you think about that, it sounds like one of those solutions looking for a problem. But you think that through.

Let's turn now to Mr. Yoder.

Mr. YODER. Thank you, Mr. Chairman.

Director Donovan, welcome to the committee.

Mr. DONOVAN. Thank you.

Mr. WOMACK. Director, you are a good man, I like you, we have had conversations in the past. But your attempts to sugarcoat this budget and its projections for the future on behalf of the administration that I know you work for is just a sad abdication of responsibility for the challenges we are facing as a country.

Chairman Rogers, my colleagues Mr. Womack, Mr. Graves, and others have really laid out some very specific concerns. And what we have gotten into is a debate, which we see all the time in Washington, D.C., about historical discussions about who is wrong and who is right, and we have really no optimism for where we are going for the future.

So I want to take our conversation to what we can do to work together to solve some of these problems going forward, because where we are headed is not a rosy situation.

Now, when you look at where we have come from, the $10 trillion to $20 trillion, that is a huge deficit increase—or huge debt increase, and no one gets a pat on the back for that. We know that if we had adopted every one of the President's budgets, our government would be 20 percentage larger today.

And so we know that we have reduced a bad situation to not as bad as it could have been. And maybe that may be the motto of what is going on in Washington these days, is things could be worse. But things need to get a whole lot better, and I know you know that. And I know that you know this budget doesn't really pass the smell test.

When you look at what is driving the costs—and we have had this discussion, sort of a straw man from the ranking member about mindless austerity, manufactured crisis—you both had that conversation. I mean, what the House has tried to do is to really shed light on and be honest with the American people about where we are going. And when you look at automatic spending, you look at the pie charts, you know, in 1965 it was 34 percent, in 2015 it is 68 percent, it is headed to 78 percent. Mr. Womack asked when it would be 100 percent. We don't know the answer to that, but it is really bad, and it is crowding out investment.

So I really pushed hard in the last budget to increase the President's budget request on NIH from $1 billion up to $2 billion. I sent a letter with a bunch of my colleagues, many folks here, to try to get to $3 billion, and we can't get there because the White House has other priorities or because we are being crowded out by mandatory spending.

I have a 3-year-old daughter—I am sorry—a 2-year-old daughter, a 3-month-old daughter. We all have children, we all have grandchildren, people that we are worried about. And I guess my questions for you are: As we go forward, what do we tell them? And when can we tell our children that the American budget will be balanced if we adopt the President's budget submission?

Mr. DONOVAN. Well, I guess I would disagree with you that I haven't been talking about forward-looking proposals here. I talked specifically about a broad set of things the President's budget does on healthcare reform. Let me take another. In fact——

Mr. YODER. I understand. I understand, Director. I just have a little bit of time here, and so I have some specific questions that

I just want to get to the heart of it. And we are going to get into a debate about semantics. And what I want——

Mr. DONOVAN. What you can tell your daughter——

Mr. YODER. But I want to know, when can we tell our children that the American Government will run in the black based upon the President's budget submission? It is a pretty simple question, and you are a very smart man. I know you know the answer to this. What is that date?

Mr. DONOVAN. I think what you should tell your daughter is that this country is facing a significant demographic challenge with the retirement of the baby boom, that we need to keep our promises to those retirees, and——

Mr. YODER. Well, let's get to that question.

Mr. DONOVAN. If I could just——

Mr. YODER. Sure.

Mr. DONOVAN. You asked a question.

One of the most important things about that is that we are now facing a world where, instead of having over three workers for every retiree, we are going to have about two and a half——

Mr. YODER. I am probably going to agree with you on a lot of the root causes, Director.

Mr. DONOVAN. Immigration reform—immigration reform is actually an area where I think we could reach a bipartisan agreement. It will help us not only grow our economy, it would reduce the deficit by a trillion dollars——

Mr. YODER. So my child asks me when is the budget going to balance and I say what?

Mr. DONOVAN. What I would tell her is that we need to do exactly the kinds of things that we are proposing to do.

Mr. YODER. So I wouldn't tell her—I would not tell her—what is the answer to the question, Director? When does the budget—when does America run a budget in the black?

Mr. DONOVAN. I am trying to answer your——

Mr. YODER. I know, but when is your projection? Give me a date. When will the American budget be in the black again?

Mr. DONOVAN. We——

Mr. YODER. Based upon the President's budget request, which lays out all of his requests—this is his vision for the future, it is your vision for the future. On what date certain can we tell the American people, if we adopt your policies wholeheartedly, the $3.5 trillion in tax increases, if we adopt all of that—because you have already asked for trillions in new taxes—if we adopt it as is——

Mr. DONOVAN. I think——

Mr. YODER [continuing]. When do we go in the black?

Mr. DONOVAN. Please don't mischaracterize our budget. We proposed a budget that has $2.9 trillion in deficit reduction, that in the 10-year window stabilizes debt and starts to bring it down, compared to a current path that we are on where debt would increase substantially as a share of the economy. Those are the critical tests that the President has laid out for fiscal stability, and we meet those tests.

Mr. YODER. Mr. Chairman, I will submit to the Director, who I have a lot of respect for, this is why people get frustrated with

Washington, because we can't ever get straight answers to straight questions.

I have other questions on here in terms of Medicare. You mentioned that. When are IPAB cuts going to start with Medicare?

Mr. DONOVAN. That will be——

Mr. YODER. Because the CMS says next year. Is that still your position, that the way to fix retirement benefits through ObamaCare that you are talking about so much as the key to these healthcare situations, that—what is the date certain when I can tell my 104-year-old grandmother that her Medicare benefits would be cut under the IPAB?

Mr. DONOVAN. Well, first of all, CMS will make a final decision this year. But you are also deeply mischaracterizing the way the IPAB works. All of those changes are presented to Congress and voted on by Congress. And so——

Mr. YODER. When will the government, when will CMS make recommendations? And how much will they be——

Mr. DONOVAN. We expect——

Mr. YODER [continuing]. Regarding how much of Medicare——

Mr. DONOVAN. We expect it to be later this year——

Mr. YODER. OK.

Mr. DONOVAN [continuing]. In the next few months.

Mr. YODER. Mr. Chairman, I will just conclude by saying this is why I think Americans are frustrated that we can't get straight answers to these questions.

We are not making the kind of progress we need to make. We are leaving a legacy of debt and despair for the next generation. Director Donovan knows it; the President knows it. And they are shutting down and going to be gone in a year, and we are going to be here left with fixing the situation. And our kids and grandkids, ultimately, after Director Donovan is gone and I am gone, we both know they are going to be left picking up this leftover expense.

And it is embarrassing, and we ought to work at it to seriously fix it and not get into a semantical debate about shaving off, of increases, and we were going to build something and we didn't build it so we are going to count that as a cut. It is a lot of Washington talk, and we all know how this works.

The reality is the debt is growing to an unsustainable level, and we are going to saddle our kids and grandkids with it. And I just hope and pray that this administration—the President has political capital left—that maybe he will come to the table and we can actually work together so we can answer that question: This is the date certain we will go in the black, and this is when we will actually solve this problem. And until then, we are going to have these conversations that ultimately get us nowhere.

I yield back, Mr. Chairman.

Mr. CRENSHAW. Thank you.

Now we will turn to Mr. Rigell.

Mr. RIGELL. Thank you, Mr. Chairman.

And, Mr. Donovan, I thank you for being here today.

Mr. DONOVAN. Thank you.

Mr. RIGELL. And I want to give you credit right from the start. I think you are trying to do the best you can. OK? That said, the

differences between your assessment of our situation and, indeed, the President's assessment of our situation and my own and what I see in my colleagues, the differences are profound, and they are fundamental.

I had the opportunity to meet with the President—it was a few years ago, and it was just for a few minutes. But in those few minutes that I had the opportunity to speak to him, I went right at this issue of our fiscal situation. Above all else, it is what concerns me.

And I would just associate myself with the remarks of my colleagues. We didn't meet beforehand to understand where we were coming from on a line of questioning, but it resonates with me, the alarm that they are expressing.

And in the Nation's capital, I think hyperbole is used oftentimes, and the word "crisis" is used on just about everything, but I am submitting to you that we do, indeed, have a fiscal crisis. I don't believe that your testimony here today reflects the crisis we are in. I don't think the President's words reflect the crisis that we are in.

In fact, I associate myself with what Mr. Womack said. I walked out of the State of the Union, and I just thought, it is like he is just completely unaware of where we are headed financially. Interest rates can only go one way, right? Which way? Up. $130 billion for each 100 basis points, 1-point increase. That is hardly reflected in all of this. I look at the President's schedule, what he talks about when he is in public. It is like fiscal Orwellian speak.

You know, I have been a businessperson all of my life and dealt with budgets. And I look at your own testimony, Mr. Donovan. Look, page 1, bottom paragraph—and I know you know the difference between the debt and the deficit, but listen to this sentence. "The 2017 budget continues this progress. It shows"—OK. You talk about that we are proud of the President's budget, that it meets the test of fiscal sustainability—listen to this part—"and putting debt on a declining path through 2025."

Does the President's budget put debt on a declining path through 2025?

Mr. DONOVAN. Yes, it does.

Mr. RIGELL. No, it does not. As a percent of the GDP, it doesn't.

And, by the way, I agree with you on that point. Everything ought to be evaluated in terms of percent of GDP—revenue, expenditures, the debt as a percent of GDP.

But words matter, Mr. Donovan. I would expect that you of all people would understand the difference here. You said you are putting the debt on a declining balance through 2025.

Mr. DONOVAN. A declining path as a share of the economy.

Mr. RIGELL. No, it is—no. No. Debt is increasing.

Mr. DONOVAN. As a share——

Mr. RIGELL. We need to be precise——

Mr. DONOVAN. As a share of the economy——

Mr. RIGELL. Oh, is that what you—that is not what it says. Look, this isn't a matter of semantics. I get the difference. Listen, I am in favor of evaluating things of the percent of GDP.

Mr. DONOVAN. Every serious economist who looks at this issue looks at debt——

Mr. RIGELL. You are misunderstanding the point I am making.

Mr. DONOVAN [continuing]. Deficits as a share of the economy.

Mr. RIGELL. No. On that point, Mr. Donovan—please. You are a smart guy. I am not trying to talk down to you. I think we are trying—the thing is we only have 5 minutes. It goes just like that.

On that point, I am in agreement with you. I really believe everything ought to be evaluated as a percent of GDP. That is how every lender does this. That is how I ran my business. It is your ability to repay. And that is a percent of—whatever it is, your business cash flow or whatever. On that point, we are in agreement.

I am saying that, even in your written testimony, you said, we are putting debt on a declining path. Now, if I was putting my business on a path of declining debt, that means I am paying down my debt.

The reason I bring this to your attention is because, when I hear the President speak—and, indeed, it is kind of embedded in your own testimony here—it is a bit Orwellian. And what I mean by that is that you are not dealing with reality, the stark and harsh and troubling reality of our fiscal situation.

The President references in extremis point of deficits, and he says, "I brought them down." He doesn't go on to say, "But they are still way too high." That is what leadership is.

And, look——

Mr. DONOVAN. Deficits today are below the 40-year average of deficits.

Mr. RIGELL. Well, no, see, the challenge that—see, this Orwellian speak here—and, look, I still associate myself—there is a fundamental difference between this side and that side. And, frankly, we are right on this. We are calling attention to our fiscal situation. You are not expressing any real concern about where we are headed.

Mr. DONOVAN. I don't——

Mr. RIGELL. I will tell you——

Mr. DONOVAN. I don't think that is accurate. I have talked a lot about the progress that we have made but also more that we need to do on——

Mr. RIGELL. You know, the President is not fighting for this. He didn't say hardly a word about it in the State of Union speech, hardly a word. That is not leadership.

Mr. DONOVAN. He talked about——

Mr. RIGELL. And the clock is ticking on his administration. The clock is ticking on our country.

Mr. SERRANO. Mr. Chairman, is this a contest of interruptions?

Mr. RIGELL. No, I am sorry. Listen, I don't mean to raise my voice. And I appreciate the ranking member——

Mr. SERRANO. Well, you are, sir, raising your voice. And we have given very little respect to the Director today.

Mr. RIGELL. No, he is——

Mr. SERRANO. I have been on this committee a long, long time, and I have never seen anyone come before us treated the way he has been treated today.

And the last time I saw—I read the Constitution and the Appropriations Committee manuals. It says that the President proposes and we dispose. So how can it be that a President is drumming up the debt when we pass bills that pay for programs in this country?

So we don't have a dictatorship, and I think it is time we realize we don't have a dictatorship. We are either all guilty or no one is guilty.

Mr. RIGELL. Mr. Chairman, may I just have 30 seconds?

Mr. CRENSHAW. Certainly. And that doesn't count against your time.

Mr. RIGELL. OK.

Mr. CRENSHAW. And if you feel like talking loud, that is—I don't think the Director——

Mr. RIGELL. And I just—I thank the——

Mr. CRENSHAW. And I can talk loud too.

Mr. RIGELL. And I respect the ranking member.

And, look, it is an honor to be on this committee. And I simply want to say, look, we are fellow Americans trying to get this right. And I have problems with my own party. The Americans for Tax Reform pledge is mathematically indefensible.

I am simply submitting to you, Mr. Donovan, that part of leadership, and I think the fundamental part of it, is the proper assessment of the current situation and the trajectory, the direction we are going.

My concern here today is not something I have contrived. I know these hearings are so often thought of as theater. I am not saying I care any more than you about our fiscal situation. But it keeps me up at night, and, frankly, I wish it didn't—I didn't think about this as much as I do.

But when we get on the flip side of debt and we are there, we are there, 200 basis points, 2 full interests—2 points going up, which is frankly within reason, $260 billion. And to the ranking member's point, my own party has contributed to this situation. I didn't like it when I was told to go out shopping when we got into wars. I wanted somebody to tell me how I needed to sacrifice. I never heard that.

But I have taken enough time, and I thank the chairman for his extension of time, and I thank the ranking member for his comment, and I thank you for your testimony today.

Mr. DONOVAN. Thank you.

Mr. RIGELL. Thank you.

Mr. CRENSHAW. And just for the record, Mr. Rigell always talks pretty loud.

Mr. RIGELL. I didn't know that.

Mr. DONOVAN. And I am from New York, so I am OK.

Mr. RIGELL. Thank you.

Mr. CRENSHAW. We will have time. We will have time. I hope you all stick around. We will have another round of questions, but let me interrupt that for a second.

I will say, as I have said in opening statement, Director, people look and they see it took 233 years to get to the point where we are $10 trillion, that is our national debt. And then they can look and see, the last 8 years, we added $10 trillion to our debt. I mean, those are things that people understand. And I think we are all trying to figure out a way forward—that is not good place to be.

But let me ask you two quick questions about the budget. As I mentioned in my opening statement, you cut the Corps of Engineers by 22 percent. And as I pointed out, too, that most of the

cargo internationally goes through our ports. We have these post-Panamax ships. They are bigger, they draw more, and so our ports need to deepen their waterways to compete internationally.

And so I guess the question is, why did the administration propose a 22-percent reduction over the Army Corps' last year's budget? And why is there a reduction of $800 million or about 40 percent for these construction accounts? And those are the ones that fund our ports. So can you tell us what went into your thinking?

Mr. DONOVAN. Look, this is—I think it was Ranking Member Lowey asked earlier about tough decisions we had to make in the budget. Given that it was basically flat from 2016, there were a series of places where we needed to find reductions, and this was one of the places that we went.

On the construction point, the operations and maintenance account for the Corps is more fixed, if you will, because they have to take care of a set of assets that are there, so it tends to be the construction account that suffers the most in those cases.

So this is something where—you know, you and I have met a number of times about Jacksonville and the focus on it. We were able to get to six new starts in 2016, which was an unusually high level. And we have allocated those to the highest-return projects.

But, as you well know, there are far more projects. And our hope is that, not only we can do more directly, but we are also working, as you and I have discussed, on ways to make sure that private resources are coming in and supporting the construction of those; and we think there is a lot of opportunity given exactly the competitive advantage that you have talked about post-Panamax, and there is a lot of ways to bring private capital into these projects as well.

Mr. CRENSHAW. So the one new start this year, six last year, one this year, is this just kind of a matter of priority in terms of not enough money to go around?

Mr. DONOVAN. That was the single most important——

Mr. CRENSHAW. What are the criteria—what do you look at when you decide what makes a new start? What do you look for? Like, on that one new start you suggest, what went into your thinking to make that decision?

Mr. DONOVAN. Really, it is working with the Army Corps, its cost-benefit analysis. So, in every case, the traditional starts that we did were over two and a half, cost-benefit ratio, so—actually, two and a half, benefits to cost. And so they showed a dramatically high level of return relative to other projects.

Mr. CRENSHAW. Gotcha.

And switching gears real quick, some agencies of the Federal Government get funded through mandatory appropriations, they are not subject to review by the full Appropriations Committee, like, I guess, the OCC and this new agency, the CFPB.

And I wonder, how vigorously does OMB look at those budgets that aren't annually reviewed by the Approps Committee? Do you look at those?

Mr. DONOVAN. We spend an enormous amount of time on that. Let me just give you a few examples.

I have already talked about the $375 billion in healthcare savings that we are proposing in the budget. That is obviously all on

the mandatory side. We have a total of about 117 different cuts, reductions, that we do——

Mr. CRENSHAW. Have you ever cut some of those mandatory—well, like, let's talk about the CFPB because that is kind of what I was focusing on.

They get a check from the Fed for $600 million. They were set up purposefully outside our appropriations process. But somebody did an independent performance audit for the CFPB, and they recommended that the Bureau expand transparency of their funding and expenditures.

Now, do you think that is a good analysis? Some of these that are funded mandatorily, do you think they ought to be a little more open and transparent?

Mr. DONOVAN. Well, CFPB is an independent agency. It is different from the vast majority of programs on the mandatory side.

Mr. CRENSHAW. So you never look at that one?

Mr. DONOVAN. We don't have authority——

Mr. CRENSHAW. OK.

Mr. DONOVAN [continuing]. Over CFPB's budget. We do look at mandatory spending broadly in a range of areas——

Mr. CRENSHAW. And when you do, do you look at their transparency of their funding and their expenditures, even though we——

Mr. DONOVAN. Absolutely.

Mr. CRENSHAW [continuing]. Don't, because we are not allowed to. Even though CFPB is not one of those. I guess OCC might be.

Mr. DONOVAN. And we think that transparency is actually a very important tool in trying to keep costs down. Drug prices is an area where we actually have some innovative proposals in our budget this year to create more transparency, which we think can help to control drugs costs.

Mr. CRENSHAW. But the CFPB is not one of those agencies that is funded outside of the appropriations process that you oversee——

Mr. DONOVAN. It is funded, as you said correctly, as most financial regulators are, through the——

Mr. CRENSHAW. And that is not an area that you oversee?

Mr. DONOVAN. It is not an area we oversee directly.

Mr. CRENSHAW. OK. Well, thank you.

Let's go now to Mr. Serrano, quietly.

Mr. SERRANO. Thank you, Mr. Chairman.

My concern, Mr. Chairman, is probably more about the process and who we are. We are appropriators. And the Appropriations Committee has a reputation, a reputation that in the 1990s became a dirty thought, that people could actually debate and then go have a beer after the debate. That is the essence of our democracy. That is who we are as a country. There are many countries throughout the world where people disagree, and they try to shoot each other after the disagreement.

But lately—maybe it is because it is an election year—lately, we have decided that President Obama is the worst President in the history of the country, he has done nothing, and his people do nothing, and that they just drive up the debt, and they drive up the debt, and they drive up the debt.

You know, we are a country, Mr. Chairman, that does worry about the senior citizen who doesn't have something to eat, and that costs money. We are a country who cares about a child going to school and has laws about a child going to school, and that costs money.

We are a country that does try, not as much as I would like to, you are hearing this from a liberal, try to take care of our veterans to the best of our ability, although liberals usually, like me, say don't go to war and when they come home, give them whatever they need, give them everything. If it was up to me, they would get a house, a car, education, everything, just for putting on the uniform. And if they are not citizens and they go to war, the minute they put on the uniform, they become citizens. That is how much I respect our veterans.

But I think we have got to understand that we have a process here. And we can't just blame one person. So he proposes a budget that we don't like. That is why there is a guy over in the Senate running for President who wants to shut the government every day, because he doesn't like that budget. That is his right to do so. But let's not make it sound like we don't play a role.

I have voted for budgets that spend money. I have proposed budgets that spend money. But I think it is a disservice by us as a group—and I am not picking on anybody—as a group to forget that you and I were that close to voting on the same bill 2 years ago until somebody in the Senate gave away a piece that even you were not interested in giving away; and that last year, we all voted for a bill that we weren't crazy about, but we knew we had to keep the government open and keep it working.

So all I am saying is probably something that nobody will pay attention to, is that he is a public servant, I am a public servant, we are all public servants. We don't get selected. We don't get picked. We come and we beg people, be it at a legion hall, be it at a foreign wars place, be it in front of a subway station in the Bronx, New York, we beg people to vote for us. I will be doing that pretty soon. My primary is in June, and I will do it again for the 20-something time in my life, to ask them to do that. But we have got to be a little more respectful of each other and a little more respectful of the process.

I will close with this thought. The worst word you hear these days is "gridlock." Gridlock. Gridlock may be democracy working. We didn't come here to agree on everything. We came here to present our positions. In China, the budget is always on time. In China, the budget is always on time. Is that the system we want?

And so rather than ask a question, I just hope that we face this year understanding what it is, and we know what it is, and we are trying to elect somebody President, and you folks are trying to elect somebody else President. I hope your nominee is that guy from New York, that will be a good thing. But, you know, we still have a good thing going in this country, and we shouldn't make it sound like the country stinks.

In fact, I will close with this thought. There is a gentleman running for President who says: Let's make America great again. You know what my answer is? America is great, we just need more people to share in its greatness. That is my philosophy. If I went

around saying America is not great, I will probably be run out of time. It is great. It is the greatest country under God's heaven. And we should preserve it by starting off and understanding what our role is and what we have to do to make it right.

And one last point. If we can get into debt looking for weapons of mass destruction that were never there, then we certainly can spend some money on education and on housing and so on.

And by the way, I found the weapons of mass destruction. They are called failing schools in some cases. They are called senior citizens who can't pay their rent. Those are the weapons that could destroy us, not the ones we are looking for.

I am sorry for the preaching, but maybe when you are not—I don't know, maybe when you are born in a territory, maybe when you are born slightly outside the boundaries, you realize how lucky you are to be in this country and how lucky you are to be a Member of Congress. And I feel like that every day.

Thank you, Mr. Chairman.

Mr. CRENSHAW. Well, thank you, Mr. Serrano. And I think we all feel like we are lucky to be Americans. And I think we all know that government needs money to provide services. But sometimes we have to be efficient and we have to make hard choices. And I am sure there are a couple more questions. And my observation is, we have worked together, and the Director knows there is disagreement on a lot of different issues, whether it is talking about the budget or whether it is talking about the fence or whatever.

So I hope nobody is kind of—one of the problems in today's world sometimes is when people disagree, they tend to demonize the person they disagree with. And I don't hear any of that today. And I don't think that is a good thing. So I think we have had a spirited discussion. We will keep on having a spirited discussion.

So I will recognize Mr. Womack. If he would like to be recognized.

Mr. WOMACK. I concur with the chairman, and I have an enormous amount of respect for the ranking member. We have had a lot of discussions, disagree on baseball and many other things. And I have an enormous amount of respect for Shaun Donovan, and I want the record to reflect that. I think the conversation we are having is healthy, and the country needs more of it.

I wasn't around politics in the 1960s when two-thirds of the Federal budget was the kind of government that we speak of here today. Mrs. Lowey talked very articulately about investment of the Federal dollar in projects that stimulate growth and development in our country, what we are doing in our harbors and in our waterways, building roads and bridges. Those are the kinds of things—I was a mayor—these are the kinds of things that the Federal Government does that helps give us a basis for economic development that creates jobs and opportunity for a lot of people.

I just know today that the percentage of money out of our Federal budget that is dedicated to discretionary spending, the government as we know it, is getting thinner and thinner, and it is putting a lot of pressure on these things, including national security, and that gives me a great deal of concern.

And when I pressed the Director about the date that all of our money goes to mandatory spending, it is somewhere out around

2030, 2035, in that timeframe, which is not very far away, and we have to be addressing these issues.

So, Mr. Donovan, thanks for your patience over the last several minutes. I am sure you were beginning to wonder if your presence was even needed any longer. But I want to go back to a couple of things and seek your input.

I want to go to paperwork reduction, because we know the regulatory burdens facing our country today are pretty intense, and I know what the PRA was designed to do. I am concerned a little bit that Federal agencies are using the generic clearances process to avoid the requirements of the Paperwork Reduction Act, as you know, enacted to minimize information collection burdens, maximize quality of information collected.

While OMB has recognized that in certain instances a Federal agency should not have to comply with the PRA's full requirements, these instances are limited. They consist of situations where there is a need for multiple similar low-burden collections that do not raise substantive or policy issues or specifics of each collection cannot be determined until shortly before the data are to be collected.

OMB has provided three examples in which generic clearance is appropriate: customer satisfaction surveys, focus group testing, and Web site usability surveys. Even though generic clearances are not allowed for collections that raise substantive or policy issues, I understand that CFPB, as an example, has used generic clearance process to collect data on topics that it intends to issue rules on. For example, overdraft.

Is it appropriate for an agency to collect information under a generic clearance process that will be used as part of its rulemaking?

Mr. DONOVAN. So, first, I would just say again, CFPB is not under our—power, and we do consult with them, but we cannot direct them, and they do not need to follow, generally, our rulemaking guidelines. So in this specific case, I don't think it is my place to determine what is appropriate for CFPB. But I would be happy, if there are other areas where you are concerned about this, I would be happy to look at it and suggest whether or not we think it violates those—our guidelines.

Mr. WOMACK. OK. Well, let me ask, maybe not for the benefit of the CFPB, which is kind of the driver of this particular question, but what steps does OMB take to prevent agencies within your jurisdiction from abusing the generic clearance process?

Mr. DONOVAN. So I would say we have a couple different ways. We do pursue regular review of the processes that they are taking. There are also a number of outside agencies that will look at, whether it is the IGs or otherwise, that will look at these kinds of processes.

The other thing that we are doing proactively is our regulatory look-back effort, which I mentioned we have achieved over $22 billion in savings. A significant share of that savings does come from paperwork reduction.

So I think it is important that we not just be enforcing our standards, but also working with agencies to find proactively new ways that they can reduce documentation. Truck drivers, for example, we have a major rule at DOT we did last year that changes

their reporting that dramatically lowered their costs there because of paperwork reduction.

Mr. WOMACK. Is the Paperwork Reduction Act having the desired effects? Could it be enhanced? Could it be better?

Mr. DONOVAN. I do think—and this is really what the guidance that you are referring—you just referred to tries to get at—as with many things in government, we need to make sure that they are modernized to keep up with technology. And so we do see increasing use of customer satisfaction surveys and other things as critical to figuring out whether we are being effective as government, whether we are doing a good job.

And I think the Paperwork Reduction Act wasn't created at a time when many of those processes existed, and so we do feel like—and we have tried it within our own guidance—I think it is worth having a discussion about whether there are some statutory changes that might be useful to try to modernize what it does.

And I think in cases we may be missing things. I have seen a lot of cases where the Paperwork Reduction is actually creating more paperwork, frankly, than it is reducing because of modern technology.

Mr. WOMACK. I thank the Director.

I have one other question, Mr. Chairman, that I am not going to ask. I will submit it for the record. A lot of attention has been given to the fiduciary rule, and I do have a question regarding it, but I will submit it for the record so as to be respectful of everyone's time.

Mr. WOMACK. I thank the gentleman for his work, his testimony today, and also for his previous work at HUD. Thank you so much for having a good, spirited, and constructive debate today. Thank you so much.

Mr. DONOVAN. Thank you.

Mr. WOMACK. I yield back.

Mr. CRENSHAW. Thank you.

Mr. Graves is recognized.

Mr. GRAVES. Thank you, Mr. Chairman.

And I want to share my respect for the ranking member, Mr. Serrano, and greatly appreciate your reflections a minute ago.

To Mr. Donovan, who has the unfortunate opportunity to be the first hearing after a district work period, what you have sensed today is in no disrespect for you or what you have presented to us. It is more of a reflection of what our jobs are, and that is to be the voices of our constituencies.

Coming back from a district work period, that is what we hear, and that is what you have heard expressed today. I understand that we are the voice of our constituencies, and obviously, today, you are the voice of the administration. So it is two very different roles there for each of us. So thank you for your patience as we have expressed our frustration after we have sensed the pulse of our districts.

But just on a different matter, I know you are a member of the National Ocean Council, if I could just ask you a question or two as it relates to that.

Can you just help us as a committee understand, in terms of funds and personnel, how is that requested or how much is re-

quested in the President's budget, fiscal year 2017, as well as maybe historically, how many resources have been allocated through dollars and personnel since its formation?

Mr. DONOVAN. To be frank, I don't have that information at hand right now. I would be happy to follow up and get you more details on that following the hearing.

[The information follows:]

The National Ocean Policy (NOP) is helping to ensure that the many Federal agencies involved in ocean management work together to reduce duplication and red tape and use taxpayer dollars more efficiently. Because NOP work is consistent with other existing agency missions and authorizations and is interwoven with base agency programs, it is not possible to separate work done to further the NOP from existing agency activities. As such, OMB does not track NOP funds and FTE across agencies.

For information on total Federal ocean and coastal spending across agencies, not specific to the NOP, please see the 2015 Federal Oceans and Coastal Activities Report (https://www.whitehouse.gov/sites/default/files/microsites/ostp/FOCAR%202012-2015.pdf).

Mr. GRAVES. OK. If you could that would be great. Maybe also include any of the annual reports that should be publicly available over the last couple of years for the committee.

Mr. DONOVAN. Yes.

Mr. GRAVES. And with that, Mr. Chairman, that is all I have.

Mr. CRENSHAW. Thank you.

Mr. Yoder.

Mr. YODER. Thank you, Mr. Chairman.

Mr. Director, three quick topics, see what we can do here in 5 minutes.

The first one deals with the gas tax, increase in the President's budget. The President told students in Georgetown University in 2011 that rising prices at the pump affect everybody, workers, farmers, truck drivers, restaurant owners, students who are lucky enough to have a car. The President himself said a $10 rise in oil prices translated to a 25 percent rise in gasoline prices.

Given the challenges that working people face already and the expense that they have from their Federal Government, I believe there is this challenge with trickle-down government, where all these taxes and regulations ultimately hit working people in my district the hardest, the folks at the poverty line, the people struggling to get by, and the Clean Power Plan is one of them.

In terms of this gas tax increase, explain to me why, given the challenges hard-working Americans are facing, why the President chose this time to put a gas tax burden on Americans.

Mr. DONOVAN. Well, first of all, this is a tax that goes across oil, not just gasoline——

Mr. YODER. Fair enough.

Mr. DONOVAN [continuing]. On oil companies directly when it is produced at the wellhead.

But I think, more importantly, we should also be focused on the burdens on families and communities that our infrastructure and the state of that infrastructure is producing. And so whether it is the hours that families spend caught in congestion, whether their inability to get to jobs or schools, we need to do something to make sure we accelerate our investment, not just in infrastructure, but smart infrastructure as well.

Traditionally, this has been a bipartisan issue. We did reach a bipartisan 6-year bill last year. But there is more that we can do. And investing in the infrastructure of the future, whether it is driverless cars or a broad range of other areas, the research and development that we need on transportation, we think that those costs on families need to be recognized as well.

Mr. YODER. In 2008, Joshua Bolten, chief of staff to then President George Bush, issued a memorandum on May 9 to the heads of executive departments and agencies, as well as the Administrator of the Office of Information and Regulatory Affairs, to encourage them to resist the historical tendency of administrations to increase regulatory activity in their final months. Later, Bolten noted "that we did not intentionally jam or burden our successors."

My question for you is, does the White House intend to issue such a similar memo along the lines taken by the chief of staff to George Bush in 2008. And at that point, of course, he didn't know if the next President was going to be a Democrat or Republican. They just said let's not jam everyone up with tons of regulations. What is your position? What is the administration's position on that?

Mr. DONOVAN. In fact, not just are we considering it, Howard Shelanski has issued a memo to agencies to try to lay out the fact that we will enforce very consistent standards on rulemaking throughout the end of the administration and to encourage agencies to finish their work as quickly as possible and to make sure that they are prioritizing so that we don't have a substantial unusual amount of rulemaking.

Mr. YODER. Great. Appreciate that, continuing that tradition.

Finally, I will ask you about the deeming rule. I know that is something that is under consideration at the OMB. FDA submitted the final set of regulations to OMB. OMB has a 90-day period to review and it can extend for another 30 days. We have currently passed that 120-day mark. So I want to ask you about that.

And then I wonder if you have taken into account the regulatory burden in terms of the expense of implementing all of that when you have tens of thousands of cigars and vapor products, and not just brand name products, but each different variation in flavor and size and consent.

And I guess, so, one, can you clarify where we are in the process? We are past the 180-day review. When do you think you will actually have a result on that?

And then wouldn't it be less costly and easier to implement and ultimately be, I think, more effective for the FDA to move a date forward for the newly deemed products and specifically set standards for vapor products? Because every single one of them have been made after the deeming date that FDA came up with. So it seems like we are putting an unfair burden on my constituents who utilize those products and maybe overwhelming for the FDA.

Mr. DONOVAN. So given that this is a rule we currently have under review, I can't speak to the specifics, the merits of the rule. It has been under review, as you say accurately, beyond the 90-day period. As I said earlier, we will take the time it takes to resolve rules, to make sure that we get cost-benefit analysis done correctly and accurately. And I expect that we will finalize soon, but I can't

give you a specific timeline on that, given that we are still under review.

Mr. YODER. All right. Well, as you are engaging in the review, those would be thoughts that you might want to take into consideration. I know you have had plenty of comments, and the FDA has as well, and I am assuming those are the types of things you are wrestling with.

Mr. DONOVAN. I can assure you those are exactly the kinds of issues that we look at.

Mr. YODER. We appreciate your thoughts on that. Thank you.

Mr. CRENSHAW. Thank you.

Mr. Serrano, do you have any closing comments?

Mr. SERRANO. No. Just to thank the chairman and thank the members of the committee for this hearing. It was spirited, that is a good thing.

And thank you, sir, for your service to our country and for making New York look good all the time. Thank you.

Mr. DONOVAN. Thank you.

Mr. CRENSHAW. And I would just add my words of thanks to your commitment to public service, and we appreciate you being here today. That is what the legislative process is all about, a give-and-take. And just appreciate your spirit and the hard job that you have. So we look forward to continuing to work with you as best we can to make this a better place for all of us.

Mr. DONOVAN. Thank you.

Mr. CRENSHAW. Thank you very much.

Mr. DONOVAN. Thank you for having me.

Mr. CRENSHAW. Thank you. This hearing is adjourned.

FY 2017 FSGG Committee Questions for the Record (OMB Director Donovan's Testimony; March 2016)

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MB Staffing

The OMB funding and staffing have been increasing since FY 2012.

Question: Please provide a table showing the number and percentage of civil service, non-SES new hires since FY 2012 that have been selected:

1. from the President Management Fellows (PMF) program?

2. from USAJobs.gov, exclusive of the PMF program?

3. at pay grade of GS-13 or higher?

4. with a veterans preference?

See attached table.

	HIRING AUTHORITIES							OTHER DATA			
	TOTAL HIRES	PMF Hires	% PMF's	From USAjobs	% from USAjobs	Hires from other authorities	% Other authorities	GS-13/15	% GS-13/15	Vet Pref	% Vet
FY12	31	8	25.8%	13	41.9%	10	32.3%	12	39%	2	6%
FY13	2	0	0	1	50%	1	50.0%	2	100%	0	0%
FY14	46	22	48%	18	39%	6	13.0%	10	22%	3	7%
FY15	114	29	25.4%	56	49.1%	29	25.4%	52	46%	9	8%

Chairman Crenshaw

Question: Please provide an organizational chart by branch or office, including ITOR, of current FTE and civil service, non-SES new hires since FY 2012.

See attached table.

OFFICE	FY 2012	FY 2013	FY 2014	FY 2015
National Security Programs	4	0	4	8
General Government Programs	3	0	6	12
Natural Resource Programs	3	0	6	8
Health Programs	3	0	3	11
Education, Income Maintenance, and Labor Programs	0	0	6	6
Office of Federal Financial Management	5	0	4	4
Office of Information and Regulatory Affairs	1	1	0	10
Office of Federal Procurement Policy	0	0	1	1
ITOR/E-Government & Information Technology	5	0	10	34
OMB-Wide Offices	7	1	6	20
Total	31	2	46	114

Chairman Crenshaw

Question: What has been the retention rate of civil service, non-SES new hires since FY 2012?

See attached table.

	TOTAL HIRES	HOW MANY HAVE LEFT	% THAT HAVE LEFT
FY12	31	15	48%
FY13	2	1	50%
FY14	46	1	2%
FY15	114	1	1%

Chairman Crenshaw

Question: Does OMB advertise vacancies on non-Federal government hiring websites?

OMB relies on USAjobs.gov as the primary mechanism for public notification. However, we have posted on external non-Federal sites for a couple of specialized positions to generate awareness and interest. In all cases, the external postings refer the applicants back to USAjobs.gov to officially apply.

- Toxicologist - posted on the Society for Risk Analysis and the Society for Toxicology
- Economist - posted on Job Openings for Economists, American Economic Association

Chairman Crenshaw

Question: What does OMB do to ensure that it throws the widest net to include the most diverse and talented pool of potential candidates?

OMB's diversity recruitment goal is to attract, develop and retain staff of the highest quality, and to provide a working environment that will enable staff members to maximize their contributions to the achievement of OMB's mission. OMB's diversity recruitment strategy focuses on several key areas including targeted outreach and engaging hiring managers, recruiters and OMB's Employee Resource Groups in the process.

OMB's diversity recruitment initiatives over the past year have adopted OPM's best practices with the creation of Employee Resources Groups. ERGs are designed to cultivate a supportive, welcoming, and inclusive work environment. They are voluntary, employee driven groups that serve as a resource for the members and the organization by providing support, identifying barriers in the workplace, enhancing an employee's professional development, and providing organized agency-wide activities. We currently have 11 employee-run groups that provide direct outreach to the staff and targeted communities:

- African American
- Arts Council
- Asian American/Pacific Islander
- Hispanic
- Interfaith
- OMB PRIDE
- NextGen Young Professionals
- Parents
- Professional Women
- Sports Enthusiasts
- Veterans

OMB also works to ensure a diverse pool in our SES Candidate Development Program to increase diversity of OMB's future managers.

OMB recognizes that its greatest single asset is its workforce and that it is only with a diverse and inclusive workplace that it can truly perform at its best.

Chairman Crenshaw

Ports and Waterways

The Administration's fiscal year 2017 budget cut Army Corps funding by 22 percent, and did not fund any new deep draft navigation project.

Question: Why did the Administration propose a 22 percent reduction over last year's Army Corps budget?

The Bipartisan Budget Act of 2015 (BBA) provided sequester relief in FY 2016 and FY 2017, with most of the relief provided in the first year. The Administration takes seriously our commitment to adhere to the funding levels in the BBA. Doing so requires tough choices. The Budget demonstrates that we can make critical investments for our economic future and our national security while maintaining fiscal stability. The 2017 President's Budget provides $4.6 billion in discretionary funding for the Corps of Engineers and focuses resources on the highest priority work within the agency's three main missions: flood and storm damage reduction; commercial navigation; and aquatic ecosystem restoration.

Chairman Crenshaw

Question: Why did the Administration propose a reduction of almost $800 million for the highly competitive construction account?

The 2017 Budget builds on the Bipartisan Budget Agreement secured last fall, adhering to the discretionary levels provided for 2017. This funding level requires tough choices and a focus on investments that will yield the highest return to the Nation. The 2017 President's Budget emphasizes investments in construction projects that will yield high economic and environmental returns or address significant risks to public safety. In addition, the Budget emphasizes funding for dam safety and related work, and projects that will complete construction with funds provided in 2017.

Chairman Crenshaw

Question: What criteria were used for the only new start selection in the Administration's FY17 request?

The FY 2017 President's Budget emphasizes investments in ongoing construction projects that will yield high economic and environmental returns to the Nation and/or address significant risks to public safety. To comply with a Biological Opinion, the Budget proposes one new construction project for work on a fish passage facility at the Mud Mountain Dam in Washington.

Chairman Crenshaw

Mandatory Agencies

Many agencies throughout the Federal government, such as the Office of Financial Research, the Office of Financial Stability and the Consumer Financial Protection Bureau, fund their operational salaries and expenses through mandatory appropriations

Question: How does OMB review the operational budgets of agencies that do not have an annual budget review by the Appropriations Committee?

OMB closely reviews the activities, efficiency, and budget estimates for all Federal programs and agencies that are included in the President's Budget regardless of whether they are funded through appropriations or through direct spending controlled by permanent laws. Reliable, non-appropriated funding mechanisms for the Office of Financial Research, the Office of Financial Stability (OFS), and the Consumer Financial Protection Bureau facilitate long-term planning and the execution of complex initiatives. OMB's annual budget review includes an evaluation of the effectiveness and efficiency of agency programs, policies, and procedures and an assessment of progress in addressing mission-related needs, challenges, and opportunities. For example, OMB has worked closely with OFS to ensure that administrative costs for oversight of the Troubled Asset Relief Program (TARP) are reduced commensurate with the divestment of assets purchased to support credit markets and financial institutions as the TARP program winds down.

Chairman Crenshaw

Question: What oversight did OMB provide in the FY17 Consumer Financial Protection Bureau's budget request?

OMB closely reviewed the estimates for the Consumer Financial Protection Bureau (CFPB) provided in the President's Budget for FY 2017 as it does for all agencies and programs. The Dodd-Frank Wall Street Reform and Consumer Protection Act established the CFPB as an independent bureau of the Federal Reserve with permanent funding derived from excess earnings of the Federal Reserve System. CFPB's budget is subject to OMB oversight though it is not subject to OMB approval. In addition, the Bureau regularly posts financial reports on its website and routinely testifies before the Congress on its budget and performance. In addition to OMB's review, CFPB is overseen by the Congress, GAO, and the Federal Reserve's Inspector General.

Chairman Crenshaw

Question: How does OMB ensure that agencies with mandatory funds are acting in a fiscally responsible manner?

When OMB reviews agency operational budgets, we take into account all sources of funding, including both discretionary and mandatory funding. Agency budget submissions include detailed information on administrative spending, including IT contracts, hiring plans, and real property expenses. OMB reviews these submissions, and works with agencies to ensure that the President's Budget reflects efficient and effective operational plans. As agencies execute their plans during the year, OMB also exercises oversight of the same financial management, information technology, procurement, and other responsibilities with respect to mandatory spending as we do with discretionary spending.

Chairman Crenshaw

Question: How many agencies use mandatory funds to pay for their staff and operating budgets?

According to data underlying the President's 2017 Budget, 34 Executive Branch agencies use mandatory funds for personnel compensation. This total includes 12 cabinet departments, four mid-size agencies, 17 smaller independent agencies, and the U.S. Postal Service. In many cases, this use of mandatory funding involves spending from revolving funds, where agencies are authorized to collect fees for services they provide and to spend those fees without further appropriation. Of the 34 agencies, 21 agencies fund these mandatory obligations from at least one revolving fund. The attached table lists the 34 agencies and indicates those where some or all of the applicable accounts involve revolving funds.

Agencies Using Mandatory Funds to Pay Staff and Operating Budgets*

Agency	With Revolving Fund**
Department of Agriculture	X
Department of Commerce	X
Department of Defense--Military Programs	X
Department of Energy	X
Department of Health and Human Services	X
Department of Homeland Security	
Department of the Interior	X
Department of Justice	X
Department of Labor	X
Department of Transportation	X
Department of the Treasury	
Department of Veterans Affairs	X
Corps of Engineers--Civil Works	
Environmental Protection Agency	X
General Services Administration	X
Office of Personnel Management	X
Bureau of Consumer Financial Protection	
Council of the Inspectors General on Integrity and Efficiency	X
District of Columbia	
Equal Employment Opportunity Commission	X
Farm Credit Administration	X
Farm Credit System Insurance Corporation	X
Federal Deposit Insurance Corporation	X
Federal Financial Institutions Examination Council	
Federal Housing Finance Agency	
Federal Retirement Thrift Investment Board	
Gulf Coast Ecosystem Restoration Council	
Independent Payment Advisory Board	
National Archives and Records Administration	
National Association of Registered Agents and Brokers	
National Credit Union Administration	X
Postal Service	X
Tennessee Valley Authority	X
Vietnam Education Foundation	

*** Executive Branch only.**
**** Some or all of the applicable accounts are revolving funds.**

Chairman Crenshaw

National Ocean Policy Executive Order

President Obama's National Ocean Policy Executive Order directs all executive departments, agencies, and offices that are members of the National Ocean Council and any other executive department, agency, or office whose actions affect the ocean, our coasts, and the Great Lakes to "take such action as necessary" to implement the National Ocean Policy and participate in the process for coastal and marine spatial planning.

Question: As a member of the National Ocean Council, what is the total funding and personnel requests in the President's FY 2017 Budget for activities in support of the National Ocean Policy?

The National Ocean Policy (NOP) is helping to ensure that the many Federal agencies involved in ocean management work together to reduce duplication and red tape and use taxpayer dollars more efficiently. Because NOP work is consistent with other existing agency missions and authorizations and is interwoven with base agency programs, it is not possible to separate work done to further the NOP from existing agency activities. As such, OMB does not track NOP funds and FTE across agencies.

For information on total Federal ocean and coastal spending across agencies, not specific to the NOP, please see the 2015 Federal Oceans and Coastal Activities Report (https://www.whitehouse.gov/sites/default/files/microsites/ostp/FOCAR%202012-2015.pdf).

Chairman Crenshaw

Question: How much has been allocated on implementation for the National Ocean Policy since the policy was established in July 2010?

Because NOP work supports and is interwoven with base agency authorizations and programs, it is not possible to separate work done to further the NOP from existing agency activities. As such, OMB does not track such allocations.

For information on total Federal ocean and coastal spending across agencies, not specific to the NOP, please see the 2015 Federal Oceans and Coastal Activities Report (https://www.whitehouse.gov/sites/default/files/microsites/ostp/FOCAR%202012-2015.pdf).

Chairman Crenshaw

Question: Pursuant to the Executive Order, what actions has OMB taken to implement the National Ocean Policy?

Any actions to implement the NOP are part of agencies' existing missions and authorizations; likewise, the actions OMB has taken are part of the normal coordination and review process of agency activities. For example, a goal of the Policy is to reduce adverse ocean and coastal conditions, which is also consistent with the core mission of several agencies. OMB worked with the National Oceanic and Atmospheric Administration to craft the FY 2016 and 2017 President's Budget requests for ocean acidification research, which, if enacted, will benefit shellfish and other fisheries, coral reefs, and coastal communities across the nation.

Chairman Crenshaw

Recommendations adopted by the National Ocean Policy Executive Order stated that the National Ocean Council Co-Chairs, "in collaboration with OMB," would "develop an annual interagency ocean budget guidance memorandum."

Question: What is the status on efforts to develop an annual interagency ocean budget guidance memorandum?

Neither the National Ocean Council Co-Chairs nor OMB issued an interagency ocean budget guidance memorandum for the FY 2017 President's Budget.

Chairman Crenshaw

The National Ocean Council's Steering Committee is to meet at least every other month in consultation with OMB.

Question: Has the National Ocean Council Steering Committee met with OMB? If so, please describe the purpose and outcome of any such consultations.

The National Ocean Council Steering Committee has not had regular or formal meetings with OMB. Steering committee staff and OMB staff informally discuss activities on an as-needed basis.

Chairman Crenshaw

President Obama's National Ocean Policy Executive Order required annual reports including actions taken by the agency in the previous calendar year to implement the order.

Question: Has OMB prepared and made publicly available any such annual report for calendar years since 2010?

The National Ocean Council released a Report on the Implementation of the National Ocean Policy in 2015 (https://www.whitehouse.gov/sites/default/files/docs/nop_highlights__annual_report_final_-_150310.pdf). This report is a compilation of coordinated Federal agency actions, consistent with their existing authorizations, that support the National Ocean Policy.

Chairman Crenshaw

DATA Act Implementation

OMB's budget request includes operational funds to be used for statutory requirements including the DATA Act. However, the FY17 budget request does not include any DATA Act implementation activities.

Question: What funds and personnel have been designated to DATA Act implementation activities?

DATA Act implementation activities are part of OMB's broader missions under government-wide financial management, Federal procurement policy, and budget formulation and execution. No new funds have been allocated for DATA Act implementation above existing levels.

OMB is devoting staff time across management, OMB-wide, and resource management offices to support DATA Act implementation and compliance. To the maximum extent possible, OMB has incorporated DATA Act activities into the broader landscape of OMB's work to promote increased transparency in Federal spending, ongoing work related to annual budget formulation and budget execution activities, and initiatives related to Federal procurement policies.

Chairman Crenshaw

Question: What resources are requested for compliance activities in the FY17 request?

OMB is devoting staff time across management, OMB-wide, and resource management offices to support DATA Act implementation and compliance. To the maximum extent possible, OMB has incorporated DATA Act activities into the broader landscape of OMB's work to promote increased transparency in Federal spending, ongoing work related to annual budget formulation and budget execution activities, and initiatives related to Federal grants and procurement policies.

DATA Act implementation activities are part of OMB's broader missions under government-wide financial management, Federal procurement policy, and budget formulation and execution. No new funds have been allocated for DATA Act implementation above existing levels.

Chairman Crenshaw

Question: How is OMB providing timely guidance to agencies on preparing its data-centric accounting and award reporting, as well as the requirement to complete the grantee and contractor award reporting pilot projects in compliance with Section 5 of the Act?

In accordance with the Act, OMB issued Memorandum M-15-12 in May 2015 to provide guidance for continued award-level reporting, new requirements for both agency-level and award-level reporting, and implementation of data standards for data published on USAspending.gov (or its successor site). OMB and the Department of the Treasury also issued data definition standards for USAspending.gov last summer. These 57 data definition standards were developed through a yearlong process, during which OMB and the Department of the Treasury consulted with representatives from the Federal councils and lines of business to discuss how agencies use these data elements in their operations, as well as non-Federal stakeholder communities, including recipients, open government groups, and industry. During the standardization process, OMB and the Department of the Treasury learned of some areas in which agencies could use more guidance; OMB will be issuing guidance to agencies to address these matters this year. Additional guidance is scheduled to be issued in spring 2016 that will include further policy clarifications on financial reporting and implementation related to DATA Act requirements.

OMB is working closely with the Department of Health and Human Services and the General Services Administration to meet the requirements of the Pilot to Reduce Recipient Reporting Burden detailed in Section 5 of the Act. Although this pilot will primarily involve recipients of Federal awards and does not contain requirements for agencies, agencies are being kept apprised of pilot activities through the existing DATA Act Implementation governance structure.

Chairman Crenshaw

OMB Oversight Related to Information Quality Act Requests

It is essential that federal agencies are appropriately evaluating the quality, objectivity, utility and integrity of any scientific and economic information supporting agency guidance and rulemakings.

Question: How does OMB review agency responses to Information Quality Act requests?

OMB's current practice is consistent with The Office of Information and Regulatory Affairs 2002 memorandum for the President's Management Council regarding "*Executive Branch Implementation of the Information Quality Law*" (available at: https://www.whitehouse.gov/sites/default/files/omb/assets/omb/inforeg/pmc_graham_100402.pdf). This memorandum requests that Federal agencies forward Information Quality requests-for-correction and administrative appeals to OMB so that we can provide clarifying guidance and assistance on applying IQA guidelines. OMB review focuses on facilitating government-wide consistency in the implementation of OMB's February 2002 "*Guidelines for Ensuring and Maximizing the Quality, Objectivity, Utility, and Integrity of Information Disseminated by Federal Agencies*" (available at: https://www.whitehouse.gov/sites/default/files/omb/assets/omb/fedreg/reproducible2.pdf).

Chairman Crenshaw

Question: What is the average amount of time OMB spends reviewing agencies Information Quality Act requests?

The staff time needed to understand the nature of the information being challenged and the agency's response to OMB inquiries varies depending on the complexity of the issue. Some requests can be reviewed by OMB in a very short time period, sometimes less than a business day. Other times, OMB may request one or more discussions with an agency.

Chairman Crenshaw

The Administrative Procedure Act (APA) generally provides for judicial review of final agency action. Final actions under the Data Quality Act, however, are currently not covered under the APA.

Question: How does OMB ensure the accuracy of information forms the basis of federal rules and regulations?

Evaluation of the quality of the information used to support policy is an important component of OMB's review under E.O. 12866 and E.O. 13563. More specifically, E.O. 13563 states that "each agency shall ensure the objectivity of any scientific and technological information and processes used to support the agency's regulatory actions."

Chairman Crenshaw

Question: Has OMB developed guidelines for ensuring and maximizing the quality, objectivity, utility, and integrity of information disseminated by federal agencies?

Yes, in fulfillment of the requirement in the Information Quality Act, OMB released guidelines in 2002: "*Guidelines for Ensuring and Maximizing the Quality, Objectivity, Utility, and Integrity of Information Disseminated by Federal Agencies*," (available at: https://www.whitehouse.gov/sites/default/files/omb/assets/omb/fedreg/reproducible2.pdf). These guidelines required Federal agencies to issue their own implementing guidelines. Agencies post their agency-specific information quality guidelines on their web site, and OMB also compiles a listing of the URLs for agency-specific guidelines (available at: https://www.whitehouse.gov/omb/inforeg_agency_info_quality_links/).

Chairman Crenshaw

Congress is increasingly focused on ensuring that federal agencies are both transparent and accountable in how they spend taxpayer funds through federal grants. However, many federal agencies still lack disclosure standards and consistent procedures.

Question: How has OMB worked with federal agencies to provide the public with readily accessible information on grantees, grant applications, evaluation criteria, and other relevant information?

OMB's leadership to reform Federal grants management policy, culminating in the issuance of the 2014 final Uniform Guidance has been important in ensuring that the public and potential grant recipients are aware of assistance opportunities, the associated eligibility requirements, and evaluation criteria. The Uniform Guidance includes requirements to provide public notice of Federal financial assistance programs to the Catalog on Federal Domestic Assistance (CFDA) and requires Federal awarding agencies to post competitive opportunities to an OMB-designated Government-wide web site, currently Grants.gov, for finding and applying for grants. For both requirements, the Uniform Guidance requires agencies to include specific information regarding program eligibility, evaluation criteria, application submission information, and post-award requirements. These requirements help ensure that the public and potential recipients are well informed regarding grant programs and opportunities.

In addition, to improve information provided to the public on grant awards made, OMB has worked with the Federal community, pursuant to the Federal Funding and Accountability and Transparency Act (FFATA), to have Federal awards published on USAspending.gov, a one-stop publicly available website with information on what Federal awards have been made, to whom, where, and for what reason. This requirement and the associated improvements related to the OMB and Treasury-led efforts to implement the Digital Accountability and Transparency Act of 2014 (DATA Act) provide the public with readily accessible information on grantees and grant awards.

Chairman Crenshaw

Question: Has OMB provided guidance establishing merit-based selection procedures for competitive grant programs?

In addition to each grant competition's requirements under statute and/or regulation, OMB has set forth general guidelines for agencies to conduct merit-based selection procedures in the Uniform Guidance. For competitive grants, the Uniform Guidance requires Federal awarding agencies to design and execute a merit review process for applications, unless prohibited by Federal statute. This process must be described or incorporated by reference in the funding opportunity notice available on Grants.gov.

Chairman Rogers

OMB Oversight Related to Information Quality Act Requests

The Committee has received reports that some agencies are placing documents on their websites which contain a disclaimer indicating that the document is exempt from the Information Quality Act because the agency is not disseminating the data or a report but only providing a "bulletin board" where outside parties can express their opinion on a particular subject matter.

Nonetheless these bulletin boards contain the logo of a federal agency and most certainly create the impression of agency approval of the content therein.

Question: What recourse do affected persons have to correct documents on agency websites when the agency claims the documents are not subject to the Information Quality Act?

OMB's "*Guidelines for Ensuring and Maximizing the Quality, Objectivity, Utility, and Integrity of Information Disseminated by Federal Agencies*" have a definition of "dissemination", which may provide guidance to interested parties on whether or not a particular item's inclusion on an agency website may be covered by the Act. In addition, we are aware that the Administrative Conference of the United State (ACUS) is currently considering making recommendations regarding publicly available online consumer complaints databases, including publication of procedures for requesting corrections in this area.

Chairman Rogers

OIRA Federal Databases

The Office of the Inspector General has reported on errors in GSA's Federal Procurement Data System which are detrimental to small businesses because they identify procurements which in fact went to large businesses in lieu of small businesses.

We believe that the aforementioned deficiency is not unique to the GSA database.

Question: What is OMB doing to make sure that publicly-searchable databases come into compliance the Information Quality Act?

OMB is responsible for general oversight of the Information Quality Act, but relies on agencies to ensure the quality of each database that they disseminate to the public is compliant with OMB's and their agency-specific Information Quality Guidelines. Consistent with OMB's Guidelines and OMB's Memorandum for Heads of Executive Departments and Agencies regarding "*Open Data Policy – Managing Information as an Asset*" (M-13-13, available at: https://www.whitehouse.gov/sites/default/files/omb/memoranda/2013/m-13-13.pdf) data should be "described fully so that consumers of the data have sufficient information to understand their strengths, weaknesses, analytical limitations, security requirements, as well as how to process them."

Chairman Rogers

OIRA Staff Level

Since its inception some thirty-five years ago, OIRA has suffered nearly a 50% reduction in its level of employment although its statutorily required workload has increased.

Question: Why hasn't OMB prioritized this office?

OMB places a high priority in providing all of its offices, including OIRA, with the resources they need to accomplish their important missions.

Chairman Rogers

OIRA Midnight Regulations

Virtually every Administration attempts to flood the Federal Register as its term comes to an end.

Question: What plan does OMB have in place to address the issue of Midnight Regulations, particularly since it is operating at a reduced staff level?

On December 17, 2015, OIRA Administrator Shelanski issued a memo to Deputy Secretaries outlining OMB's expectations about regulatory review at the end of the Administration. The memo reiterates that OIRA will continue to be guided by the same practices and principles for the development and review of regulations that we have upheld throughout this Administration. OIRA is committed to reviewing all regulations in compliance with governing Executive Orders and OMB Circulars. Agencies should therefore plan accordingly to avoid a last minute rush of regulations.

Chairman Rogers

OIRA Outreach to Small Businesses under the Information (Data) Quality Act

The Information (Data) Quality Act has been used by a number of sectors to reduce the regulatory burden resulting from poor data.

However one sector which is marked by its absence from the use of the DQA is the small business sector. Historically the small business sector did not have the resources to file petitions under the Act or were concerned about incrimination.

At the same time federal agencies had no incentive to promote the use of a statute which would allow their constituencies to challenge their work.

Question: Given that the statute designates OMB as the agency in charge of the implementation of the Information (Data) Quality Act, please inform the Committee of any program OMB has to address its absence from the small business community.

The concerns of the small business sector are important to the Administration; however, OMB does not recruit stakeholders to use the process. We do respond to procedural questions raised by those who would like to use the request-for-correction process, and we have issued guidance, and have given presentations to organizations that have requested information about how the request-for-correction process works.

We would also note that GAO's recent report listed the organizations who filed requests for correction with agencies tween 2010 and 2014 (Appendix 2, beginning on page 44 of http://www.gao.gov/products/GAO-16-110). Although they do not list "small businesses" as a category, the list does include some smaller organizations.

Rep. Yoder

Regulatory Environment in Administration Changeover

Thank you for your recent testimony before the House Financial Services and General Government Appropriations Subcommittee. During our questioning, I asked you a question regarding the current Administration's plans for transitioning to the next President. Near the end of George W. Bush's Presidency, former White House Chief of Staff John Bolten issued a memorandum to the Heads of Executive Departments and Agencies as well as the Administrator of the Office of Information and Regulatory Affairs (OIRA). This memo directed the agencies to "resist the historical tendency of administrations to increase regulatory activity in their final months." Bolten's stated goal was to reduce the potential burden that last-minute regulatory action could have on the incoming administration.

My question to you was whether the current Administration would take a similar approach to the coming transition. I was pleased to hear you affirm that the Administration's position is to complete all rulemaking in a timely manner and abstain from undertaking an unusually high amount of regulatory action. You also stated that OIRA Administrator Howard Shelanski has already circulated a memorandum to that effect. I read that memo, and would like to ask three more questions to clarify the Administration's regulatory intentions.

Administrator Shelanski's memo asks agencies to "complete their highest priority rulemakings by the summer of 2016."

Question: Does the term "complete" in this instance refer to issuing a final rule?

not, please define precisely what "complete" means in this context.

The memorandum states that agencies should strive to complete their rulemakings by the summer of 2016. The memorandum encouraged agencies to issue such final rules in that general time period; however, the memorandum also states that agencies will be issuing rules throughout 2016, and that the dates established in the latest Regulatory Plan and Agenda should be adhered to. In addition, while many agencies are striving to issue final rules by the end of the Administration, we nevertheless anticipate that agencies will continue to issue proposed rules throughout 2016. Such proposed rules may implement statutory changes, initiate new retrospective review efforts, or be necessary for continued program operations. Administrator Shelanski's memo was meant to encourage agencies to submit draft regulations to OIRA in a timely manner so that OIRA can continue to review regulations consistent with the practices and principles for the development and review of regulations that we have upheld throughout this Administration.

Rep. Yoder

Administrator Shelanski's memo appears to be based on a wish to "avoid an end-of-year scramble." Administrator Shelanski seems to be more concerned about administrative inconvenience rather than about the potential harm that rushed regulation might have on the American people and the next president.

Question: Do you agree that the cumulative impact of regulations and the potential for unintended consequences should be taken into account as agencies consider completing their regulatory actions before the end of the Administration's term?

OMB takes seriously an orderly transition between administrations. It is essential to assure that regulations issued at the end of the Administration are not rushed, but rather reflect the same high standards that have applied throughout this Administration. OMB's review standards always include the consideration of the cumulative impact of regulations on an industry when deciding whether to issue a new one, and the retrospective review of regulations already on the books to see if they are no longer necessary.

Rep. Yoder

The memo states that "OIRA will continue to be guided by the same practices and principles for the development and review of regulations that we have upheld throughout this Administration." In light of the potential cumulative impact of increased regulatory action in the final months of an administration, it seems that new regulations this year may warrant increased scrutiny.

Question: Have you considered using a higher standard of review for new regulations in 2016, in order to better prevent rushed, burdensome rulemaking from taking place?

As Administrator Shelanksi's memo states, OIRA will continue to be guided by the same practices and principles for the development and review of regulations that we have upheld throughout this Administration. These principles include the standards set forth in E.O. 12866. This executive order has effectively guided regulatory review across multiple administrations. We do not see a reason to deviate from standard practices or to impose a higher standard in the last year of an administration.

Rep. Womack

Fiduciary Definition – Morning Star

OMB currently has under review the U.S. Department of Labor's highly-controversial second attempt at proposed regulations concerning the definition of fiduciary. In December, a study by Morningstar agreed with critics of the rulemaking that the Department is "vastly underestimating the rule's potential impact. This highly-regarded company noted that while the government's economic analyses "have a high-end annual cost estimate of $1.1 billion," Morningstar's own analysis resulted in a "low-end" estimate that is "more than double" this "high-end" projection by the government.

Question: What procedures does OMB undertake when there is such a discrepancy between an agency's analysis and that of highly-regarded, disinterested parties?

OMB is aware of the Morningstar study and, as with all other regulatory reviews, OMB may consider third-party research and analysis during the course of a review.

Rep. Womack

Fiduciary Definition – Office of Advocacy

Besides the discrepancies between the Department of Labor (DOL) economic impact analysis and the assessments of highly-regarded private parties is the disagreement the "fiduciary" rule has engendered between government agencies concerning the rule's compliance with regulatory analysis mandates related to small business. The Small Business Administration's Office of Advocacy said in a letter to DOL that it is:

"[C]oncerned that the Initial Regulatory Flexibility Analysis ("IRFA") contained in the proposed rule lacks essential information required under the Regulatory Flexibility Act ("RFA"). Specifically, the IRFA does not adequately estimate the costs of the proposal or the number of small entities that would be impacted by it." The Office of Advocacy further explained to DOL that its Initial Regulatory Flexibility analysis is deficient to the extent it "does not clearly state what constitutes a small business in the analysis for this rulemaking... [and] it is uncertain whether the IRFA contained in the proposed rule accurately takes into account all of the potential small business impacts of the proposal." The Office of Advocacy went on to recommend to DOL that it "should consider both obtaining additional information on small entities as well as providing cost estimates in ranges and running multiple sensitivity analyses to see how the costs of the rule might change if some of the factors considered by DOL are different than its assumptions."

DOL seems to have ignored these recommendations from the Office of Advocacy as to steps it could take to ensure an adequate assessment of the rule's potential impacts on small business.

Question: What is OMB's policy when reviewing a rulemaking from an agency that the Office of Advocacy considers to have a deficient analysis concerning potential impacts on small business?

With regards to OMB interaction with SBA's Office of Advocacy during a rule review, there is a standard interagency process OIRA follows. When OMB reviews a draft regulation under Executive Order 12866 that is anticipated to impose a significant economic impact on a substantial number of small businesses, OMB relies on the expertise of the Office of Advocacy. This helps ensure that the issuing agency prepares a regulatory flexibility analysis when required by the Regulatory Flexibility Act. When the Office of Advocacy considers a regulatory flexibility analysis to be deficient, OMB ensures that the specific issues raised by the Office of Advocacy are addressed during the course of OMB's review of the rule. The process of addressing these issues is similar to that used to address other issues of analysis or policy that are identified during OMB review.

Rep. Womack

Question: Does OMB defer to the Office of Advocacy on such issues?

Please see response above.

Rep. Womack

Question: Does OMB ignore the Office of Advocacy?

Please see responses above.

Rep. Womack

Question: And in relation to this rule, do you agree with the Office of Advocacy's assessment?

Please see responses above. OMB relies on the expertise of the Office of Advocacy when reviewing draft rules that are likely to impose a significant economic impact on a substantial number of small businesses.

Rep. Womack

Question: Is OMB requesting any additional analysis from DOL to address the issue raised by the Office of Advocacy concerning the deficiencies in DOL's Regulatory Flexibility Analysis?

When OMB reviews a draft regulation that is anticipated to impose a significant economic impact on a substantial number of small businesses, we involve SBA's Office of Advocacy in the interagency review process established by Executive Order 12866. Doing so helps ensure that the issuing agency prepares a regulatory flexibility analysis when required by the Regulatory Flexibility Act. When the Office of Advocacy considers a regulatory flexibility analysis to be deficient, OMB ensures that the specific issues raised by the Office of Advocacy are considered during the course of OMB's review of the rule.

Rep. Amodei

Department of Labor fiduciary rule: OMB Review responsibility

The Department of Labor proposed a rule that could dramatically limit the amount of services retail investors are able to provide particularly lower-dollar retirement accounts. This would include many small business investors and individuals who need financial advice but can't afford a fully managed account. The rule would have significant and broad effects on the investment industry.

All indication from the Department of Labor per their previous hearings has indicated the rule will be implemented before January of 2017 and a new president takes over, pending OMB review completion and approval. These implementation plans are a part of the information that OMB must review and decide if they are compliant with the law governing the regulation process which states that regulation must consider the burden to stake holders.

The Chamber of Commerce believes the cost of implementation will be around $3.9 billion which is far greater than the DOL estimates. The Chamber also expresses concern that the Small Business Administration's Office of Advocacy was not allowed to review the rule before it was sent to OMB.

The OMB review process is dictated by Executive Order 12866 which was signed by President Bill Clinton in 1993. President Barrack Obama made a supplemental executive order on the review process in 2011, EO 13563. Both EOs state that regulators must consider a cost-benefit analysis including the total cost of cumulative regulations. OMB is responsible through the Office of Regulatory Affairs for ensuring regulations proposed by agencies have followed the EOs standards. OMB has no minimum requirement for review, only a maximum of 90 days. The EOs require OMB to ensure new regulations are conducted in the principals set forth in the EO which include cost burden analysis on industries of varied sizes and the tailoring of regulation to be of the least burden (implementation).

Question: What consideration will OMB use when reviewing the rule in regards to Department of Labor best practices in determining appropriate cost benefit analysis?

As you summarized above, OMB reviews agency regulatory impact analyses for consistency with EO 12866 and EO 13563. OMB also reviews regulatory impact analyses for consistency with OMB Circular A-4, which provides guidance to agencies on conducting regulatory analyses.

Rep. Amodei

Question: Does OMB believe that an 8 month implementation period for a rule as large as the DOL's conflict of interest proposal is in the spirit of either EO 12866 or 13563?

DOL has received considerable input on the implementation period, as has OMB during the course of the meetings we conduct upon request with outside parties as part of the EO 12866 review process. While we cannot comment on DOL's draft final rule at this time, OMB reviews all provisions of draft regulations using the principles set forth in EO 12866 and 13563. OMB will consider the length of the implementation period as it would any other provision of DOL's draft final rule.

Rep. Amodei

Question: Because OMB does not have the input of the SBA office of Advocacy in the DOL proposal, how will it determine how small businesses are affected per the EO requirements?

OMB shared the draft final rule with the Office of Advocacy during the course of the review. As a general matter, when OMB reviews a draft regulation that is anticipated to impose a significant economic impact on a substantial number of small businesses, we involve SBA's Office of Advocacy in the interagency review process established by Executive Order 12866. Doing so helps ensure that the issuing agency prepares a regulatory flexibility analysis when required by the Regulatory Flexibility Act. If the Office of Advocacy considers a regulatory flexibility analysis to be deficient, OMB will ensure that the specific issues raised by the Office of Advocacy are considered during the course of OMB's review of the rule. The process of addressing these issues is similar to that used by OMB to address other issues of analysis or policy that are identified during OMB review.

Rep. Amodei

Section 913(g) of Dodd-Frank passed into law in 2010 gives explicit authority to establish fiduciary standards to the Securities Exchange Commission (SEC). The law specifically states the SEC must promulgate rules restricting certain practices and conflicts of interests if the SEC deems such rules appropriate and current practice contrary to public interest. However, 5 U.S.C. includes the Reorganization Order no. 4 of 1978 which transferred the authority of fiduciary obligations under the Employee Retirement Investment Act (ERISA) to the Department of Labor. In The FDA V. Brown and Williamson Tobacco Corp. the Supreme Court of the United States decided that later decisions made by Congress that are more specific than earlier granted authorities take precedence to the older authorities, and closes out the ability of the former agency of jurisdiction to regulate even if the new law does not expressly revoke the older authority. The 2010 Dodd-Frank law is a clear intent of Congress to give fiduciary rule making authority to the SEC. The 1978 regulatory order was codified through executive order and by its own text intended to be temporary until the efficacy of the new jurisdiction was determined and proposals were made to Congress for permanent legislative solutions. In 1980, OMB determined the reorganization had alleviated confusion aud improved administration of the law. Congress never legislated a long-term solution and the E.O. was codified through lack of Congressional disapproval not through express Congressional intent.

At minimum, the authority of the DOL to promulgate fiduciary regulations is debatable. SEC chairman, Mary Jo White stated that the issuance of fiduciary standard rules were in draft stages and a top SEC priority. In fact, the SEC agenda for 2016 published with OMB states that the SEC will propose a new uniform fiduciary standard by fall of 2016.

`uestion: OMB is directed to ensure regulations are consistent with applicable law. Does OMB believe that ̲gal authority as conflicting as the DOL's in regard to fiduciary is an appropriate statutory foundation for regulation?

While we cannot comment on the specifics of this rulemaking, as it is under formal review under EO 12866, we would note that section 3(21)(A) of ERISA provides that a person is a fiduciary with respect to a plan to the extent he or she (i) exercises any discretionary authority or discretionary control with respect to management of such plan or exercises any authority or control with respect to management or disposition of its assets; (ii) renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such plan, or has any authority or responsibility to do so; or, (iii) has any discretionary authority or discretionary responsibility in the administration of such plan. Section 4975(e)(3) of the Internal Revenue Code identically defines "fiduciary" for purposes of the prohibited transaction rules set forth in Code section 4975.[1]

[1] Under Reorganization Plan No. 4 of 1978, 5 U.S.C. App. 1, 92 Stat. 3790, the authority of the Secretary of the Treasury to issue regulations, rulings, opinions, and exemptions under section 4975 of the Code has been transferred, with certain exceptions not here relevant, to the Secretary of Labor.

Rep. Amodei

OMB is directed to ensure the decisions of one agency do not conflict with policies or actions taken or planned by another agency.

Question: Since OMB published the SEC 2016 agenda and is aware of their intent to propose a uniform fiduciary standard per the 2010 Dodd-Frank law, how will that effect their review of the Department of Labor rule on the same subject matter?

To ensure that draft regulations would not conflict with the actions of another agency, OMB shares draft regulations with other relevant agencies in the course of the interagency review process. OMB will then convey the views provided by agencies involved in the review to the issuing agency. OMB has shared DOL's draft final rule with SEC during this review. OMB also notes that DOL has consulted with SEC of its own accord on numerous occasions.[1]

[1] See letter from Acting Assistant Secretary Adri Jayaratne to Chairman Kline and Chairman Roe dated March 16, 2015.

U.S. Department of Labor

Assistant Secretary for
Congressional and Intergovernmental Affairs
Washington, D.C. 20210

March 16, 2015

The Honorable John Kline
Chairman
Committee on Education and the Workforce
U.S. House of Representatives
2181 Rayburn House Office Building
Washington, D.C. 20515-6100

The Honorable Phil Roe, M.D.
Chairman
Subcommittee on Health, Employment,
Labor and Pensions

Dear Chairman Kline and Chairman Roe:

I am writing in response to your March 4, 2014 letter to Secretary Thomas E. Perez regarding the Department of Labor's efforts to protect retirement savings for middle class families from harmful conflicts of interest by updating the fiduciary standard under the Employee Retirement Income Security Act of 1974 (ERISA). The Department appreciates the opportunity to provide you with an update on our efforts and coordination between the Department of Labor and the Securities and Exchange Commission.

A new report from the President's Council of Economic Advisers shows that the current, broken regulatory environment creates misaligned incentives that cost working and middle class families billions of dollars a year—with some individual families losing tens of thousands of dollars of their retirement savings.[1] These incentives cause some retirement advisers, including brokers and insurance agents, to encourage working and middle class families to move from low-cost employer plans to individual retirement accounts (IRA) that typically entail higher fees—and to steer working and middle class families into higher-cost products within the IRA market. Conflicts of interest, such as back-door payments or hidden fees for directing investors to products that are not in their best interest, likely lead, on average, to $17 billion of losses every year for working and middle class families. The Department's new proposal aims to remove outdated regulatory loopholes that make it hard for America's workers to count on receiving retirement investment advice that is in their best interest.

Although the Department and the SEC have different statutory responsibilities, we both recognize the importance of working together on regulatory issues in which our interests overlap, particularly where action by one agency may affect the community regulated by the other agency. To that end, the Department sought technical assistance from the SEC during the development of the draft proposal. That technical assistance has helped the Department draft a proposal that strikes a balance between protecting individuals looking to build their savings and

[1] White House Council of Economic Advisers, The Effects of Conflicted Investment Advice on Retirement Savings (Feb. 2015), https://www.whitehouse.gov/sites/default/files/docs/cea_coi_report_final.pdf.

minimizing disruptions to the many good practices and good advice that the financial services industry provides today.

As SEC Chair Mary Jo White has acknowledged on numerous occasions,[2] over the past two years, the Department has consulted extensively with SEC staff on the draft proposal. Indeed, Secretary Perez has discussed relevant aspects of the draft proposal with SEC Chair White on at least eight occasions, including:

- Nov. 22, 2013: Secretary Perez met with SEC Chair White and staff
- Jan. 8, 2014: Secretary Perez met with SEC Chair White
- Apr. 3, 2014: Secretary Perez spoke by phone with SEC Chair White
- Jul. 28, 2014: Secretary Perez spoke by phone with SEC Chair White and staff
- Aug. 26, 2014: Secretary Perez met with SEC Chair White and staff
- Nov. 6, 2014: Secretary Perez spoke by phone with SEC Chair White
- Dec. 3, 2014: Secretary Perez spoke by phone with SEC Chair White
- Jan. 8, 2015: Secretary Perez met with SEC Chair White and staff

Other senior officials and staff from both agencies have held numerous meetings and phone calls throughout the development of the draft proposal. These collaborative discussions were wide-ranging. The SEC staff provided technical assistance on the Department's proposal, including the regulatory impact analysis. The Department has made numerous changes in response to observations and issues raised by SEC staff and is grateful for the staff's thorough technical assistance.

The development of a draft proposal is just an initial step in the regulatory process. As you may be aware, on February 23, 2015, the Department submitted a draft proposal to the Office of

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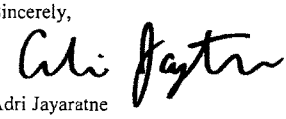
[2] See, SEC Chair Mary Jo White testimony, U.S. House of Representatives Committee on Appropriations, Financial Services and General Government Subcommittee, "Budget Hearing – Securities and Exchange Commission" (May 7, 2013); SEC Chair Mary Jo White testimony, U.S. Senate Banking Committee Hearing, "Mitigating Systemic Risk in Financial Markets through Wall Street Reforms" (Jul. 30, 2013); SEC Chief to Break her Silence on Fiduciary in 'Short Term' (Feb. 20, 2015) http://www.thinkadvisor.com/2015/02/20/sec-chief-to-break-her-silence-on-fiduciary-in-sho.

Management and Budget for review.[3] Under Executive Order 12866, OMB will coordinate review of the draft proposal to ensure it is consistent with applicable laws and that the policies of one agency do not conflict with the policies or actions taken by another agency, including the SEC.[4] During this review process, federal agencies with an equity in the draft proposal will have an opportunity for review and comment. This is another opportunity for SEC views to be considered. After DOL responds to comments received through OMB's interagency review process, the proposal will be issued as a notice of proposed rulemaking, along with proposed prohibited transaction exemptions. At that time, any interested party will have the opportunity to provide comment on all aspects of the proposal, including whether and how it accomplishes our goals of protecting individuals looking to build their savings and harmonizing with the regulated communities' responsibilities under the statutes enforced by the SEC.

Given the extensive technical assistance provided by SEC staff, any delay in moving forward would only hinder efforts to protect consumers from conflicts of interests among brokers, dealers, financial advisers, and others whose incentives may be misaligned with investors, potentially leading to deceptive and abusive practices. It will also delay the opportunity for the public to evaluate our proposal by participating in the comment process.

I am sure you would agree that all savers, regardless of their income level, deserve access to advice that is in their best interest. It is essential that any rulemaking in which we engage take into account the impact on middle and low-income Americans and on the regulated community, and we look forward to working with you on this and other issues of importance affecting America's workers. If you or any member of your staff has questions, please contact Kate Garza in the Department's Office of Congressional and Intergovernmental Affairs. She may be reached at (202) 693-4600.

Sincerely,



Adri Jayaratne
Acting Assistant Secretary

cc: The Honorable Robert C. Scott
Ranking Member
Committee on Education and the Workforce

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[3] The Department's Fall 2014 Regulatory Agenda indicated that a new notice of proposed rulemaking was under development. The Department's Regulatory Agenda and Regulatory Plan are available at http://www.dol.gov/asp/regs/agenda.htm.
[4] 58 Fed. Reg. 51735 (Oct. 4, 1993).

COMMITTEE ON EDUCATION
AND THE WORKFORCE
U.S. HOUSE OF REPRESENTATIVES
2181 RAYBURN HOUSE OFFICE BUILDING
WASHINGTON, DC 20515-6100

March 4, 2015

The Honorable Thomas E. Perez
Secretary
U.S. Department of Labor
200 Constitution Avenue, NW
Washington, D.C. 20210

Dear Secretary Perez:

President Obama recently directed the Department of Labor (DOL) to move forward with a repackaged rulemaking to expand fiduciary liability.[1] DOL's initial attempt to regulate in this area in 2010 was roundly criticized by stakeholders and by lawmakers on a bipartisan basis and subsequently withdrawn.[2] We continue to have strong reservations about any policy that could reduce access to retirement savings options and increase costs for lower and middle-income Americans.[3] Additionally, we remain concerned this project could conflict with Securities and Exchange Commission (SEC) rulemakings authorized by the *Dodd-Frank Wall Street Reform and Consumer Protection Act* (Dodd-Frank Act).[4] Consequently, we write to request documents and communications demonstrating the coordination between DOL and SEC regarding DOL's ongoing project to expand fiduciary liability.

In anticipation of DOL's retooled proposal, SEC Commissioner Gallagher recently raised a number of substantive concerns.[5] Like Commissioner Gallagher, we believe "[i]nvestors benefit from choice; choice of products, and choice in advice providers." We share his concern

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[1] *Remarks by the President at the AARP*, Feb. 23, 2015, http://www.whitehouse.gov/the-press-office/2015/02/23/remarks-president-aarp.

[2] On October 15, 2010, DOL published a notice of proposed rulemaking amending the regulatory of "fiduciary" under the *Employee Retirement Income Security Act*. 75 Fed. Reg. 65263 (Oct. 15, 2010). After receiving hundreds of comments, DOL announced it would repropose the regulation. "US Labor Department's EBSA to re-propose rule on definition of a fiduciary," Sept. 19, 2011, http://www.dol.gov/ebsa/newsroom/2011/11-1382-NAT.html.

[3] *See, e.g.*, Letter from Rep. Kline, Rep. Camp, Sen. Enzi, and Sen. Hatch to Secretaries Solis and Geithner, and IRS Commissioner Shulman, April 14, 2011.

[4] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 913, 124 Stat. 1376, 1824 (2010).

[5] Commissioner Daniel M. Gallagher, *Remarks at The SEC Speaks in 2015*, Feb. 20, 2015, http://www.sec.gov/news/speech/022015-spchcdmg.html.

that "[o]ne size fits all regulation, in practice, tends to end up as one size fits none. And when all is said and done, it means investors are presented with fewer choices and higher prices."

As in the past, we are also concerned DOL could establish a conflicting and confusing regulatory morass harming retirement savers. For example, Section 913 of the Dodd-Frank Act directed the SEC to study the standard of care for investment advisers and broker-dealers, and it authorized SEC to promulgate rules based on the results. Policymakers have consistently warned DOL's approach could conflict with SEC's rulemaking — authorized by the Dodd-Frank Act — resulting in uncertainty, higher costs, and less financial information for investors.[6] Despite these warnings, the President has directed DOL to press ahead without regard to SEC action.

It is clear coordination between SEC and DOL is vital to ensure a functioning regulatory framework; it is unfortunately far less clear that such coordination is occurring. We are especially disappointed and alarmed by Commissioner Gallagher's allegations that no meaningful engagement has occurred:

> ... [T]he DOL has not formally engaged the Commissioners, at least not this Commissioner, on its fiduciary rulemaking process and the impact it may have on investors. And despite public reports of close coordination between the DOL and SEC staff, I believe this coordination has been nothing more than a "check the box" exercise by the DOL designed to legitimize the runaway train that is their fiduciary rulemaking.[7]

This is inconsistent with public pronouncements from the administration. For example, in testimony before the Health, Employment, Labor, and Pensions Subcommittee, Assistant Secretary Borzi promised DOL, SEC, and others "are actively consulting with each other and coordinating our efforts."[8] This pledge was echoed in the press release withdrawing the initial rule.[9] More recently, Assistant Secretary Borzi has publicly repeated this promise.[10]

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[6] Letter from Senator Tester, et al to The Honorable Sylvia Matthews Burwell, Director, Office of Management and Budget, Aug. 2, 2013 ("We remain very concerned that uncoordinated efforts undertaken by the agencies could work at cross-purposes in a way that could limit investor access to education and increase costs for investors, most notably Main Street investors.)

[7] Gallagher, *supra* note 5.

[8] *Redefining 'Fiduciary': Assessing the Impact of the Labor Department's Proposal on Workers and Retirees: Hearing Before the House Committee on Education and the Workforce's Health, Employment, Labor, and Pensions Subcommittee* (July 26, 2011) (statement of the Honorable Phyllis Borzi, Assistant Secretary, Employee Benefits Security Administration).

[9] "US Labor Department's EBSA to re-propose rule on definition of a fiduciary," *supra* note 2 ("EBSA will continue to coordinate closely with the Securities and Exchange Commission and the Commodities Futures Trading Commission to ensure that this effort is harmonized with other ongoing rulemakings.").

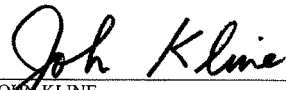
[10] *See, e.g.*, Sean Forbes, *Borzi Plays 'Three Questions' with Critics of DOL's Expected Fiduciary Rule Re-Proposal*, BLOOMBERG BNA PENSION AND BENEFITS BLOG, March 19, 2014, http://www.bna.com/borzi-plays-three-b17179886023/ (claiming leaders and staff have been constantly meeting each other); Emmanuel Olaoye, *INTERVIEW: U.S. Labor Department's point person on fiduciary rule: disclaimers are not enough*, THE KNOWLEDGE EFFECT (June 24, 2013), http://blog.thomsonreuters.com/index.php/interview-u-s-labor-departments-point-person-on-fiduciary-rule-disclaimers-are-not-enough ("If we have a proposal we would share it with them. The economists at the SEC are consulting with the DOL."); American Bar Association Section of Labor and

Concern over this coordination — or lack thereof — was so grave as to warrant Congressional action. On October 29, 2013, the House of Representatives passed H.R. 2374, the *Retail Investor Protection Act*, which required DOL to delay its rulemaking until after the SEC acts.[11] The bill passed the House on a strong bipartisan basis.

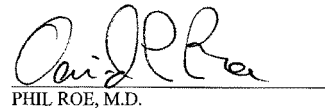
In recognition of this concern, a revised notice of proposed rulemaking should not be issued until after Congress is satisfied sufficient coordination has occurred. So that we can better understand the coordination between DOL and SEC, please furnish all communications after September 19, 2011, between DOL and SEC regarding this rulemaking. In addition, please provide all documents and materials addressing how DOL has considered, adopted, or discarded any concerns raised by SEC as it revised its regulatory proposal.

Please provide the requested information by March 18, 2015. If you are unable to do so, please inform the Committee in writing why you cannot meet the deadline, and the date by which you will provide the requested information. If you have additional questions or comments, please contact Andy Banducci or Joe Wheeler of the Committee staff at (202) 225-7101.

Sincerely,



JOHN KLINE
Chairman
Committee on Education and the Workforce



PHIL ROE, M.D.
Chairman
Subcommittee on Health, Employment, Labor and Pensions

Enclosure

CC: The Honorable Robert C. Scott, Ranking Member, Committee on Education and the Workforce

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Employment Law, *Interview with Phyllis Borzi*, Employee Benefits Committee Newsletter, Fall 2013, http://www.americanbar.org/content/newsletter/groups/labor_law/ebc_newsletter/13_fall_ebcnews/interview.html ("The SEC and the Department of Labor are coordinating on our respective fiduciary projects, and we have a shared goal of ensuring that compliance with one standard will not threaten compliance with the other.").

[11] H.R. 2374, 113th Cong. §2 (as passed by the House, Oct. 29, 2013). On February 25, 2015, Rep. Wagner reintroduced the bill. H.R. 1090, 114th Cong. (2015).

Responding to Committee Document Requests

1. In complying with this request, you should produce all responsive documents that are in your possession, custody, or control, whether held by you or your past or present agents, employees, and representatives acting on your behalf. You should also produce documents that you have a legal right to obtain, that you have a right to copy or to which you have access, as well as documents that you have placed in the temporary possession, custody, or control of any third party. Requested records, documents, data or information should not be destroyed, modified, removed, transferred or otherwise made inaccessible to the Committee.

2. In the event that any entity, organization or individual denoted in this request has been, or is also known by any other name than that herein denoted, the request shall be read also to include that alternative identification.

3. The Committee's preference is to receive documents in electronic form (i. e., CD, memory stick, or thumb drive) in lieu of paper productions.

4. Documents produced in electronic format should also be organized, identified, and indexed electronically.

5. Electronic document productions should be prepared according to the following standards:

   (a) The production should consist of single page Tagged Image File ("TIF"), files accompanied by a Concordance-format load file, an Opticon reference file, and a file defining the fields and character lengths of the load file.

   (b) Document numbers in the load file should match document Bates numbers and TIF file names.

   (c) If the production is completed through a series of multiple partial productions, field names and file order in all load files should match.

6. Documents produced to the Committee should include an index describing the contents of the production. To the extent more than one *CD,* hard drive, memory stick, thumb drive, box or folder is produced, each *CD,* hard drive, memory stick, thumb drive, box or folder should contain an index describing its contents.

7. Documents produced in response to this request shall be produced together with copies of file labels, dividers or identifying markers with which they were associated when they were requested.

8. When you produce documents, you should identify the paragraph in the Committee's request to which the documents respond.

9. It shall not be a basis for refusal to produce documents that any other person or entity also possesses non-identical or identical copies of the same documents.

10. If any of the requested information is only reasonably available in machine-readable form (such as on a computer server, hard drive, or computer backup tape), you should consult with the Committee staff to determine the appropriate format in which to produce the information.

11. If compliance with the request cannot be made in full, compliance shall be made to the extent possible and shall include an explanation of why full compliance is not possible.

12. In the event that a document is withheld on the basis of privilege, provide a privilege log containing the following information concerning any such document: (a) the privilege asserted; (b) the type of document; (c) the general subject matter; (d) the date, author and addressee; and (e) the relationship of the author and addressee to each other.

13. If any document responsive to this request was, but no longer is, in your possession, custody, or control, identify the document (stating its date, author, subject and recipients) and explain the circumstances under which the document ceased to be in your possession, custody, or control.

14. If a date or other descriptive detail set forth in this request referring to a document is inaccurate, but the actual date or other descriptive detail is known to you or is otherwise apparent from the context of the request, you should produce all documents which would be responsive as if the date or other descriptive detail were correct.

15. The time period covered by this request is included in the attached request. To the extent a time period is not specified, produce relevant documents from January 1, 2009 to the present.

16. This request is continuing in nature and applies to any newly-discovered information. Any record, document, compilation of data or information, not produced because it has not been located or discovered by the return date, shall be produced immediately upon subsequent location or discovery.

17. All documents shall be Bates-stamped sequentially and produced sequentially.

18. Two sets of documents should be delivered, one set to the Majority Staff in Room 2181 of the Rayburn House Office Building and one set to the Minority Staff in Room 2101 of the Rayburn House Office Building.

19. Upon completion of the document production, you should submit a written certification, signed by you or your counsel, stating that: (1) a diligent search has been completed of all documents in your possession, custody, or control which reasonably could contain responsive documents; and (2) all documents located during the search that are responsive have been produced to the Committee.

Definitions

1. The term "document" means any written, recorded, or graphic matter of any nature whatsoever, regardless of how recorded, and whether original or copy, including, but not limited to, the following: memoranda, reports, expense reports, books, manuals, instructions, financial reports, working papers, records, notes, letters, notices, confirmations, telegrams, receipts, appraisals, pamphlets, magazines, newspapers, prospectuses, inter-office and intra-office communications, electronic mail (e-mail), contracts, cables, notations of any type of conversation, telephone call, meeting or other communication, bulletins, printed matter, computer printouts, teletypes, invoices, transcripts, diaries, analyses, returns, summaries, minutes, bills, accounts, estimates, projections, comparisons, messages, correspondence, press releases, circulars, financial statements, reviews, opinions, offers, studies and investigations, questionnaires and surveys, and work sheets (and all drafts, preliminary versions, alterations, modifications, revisions, changes, and amendments of any of the foregoing, as well as any attachments or appendices thereto), and graphic or oral records or representations of any kind (including without limitation, photographs, charts, graphs, microfiche, microfilm, videotape, recordings and motion pictures), and electronic, mechanical, and electric records or representations of any kind (including, without limitation, tapes, cassettes, disks, and recordings) and other written, printed, typed, or other graphic or recorded matter of any kind or nature, however produced or reproduced, and whether preserved in writing, film, tape, disk, videotape or otherwise. A document bearing any notation not a part of the original text is to be considered a separate document. A draft or non-identical copy is a separate document within the meaning of this term.

2. The term "communication" means each manner or means of disclosure or exchange of information, regardless of means utilized, whether oral, electronic, by document or otherwise, and whether in a meeting, by telephone, facsimile, email, regular mail, telexes, releases, or otherwise.

3. The terms "and" and "or" shall be construed broadly and either conjunctively or disjunctively to bring within the scope of this request any information which might otherwise be construed to be outside its scope. The singular includes plural number, and vice versa. The masculine includes the feminine and neuter genders.

4. The terms "person" or "persons" mean natural persons, firms, partnerships, associations, corporations, subsidiaries, divisions, departments, joint ventures, proprietorships, syndicates, or other legal, business or government entities, and all subsidiaries, affiliates, divisions, departments, branches, or other units thereof.

5. The term "identify," when used in a question about individuals, means to provide the following information: (a) the individual's complete name and title; and (b) the individual's business address and phone number.

6. The term "referring or relating," with respect to any given subject, means anything that constitutes, contains, embodies, reflect s, identifies, states, refers to, deals with or is pertinent to that subject in any manner whatsoever.

Rep. Serrano

Budget Request

Question: How does your request of $100.7 million, an increase of $5.7 million, or 6 percent, above the fiscal year 2016 enacted level repair some of the damage that has been done in previous years by sequestration and the low funding levels that followed?

The FY 2017 Budget allows OMB to achieve a staffing level comparable to the FY 2012 pre-sequester staffing level and will still be approximately 3 percent below its FY 2010 staffing levels. This staffing level will strengthen OMB's ability to meet new statutory requirements and continue improving its effectiveness on older ones.

OMB has taken on numerous new responsibilities due to provisions in legislation, including the FAST Act; DATA Act; the Statutory Pay-as-You-Go Act of 2010; the GPRA Modernization Act; the Balanced Budget and Emergency Deficit Control Act (as amended); and the National Defense Authorization Act of 2013. These additional responsibilities include, among others: improving the Federal permitting and environmental review process for major infrastructure projects; meeting the new reporting requirements associated with the DATA Act; supporting the statutory OMB representative on the FirstNet Board; scoring legislation for PAYGO, publishing the PAYGO scorecard, and determining sequesterable amounts and issuing sequestration reports; coordinating the development and quarterly OMB reviews of cross-agency priority goals as well as establishing a central performance.gov site with all agency strategic plans and priority goals information; working with the Department of Defense and other agencies to modernize personnel security; overseeing spending transparency via USASpending.gov; and overseeing and coordinating intellectual property enforcement.

Rep. Serrano

I note that, as was the case with last year's request, almost half of your requested increase is essentially for inflation in personnel and rent costs.

Question: What will be the effect if you do not get the increase you're requesting?

OMB has limited ability to absorb budget reductions. With 98 percent of OMB's budget consisting of salaries and benefits, rent, and maintenance of our core budget system, not receiving the FY 2017 requested increase will require that OMB reduce its staffing levels.

The FY 2017 requested staffing level is essential for OMB to continue its work on developing and executing the President's Budget, overseeing the performance of Federal agencies, and undertaking new statutory responsibilities in an effective manner. Demands on OMB's staff will be especially high this year given it will be a presidential transition year, in which OMB will play a key role in developing and transmitting the new Administration's initial budget request and implementing its performance and management approach.

Rep. Serrano

ITOR

You're requesting an increase of $5.2 M for ITOR (Information Technology Reform and Oversight). Most of that increase is for the U.S. Digital Service, which was started in FY 14 with a pilot program.

Question: Please give us some examples of the successes the program has had.

Category

Accomplishments

Transforming critical services

- **Healthcare.gov, Department of Health and Human Services**: We supported CMS during the 2015 open enrollment season to keep Healthcare.gov live, and helped transition to a new Scalable Login Service (SLS) which dramatically improved site performance and saves over $60 million per year in operating expenses. We advised changes to the website between open enrollment seasons and have a team in place to support enrollment this fall.

- **Improving the immigration process, Department of Homeland Security**: In collaboration with 18F at GSA, we launched myUSCIS, a platform that allows users to easily access information about the immigration process and find immigration options for which they may qualify. We also worked with USCIS to transition to electronic filing of the I-90 form—the form to renew or replace a green card—which represented the first piece of delivered code in a multi-year contract on this project. More than 400,000 cases have been processed electronically to date.

- **Immigration statistics reporting, Department of Homeland Security:** We worked with the Department's Office of Immigration Statistics to establish more accurate data aggregation pipelines that require less manual effort. We helped transition the monthly enforcement report to the new process, and the Department will able to provide more accurate and timely reports to Congress.

- **CCD Rapid Response, Department of State**: When the Consular Consolidated Database suffered an outage that prevented visas from being issued for several weeks in June 2015, we helped stabilize and return CCD to service. Our recommendations for improving CCD, and other parts of the visa process, were part of the President's July 2015 report titled *Modernizing and Streamlining our Legal Immigration System for the 21st Century*.

- **College Scorecard, Department of Education**: Working alongside the Department of Education and 18F, we launched the College Scorecard to provide students, parents, and counselors with the information they need to make more informed choices about college. We helped deliver three distinct components: a public-facing website, an API that allows for other groups to easily create tools using the complete set of backing data, and a tool for data researchers.

- **The U.S. Web Design Standards:** A team of visual and user experience designers at USDS at 18F created the U.S. Web Design Standards, which launched in September 2015. These standards set a new bar for

simplicity across U.S. government websites, and they aim to make government tools more consistently built and more easily accessible to everyday people

- **Service Treatment Record completeness, Department of Defense/Veterans Affairs**: We surfaced and helped correct a cross-agency interoperability issue to ensure all components of the Service Treatment Record were properly transmitting to the VA after a service member's separation.

- **SBA One/BusinessUSA, Small Business Administration:** We helped the SBA define requirements and a procurement strategy for modernizing its small business certification applications, and have provided some limited consulting as the implementation has progressed.

- **Precision Medicine/Million Veteran Project, Department of Veterans Affairs:** USDS has lent technical expertise to NIH's efforts in the Precision Medicine Initiative (PMI), while also bridging efforts between the participating agencies.

Recruiting top talent

- **The goal**: We aim to bring 500 digital service experts—in engineering, product management, design, and user experience—to the Federal Government (USDS and 18F) by the end of the Administration.

- **To date:** 5,418 people have applied to work for the U.S. Digital Service or 18F, and 307 digital service experts have been hired and are currently on the job: 140 at the USDS (headquarters and agency teams) and 167 at 18F. In addition, 67 additional candidates have been qualified to work at USDS or 18F and are in various stages of being matched with a team, cleared, and on boarded.

Reforming the procurement of digital services

- **Digital Service Contracting Professional Training and Development Program**: USDS and the Office of Federal Procurement Policy (OFPP) created and launched the Digital Service Contracting Professional Training and Development Program—which seeks to spur innovation in the training of Contracting Officers. This program challenged companies to develop a program for Contracting Officers that will teach best practices in the procurement of digital services and the important role Contracting Officers can play in building meaningful, successful services. USDS and OFPP issued an open challenge, narrowed the submissions through two rounds of competition, and identified the winning training program. The pilot class of thirty Contracting Officers will enroll this month.

- **Digital Services Playbook.** The Digital Services Playbook that lays out best practices for effective digital service delivery and that will serve as a guide for agencies across government. To increase the success of government digital service projects, the Playbook outlines 13 key "plays" drawn from private and public-sector best practices that, if followed together, will help Federal agencies deliver services that work well for users and require less time and money to develop and operate. Since the launch in 2014, we have seen adoption of the Playbook by agencies, State governments, and local governments as well.

- **TechFAR Handbook.** The TechFAR Handbook is a guide that explains how agencies can execute key plays in the Digital Services Playbook in ways consistent with the Federal Acquisition Regulation (FAR), which governs how the government must buy goods and services from the private sector. This document helps agencies take advantage of existing authorities to procure development services in new ways that more closely match the modern software development techniques used in the private sector.

Rep. Serrano

Question: What are some of the challenges you've encountered?

Demand overpowering Supply of Digital Service Experts: USDS's work spans across all Federal agencies, and each agency has unique requests and digital service projects needing USDS's attention. While USDS currently does not have enough staff to meet the volume of work required, USDS is working to bring 500 digital service experts—in engineering, product management, design, and user experience—to the Federal Government by the end of the Administration.

Rep. Serrano

Question: Do you find that the other subcommittees are funding Digital Services Teams at their agencies?

In FY16, 25 agencies requested a total of $105M for digital services teams and six agencies received a total of $17 million for their digital service teams. These agencies include DHS ($10M), NARA ($1M), NRC ($1M), SSA ($2.2M), USACE ($1.2M), and Treasury ($2M).

Even when agency teams receive USDS funds, ITOR-funded USDS staff are uniquely positioned to assist agency teams in several ways including central operations, strategy, and hiring/recruiting.

Rep. Serrano

Small Business

Question: What work does OMB do to help small businesses both in terms of procurement opportunities and regulatory impact?

OMB's Office of Federal Procurement Policy (OFPP) works closely with the Small Business Administration's Office of Government Contracting and Business Development on the development and implementation of policies, practices, and tools to increase Federal contracting opportunities for small businesses and help agencies meet and exceed their small business contracting goals. These efforts include:

- working with SBA and members of the Federal Acquisition Regulatory Council (FAR Council) to develop and implement government-wide regulations that promote and protect the interests of small business contractors in Federal contracting, including new statutory authorities provided by Congress;
- working with Executive Branch Officials – including agency Chief Acquisition Officers, Senior Procurement Executives, and small business directors – to share best practices and establish new policies to create an environment that is conducive to growing businesses and creating jobs, such as the policies OMB has issued to accelerate payment to small business prime contractors and subcontractors; and
- conducting outreach, including through online dialogues, to understand barriers small business contractors face in doing business with the government and working with agencies to address these barriers.

In addition, OFPP and OMB's Office of Information and Regulatory Affairs work together to evaluate paperwork burdens associated with new regulatory actions as well as with SBA's Office of Advocacy to ensure the effective implementation of the Regulatory Flexibility Act, which requires the FAR Council to ensure rules contain flexibility in their compliance requirements so that small businesses will not be unduly burdened.

These collaborative efforts have helped the Federal government meet its 23 percent small business procurement goal for the third consecutive year. In addition, in FY 2015, agencies met the government-wide 5 percent women-owned small business goal for the first time ever and awarded a record-setting 10.06%, or $35.4 billion, to small-disadvantaged businesses.

Rep. Quigley

McCook Reservoir

I was deeply disappointed to find after many years of strong support from this Administration for one of the Corps' most competitive flood protection projects that there was no funding for continuation of construction of the McCook Reservoir of the Chicagoland Underflow Plan in the Administration's FY2017 Budget.

It is inconceivable to me how such a top tier, fully authorized flood protection project, which is 65 percent complete and in active federal construction, has a 3 to 1 Benefit Cost Ratio, and benefits Chicago and 36 suburbs, including 1.5 million structures and 5 million people, can be dropped from this year's Budget.

Assistant Secretary of the Army Jo-Ellen Darcy has omitted FY17 funding for Stage 2 due to a mistaken belief that Stage 2 is related to water pollution control. It is in fact for flood control and fully authorized and documented in the Corps system as such. Additionally, the project is being recommended by the Corps for flood protection.

Question: Can you offer me any explanation or clarification as to why the Administration would stop construction of a highly-acclaimed and high-ranking project that will help to prevent the flooding of homes and businesses in the Chicago region?

The Administration has not stopped construction of this project. The Army Corps of Engineers 2016 work plan for the civil works program includes $14 million for construction of this project. With that funding, the Corps expects to complete stage 1 of the McCook Reservoir by the end of December 2017. The schedule is based on a December 2011 consent decree, which the non-Federal sponsor of this project signed in response to a lawsuit, brought by the United States on behalf of the U.S. Environmental Protection Agency, concerning its compliance with section 301(a) of the Clean Water Act and with terms and conditions of national pollutant discharge elimination system permits issued by the Illinois Environmental Protection Agency.

Rep. Quigley

Question: Can you assure me that the Administration will work with me to rectify this oversight by including $11 million in the FY17 Work Plan of the Corp of Engineers for the continuation of construction for the McCook Reservoir?

If the Congress were to provide additional funding for the Army Corps of Engineers civil works program (Corps), above the amounts recommended in the Budget for this program, the Administration would work with the Corps to develop performance-based criteria to guide project-specific allocation decisions.

Rep. Quigley

Searchable, Sortable Budgets

I have a bill that focuses on various aspects of government transparency- the Transparency in Government Act. One section of this legislation is focused on centralizing departmental budget requests. Right now, you require that agencies post their budget requests and justifications to their own websites within two weeks of submission. OMB has lots of data on a central website right now, and I can tell you have made great strides to make all of this accessible.

Budget summaries and numbers are available in a central location, but budget justifications, the critical "why we need this money" portion of budgets, is still scattered across hundreds of government websites. These justifications often not available in any sort of "searchable, sortable" format. Many are in formats such as .pdf that are hard for third parties to easily pull data and information from.

I think it is important that we have a central repository that places all agency budgets, and their justifications in "searchable, sortable, and machine readable" format. That's why I pushed bard for language that was included in last year's budget to encourage OMB to do just that.

Question: Can you tell me a little bit about your efforts to get all of this data in one place, in one accessible, usable format?

The budget process should be a reflection of our values as a country, and we think it's important that members of the public have tools at their disposal to review the President's proposals -- and to have an opportunity to give feedback.

For several years, OMB has released the President's budget online via machine-readable data files and PDFs. While a tremendous effort, we also sought to find new ways for the public to understand the President's proposals. To promote transparency and collaboration, beginning with the FY 2016 Budget OMB made budget data available online through GitHub, an open data platform. For the President's FY 2017 Budget, OMB also leveraged the use of a visualization tool to make the budget data more easily understood. This budget explorer makes it easier for the public to understand, analyze, and review what has been proposed in the President's Budget. This new tool also combines a familiar, intuitive interface with powerful search and multi-faceted visualization capabilities. It also allows citizens to navigate the Budget's spending data and see how their tax dollars would be used. Using the new Socrata budget application, taxpayers can now quickly explore funding by agency and program area—not only for the current budget, but also the last 20 years and the next 5 years of budget projections included in the FY 2017 budget.

With these new changes, OMB has also continued some of our past practices to ensure better access to the budget data. Like previous years, OMB's website (www.omb.gov) includes a significant amount of searchable data on the President's Budget request. Our website also includes information that helps explain and justify the Administration's request. For instance, it includes a more than 1,400 page Budget Appendix, which includes appropriations language and account level detail on the President's request. It also includes links to fact sheets for Cabinet Departments and major agencies, which further explain and justify the Budget request, and an interactive budget tool that allows users to see what percentage of the Federal budget is dedicated to different program areas.

As you note, OMB requires agencies to make their congressional budget justification materials available online to the public no later than two weeks after transmittal of those materials to the Congress. Through the Budget Formulation and Execution Line of Business (BFELoB), OMB also works with agencies to develop automated tools that could help facilitate collecting and publishing congressional budget justifications and other budget materials. These BFELoB

tools may be able to help agencies produce budget requests and justification materials in a more searchable and sortable format. Providing these data in an accessible format raises difficult questions of common data definitions and reporting formats across different agencies and programs. OMB will continue to explore the potential for improvements in this area.

Rep. Quigley

Fiduciary Duty

I strongly support the Department of Labor's goal to ensure that financial advisors should always put the interest of their clients before their own. However, I recognize the important role that commissioned-based brokerage accounts serve for low and middle-income savers. That's why it's so important that regulators continue to engage with the advisory community and rigorously analyze the potential consequences to ensure that a finalized rule reflects the proper balance between robust consumer protection and access to low-cost retirement options.

Question: I understand that the Department of Labor's proposed rule is now under review at OMB. When do you anticipate finalizing your review?

E.O. 12866 provides OMB with a 90-day review period, though the agency may request the review be extended. However, OMB may conclude its review in fewer than 90 days. Regardless of the amount of time it takes, OIRA will facilitate and conduct a thorough review of the rule.

Rep. Quigley

Question: What factors is OMB taking into consideration as it reviews the rule?

OMB reviews agency draft regulations for consistency with the principles set forth in EO 12866 and EO 13563, and the analytical guidelines contained in OMB Circular A-4. For instance, EO 13563 directs agencies to "tailor its regulations to impose the least burden on society, consistent with obtaining regulatory objectives;" to "select, in choosing among alternatives, regulatory approaches that maximize net benefits;" while permitting agencies (where appropriate and permitted by law) to "consider (and discuss qualitatively) values that are difficult or impossible to quantify, including equity, human dignity, fairness, and distributive impacts."

Rep. Quigley

DATA Act

In your testimony you stated that the 6% increase in OMB's requested operational funds is in part to be used to "execute the additional responsibilities we have been given...many of them by statute...the DATA Act is another good example". You also alluded to the fact that some of the previous twenty-five new hires and the requested ten new hires are as a result of working on statutory requirements like the DATA Act. However, your FY17 budget request does not mention any planned DATA Act implementation activities amongst the list of reform priorities.

Question: Please detail what resources have been devoted to date on DATA Act implementation activities (both a staffing and systems). In addition, what resources are planned or assigned for such compliance activities as a part of your appropriations budget request—specifically in regards to how your office is providing timely guidance to agencies on preparing their data-centric accounting and award reporting, as well as the requirement to complete the grantee and contractor award reporting pilot projects in compliance with *Section 5* of the Act?

DATA Act implementation activities are part of OMB's broader missions under government-wide financial management, Federal procurement policy, and budget formulation and execution. No new funds have been allocated for DATA Act implementation above existing levels.

OMB is devoting staff time across management, OMB-wide, and resource management offices to support DATA Act implementation and compliance. To the maximum extent possible, OMB has incorporated DATA Act activities into the broader landscape of OMB's work to promote increased transparency in Federal spending, ongoing work related to annual budget formulation and budget execution activities, and initiatives related to Federal procurement policies.

Guidance to Agencies:

In accordance with the Act, OMB issued Memorandum M-15-12 in May 2015 to provide guidance for continued award-level reporting, new requirements for both agency-level and award-level reporting, and implementation of data standards for data published on USAspending.gov (or its successor site). OMB and the Department of the Treasury also issued data definition standards for USAspending.gov last summer. These 57 data definition standards were developed through a yearlong process, during which OMB and the Department of the Treasury consulted with representatives from the Federal councils and lines of business to discuss how agencies use these data elements in their operations, as well as non-Federal stakeholder communities, including recipients, open government groups, and industry. During the standardization process, OMB and the Department of the Treasury learned of some areas in which agencies could use more guidance; OMB will be issuing guidance to agencies to address these matters this year.

OMB is working closely with the Department of Health and Human Services and the General Services Administration to meet the requirements of the Pilot to Reduce Recipient Reporting Burden detailed in Section 5 of the Act. Although this pilot will primarily involve recipients of Federal awards and does not contain requirements for agencies, agencies are being kept apprised of pilot activities through the existing DATA Act Implementation governance structure.

TUESDAY, MARCH 22, 2016.

SECURITIES AND EXCHANGE COMMISSION

WITNESS

HON. MARY JO WHITE, CHAIR, SECURITIES AND EXCHANGE COMMISSION

Mr. CRENSHAW. The hearing will come to order. The ranking member. Mr. Serrano, has tweeted that the meeting will start 11:00 promptly, and I know people are anxiously reading his tweet at this point, so we will start.

This is the final hearing of our subcommittee, so I want to welcome our witness, the Securities and Exchange Commission Chair, Mary Jo White. Thank you for being here today. We always enjoy having you before our subcommittee. I know the subcommittee members look forward to having a good exchange with you.

The SEC plays a critical role in protecting investors, encouraging capital formation, and maintaining fair and efficient markets, just as buyers and sellers expect the U.S. markets to be fair and efficient, the regulator who oversees them is expected to be fair and efficient as well. For fiscal year 2017, the SEC is requesting $1.781 billion, which is $176 million, or an 11 percent increase over fiscal year 2016.

While the SEC is a fee-funded agency, congressional oversight over the Commission is essential in holding the SEC accountable in fulfilling its mission, and making sure that it is responsive to the markets and investors, as well as congressional concerns.

I look forward to discussing your request, and why the Commission believes it needs these additional fundings. For the past 3 years, the Committee has set aside resources within the overall SEC funding amount to fully fund the Division of Economic and Risk Analysis, the so-called DERA. In that time, the funds this Committee provided have given DERA the ability to grow by almost 50 positions, including 16 PhD economists. And I happen to believe that cost-benefit analysis of SEC rulemakings is very, very informative, and I support the work that DERA does to educate the Commission about the macro, as well as the micro, economic effects of SEC rulemakings. So, I want to express my support for other DERA functions, such as developing risk-based models for the Commission's inspections and enforcement divisions.

In addition to your duties as chair of the SEC, you are also a member of the Financial Stability and Oversight Council, the so-called FSOC, and I know we discussed this a bit last year, but the designation process for systemically important financial institutions, SIFIs, still is a concern for me.

Although FSOC has adopted some transparency measures since we last spoke, I am not sure that they go far enough. In addition, I still believe the current designation process is not flexible enough. Entities should be given the opportunity to address systemic risk before being designated. FSOC's success should be measured by how it mitigates systemic risk, not by the number of institutions it designates.

Another issue that we discussed last year was liquidity in the markets, especially in the fixed income markets. As I am sure you know, the fiscal year 2016 omnibus required DERA to report back to the committee within one year of enactment, on the combined impact of the Volcker rule, Basel III, and other financial regulations, and the impact they have had on access to capital for consumers, investors, businesses, and on market liquidity.

I continue to have concerns that the cumulative effect of these layers of regulations has adversely impacted overall market conditions and market liquidity. So, I look forward to reading the report and discussing with you today what the SEC is doing to address this issue.

The 2016 omnibus also included a provision which prohibits the SEC from finalizing, issuing, or implementing any rule or order regarding the disclosure of political contributions in the SEC filings. I believe Congress has been very clear on this issue. However, I understand that there are some who believe the SEC is still able to work on a potential rule without actually finalizing that rule. Let me just caution you against this interpretation.

I think the Commission has a lot of work to do, including Congressionally mandated work that is more important than advancing a policy that Congress has never actually required, and in fact, has plainly rejected in statute.

On a bipartisan note, last month, the House passed H.R. 3784, that is called the SEC Small Business Advocate Act. Mr. Quigley and I were sponsors of the bill, and I hope the Senate takes up this legislation soon, because small businesses are on the forefront of job creation and technology innovation. The SEC's Small Business Advocate Act establishes an Office of the Advocate for Small Business Capital Formation, and the Small Business Capital Formation Advisory Committee, to assist small businesses and small businesses' investors with any problems that they may have with the Commission, identify difficulties small businesses have in securing access to capital, including unique challenges for minority and women-owned businesses, analyzing the potential impact of SEC regulations on small businesses, and propose changes to SEC regulations which would better promote the interests and needs of small businesses and their investors.

I am interested to hear from you, Chair White, on how the SEC is currently making small businesses and small businesses' capital formation a priority, and any thoughts you might have on this bipartisan legislation.

The SEC should be one of the leaders in helping further grow our economy, while at the same time keeping our markets fair and orderly. That is an important responsibility, and I know that you take it very seriously. We thank you for the work that you do, and the staff for the work that they do. We look forward to your testi-

mony today, but first, I am going to turn to Mr. Serrano, the ranking member, for any comments he might make.

Mr. SERRANO. Thank you, Mr. Chairman. Crenshaw and Quigley? Was I out that day?

Mr. QUIGLEY. Yes.

Mr. SERRANO. Yes? OK, thank you. Thank you, Chairman Crenshaw. I join you in welcoming Chair White back before our subcommittee. It is a pleasure to see you once again as you come to testify about the fiscal year 2017 budget request for the Securities and Exchange Commission. Your budget request for this fiscal year is quite reasonable, in my opinion, given the large and growing oversight role that you are expected to undertake.

With so many new responsibilities, not just from Dodd-Frank, but also the JOBS Act, we could argue that you should be requesting even more funding than you are. Your total budget request is dwarfed by most big banks, I.T. investments. So, despite recent increases, you are always fighting an uphill battle with fewer resources that are needed to do the job.

Last year, we succeeded in increasing the SEC's budget level to $1.6 billion, which has allowed you to at least not lose ground. Your fiscal year 2017 request asked for a further increase of more than $100 million to a total of $1.781 billion. This will help increase your enforcement capacity, your ability to conduct oversight, and examinations of regulated entities, and your ability to protect consumers.

Although the financial meltdown of 2007 and 2008 fades in the memories of some people, it remains foremost in my mind. At that time, we had regulatory agencies that were negligent in their duties to protect consumers and cut back on abusive practices. And we all paid dearly for that. People lost their retirement incomes. They lost their savings. And the American people were forced to bail out actors who had taken unnecessary and harmful risks that undermined our economic system.

That is why a strong and vigilant SEC is vital to protecting not just those who invest in the financial markets, but the American people as a whole. As we found out several years ago, guaranteeing that you have the resources to ensure fair and open financial markets is key to every American's economic security. Dodd-Frank gave you significant new tools and oversight abilities, and it is up to this subcommittee to make sure you are able to carry out the intent of that law.

I do also want to mention another part of this equation that threatens to undermine the system of safeguards and protections provided by the SEC and other financial regulators. As in previous years, last year's House and Senate appropriations bills contained numerous riders that are both unnecessary and procedurally flawed. These riders opened up loopholes in Dodd-Frank, and undermined the ability of the SEC to do its job.

Before I close, Chair White, I just want to thank you for your dedication to this agency, and to this Nation. You have a tough job to do, and hopefully, this subcommittee makes it easier rather than more difficult. I know you are a fellow Yankees fan, and since baseball season will soon be underway, I am sure I will see you in the

Bronx soon. Thank you, Mr. Chairman, and thank you, Chairman White.

Mr. CRENSHAW. Thank you. Now, we will turn to Chair White for your opening statement. If you could keep it in the range of 5 minutes, that will give us plenty of time to answer questions.

So, the floor is yours.

Ms. WHITE. Thank you. Chairman Crenshaw, Ranking Member Serrano, and members of the subcommittee, thank you for inviting me to testify in support of the President's fiscal year 2017 budget for the Securities and Exchange Commission. I appreciate the opportunity to discuss with you why the funding of the agency at a level of $1.781 billion is critically needed to enable the agency to fulfill its important responsibilities to investors, our markets, and companies seeking to raise capital to fuel innovation and economic growth.

The SEC has made great strides in recent years to strengthen its operations and programs, adopting strong measures, and bringing important enforcement actions to protect investors and our markets. We do not want this progress to stall, because we fall short in the funding necessary to maintain our positive trajectory in fulfilling our mission.

On the rulemaking and policy fronts, we finished our JOBS Act mandates in 2015 with the adoption of both Regulation A Plus and Regulation Crowdfunding, and are nearing completion of all of our Dodd-Frank mandates. We also advanced other key rules and comprehensive initiatives in mission-critical areas. Beyond the specific rulemakings, the SEC has, for example, continued its review of equity and fixed income market structure issues, advanced its disclosure effectiveness review to improve the public company disclosure regime for investors and companies, and undertaken the modernization and enhancement of our regulatory regime for asset managers.

The Commission also continued in 2015 to hold securities law violators accountable in record numbers, with record recovery orders, in all market strata, and in a number of cutting edge, first-of-their-kind enforcement cases.

Systemic enhancements in the SEC's national examination program, including increased recruitment of industry experts, the augmentation of data analytics, and enhanced training have led to a more effective and efficient program. We are, throughout the agency, increasingly harnessing technology to better identify risks, uncover frauds, sift through large volumes of data, inform policy making, and streamline operations.

While these achievements clearly evidence a stronger and more efficient agency, significant work and challenges remain if we are to be successful in executing the SEC's broad mandates and responsibilities. Currently, the SEC is charged with overseeing approximately 27,000 market participants, as well as 18 national securities exchanges, the PCAOB, FINRA, the MSRB, SIPC, and the FASB. In addition, the SEC is responsible for selectively reviewing the disclosures and financial statements of over 9,100 reporting companies.

Since 2001, the markets and registrants we oversee have grown exponentially in size and complexity, with the trading volume and

the equity markets tripling—nearly tripling, to $70 trillion, and the assets under management of registered advisers more than tripling, from approximately $21.5 trillion to about $66.8 trillion. At the same time, as the ranking member alluded to, the annual budgets for I.T. alone, for some of our largest registrants, are reported to be up to $10 billion, more than five times the SEC's entire budget.

The SEC's responsibilities have also dramatically increased in recent years, with new duties or expanded jurisdiction over securities-based derivatives, hedge, and other private fund advisers, credit rating agencies, municipal advisors, and clearing agencies, in addition to the responsibility to implement and oversee an entirely new crowdfunding regime.

The SEC greatly appreciates the confidence that Congress and this subcommittee have placed in us in recent appropriation cycles, and we are seeking that support this year. The requested level for fiscal year 2017, which has been carefully thought through and targeted, will permit the agency to hire an additional 250 staff in critical core areas, and continue to improve our information technology. Specifically, the SEC's budget for 2017 seeks to increase examination coverage of investment advisors, where current funding enables the agency to examine only 10 percent of the approximately 12,000 registered investment advisors; further leverage cutting edge technology; protect investors by expanding our enforcement program's investigative capacities, including in new, complex areas, and to strengthen our ability to successfully litigate against wrongdoers; further bolster the SEC's economic and risk analysis functions; and hire market and other experts to enable the SEC to fulfill its expanded rulemaking and oversight responsibilities. The funding we are seeking is imperative to protecting investors, and to meeting the challenges of today's markets and the SEC's expanded responsibilities.

As the Chairman alluded to, the SEC's funding is deficit-neutral, so that any amount appropriated to the agency will be offset by modest transaction fees, and therefore, will not impact the deficit or the funding available for other agencies. Our appropriation also does not count against the fiscal 2016, or fiscal year 2017 caps in the Bipartisan Budget Act of 2015. I hope and believe that we have shown ourselves to be good stewards of the funds we have been appropriated, and we will continue to be.

So, I look forward to working with the subcommittee to provide the SEC with the resources it needs to fulfill its critical mission, and I thank you again for the support you have shown the agency. I would be happy to answer your questions.

[The statement of Ms. White follows:]

Testimony on the Fiscal Year 2017 Budget Request
of the U.S. Securities and Exchange Commission
by
Chair Mary Jo White
U.S. Securities and Exchange Commission

Before the
Subcommittee on Financial Services and General Government
Committee on Appropriations
United States House of Representatives
March 22, 2016

Chairman Crenshaw, Ranking Member Serrano, and Members of the Subcommittee:

Thank you for inviting me to testify today in support of the President's fiscal year 2017 budget request for the Securities and Exchange Commission.[1] At the outset, I want to thank the Chairman, the Ranking Member, and all of the Subcommittee for your support of the SEC's important mission in previous budget cycles. And today, I very much appreciate the opportunity to discuss with you why funding the agency at a level of $1.781 billion for Fiscal Year (FY) 2017 is necessary for the SEC to continue to fulfill its critical responsibilities to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation.[2]

The SEC has made great strides in recent years to strengthen its operations and programs, adopting strong measures that protect investors and our markets, and aggressively enforcing the securities laws to punish wrongdoers.

With respect to rulemaking, the agency has proposed or adopted nearly all of the mandatory rulemakings required by the Dodd-Frank Wall Street Reform and Consumer

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[1] A copy of the SEC's FY 2017 Congressional Budget Justification can be found on our website at http://www.sec.gov/about/reports/secfy17congbudgjust.pdf.

[2] The views expressed in this testimony are those of the Chair of the Securities and Exchange Commission and do not necessarily represent the views of the President, the full Commission, or any Commissioner. In accordance with past practice, the budget justification of the agency was submitted by the Chair and was not voted on by the full Commission.

Protection Act (Dodd-Frank Act) and the Jumpstart Our Business Startups Act (JOBS Act), in addition to advancing other key rules in mission critical areas. Actions implementing the Congressional mandates have included final rules governing credit rating agencies and the public securitization markets; rules to address over-the-counter derivatives; new means for small businesses to access capital (including rules to expand the Regulation A exemption and permit securities-based crowdfunding offerings); executive compensation disclosures; and the removal of references to credit ratings from SEC rules. In addition to the Congressional mandates, the SEC has also advanced other important policy objectives, including rules to enhance oversight of high-frequency traders; the agency's supervision of investment advisers and mutual funds; and the structure and resiliency of money market funds. The agency has also adopted requirements for comprehensive new controls at critical market participants to strengthen key technological systems.

Beyond the specific rulemakings, the SEC has intensified its review of equity and fixed income market structure issues; undertaken a comprehensive disclosure effectiveness initiative seeking ways to improve the public company disclosure regime for investors and companies; and undertaken the modernization and enhancement of our regulatory regime for the asset management industry. We also have continued to hold securities law violators accountable by bringing cutting-edge cases in record numbers and in all market strata. Systemic enhancements in the SEC's National Examination Program (NEP) – including increased recruitment of industry experts, the augmentation of data analytics capacities, and enhanced training programs – have produced a more effective, efficient program. We are also throughout the agency increasingly harnessing technology to better identify risks, uncover frauds, sift through large volumes of data,

inform policymaking, and streamline operations, while at the same time improving internal collaboration and recruiting more staff with specialized expertise and experience.

While these accomplishments and enhancements clearly evidence a stronger and more effective agency, challenges remain if we are to be successful in addressing the growing size and complexities of the securities markets and fulfill the SEC's broad mandates and responsibilities. Currently, the SEC is charged with overseeing approximately 27,000 market participants, including nearly 12,000 investment advisers, almost 11,000 mutual funds and exchange-traded funds, over 4,000 broker-dealers, and over 400 transfer agents. The agency also oversees 18 national securities exchanges, 10 credit rating agencies, and six active registered clearing agencies, as well as the Public Company Accounting Oversight Board (PCAOB), Financial Industry Regulatory Authority (FINRA), the Municipal Securities Rulemaking Board (MSRB), the Securities Investor Protection Corporation (SIPC), and the Financial Accounting Standards Board (FASB). In addition, the SEC is responsible for selectively reviewing the disclosures and financial statements of over 9,100 reporting companies. In recent years, the SEC's responsibilities have also dramatically increased, adding new duties or expanded jurisdiction over securities-based derivatives, hedge fund and other private fund advisers, credit rating agencies, municipal advisors, and clearing agencies, as well as a responsibility to implement a new regime for crowdfunding offerings.

The size and complexity of the entities the SEC regulates has also expanded exponentially. From 2001 to 2015, assets under management of SEC-registered advisers more than tripled from approximately $21.5 trillion to approximately $66.8 trillion, and assets under management of mutual funds more than doubled from $7 trillion to over $15 trillion. Trading volume in the equity markets from 2001 through 2015 nearly tripled to over $70 trillion.

While the SEC greatly appreciates the confidence that Congress has placed in it in recent appropriation cycles, additional funding is imperative if we are to continue the agency's progress in fulfilling its responsibilities over our increasingly fast, complex, and growing markets. Funding at the requested level will permit the agency to hire an additional 250 staff in critical, core areas and continue to improve our information technology so that we can better oversee today's markets with the sophisticated tools necessary to safeguard investors. Specifically, as described in more detail below and consistent with the planning reflected in our recent requests, the budget for FY 2017 seeks to:

- Increase examination coverage of investment advisers and other key entities who interact with retail and institutional investors;
- Further leverage cutting-edge technology to permit the SEC to better keep pace with the entities, markets, and products we regulate;
- Protect investors by expanding our enforcement program's investigative capabilities and strengthen our ability to litigate against wrongdoers;
- Further bolster the SEC's economic and risk analysis functions; and
- Hire market and other experts to enable the SEC to fulfill its expanded rulemaking and oversight responsibilities.

As the Subcommittee is aware, the SEC's funding is deficit-neutral, which means that any amount appropriated to the agency will be offset by modest transaction fees (approximately $.02 per $1,000) and therefore will not impact the deficit or the funding available for other agencies.[3] Our appropriation also does not count against the FY 2016 or FY 2017 caps set in the Bipartisan Budget Act of 2015.

Last year was one of important achievements for the SEC, but significant work remains.

[3] Section 991 of the Dodd-Frank Act requires the SEC to collect transaction fees from self-regulatory organizations in an amount designed to directly offset our appropriation.

Below is a summary of the accomplishments of the SEC in fiscal year 2015 and of the principal challenges ahead, as well as a more detailed description of key aspects of the FY 2017 budget request.

Many Accomplishments, But Significant Work Remains

Fiscal year 2015 was one of great accomplishment for the agency. The SEC brought an unprecedented number of enforcement cases (807 in total), secured an all-time high for orders directing the payment of penalties and disgorgement (over $4.2 billion), performed exams at a level not seen for the past five years (over 2,200), and, even more importantly, continued to develop cutting-edge cases and smarter, more efficient exams. Aided by enhanced technology to identify and analyze suspicious activity and strengthened by initiatives like self-reporting, SEC staff was able to identify and target the most significant risks for investors across the market. Areas of focus included cybersecurity, market structure requirements, dark pools, microcap fraud, financial reporting failures, insider trading, disclosure deficiencies in municipal securities offerings, and protection of retail investors and retiree savings.

The imperative of investor protection was carried forward by all of our divisions and offices. While numbers of course only tell part of the story, the Division of Corporation Finance reviewed the annual and periodic reports of thousands of issuers last year, helping to ensure that investors receive full and fair disclosure about the public companies in which they invest. The Division of Trading and Markets reviewed more than 2,100 filings from exchanges and other self-regulatory organizations (SROs), standing guard for investors over major changes to the markets in which they entrust their savings. The Division of Investment Management reviewed filings covering more than 12,500 mutual funds and other investment companies, where the great

majority of individual investors send their hard-earned money. And our economists in the Division of Economic and Risk Analysis produced more than 30 incisive papers and publications, including two major analyses to inform our work on asset management rules.

The agency's accomplishments on the rulemaking front in FY 2015 were particularly noteworthy. The SEC has now executed a vast majority of the voluminous congressional mandates for a wide range of complex rulemakings. In 2015, with the adoption of Regulation A+ and Regulation Crowdfunding, the agency completed all of the major rulemakings directed by the JOBS Act. The SEC also moved into the final phase of implementing the Dodd-Frank Act, focusing on the two major remaining areas of mandates: security-based swaps and executive compensation. We marked two key milestones in the first area: first, with the adoption of rules for reporting and disseminating security-based swap information; and second, with final rules for registering security-based swap dealers. We proposed a process for dealing with bad actors in the security-based swap market and adopted rules to help ensure that non-U.S. dealers participating in the U.S. market play by our rules. These reforms will give us powerful tools to oversee an $11 trillion market and provide investors with unprecedented transparency into trading that had long been dangerously opaque.

During the past year, we also issued proposals for the remaining executive compensation rulemakings required by the Dodd-Frank Act, including disclosure of whether a company allows executives to hedge the company's stock, disclosure of pay versus performance measures of executive compensation, and new disclosures and rules for clawing back incentive compensation erroneously awarded. And following the analysis of some 285,500 total comment letters, 1,500 of them unique, the final pay ratio rule was adopted in August 2015.

There is much that the SEC still needs to do: from completing the implementation of our mandated rulemakings,[4] to continuing the core initiatives described above,[5] to further strengthening our economic and risk analysis functions, to hiring additional market and quantitative experts to further address our expanded responsibilities, to continuing to improve our technology and operations to make the agency more agile and effective, to ensuring that both our examination and enforcement function are strong and effective to match and address current markets. Outlined below is a brief overview of some of the key components of our request.

Expanding Oversight of Investment Advisers and Strengthening Compliance

The need for significant additional resources to permit the agency to increase its examination coverage of registered investment advisers and investment companies cannot be overstated. Increasing this examination coverage is vital to the SEC's ability to protect investors and the nation's securities markets.

The largest increase in entities registered with the SEC has occurred among investment advisers: a decade ago, there were approximately 9,000 investment advisers managing $28

[4] The SEC will continue in 2016 to complete its remaining mandates. Of particular focus and priority will be to finalize the remaining security-based swap rules required of the SEC by Title VII of the Dodd-Frank Act. Last month, the agency passed another key Title VII milestone with the adoption of the last set of rules for cross-border dealer activity. Adoption of the substantive requirements for security-based swap dealers – specifically, the rules governing their business conduct and the requirements for their capital, margin, and asset segregation – are expected to be adopted soon.

[5] The SEC has continued its discretionary rulemaking in a number of areas essential to our mission. Three of the most prominent of these initiatives center on the asset management industry, the structure of the equity markets, and the SEC's disclosure regime. The Commission took action on all three in 2015, and I expect additional actions this year. Going forward, additional rulemaking initiatives to be considered will likely also include: shortening the securities transaction settlement cycle to support industry efforts and reduce potential systemic risk; further enhancing filings through the expanded use of structured data; and finalizing rules to update the intrastate offering exemption and recommendations for a universal proxy. In addition, I expect to continue to develop support from my fellow Commissioners for a uniform fiduciary duty for investment advisers and broker-dealers, and to bring forward a workable program for third party assessments to enhance the compliance of registered investment advisers.

trillion in assets, while the current projection is that these figures will grow to 12,500 investment advisers managing more than $70 trillion in assets by FY 2017. Beyond an increase in the number of advisers and assets under management, additional challenges to examination staff are posed by the increased use of new and complex products by both investment advisers and broker-dealers, an increasing use of technology in registrants' operations that facilitate activities such as high-frequency and algorithmic trading, and the growth of complex "families" of financial services companies with integrated operations that include both broker-dealer and investment adviser affiliates. As a point of reference, a decade ago we had approximately 17 OCIE staff per trillion dollars in investment adviser assets under management, but today have only approximately 8 OCIE staff per trillion dollars.

In FY 2015, SEC staff, through risk-targeted exams, examined approximately 10 percent of registered investment advisers; these firms manage more than 30 percent of the assets under management of currently registered advisers. The program also continued its emphasis on the roughly 40 percent of all registered investment advisers that have never been examined through the continuation of the NEP's never before examined adviser initiative started in 2014. Significant additional resources are critical to improve the examination coverage of this important industry. Under the FY 2017 request, a top priority will be to hire 127 additional examiners, primarily to conduct additional examinations of investment advisers, but also to improve oversight and examination functions related to broker-dealers, clearing agencies, transfer agents, SROs, swap data repositories, municipal advisors, and crowdfunding portals, among others.

Continue to Leverage Technology

The SEC has made substantial progress in modernizing its technology systems, streamlining operations, increasing our use of data analytics, and increasing the effectiveness of its programs. The SEC's FY 2017 budget request, which includes full use of the Reserve Fund, seeks to build on this progress by supporting a number of key information technology (IT) initiatives, including:

- **Expanding data analytic tools** that assist in the integration and analysis of huge volumes of financial market data, employing algorithms and quantitative models that can lead to earlier detection of fraud or suspicious behavior and ultimately enabling the agency to allocate its resources more effectively. For example, SEC staff has used data analytic (including pattern recognition) tools to, among other things, detect potential fraudulent or manipulative trading, identify financial statement outliers or unusual trends indicative of possible accounting fraud, discover possible money laundering, sift through massive volumes of trading data to detect suspicious trading patterns, and flag higher risk registrants for examination prioritization.

- **Increasing investments in Information Security** to address, as a top priority, the ability to monitor and avoid advanced persistent threats. The SEC's IT security program plans to focus its efforts on improved risk management and monitoring and continuing to invest in modernizing and securing the SEC's infrastructure to enhance workflow and document management, the SEC's electronic discovery program, operational resiliency, and internal communications to staff.

- **Redesigning the Electronic Data Gathering, Analysis and Retrieval (EDGAR) system,** an ongoing, multi-year effort to simplify and optimize the financial reporting process to promote automation and reduce filer burden. With a more modern EDGAR, both the investing public and SEC staff will benefit from having improved access to better data. We are also making incremental enhancements to the existing system to improve the user experience, accommodate new submission requirements, and other improvements that are needed prior to the full redesign.

- **Improving examinations through risk assessment and surveillance tools** that will help staff monitor for trends and emerging fraud risks, as well as improving the efficiency of the examination program so it can cover higher risk areas with its resources.

- **Enhancing the Tips, Complaints, and Referral system (TCR)** to bolster its flexibility, configurability, and adaptability. TCR investments will provide more flexible and comprehensive intake, triage, resolution tracking, searching, and reporting functionalities, with full auditing capabilities.

- **Improving enforcement investigation and litigation tracking** to better handle the substantial volume of materials produced during investigations and litigation. Among other initiatives, the SEC needs to build capacity to electronically transmit data for tracking and loading (versus the current practice of receiving content via the mail); implement a document management system for Enforcement's internal case files; and revamp the tools used to collect trading data from market participants.

- **Further modernize SEC.gov** to make one of the most widely used Federal Government websites more flexible, informative, easier to navigate, and secure for investors, public companies, registrants, and the general public.

- **Invest in further business process automation and improvements** to build workflow applications that will improve the efficiency and effectiveness of the agency in serving the public.

To better execute these and other technology initiatives, the FY 2017 request includes eight new positions for Office of Information Technology (OIT). These staff would serve as project managers, business analysts, and technical resources who will improve technology and data management support for the SEC's business areas. In addition, the positions will enhance information security through monitoring, and drive further improvements in IT equipment management and reporting.

Bolster Enforcement Resources to Address Wrongdoing in Today's Markets

It is vital to the SEC's mission to bring timely, high-quality enforcement actions when violations of the Federal securities laws are identified. In FY 2015, the SEC brought a record number of enforcement actions against those who defrauded investors and violated the law – including many first of their kind actions – and obtained order for monetary remedies exceeding $4 billion. Building on these very strong efforts, the agency must continue to enhance its enforcement function to keep pace with the growing size and complexity of the nation's markets and to swiftly and aggressively address misconduct.

For FY 2017, the SEC is requesting 52 additional positions for the Enforcement Division. The Division will use the additional requested positions to support its three core functions: intelligence analysis, investigation, and litigation. Specifically, these additional resources will support the Enforcement program's current and future initiatives by, among other things:

- increasing the experienced forensic accountants, attorneys, industry experts, and information technology and support staff needed to promptly detect, prioritize, and investigate areas appropriate for enhanced enforcement efforts (30 positions);
- adding experienced trial attorneys to prosecute the growing number of highly-complex enforcement actions (12 positions);
- enhancing Enforcement's data analytics expertise to assist in the implementation of data intensive projects, state-of-the-art investigative tools (such as eDiscovery and knowledge management), and improved forensic capabilities (5 positions); and
- bolstering staffing for intelligence functions, including the collection, analysis, triage, referral, monitoring, and follow-through on the thousands of TCRs received each year (5 positions).

With respect to the latter two priorities, analysis of large datasets, including SEC filings and trading data in equities, options, municipal bonds, and other securities, helps to limit investor harm by increasing the chances of detecting misconduct earlier. The SEC's Enforcement program expects the improved data analysis capabilities derived from the agency's investments in IT will yield additional important case leads in FY 2017. As a result, the Enforcement program would dedicate 10 of the requested positions to further develop its data analytic function, increasing the number of staff responsible for reviewing and triaging incoming TCRs and bolstering the number of staff to whom TCRs are sent for further investigation.

The Enforcement program also requires increased staffing to promptly detect complex frauds and other difficult-to-detect misconduct, whether it occurs at hedge funds, broker-dealers, or "boiler rooms;" respond to misconduct in the changing equity markets relating to algorithmic trading and dark pools; address large-scale insider trading and stock manipulation; and keep pace

with a rapidly evolving industry. As a result, 30 of the positions the SEC is seeking in FY 2017 would be to reinforce its investigative functions. These new positions will help the Division continue progress on existing investigations and handle its increasing case load, while quickly investigating and bringing emergency actions as necessary in matters where investors' money may dissipate if immediate action is not taken.

Finally, 12 of the new positions the SEC is requesting in FY 2017 would reinforce its litigation operations nationwide. This increased allocation will enable the SEC to handle the higher proportion of enforcement actions that are being filed as contested matters as well as to follow through on its commitment to litigate any case where it believes admissions of wrongdoing are necessary to achieve greater public accountability.

Focus on Economic and Risk Analysis to Support Rulemaking and Oversight

The SEC remains committed to strengthening the economic and risk analysis functions of its Division of Economic and Risk Analysis (DERA) and for FY 2017 plans to add six new positions to DERA. DERA is our fastest growing division, and this additional growth would continue to deepen the Division's expertise in support of rulemaking initiatives affecting the capital markets as well as initiatives to detect violations of the securities laws.

The DERA positions requested would focus on areas including exchange-traded funds, microcap stocks, the derivatives markets, and asset-backed securities. These staff would work with colleagues across the SEC to proactively monitor these markets from a systemic perspective, as well as to develop analytical tools to assist the Division of Enforcement in analyzing and identifying potential illicit activity in these areas.

Meet Expanded Rulemaking and Oversight Responsibilities

The agency is also requesting seven additional positions in FY 2017 for its Division of Trading and Markets. In FY 2017, the Division plans to use the additional positions requested to undertake new market-related responsibilities resulting from ongoing or recently completed rulemakings, as well as continuing to improve the agency's market supervision. Three of these positions would help the Division implement its new or enhanced responsibilities to oversee clearing agencies and swap data repositories. The other four would help improve the SEC's analytics and reporting on broker-dealers' finances, internal controls, and risk management practices; process rule proposals from a growing number of SROs; and provide interpretive guidance related to the derivatives markets.

The SEC is also requesting seven new positions for the Division of Investment Management to implement key policy objectives. These personnel would conduct ongoing data analysis, including new data that would be submitted to the SEC as part of the investment company reporting modernization initiative. In addition, they would monitor issues related to asset management risks (including those related to liquidity, derivatives, stress testing and transition planning rulemaking initiatives), provide interpretive advice, and respond to exemptive applications.

Conclusion

Thank you again for the opportunity to present the President's FY 2017 budget request. The SEC has made great progress with the recent funding increases approved by Congress, and I deeply appreciate the President's and Congress' continued support of the agency. I look forward to working with the Subcommittee to provide the SEC with the resources it needs to fulfill its

important responsibilities to investors and our capital markets. I would be happy to answer any questions.

Mr. CRENSHAW. Well, thank you very much. We will start the questions now, and we will try to observe the 5 minute rule, though there will be some members coming and going—there are other hearings going on at this very moment. Some are right across the hall; some are right down the hall.

But let me start by just asking you about your budget this year, a requested increase of $176 million. And I mentioned that is an 11 percent increase over last year. Last year, you received a $105 million of an increase, which is $281 million over 2 years. But from 2015 to 2016, there was $51 million in carryover. I wonder how that happened, and how that works when you also have access to a reserve fund that was set up under Dodd-Frank. Just talk about the funding over the last 2 years, and that $51 million. How does that occur, and what do you plan to do with that $51 million?

Ms. WHITE. I think you are referring to carryover balances, and I think we spoke about this last year. The SEC, unlike, a number of other Federal agencies have what are called no-year funds, so that we are allowed to carryover funds that we have not spent during the particular appropriations cycle. It allows for better financial planning and smarter hiring. You do not want to be rushed to hire the wrong experts, or enter into the wrong contracts because you have got an artificial deadline. In the last several years, the carryover balances have actually come down. Some of those balances are also attributable to de-obligating funds on completed contracts. So, again, that is good financial management.

We take into account those carryover balances when we make our request for the subsequent year. You cannot estimate precisely what you are going to have in a given year and it depends on when we get our appropriation as well. Obviously, if we get it late in the year then that puts more pressure on us to spend by the end of that year. But fortunately, because of the no-year funds, we are able to spend it smartly, wisely, and be good stewards of the funds that Congress appropriates for us.

Mr. CRENSHAW. I got you. And last year, you received a $105 million increase, but it was less than you requested. I think $117 million less than that. So, when you do not get as much as you ask for, how do you prioritize—of that $105, what will your—I know you have done a lot of work in enforcement investigations. But when you do not have as much as you had requested, tell us a little bit about how the priorities were with the money you did receive, including from last year.

Ms. WHITE. Basically, what we try to do—and obviously, it makes a difference what our most pressing needs are in a given appropriations cycle. For example, last year and this year, one of our very high priorities is to try to increase the number of examiners we have to examine that investment advisor space we have talked about for at least our last two or three hearings, to strengthen enforcement.

We align the priorities we sought the funding for, and then make separate judgments based on the reduced amount that we receive. We essentially allocated through a very thorough process those positions to best meet the priorities that were contained in our budget request.

So, a number of them went, indeed, to I.A., investment advisor examiners. A number went to Enforcement. A number obviously went to the Division of Economic and Risk Analysis. A number went to—I wish it was a bigger number, but a number also went to hiring more market experts, as we outlined, as well as to the extent that the money was available it went to continue the technology projects that are so critical to us.

You mentioned the reserve fund. We have used, at the SEC, the reserve fund set up by Dodd-Frank, as you indicated, for the long-term mission critical I.T. projects that are so essential to us. I think we had $25 million of that rescinded last year, so we had to deal with, less money than we really needed last year. But again, we try to do smart budgeting after we get our appropriation, as well as before, when we make our request.

Mr. CRENSHAW. Got it. You mentioned DERA, and I mentioned in my opening statement that we have carved out money for that division. We think that is important in terms of understanding the cost-benefit analysis, and I want to get you to comment on that. How has that worked out? I mean, has that been helpful, across the board, in assisting what you do?

Ms. WHITE. Well, certainly, I would say that yes, and I have said before that I think DERA is one of the great success stories of the SEC. I very much appreciate the support that we have gotten through the appropriations process for DERA. It is also our fastest growing division. And they essentially, in addition to cost-benefit analysis on our rulemakings, also do what I would call substantive, original research on our rulemaking. They are able to do that, as not only we have gotten more positions, more economists, but have really built the infrastructure for them to be able to do their work.

So they get involved earlier in the rulemakings. You will see, often now, their own studies, their own original research is actually put into the public comment file and arena for people to comment on.

And so, that has really come a long way, and you cannot overstate its importance to the quality of our rulemaking. They also are, now, in the last couple of years at least—maybe a little longer than that, really—and increasingly so, integrated into the entire agency. They are the ones who primarily manage our big data, structured and unstructured, not only for themselves and their research, but for the other divisions to help them do their job much better.

They are also the ones that have really designed and conceived of and work with the other divisions on these data analytics that we have talked about throughout our budget requests and in prior hearings so that Enforcement and our exam staff is better able to identify high-risk areas. Where do we go to examine? Where is this suspicious activity that we need to go and look at more deeply? They are really doing, I think, fantastic work at the agency.

Mr. CRENSHAW. Well, thank you. I am glad to hear that. One of the things that we asked last year in the omnibus bill is for them to do a study, and report back to us because I think there is some concern that there is an awful lot of regulation. I mentioned in my opening statement that you have Basel III, and this, that, lots of

regulations. And there is some concern among folks that there layers of regulations have impacted the liquidity of the markets.

So, we ask for a report to see what they would have to say, and I am looking forward to reading that report, but do you think some of those regulations—if there is a lack of liquidity, was that an unintended consequence, or do you think that was part of the plan in cooling down the economy, or heating it up, based on your view of what happened in 2008?

Ms. WHITE. Unintended consequences, is something all the regulators must be focused on, at all times, and certainly, with respect to the enormous amount of rulemaking that has been done since the crisis that also applies. And all of the rulemakings we do at the SEC are looked at through that lens. I guess I would say two things about this.

Liquidity is enormously important to the functioning in our markets, our economy, and to growth. So, it is an enormously important set of issues, I would say, that all the regulators, certainly the SEC, are focused on. Determining whether you have a reduction in liquidity, to what extent, and if so, what the causes are, I think any economist will tell you, whether they are in DERA or they are elsewhere, is extraordinarily difficult. We have, for example, with our fellow banking regulators, and I think the CFTC, reported quarterly to the House of Financial Services Committee, on whether we can determine whether the Volcker Rule has had a negative impact on the corporate bond—the liquidity in the corporate bond markets.

And, thus far, clearly the conclusion is we cannot say that it has had an impact. So, it is enormously important to study and enormously important to try to figure it out, just what you are dealing with, looking for unintended consequences, if you find them. And if they are negative, doing something about them.

I did see—and I am glad to see the academic community getting into this issue. A fairly recent study that was presented, or is to be presented at one of our DERA conferences, I think a British Columbia study really looked precisely at this question of the combined regulations, but more specifically, even the impact of the Volcker Rule on liquidity.

That particular study determined that it has not had a negative impact on liquidity, and indeed, you see liquidity deteriorating right after the crisis, but you do not see blips up after regulators have been put into place. Obviously, there will be more studies coming forth, as there should be. So, it is enormously important to stay on top of.

Mr. CRENSHAW. So, it is a concern, and it sounds to me like you all have looked at that from time and time, and I think this study will give us even more information about that. Do you ever talk about what is the appropriate liquidity level? I mean, you cannot really pin that down, but it is something you all talk about as you look at the markets?

Ms. WHITE. Yes, no question about it. Obviously, you have other objectives you are trying to achieve as well that you are balancing from time to time with regulations with liquidity. But it is enormously important all the time to look at that.

Mr. CRENSHAW. Got it. OK. Now, let's turn to Mr. Serrano.

Mr. SERRANO. Thank you, Mr. Chairman. Chair White, the President's budget request of $1.781 billion, an increase of about six percent for fiscal year 2016, will support 250 new positions. You are requesting 52 new positions in enforcement, 127 in compliance, four in corporate finance, and seven each in trading and markets, and investment management.

Please explain what functions these will serve, and why they are needed. And also, as a follow-up, what would happen if you did not get these positions?

Ms. WHITE. Well, starting with the exam positions, I think we have requested 127, about, I think, 105 or 107 of those would actually go to that investor advisor space, which we have talked about before, where we have resources only to examine about 10 percent a year, which obviously creates a very significant investor protection issue. So, you know, that is what—primarily we would use those for.

We would also use the examiners in other spaces, as well such as our oversight responsibilities over the exchanges, the SROs and broker dealers. Enforcement: I cannot overstate the importance of strong enforcement, particularly in these markets as they get faster, more complex. We need market experts, and we need people who know how to use these data analytics and apply them smartly.

We are charging more individuals now in our Enforcement program, which I think is very important to stronger deterrence. That means, or at least, this would be my theory of why that means we have had more trials recently, so a dozen of those positions in Enforcement would be devoted to bolstering our litigation unit—our trial unit in the office.

And then, I think 24 of the positions really spread over DERA, Corporation Finance, Trading and Market, and Investment Management would be for market oversight, and just as our responsibilities are diverse and expansive, different ones of these hires would be used in order to be able to cover those responsibilities as best we can.

And so, if we were not to get these positions, you essentially would see a deterioration in every one of those priorities that we outlined in our budget request. We would be examining less, therefore subjecting investors to much more risk. We would not be enforcing as we should be. We could not try the cases that we need to try and prevail in, in order to send a strong deterrent message. We have new responsibilities under Dodd-Frank and the JOBS Act, and we have to oversee the new crowdfunding regime. We have examiners devoted to the Volcker Rule.

So, it is really spread out among, and I think smartly, the priorities and the responsibilities that we have. And if we were not to get the funding we need, we would clearly be compromising our mission, compromising the markets, and compromising investor protection.

Mr. SERRANO. Well, I am glad to hear that you used the word enforcement because I keep telling this story, but it cannot be told enough. Some years ago, this agency—you were not there, came to the subcommittee and actually said, "We do not need any more money. We are fine." And we later found out why. They were not

enforcing anything, and only history will tell what role they played in that 2007/2008 fiasco.

Let me take you, very quickly, to Puerto Rico, which is not a bad place to take anyone. Puerto Rico is in the midst of an economic crisis that is so bad it really is becoming a humanitarian one. Your investment management division is urging funds, especially those with exposure to Puerto Rico, set to monitor, to continually update their disclosure based on the risk associated with their investments. Can you talk a little about that and any other role the SEC may have in what is unfolding in Puerto Rico?

Ms. WHITE. Yes. I think the guidance update that you are referring to really is to make sure that investors are looking out for risks they may face—losses they may face that are due to market events. And obviously, and sadly and tragically, what is going on in Puerto Rico creates those, in some situations. So, it is really a prudent set of guidance for investors.

In terms of the SEC's role in the underlying crisis, beyond attending to investors and holdings in funds, which really the guidance goes to, we do not have a direct role in that, although as a member of FSOC, I clearly am in discussions about that with Secretary Lew and the FSOC members who are—and particularly Secretary Lew, as you know, is very, very focused on the core of that crisis. We also coordinate with our fellow financial regulators, just in terms of impacts and possible impacts not only on investors—direct investors, but in the broader markets.

Mr. SERRANO. Thank you. Thank you, Mr. Chairman.

Mr. CRENSHAW. Thank you. I am going to turn now to Mr. Graves, and then Mr. Quigley, but I wanted to note that we have been joined by the ranking member of the full committee, Mrs. Lowey, and she will be here to ask a question or two along the way. So, welcome. Mr. Graves.

Mr. GRAVES. Thank you, Mr. Chairman. Chair White, good to see you again. I know many of the members of this subcommittee have raised concerns related to the DOL and SEC fiduciary rulemaking, so I want to talk about that just a minute.

It was brought up with Director Donovan a few weeks ago, as we all met. And there was an area that we feel like has just been ignored a little bit too much, and its implications of the rule, we feel like impact hardworking constituents that we all represent, including hardworking Georgians that I do. Chairman Johnson in the Senate produced a report on the problems with the Department's rule, and he published it on February 24th, and Mr. Chairman, I would like that submitted for the record, for the committee.

And that is a 40 page report, so I do not expect everybody to go through it right now, but there is one area I wanted to focus on, and I am going to quote the report. It says, "Despite public assurances that that the Labor Department has collaborated with the SEC, emails between a Labor Department employee and an SEC expert revealed discord between the agencies about the rulemaking." And the report goes on, with a senior SEC official stating concerns about reduced pricing options, rising cost, and limited access to retirement advice, particularly for retail investors—in other words, our constituency.

[The information follows:]

THE LABOR DEPARTMENT'S FIDUCIARY RULE: HOW A FLAWED PROCESS COULD HURT RETIREMENT SAVERS

A Majority Staff Report of the
Committee on Homeland Security and Governmental Affairs
United States Senate
Senator Ron Johnson, Chairman

February 24, 2016

EXECUTIVE SUMMARY

For millions of Americans, retirement saving is an important step in ensuring a comfortable standard of living well past employment. However, the process of saving for retirement can be difficult, confusing, and scary. To navigate the wide array of saving plans and options, individuals often turn to investment advisors for advice. A 2015 study reported that receiving investment advice significantly increases retirement savings.[1] According to the report, among individuals with $100,000 or less in annual income, individuals who receive investment advice save at least 38% more than individuals who do not receive investment advice.[2] For individuals of retirement age (65 and older), the disparity increases: advised individuals have more than double the assets of non-advised individuals.[3]

The Department of Labor issued a proposed rule ("rule," "proposed rule," or "proposal") on April 20, 2015, which would expand the definition of a fiduciary under the Employee Retirement Income Security Act of 1974 (ERISA). The Labor Department's proposed rule redefined the term "investment advice" to encompass activities that occur within pension and retirement plans, but that do not constitute investment advice under the existing definition of investment advice. The Labor Department touts its rule as a necessary reform to the investment advice industry to ensure that investment advisors avoid conflicts of interest and act in the best interest of their clients.

In February 2015, Senator Ron Johnson, Chairman of the Senate Committee on Homeland Security and Governmental Affairs, initiated an inquiry to examine the Labor Department's fiduciary rulemaking. This inquiry found that career, non-partisan professional staff at the Securities and Exchange Commission (SEC); regulatory experts at the Office of Information and Regulatory Affairs (OIRA) within the Office of Management and Budget (OMB); and Treasury Department officials expressed numerous concerns to the Labor Department about its proposed rule. Documents obtained by the Committee also indicate that officials at the Labor Department disregarded many of these concerns and declined to implement recommendations from the SEC, OIRA, and the Treasury Department. The majority staff found that the Labor Department frequently prioritized the expeditious completion of the rulemaking process at the expense of thoughtful deliberation. Additionally, the majority staff found indications that political appointees at the White House played a key role in driving the rulemaking process at the inception of the redrafting effort.

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[1] OLIVER WYMAN, THE ROLE OF FINANCIAL ADVISORS IN THE US RETIREMENT MARKET 16 (2015)

[2] *Id.*; *Restricting Advice and Education: DOL's Unworkable Investment Proposal for American Families and Retirees, Hearing Before the Subcomm. on Emp't & Workplace Safety of the S. Comm. on Health, Educ., Labor & Pensions*, 114th Cong. (2015) [hereinafter Senate HELP Committee Hearing] (statement of Peter Schneider, President, Primerica, Inc.).

[3] WYMAN, *supra* note 1; Senate HELP Committee Hearing (statement of Peter Schneider), *supra* note 2.

Specifically, the report's findings include the following information:

- Despite public assurances that the Labor Department had collaborated with the SEC, emails between a Labor Department employee and an SEC expert reveal discord between the agencies about the rulemaking. The Labor Department employee wrote to his SEC counterpart: "Well, I hate to break it to you, but you're wrong," and "**We have now gone far beyond the point where your input was helpful to me. . . . If you have nothing new to bring up, please stop emailing me**." The SEC staffer responded: "**I am now also utterly confused as to what the purpose of the proposed DOL rule is . . . .**"[4]
- Career, non-partisan SEC staff identified at least 26 items of concern related to the substantive content of the proposed rule, and the Labor Department declined to fully resolve all of the concerns.[5]
- After the Labor Department sought to address to the SEC's stated items of concern, a senior SEC official emphasized to the Labor Department that concerns remained:

  > *[W]e continue to believe that commentators are likely to raise concerns that the proposal may result in reduced pricing options, rising costs and limited access to retirement advice, particularly for retail investors. Commentators also may express concerns that broker-dealers, as a practical matter, may be unlikely to use the exemptions provided and may stop providing services because of the number of conditions imposed, likely compliance costs, and lack of clarity around several provisions.*[6]

- The Labor Department rejected the SEC's recommendation and ignored the requirements of Executive Orders 12866 and 13563 to quantify the costs and benefits of alternative approaches. As a Labor Department employee explained, "**We think this would be extraordinarily difficult and would appreciably delay the project for very little return . . . .**"[7]
- Treasury officials voiced concerns that the Labor Department's proposal, by attempting to regulate IRAs through the proposed rule, "fl[ies] in the face of logic" and was contrary to Congressional intent. The Labor Department promulgated the proposed rule less than two weeks after circulating this draft, undoubtedly limiting the extent to which the Department considered the comments it received from the Treasury Department.[8]
- The Administration was predetermined to regulate the industry and sought evidence to justify its preferred action. In emails to senior White House advisors, a Labor Department official wrote of the "**challenges in completing the [regulatory impact**

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[4] *Infra* Part II(a).
[5] *Infra* Part II(a).
[6] *Infra* Part II(a).
[7] *Infra* Part II(a)(iv).
[8] *Infra* Part II(d).

analysis]" and of the need to find literature and data that **"can be woven together to demonstrate that there is a market failure and to monetize the potential benefits of fixing it."** In another email, a Labor Department official discussed **"building the case for why the rule is necessary."**[9]

- The Labor Department rejected OIRA's recommendation to add language stating that the rule would "permit firms to continue *to rely on all* common fee and compensation practices . . . ." The Labor Department responded that "[n]ot all fee practices will be permitted by the exemptions" and that "[b]y deleting 'all' we slightly soften this by leaving it at 'common fee and compensation practices.'"[10]

Investment advisors, in general, do not dispute the importance of acting in the best interest of their clients, and many advisors already abide by a best interest standard.[11] However, experts have criticized the proposed rule as burdensome and complex,[12] and have challenged the Labor Department's claims that the rule will generate benefits for investors.[13] They contend that the Administration has reported inflated numbers for the harm that results from investors relying on "conflicted advice,"[14] with one expert opining "[y]ou don't have to be an economist to recognize the Administration's $17 billion talking point significantly overestimates the costs, if any, to investors relying on the 'conflicted advice' of brokers."[15] Experts also caution that the proposal's conditions and requirements would create uncertainty for investment advisors and would increase compliance costs and litigation risks. They warn that the Labor Department's analysis overstates the rule's benefits and that the rule could actually result in net losses to retirement savers.[16] These experts emphasize that the rule would actually harm the investors it is supposed to protect; the rule would drive up the price of investment advice and would ultimately decrease the availability of advice for low- and middle-income investors.

A 2015 report estimates that the rule will cause a loss of retirement savings of $68–80 billion per year, and will "jeopardize retirement readiness for 11.9 million IRA and retirement participants."[17] Robert Litan, an economist and attorney who served as the associate director of

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[9] *Infra* Part IV.
[10] *Infra* Part II(c).
[11] *E.g.*, Senate HELP Committee Hearing, *supra* note 2 (statement of Robert Litan).
[12] *Id.*
[13] *Id.* (statement of Peter Schneider); QUANTRIA STRATEGIES, LLC, UNINTENDED CONSEQUENCES: POTENTIAL OF THE DOL REGULATIONS TO REDUCE FINANCIAL ADVICE AND ERODE RETIREMENT READINESS 1 (2015) (prepared for Davis & Harman).
[14] EXEC. OFFICE OF THE PRESIDENT, THE EFFECTS OF CONFLICTED INVESTMENT ADVICE ON RETIREMENT SAVINGS (2015).
[15] Craig M. Lewis, *An Inflated $17 Billion Talking Point From the DOL*, FORBES (Dec. 16, 2015, 12:30 PM), http://www.forbes.com/sites/realspin/2015/12/16/an-inflated-17-billion-talking-point-from-the-dol/#782b028439e1.
[16] QUANTRIA STRATEGIES, *supra* note 13, at 1; Senate HELP Committee Hearing, *supra* note 2 (statement of Robert Litan).
[17] QUANTRIA STRATEGIES, *supra* note 13, at 1; Senate HELP Committee Hearing, *supra* note 2 (statement of Peter Schneider).

the White House budget office in the Clinton Administration, predicts that seven million or more small investors could lose their brokers as a result of the rule.[18] This would be costly to investors, who may make worse investing decisions when they do not receive human investment advice.[19]

Some observers suggest that this is actually an *intended* effect of the rule, and that the Labor Department believes that low- and middle-income investors should receive advice primarily from robo-advisors to avoid conflicts of interest.[20] If accurate, it is alarming that the Labor Department is intentionally restricting low- and middle-income investors to robo-advice based on a presumption that those investors lack the sophistication to interact with an individual investment advisor and to understand options presented to them.

As the majority staff puts forward its findings, it is important to note that Chairman Johnson performed this oversight in the face of continuous obstruction from the Labor Department. In February 2015, Chairman Johnson requested documents, including communications between the Labor Department and the White House and between the Labor Department and the SEC. However, to date, the Labor Department has not fulfilled Chairman Johnson's requests. The Labor Department has produced no material responsive to Chairman Johnson request for communications between the Department and the White House. The Department initially claimed that no responsive documents existed, but refused to provide Chairman Johnson with information about how Labor Department officials searched for documents. Chairman Johnson later received, from the SEC, communications between the Department and the White House. Additionally, the Department has produced only a limited subset of self-selected communications between the Department and the SEC and provided short briefings to the Committee. These productions fall short of full compliance. Most egregiously, the Labor Department even urged the SEC to similarly hinder Chairman Johnson's oversight work by asking the SEC to reject the Chairman's separate requests to the SEC for documents in the control and possession of the SEC.

Due to the Labor Department's obstructionism, Chairman Johnson and the majority staff have not had the opportunity to review the full universe of documents and communications related to the rule. The analysis and findings in this report are based on the information received. However, the information that Chairman Johnson was able to obtain strongly suggests that the Labor Department engaged in a flawed rulemaking process to craft a rule that will hurt millions of American retirement savers.

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[18] Senate HELP Committee Hearing, *supra* note 2 (statement of Robert Litan).
[19] *Id.*
[20] *Id.*

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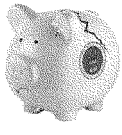

I. INTRODUCTION

On April 20, 2015, the Department of Labor issued a proposed rule to expand the definition of a fiduciary under the Employee Retirement Income Security Act of 1974 (ERISA).[21] The Labor Department's proposed rule redefined the term "investment advice" to encompass activities that occur within pension and retirement plans, but do not constitute investment advice under the existing definition of investment advice.[22] The Labor Department's promulgation of this rule was the culmination of a years-long effort by the Department's Employee Benefits Security Administration (EBSA).[23]

Even before the latest proposal was announced, stakeholders began raising concerns that the rule would adversely affect access to investment advice for low- and middle-income Americans.[24] Additional questions were raised about the close involvement of the White House in shaping the proposal.[25] In light of these concerns, Senator Ron Johnson, Chairman of the Senate Committee on Homeland Security and Governmental Affairs, initiated an inquiry in early February 2015.[26]

Under Senate rules and precedent, the Committee has legislative jurisdiction over intergovernmental relations and the regulatory process of the federal government. The Committee also has specific authority to examine "the efficiency and economy of all branches and functions of Government with particular references to the operations and management of Federal regulatory policies and programs."[27] Chairman Johnson initiated the inquiry pursuant to these authorities.

Chairman Johnson sought to examine the Labor Department's rulemaking process to ensure that the Department solicited and fully considered advice from career, non-partisan professionals with expertise in the proposal's subject matter.[28] As part of its inquiry, Chairman Johnson requested information and documents from the Securities and Exchange Commission

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[21] CONG. RESEARCH SERV., R44207, DEPARTMENT OF LABOR'S 2015 PROPOSED FIDUCIARY RULE: BACKGROUND AND ISSUES 1 (2015).
[22] *Id.*
[23] Mark Schoeff, *DOL Proposal of Fiduciary-Duty Rule Delayed Again*, INVESTMENT NEWS (May 28, 2014, 8:30 AM), http://www.investmentnews.com/article/20140528/FREE/140529932/dol-proposal-of-fiduciary-duty-rule-delayed-again.
[24] *Id.*
[25] *E.g.*, Melanie Waddell, *White House Getting Involved with DOL Fiduciary Redraft*, THINK ADVISOR (July 1, 2014), http://www.thinkadvisor.com/2014/07/01/white-house-getting-involved-with-dol-fiduciary-re.
[26] Appendix A, Ex. 1, Letter from Hon. Ron Johnson, Chairman, S. Comm. on Homeland Sec. & Governmental Affairs (HSGAC), to Hon. Thomas E. Perez, Sec'y, U.S Dep't of Labor (DOL) (Feb. 5, 2015).
[27] S. Res. 73 § 12, 114th Cong. (2015).
[28] *See* Appendix A, Ex. 1, Letter from Chairman Johnson to Sec'y Perez, DOL (Feb. 5, 2015); Appendix A, Ex. 2, Letter from Chairman Johnson to Sec'y Perez, DOL (Mar. 17, 2015).

(SEC),[29] the Financial Industry Regulatory Authority (FINRA),[30] the Office of Information and Regulatory Affairs (OIRA),[31] the Department of the Treasury,[32] and the Labor Department.[33] In response, the SEC provided three document productions to the Committee.[34] These productions, which the SEC made despite the Labor Department's attempt to persuade the SEC to reject the Chairman's requests,[35] shed significant light on the recommendations and concerns that career, non-partisan, professional staff at the SEC provided prior to the release of the proposal. The SEC documents also shed light on aspects of the recommendations and concerns offered by regulatory experts at OIRA and from Treasury Department officials. FINRA additionally provided two document productions to the Committee.[36] OIRA provided one document production, although it was largely nonresponsive to Chairman Johnson's requests.[37] Finally, the Committee received a limited subset of documents from the Labor Department regarding its communications with the SEC; however, the Labor Department continues to withhold other responsive documents from the Committee.[38]

Based on the information received by the Committee, the majority staff has found that career, non-partisan, professional staff at the SEC, regulatory experts at OIRA, and Treasury Department officials expressed concerns to the Labor Department about its proposed rule. While Chairman Johnson and the majority staff do not have access to the entirety of Labor Department records, it appears that the Labor Department ignored and rejected many concerns and recommendations by subject-matter and regulatory experts.

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[29] Appendix A, Ex. 3, Letter from Chairman Johnson to Hon. Mary Jo White, Chair, SEC (Apr. 21, 2015); Appendix A, Ex. 4, Letter from Chairman Johnson to Chairwoman White, SEC (May 20, 2015); Appendix A, Ex. 5, Letter from Chairman Johnson to Chairwoman White, SEC (July 13, 2015).

[30] Appendix A, Ex. 6, Letter from Chairman Johnson to Richard Ketchum, Chairman, FINRA (Sept. 16, 2015).

[31] Appendix A, Ex. 7, Letter from Chairman Johnson Hon. Howard Shelanski, Admin'r, OIRA (May 1, 2015); Appendix A, Ex. 8, Letter from Chairman Johnson to Admin'r Shelanski, OIRA (Dec. 3, 2015).

[32] Appendix A, Ex. 9, Letter from Chairman Johnson to Hon. Jacob Lew, Sec'y, Treasury Dep't (Nov. 12, 2015).

[33] Appendix A, Ex. 3, Letter from Chairman Johnson to Chairwoman White, SEC (Apr. 21, 2015).

[34] Appendix A, Ex. 10, Letter from Chairwoman White, SEC, to Chairman Johnson (May 5, 2015); Appendix A, Ex. 11, Letter from Tim Henseler, Dir., Office of Leg. & Intergovernmental Affairs, SEC, to Chairman Johnson (July 27, 2015); Appendix A, Ex. 12, Letter from Tim Henseler, SEC, to Chairman Johnson (Sept. 15, 2015); Appendix A, Ex. 13, Letter from Tim Henseler, SEC, to Chairman Johnson (Nov. 25, 2015) (complete document productions on file with Committee).

[35] Appendix A, Ex. 14, Letter from Adri Jayaratne, Acting Asst. Sec'y, Office of Cong. & Intergovernmental Affairs, DOL, to Chairman Johnson (July 8, 2015).

[36] Appendix A, Ex. 15, Letter from Robert Colby, Exec. VP & Chief Legal Officer, FINRA, to Chairman Johnson (Oct. 15, 2015); Appendix A, Ex. 16, Letter from Robert Colby, FINRA, to Chairman Johnson (Oct. 29, 2015).

[37] Appendix A, Ex. 17, Letter from Admin'r Shelanski, OIRA, to Chairman Johnson (May 18, 2015); Appendix A, Ex. 18, Letter from Admin'r Shelanski, OIRA, to Chairman Johnson (Jan. 20, 2016).

[38] Appendix A, Ex. 19, Letter from Acting Asst. Sec'y Jayaratne, DOL, to Chairman Johnson (Feb. 9, 2015); Appendix A, Ex. 20, Letter from Acting Asst. Sec'y Jayaratne, DOL, to Chairman Johnson (Feb. 23, 2015);Appendix A, Ex. 21, Letter from Acting Asst. Sec'y Jayaratne, DOL, to Chairman Johnson (Mar. 23, 2015); Appendix A, Ex. 22, Letter from Acting Asst. Sec'y Jayaratne, DOL, to Chairman Johnson (Apr. 3, 2015); Appendix A, Ex. 23, Letter from Acting Asst. Sec'y Jayaratne, DOL, to Chairman Johnson (June 15, 2015); Appendix A, Ex. 14, Letter from Acting Asst. Sec'y Jayaratne, DOL, to Chairman Johnson (July 8, 2015); Appendix A, Ex. 24, Letter from Acting Asst. Sec'y Jayaratne, DOL, to Chairman Johnson (July 27, 2015).

The Department's proposal appears to be a solution in search of a problem, driven by ideology rather than a market need. As a result, some studies suggest that the proposal could result in losses to retirement savers of $68–80 billion each year and will drive smaller investment advisors out of the marketplace.[39] Experts have criticized the Labor Department's rule as burdensome and complex and caution that the rule's conditions and requirements will create uncertainty for investment advisors and drive up compliance costs and litigation risks.[40] Ultimately, the rule will likely prompt investment advisors to increase the price of services they offer to investors and to reduce the services they provide to middle-income investors.[41]

II. THE LABOR DEPARTMENT DECLINED TO INCORPORATE RECOMMENDATIONS FROM SUBJECT-MATTER AND REGULATORY EXPERTS

a. The Labor Department Declined to Incorporate Recommendations from Career Experts at the SEC into the Proposed Rule

Under the Dodd-Frank Act, the SEC has authority to regulate standards of care for broker-dealers and investment advisers.[42] Section 913 of the Dodd-Frank Act directed the SEC to examine existing regulations, evaluate their potential effects on retail customers, and to recommend fiduciary standards to govern the industry.[43] Additionally, based on the authority granted by the Investment Advisers Acts in 1940, the SEC has historically regulated the investment industry.[44] The SEC is, therefore, the proper entity with the appropriate securities law expertise, to consider issues such as requiring a best interest standard for investment advisors. The SEC has reported plans to issue a uniform regulation governing retail investment advice, which could result in "two incredibly burdensome and redundant rules"[45] disseminated by the Labor Department and the SEC.[46]

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[39] QUANTRIA STRATEGIES, *supra* note 13, at 1.
[40] *Infra* Part III.
[41] *Infra* Part III.
[42] The Dodd-Frank Wall Street Reform and Consumer Protection Act § 913, 124 Stat. 1376 (2010).
[43] *Id.*; MEGAN MILLOY, AM. ACTION FORUM, DOL'S PROPOSED FIDUCIARY RULE: NOT IN THE BEST INTEREST OF INVESTORS (2015).
[44] Investment Advisers Act of 1940, 15 U.S.C. § 80b-1.
[45] Appendix A, Ex. 25, Letter from Daniel Gallagher, Comm'r, SEC, to Sec'y Perez, DOL (July 21, 2015).
[46] SEC Office of Mgmt. & Budget Fall Agenda, Personalized Investment Advice Standard of Conduct, *available at* http://www.reginfo.gov/public/do/eAgendaViewRule?pubId=201510&RIN=3235-AL27 (scheduling a notice of proposed rulemaking for October 2016); Mark Schoeff, Jr., *SEC's Mary Jo White Says Agency Will Develop Fiduciary Rule for Brokers*, INVESTMENT NEWS (Mar. 17, 2015, 12:31 PM), http://www.investmentnews.com/article/20150317/FREE/150319919/secs-mary-jo-white-says-agency-will-develop-fiduciary-rule-for.

The Labor Department has authority under ERISA to regulate private-sector, employer-provided benefit plans. However, according to the former head of EBSA, the Labor Department has significantly departed from its traditional view of its jurisdiction by attempting to regulate compensation and conduct for *all* types of financial advisors, including registered investment advisors and registered representatives of broker dealers.[47] At a minimum, given the SEC staff's expertise in securities regulation and the potential for conflict between the two rules, the Labor Department should have ensured that its rule incorporated recommendations and addressed concerns voiced by professional experts at the SEC.

However, former SEC Commissioner Daniel Gallagher emphasized that the Labor Department did not collaborate with the SEC in the rulemaking process.[48] Commissioner Gallagher called the rulemaking a "fait accompli" and criticized the comment process for being "merely perfunctory."[49] Commissioner Gallagher dispelled Department of Labor Secretary Thomas Perez's claims that the Labor Department "met substantively" with career, non-partisan staff at the SEC, pointing out that Commissioner Gallagher was not included in any such conversations.[50] Commissioner Gallagher wrote that, in contrast to Secretary Perez's claims, "the [Labor Department's] actions, and the substance of the [Labor Department] Fiduciary Proposal, reflect a lack of concern for the [SEC's] views on these issues."[51] He continued:

> Strikingly, the Fiduciary Proposal does not contemplate or even mention potential SEC rules or the SEC's existing regime for regulating broker-dealers and investment advisers. If the DOL were actually serious about working together with the SEC on an implementable standard, it could have—and should have—included in its proposal some type of substituted compliance mechanism, in which compliance with an SEC fiduciary standard would satisfy the DOL rules.[52]

Chairman Johnson has obtained information that supports Commissioner Gallagher's position that the Labor Department failed to work in good faith with the career, non-partisan, professional staff at the SEC. For more than a year preceding the Labor Department's promulgation of the proposed rule, SEC staff received draft portions of the proposed rulemaking package, including a draft regulatory impact analysis, draft global exemption (Best Interest Contract Exemption), and background on the point of sale disclosure.[53] Communications between the Labor Department and the SEC staff reveal numerous instances in which the Labor Department requested advice from SEC staff on fundamental aspects of the proposal, but

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[47] *Hearing on the Department of Labor's Proposed Fiduciary Rule Before the Subcomm. on Oversight of the H. Comm. on Ways & Means*, 114th Cong. (2015) [hereinafter House Ways & Means Committee Hearing] (statement of Bradford Campbell).
[48] Appendix A, Ex. 25, Letter from Comm'r Gallagher, SEC to Sec'y Perez, DOL (July 21, 2015).
[49] *Id.*
[50] *Id.*
[51] *Id.*
[52] *Id.*
[53] Briefing by Staff, DOL, to Committee Staff, HSGAC (Aug. 28, 2015) (notes on file with Committee).

disagreed with the SEC's recommendations and, in doing so, disregarded the SEC staff's subject-matter expertise.

Although Secretary Perez publicly assured stakeholders that the Labor Department collaborated with the SEC and "worked extensively with colleagues throughout the government, including and especially the [SEC],"[54] documents obtained by the Committee paint another picture. A series of emails in July and August 2012 reveal disagreements between Labor Department staff and SEC staff about the type of improper activity the proposal should measure. The SEC staff suggested that the proposal should measure conflicts of interest, whereas the Labor Department sought to measure investment returns.[55] These men were apparently classmates in a PhD program—which may account for the candid tone of the emails—but the email exchange suggests that the Labor Department disregarded an SEC expert's serious concerns about the rule.[56] In one email, after a lengthy discussion of the proposal, a Labor Department staffer wrote to an SEC staffer:[57]

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[54] Senate HELP Committee Hearing, *supra* note 2 (statement of Thomas Perez, Sec'y of Labor).

[55] Appendix B, Ex. 1, Emails between Matthew Kozora, SEC, and Keith Bergstresser, U.S. Dep't of Labor (July 2012), SEC-DOL008040–008052.

[56] The Labor Department represented to Committee staff that the Labor Department employee, Keith Bergstresser, and the SEC employee, Matthew L. Kozora, attended school together. Mr. Bergstresser received a Ph.D. in Economics from the University of Maryland, College Park, in 2009, and has been an economist at the Labor Department since June 2009. *See* Linkedin.com, Keith Bergstresser, https://www.linkedin.com/in/keith-bergstresser-10651482. He serves in the Office of Policy and Research within the Employee Benefits and Security Administration. *In re: Conflict of Interest Proposed Rule, Related Exemptions, and Regulatory Impact Analysis Hearing*, U.S. Dep't of Labor, Employee Benefits Security Admin. (Aug. 11, 2015). Mr. Bergstresser reports to the head of EBSA, Assistant Secretary Phyllis Borzi, a presidentially appointed official who has been described as the "main architect" of the fiduciary rule. Melanie Waddell, *DOL to 'Simplify and Streamline' Fiduciary Rule: Borzi*, THINKADVISOR (Oct. 20, 2015). Mr. Kozora received a Ph.D. in Finance from the University of Maryland, College Park, in 2010, and has been a financial economist at the SEC since 2010. *See* Matthew L. Kozora, Financial Economist, Office of Asset Management, SEC.gov, http://www.sec.gov/divisions/riskfin/economistbios/matthew-l-kozora.shtml. Mr. Kozora serves in the Office of Asset Management within the Division of Economic and Risk Analysis. *Id.* As the SEC's "think tank," the Division provides "detailed, high-quality economic and statistical analyses, and specific subject-matter expertise . . . ." *About the Division of Economic and Risk Analysis*, SEC.GOV, https://www.sec.gov/dera/about. Ultimately, the SEC's regulatory authority is vested in a bipartisan, five-member commission who serve staggered terms—in the words of the SEC, "ensuring non-partisanship." *The Investor's Advocate: How the SEC Protects Investors, Maintains Market Integrity, and Facilitates Capital Formation*, SEC.GOV, https://www.sec.gov/about/whatwedo.shtml. While both men possess financial expertise, the different structures of their respective agencies and the Labor Department's advocacy for the rulemaking appear to have caused the men to adopt differing opinions about the Labor Department's proposal.

[57] Appendix B, Ex. 1, Email from Keith Bergstresser, U.S. Dep't of Labor, to Matthew Kozora, SEC (July 31, 2012, 1:49 PM), SEC-DOL008057–008058.

From: Bergstresser, Keith - EBSA [redacted]@dol.gov]
Sent: Tuesday, July 31, 2012 1:50 PM
To: Kozora, Matthew
Subject: RE: question

Well, I hate to break it to you, but you're wrong. People do not respond to fees or any other costs, but they do chase returns. This and our other reasons for choosing the disclosure that we have developed are laid out in the document that we've already sent over to you (attached). You might try reading the paragraph labeled "Portfolio Returns" on page 4. And do look into the references. They are very convincing.

In a later email, Labor Department staff dismissively wrote to the SEC financial economist:[58]

From: Bergstresser, Keith - EBSA [redacted]@dol.gov]
Sent: Tuesday, July 31, 2012 3:23 PM
To: Kozora, Matthew
Subject: RE: question

See my responses below. We have now gone far beyond the point where your input was helpful to me. You keep circling back to the same statements, many of which are unsupported conjectures on your part, and most of which I have addressed even before you brought them up. Yet, your statements do not seem to even acknowledge the points that I already made (with supporting evidence) in the document we sent. If you have nothing new to bring up, please stop emailing me about this topic.

[58] Appendix B, Ex. 1, Email from Keith Bergstresser, U.S. Dep't of Labor, to Matthew Kozora, SEC (July 31, 2012, 3:22 PM), SEC-DOL008056.

The SEC financial economist responded, expressing confusion about the fundamental purpose of the Labor Department's proposal:[59]

From: Kozora, Matthew [redacted]SEC.GOV]
Sent: Tuesday, July 31, 2012 3:43 PM
To: Bergstresser, Keith - EBSA
Subject: RE: question

I apologize if I have overstepped my boundaries. This is a difficult topic for sure, and I was under the impression that my opinion was a. helpful and b. wanted.

I am also now utterly confused as to what the purpose of the proposed DOL rule is then, if not to limit advisor conflicts when providing retirement advice? Considering that my prior is that the DOL wants to reduce advisor conflicts, it just seems logical to me that the end result should measure advisory conflicts.

Good luck with your rulemaking.

Matt

Finally, SEC staff expressed concern about "intent of the measure itself," and wrote that the SEC and the Labor Department "just have two opposing viewpoints on the matter."[60] Labor Department staff deferred continuing the conversation to a later date,[61] but documents the Committee received provide no indication of future discussion on this topic. The SEC staff also raised concerns about the Labor Department's reliance on psychology literature to draft the rule, which would result in comparisons that "have very little economic meaning and thus no value to consumers."[62]

[59] Appendix B, Ex. 1, Email from Matthew Kozora, SEC, to Keith Bergstresser, U.S. Dep't of Labor (July 31, 2012, 3:42 PM), SEC-DOL008055–008056.
[60] Appendix B, Ex. 1, Email from Matthew Kozora, SEC, to Keith Bergstresser, U.S. Dep't of Labor (Aug. 2, 2012, 11:57 AM), SEC-DOL008054–008055.
[61] Appendix B, Ex. 1, Email from Keith Bergstresser, U.S. Dep't of Labor, to Matthew Kozora, SEC (Aug. 2, 2012, 2:00 PM), SEC-DOL008054.
[62] Appendix B, Ex. 1, Email from Matthew Kozora, SEC, to Keith Bergstresser, U.S. Dep't of Labor (Aug. 2, 2012, 11:57 AM), SEC-DOL008054–008055.

From: Bergstresser, Keith - EBSA [redacted]@dol.gov]
Sent: Tuesday, July 31, 2012 4:15 PM
To: Kozora, Matthew
Subject: RE: question

I would be happy to have a phone conversation to discuss the purpose of the rule, the purpose of the exemption conditions and distinctions between the two. don't think I want to try to have that conversation via email. I might have some time tomorrow, but I'm at a conference Thursday and Friday and then on vacation next week.

From: Kozora, Matthew [redacted]@SEC.GOV]
Sent: Thursday, August 02, 2012 11:57 AM
To: Bergstresser, Keith - EBSA
Subject: RE: question

Dear Keith,

There is a fundamental difference between price variation and the risk investors bear. For instance, prices may not change over a given period of time but yet investors might still bear much risk. There will also be problems with respect to measuring price variation with respect to illiquid securities or securities that are not traded very often (muni bonds, structured products, real estate). You are also treating systematic risk with idiosyncratic risk equally. Literature tells us (Sharpe (1964), Lintner (1965)) that such risks are not the same and should be treated much differently.

I understand you want to measure returns due to the psychology literature, however, I am quite concerned your benchmarks based on ex-post price variation will make such comparisons have very little economic meaning and thus no value to consumers. I am also concerned as to the intent of the measure itself. Do you want to "weed out" bad providers of advice by reporting performance measures? Or do you want to "protect participants from conflicts of interest" as proposed rule suggests? Those are two separate and different intents.

If/when you have a formal rule proposal that you want comments on, I will be more than happy to share my thoughts and views. Otherwise, I think we just have two opposing viewpoints on the matter.

Matt

It is evident from these emails that the SEC's expert staff had serious concerns about the rule. The financial economist at the SEC emailed Labor Department staff repeatedly and expressed serious concerns about fundamental principles of the rule. However, not only did the Labor Department dismiss the concerns, but the Department went a step further by actually demanding that the SEC expert stop emailing about the proposal.

The Labor Department restricted the Committee's review of these emails to a limited *in camera* review.[63] The Committee, however, ultimately obtained the communications from another source.

The SEC received the full proposed rulemaking package from the Labor Department in November 2014 and exchanged edits and comments with the Labor Department in January 2015.[64] Career, non-partisan SEC staff identified at least 26 items of concern related to the substantive content of the proposed rule.[65] The SEC staff's concerns included issues of clarity in the rule's "best interest" standard, inadvertent consequences of a *de minimis* breach, conflicts with federal securities laws and FINRA rules, and a lack of cost-benefit analysis of alternatives.[66] The SEC's point of contact in transmitting these concerns to the Labor Department was Sharon Block, a Senior Counselor to the Secretary of Labor, who formerly served as a political advisor in the Obama Administration, and whom President Obama recess appointed to be a member of the National Labor Relations Board, an appointment ultimately struck down by the Supreme Court.[67] The Labor Department repeatedly provided an incomplete response, declined to accept the SEC staff's recommendations, or incorrectly implemented the SEC expert's recommendations.[68] Specifically, in response to eight recommendations, the Labor Department declined to edit the operative language of the proposal, and instead merely modified or added language in the proposal's preamble.[69] The Labor Department outright rejected the SEC's two recommendations related to providing a quantitative cost-benefit analysis of considered alternatives to the rule.[70] Finally, the Labor Department implemented incorrect or

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[63] The Department of Labor provided Committee staff with an *in camera* review of a limited subset of self-selected documents on August 28, 2015. Notes are on file with the Committee.
[64] *See* Appendix B, Ex. 2, E-mail from Lona Nallengara, SEC, to Sharon Block, DOL (Jan. 26, 2015, 7:36 PM), SEC-DOL003234–003239 [hereinafter Items of Concern Chart] (attachment is a chart containing items of concern about the proposed rule).
[65] *Id.*
[66] *Id.*
[67] Edward-Isaac Dovere, *White House Pulls Controversial NLRB Pick*, POLITICO (Nov. 12, 2014), http://www.politico.com/story/2014/11/nlrb-sharon-block-lauren-mcferran-112833; Melanie Trottman, *President Obama Taps Former NLRB Recess Appointee for Board Again*, WSJ (July 11, 2014, 3:34 PM), http://www.wsj.com/articles/president-obama-taps-former-nlrb-recess-appointee-for-board-again-1405101028.
[68] Appendix B, Ex. 2, Items of Concern Chart, SEC-DOL003234–003239.
[69] *Id.*
[70] *Id.*

insufficient edits in response to at least four of the SEC's recommendations, evidenced by the SEC staff's follow-up on multiple issues of concern.[71]

Following the SEC staff's exchange of recommendations and concerns with the Labor Department, SEC experts continued to raise concerns "regarding the complexity of the proposal," and noted that the Labor Department had not fully addressed the SEC staff's enumerated issues of concern.[72] Then-SEC Chief of Staff Lona Nallengara, who has 20 years of experience in capital markets and corporate finance law,[73] explained in a January 26, 2015 email to Ms. Block:[74]

[71] Appendix B, Ex. 3, Email from Lona Nallengara, SEC, to Sharon Block, DOL (Jan. 26, 2015), SEC-DOL003274–003276.
[72] *Id.*
[73] Press Release, SEC, SEC Chief of Staff Lona Nallengara to Leave Agency (May 19, 2015).
[74] Appendix B, Ex. 3, Email from Lona Nallengara, SEC, to Sharon Block, DOL (Jan. 26, 2015), SEC-DOL003274–003276.

To: Nallengara, Lona[redacted]@SEC.GOV]
Cc: Hauser, Timothy - EBSA[redacted]@dol.gov]; Porter, Jennifer R.[redacted]@SEC.GOV]
From: Block, Sharon I - OSEC
Sent: Mon 1/26/2015 7:40:58 PM
Importance: Normal
Subject: RE: EBSA responses to SEC comments

Thanks Lona. We appreciate all the time your team has put in and their thoughtful comments.

From: Nallengara, Lona[redacted]@SEC.GOV]
Sent: Monday, January 26, 2015 7:37 PM
To: Block, Sharon I - OSEC
Cc: Hauser, Timothy - EBSA; Porter, Jennifer R.
Subject: RE: EBSA responses to SEC comments

Sharon,

Thank you for sending the chart showing your responses to SEC staff comments on the rule package that we discussed with you in December.

We asked the staff to review the chart and below are a few additional thoughts from the staff on several of the items that you can consider as you prepare your proposal (the staff has identified their comments using the item numbers in your chart).

I would also like to note that although the chart shows that several changes were made to the proposal to address the potential concerns that we have discussed regarding the complexity of the proposal, we continue to believe that commenters are likely to raise concerns that the proposal may result in reduced pricing options, rising costs and limited access to retirement advice, particularly for retail investors. Commenters also may express concerns that broker-dealers, as a practical matter, may be unlikely to use the exemptions provided and may stop providing services because of the number of conditions imposed, likely compliance costs, and lack of clarity around several provisions.

We hope these comments will continue to be helpful to you as you finalize the proposed rules.

- Lona

Documents received by the Committee and language in the promulgated proposed rule indicate that the Labor Department declined to resolve these outstanding concerns.

i. The "Best Interest" Standard

SEC staff recommended that the Labor Department add language to clarify the meaning of the term "best interest" in the proposal.[75] The Labor Department disregarded the recommendation, and stated that they "would prefer to see what commenters say before adding any additional explanatory language."[76]

Indeed, commentators criticized the "best interest standard" in the promulgated proposal and recommended that the Labor Department clarify the standard's requirements.[77] FINRA, the self-regulatory organization for the securities industry, focused on language requiring an investment advisor to provide advice that is in the best interest of the investor, "*without regard to the financial or other interests*" of the investment advisor.[78] FINRA explained that the "without regard to" phrase does not provide clear guidelines on limitations on compensation that varies depending on investment advice.[79]

Additionally, FINRA criticized the "best interest" standard's requirement that financial institutions and advisors act prudently, explaining that the "prudence standard" could be "interpreted to require the financial institution and adviser to provide ongoing advice to the customer."[80] FINRA recommended that the Labor Department make clear that the best interest standard does not require ongoing monitoring, and that the terms of the contract should control whether the financial institution or advisor will provide ongoing monitoring.[81]

Finally, FINRA questioned whether the Labor Department intended the best interest standard to require an investment advisor "to recommend the investment that is 'best' for the customer."[82] FINRA reasoned that the Labor Department did intend such a result, and pointed to a statement by Secretary Perez, in which he stated:

> If you're an adviser operating under a suitability standard, once you narrow the options down to those that are suitable, you can recommend the one that is most lucrative for you—even though that might mean a lower return for the client. Under a best interest standard, you would need to choose the one that is the best for the client.[83]

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[75] Appendix B, Ex. 2, Items of Concern Chart, SEC-DOL003234–003239.
[76] *Id.*
[77] Appendix A, Ex. 26, Letter from Marcia E. Asquith, Sr. Vice President & Corp. Sec'y, FINRA, to DOL, at 6–8 (July 17, 2015) [hereinafter FINRA Comments].
[78] *Id.* at 6 (emphasis added).
[79] *Id.*
[80] *Id.* at 7.
[81] *Id.* at 8.
[82] *Id.* at 7.
[83] *Id.*

FINRA cautioned that such a standard "would impose unnecessary and untenable litigation risks on fiduciaries," and explained that reasonable investment advisors may consider different factors in evaluating products and may reach different conclusions about which product is the "best" product for the customer.[84]

ii. Accidental Forfeiture of the Best Interest Contract Exemption in Case of a de Minimis Breach

SEC staff raised a concern about language in the proposal's Best Interest Contract Exemption, which required compliance with all applicable federal and state laws.[85] SEC staff warned that this requirement "could result in loss of exemption for trivial breaches," and suggested that the Labor Department clarify that a *de minimis* breach would not disallow the exemption.[86] According to this language, if an advisor violated a state law unrelated to the contract or to the service of providing investment advice, the advisor would not be compliant with applicable state laws, which could technically result in loss of the exemption. For example, an advisor's violation of a state law requiring a handicap-accessible ramp at the entrance to the building could result in loss of the exemption. The Labor Department attempted to implement the SEC staff's suggestion,[87] but failed to resolve the problem. The SEC staff again recommended that the Labor Department make additional changes to this provision of the rule.[88] Career experts at the SEC later advised Labor Department officials that this problem had not been resolved, but the Labor Department failed to address the issue in the final proposal.[89]

Specifically, Section II(a) of the Best Interest Contract Exemption in the proposal requires that "the Advisor and Financial Institution enter into a written contract with the Retirement Investor that *incorporates the terms required by Section II(b)–(e).*"[90] Section II(d), in turn, requires that "[t]he Adviser, Financial Institution, and Affiliates will comply with all applicable federal and state laws."[91] As such, by its terms, the Section could cause an advisor to forfeit the exemption for a small breach of state contract law.

Despite feedback from career, expert SEC staff regarding the inadequate revision three months in advance of the promulgation of the proposed rule,[92] the Labor Department declined to

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[84] *Id.*
[85] Appendix B, Ex. 2, Items of Concern Chart, SEC-DOL003234–003239.
[86] *Id.*
[87] *Id.* (responding that "as a result, failure to comply with law will not disallow the exemption").
[88] Appendix B, Ex. 3, Email from Lona Nallengara, SEC, to Sharon Block, DOL (Jan. 26, 2015), SEC-DOL003274–003276.
[89] *Id.*
[90] Best Interest Contract Exemption § II(a), 80 Fed. Reg. 21,960, 21,984 (proposed Apr. 20, 2015) (to be codified at 29 C.F.R. pt. 2550) (emphasis added).
[91] Best Interest Contract Exemption § II(d)(1), 80 Fed. Reg. at 21,984.
[92] Appendix B, Ex. 3, Email from Lona Nallengara, SEC, to Sharon Block, DOL (Jan. 26, 2015), SEC-DOL003274–003276.

update the rule. Therefore, the proposed rule contains language that requires compliance with federal and state laws for application of the exemption[93] and creates the possibility of forfeiture of the exemption in case of a trivial breach.[94]

iii. Lack of a Cost-Benefit Analysis for Alternative Approaches

The Labor Department rejected the SEC's recommendation to conduct quantitative analysis of the costs and benefits of alternative approaches to the rule, as required by Executive Orders (EOs) 12866 and 13563.[95] According to the Labor Department, expert, non-partisan, career SEC staff urged the Labor Department to "[c]onsider quantifying the costs and benefits of all the alternative approaches we considered and rejected."[96] The Department rejected the SEC expert's recommendation on the basis that its qualitative analysis sufficed:

> We think this would be extraordinarily difficult and would appreciably delay the project for very little return. The extensive *qualitative* descriptions of the bases for rejecting the alternatives included in the current [regulatory impact analysis] effectively explain the bases for rejecting the alternative approaches. We would prefer to get feedback from OMB before undertaking any additional quantitative analyses.[97]

The Labor Department informed the Committee that following OMB's review of the rule, the Department declined to complete quantitative analysis because it found the regulatory impact analysis to be sufficiently "compelling."[98]

SEC staff also recommended that the Labor Department analyze the costs and risks associated with the possibility that the rule could decrease the availability of investment advice and could drive firms to switch to registered investment advisor models from broker-dealer models.[99] The Labor Department responded that the regulatory impact analysis addressed these

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[93] Best Interest Contract Exemption § II(a), II(d)(1), 80 Fed. Reg. at 21,984.
[94] Appendix B, Ex. 2, Items of Concern Chart, SEC-DOL003234–003239.
[95] Exec. Order No. 12866, 3 C.F.R. 638 (1994); Exec. Order No. 13563, 3 C.F.R. 215 (2012).
[96] Appendix B, Ex. 2, Items of Concern Chart, SEC-DOL003234–003239. From the context of the document, it appears that "we" as used in this quotation refers to the Labor Department, rather than the Labor Department and the SEC collectively. The document was prepared by the Labor Department and transmitted to the SEC. *See* Appendix B, Ex. 2, Email from Sharon Block, DOL, to Lona Nallengara, SEC (Jan. 9, 2015), SEC-DOL003234. Elsewhere in the document, the drafters used "we" to the exclusion of the SEC. *See* Appendix B, Ex. 2, Items of Concern Chart, SEC-DOL003234–003239 ("We have edited the language based on our conversations with SEC staff"; "We are confident that the language in the regulation lines up with the SEC and CFTC language, but are reaching out to the SEC regulatory team . . . ."). Nowhere in the document is the Labor Department referenced similarly in the third person. Based on this contextual evidence, it appears that the phrasing of the SEC's comments is the Labor Department's articulation of the SEC's concerns, rather than the SEC's own words.
[97] Appendix B, Ex. 2, Items of Concern Chart, SEC-DOL003234–003239 (emphasis added).
[98] Briefing by Staff, DOL, to Committee Staff, HSGAC (Aug. 28, 2015) (notes on file with Committee).
[99] Appendix B, Ex. 2, Items of Concern Chart, SEC-DOL003234–003239.

issues, but that the Department was "reviewing to see if there is anything more . . . to say on the topic,"[100] and that it might "make additional edits after getting feedback from OMB."[101] However, the Labor Department apparently did not conduct any additional follow-up work after OMB completed its review of the proposal.[102]

EOs 12866 and 13563 were enacted to improve the regulatory process. EO 12866 requires a federal agency to "assess all costs and benefits of available regulatory alternatives, including the alternative of not regulating," and provides that the assessment should include "quantifiable measures."[103] EO 13563, which supplements EO 12866, requires a federal agency to "tailor its regulations to impose the least burden on society," to "choos[e] among alternative regulatory approaches," and to "identify and assess available alternatives to direct regulation."[104] EO 13563 also directs an agency to include "quantify[ing] anticipated present and future benefits and costs as accurately as possible."[105] EOs 12866 and 13563 permit agencies to conduct qualitative analysis in place of quantitative analysis where the costs and benefits are "difficult or impossible to quantify."[106] EO 13563 offers guidance on the types of factors that are difficult or impossible to quantify: "human dignity, fairness, and distributive impacts."[107] Here, the costs and benefits associated with the Labor Department's proposed fiduciary rule do not seem to meet the "difficult" or "impossible" threshold.

Additionally, OIRA issued a primer on EOs 12866 and 13563 to provide guidance to federal agencies in drafting a regulatory impact analysis.[108] OIRA emphasizes the importance of providing a quantitative analysis of alternatives and provides that agencies should conduct a quantitative analysis when at all possible.[109] For factors where quantification or monetization is not possible, OIRA instructs that the agency is not exempt from providing a quantitative analysis altogether and should still "present all available quantitative information."[110] Like the Executive Orders, OIRA also provides examples of values that are not readily quantifiable, including privacy, dignity, ecological gains, improvements to quality of life, and aesthetic beauty.[111]

OIRA dedicates the large majority of the guidance to explaining, in great detail, how agencies should conduct quantitative analysis.[112] OIRA focuses in particular on factors that are

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[100] *Id.*
[101] *Id.*
[102] Briefing by Staff, DOL, to Committee Staff, HSGAC (Aug. 28, 2015) (notes on file with Committee).
[103] Exec. Order No. 12866 § 1(a), 3 C.F.R. 638 (1994).
[104] Exec. Order No. 13563 § 1(b)(3), (b)(5), 3 C.F.R. 215 (2012).
[105] *Id.* § 1(c).
[106] *Id.*
[107] *Id.*
[108] OIRA, REGULATORY IMPACT ANALYSIS: A PRIMER.
[109] *Id.*
[110] *Id.* at 12.
[111] *Id.* at 12, 13.
[112] *See id.*

not easily quantified or monetized and on future projections and uncertainties.[113] Two full sections of the guidance are dedicated to analyzing "future benefits and costs" and "forecasts about the future."[114] OIRA instructs that while forecasts about the future may be uncertain, those uncertainties should be analyzed—agencies should specify potential scenarios, calculate the benefits and costs associated with each scenario, and construct ranges of values.[115] OIRA further emphasizes that this is the minimum agencies should do, and that agencies should assign probabilities and calculate expected values based on those probabilities, if possible.[116]

The Executive Orders and the OIRA guidance do not exempt the Labor Department from conducting a quantitative analysis simply because the analysis would involve complicated calculations and future projections. The examples provided in the Executive Orders and the OIRA guidance indicate that factors that qualify as "difficult" or "impossible" to quantify are factors with inherently intangible or subjective properties.[117] Monetary costs and benefits very clearly do not fit into this category because they are both countable and objective. The fact that determining costs and benefits may involve complex calculations and future uncertainties is a distinguishable obstacle. In fact, OIRA emphasizes the importance of providing a quantifiable analysis, even when it involves complex calculations or future uncertainties.[118] While the Labor Department might not be able to capture every potential cost and benefit of the rule, OIRA's guidance to agencies indicates that the Labor Department should have provided monetary and quantitative analysis of as many factors as possible. The Labor Department's approach of determining that it would be difficult to calculate costs and benefits, and thus abandoning the effort altogether, starkly contrasts with the guidance provided by OIRA.

More broadly, the Labor Department's dismissive response of the SEC experts' recommendation calls into question the Department's priorities in the rulemaking process and its commitment to thoughtfully considering the SEC staff's input. The Labor Department's decision to not undertake additional analysis following OMB's review is indicative of the Department's prioritization of accelerating its release of the proposal at the expense of a thorough process that appropriately reflected the input of the SEC staff.

b. The Labor Department Failed to Incorporate Principles from Existing Federal Securities Laws and FINRA Rules

FINRA—the Financial Industry Regulatory Authority—is the leading non-governmental regulator of brokerage firms and exchange markets and ensures that the security industry

[113] *See id.*
[114] *Id.* at 11, 12.
[115] *Id.*
[116] *Id.* at 14–15.
[117] *Id.* at 12, 13; Exec. Order No. 12866; Exec. Order No. 13563.
[118] OIRA, REGULATORY IMPACT ANALYSIS: A PRIMER, *supra* note 108.

operates fairly and honestly.[119] FINRA writes and enforces rules for every brokerage firm and broker in the United States, and also enforces federal securities laws and Municipal Securities Rulemaking Board (MSRB) rules.[120] FINRA has authority from the SEC to discipline brokers and brokerage firms for violations of FINRA rules, federal securities laws, and MSRB rules.[121] FINRA monitors more than 3,955 securities firms with approximately 643,320 brokers.[122]

In addition to ignoring substantive suggestions from subject-matter experts at the SEC, the Labor Department likewise apparently declined to incorporate existing federal securities laws and FINRA rules. Upon review of the proposed rule, FINRA provided critical feedback, stating that the rule "established principles that employ imprecise terms with little precedent in the federal securities laws or, in many cases, ERISA," and that "[i]n some respects these principles even conflict with FINRA rules."[123]

For example, FINRA highlighted that the proposed Best Interest Contract Exemption contains a provision that directly conflicts with FINRA rules.[124] Section III(a)(1) requires, prior to the purchase of a recommended asset, that an advisor project the total cost of investing in the asset for 1-, 5-, and 10-year periods, expressed as a dollar amount.[125] Such a projection requires the advisor to incidentally project investment performance because fees are tied to an asset's value. This requirement directly conflicts with FINRA Rule 2210, which generally prohibits broker-dealers from making performance projections to the public.[126] Thus, by requiring advisors to project the future value of assets under management, the Labor Department's rule would actually require advisors to violate FINRA rules.

The Labor Department's failure to "build upon existing principles in the federal securities laws and FINRA rules"[127] is despite SEC staff urging the Labor Department to incorporate references to and aspects of federal securities laws and FINRA rules. In September and October 2014, SEC staff provided to the Labor Department, on multiple occasions, lists of relevant laws and rules, including rules from the Securities Act, Advisers Act, Exchange Act, FINRA, the National Association of Securities Dealers (NASD), and the Municipal Securities Rulemaking Board.[128]

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[119] News Release, FINRA, NASD and NYSE Member Regulation Combine to Form the Financial Industry Regulatory Authority—FINRA (July 30, 2007); *About FINRA*, FINRA, http://www.finra.org/about.
[120] *What We Do*, FINRA, http://www.finra.org/about/what-we-do.
[121] News Release, FINRA (July 30, 2007), *supra* note 119; *About FINRA*, *supra* note 119.
[122] *For Industry Professionals*, FINRA, https://www.finra.org/industry.
[123] Appendix A, Ex. 26, FINRA Comments, at 11.
[124] *See id.* at 14.
[125] Best Interest Contract Exemption § III(a)(1), 80 Fed. Reg. 21,960, 21,985 (proposed Apr. 20, 2015) (to be codified at 29 C.F.R. pt. 2550) (emphasis added).
[126] FINRA, RULE 2210; Appendix A, Ex. 26, FINRA Comments, at 14.
[127] Appendix A, Ex. 26, FINRA Comments, at 11.
[128] Appendix B, Ex. 4, E-mail from Jennifer Porter, SEC, to Timothy Hauser, DOL (Sept. 4, 2014, 3:55 p.m.), SEC-DOL001768–001771; Appendix B, Ex. 5, E-mail from Jennifer Porter, SEC, to Timothy Hauser, DOL (Oct. 8, 2014, 10:35 a.m.), SEC-DOL001900–001901.

Additionally, SEC staff identified several items of concern relating to the Labor Department's lack of incorporation of federal securities laws and FINRA rules. For example, SEC staff recommended that the Labor Department redraft definitions in the disclosure requirements and document retention provisions so that the provisions expressly referenced SEC and FINRA definitions.[129] SEC staff reasoned that this would ensure that the Labor Department would receive complete and sufficiently comparable data from investment advisors.[130] However, the Labor Department dismissed the suggestion, instead merely including in the proposal's preamble a request for comment "as to whether the terms used and definitions are sufficient so that the information received will be reasonably comparable across different financial institutions."[131]

The Labor Department's failure to incorporate fundamental principles from federal securities laws and FINRA Rules further suggests that the Department did not thoroughly consult regulatory experts. This resulted in a rule that experts have highlighted as problematic, in part because of the conflicts it creates with existing and anticipated future regulatory frameworks.[132]

c. The Labor Department Declined to Incorporate OIRA's Recommendations into the Proposed Rulemaking

OIRA employs regulatory experts who carry out the office's mission as the federal government's chief review and oversight authority on Executive Branch rulemaking measures. Career, non-partisan, professional staff at OIRA conduct reviews of draft and final regulatory proposals, coordinate interagency review of proposals, consider and review comments from outside groups on proposed rulemakings, and offer guidance on how rulemakings can best achieve the intended purpose. In several instances, it appears that the Labor Department disregarded OIRA's recommendations and concerns about the Department's fiduciary rule.

The Labor Department declined OIRA's recommendation to add clarity to a particular provision of the rule. Specifically, OIRA instructed the Labor Department to add the qualifying adjective "all" to describe the types of common fee and compensation practices that the rule would preserve as exempt from ERISA's prohibited transactions rules.[133] OIRA proposed the following language: "the Department has worked to preserve beneficial models by separately proposing new exemptions from ERISA's prohibited transaction rules that will broadly permit firms to continue *to rely on all* common fee and compensation practices . . . ."[134] The Labor

[129] Appendix B, Ex. 2, Items of Concern Chart, SEC-DOL003234–003239.
[130] *Id.*
[131] *Id.*
[132] *See* Appendix A, Ex. 26, FINRA Comments, at 11.
[133] *See* Appendix B, Ex. 6, Conflict of Interest Rule, Apr. 8, 2015 Draft, EBSA Pass Back, SEC-DOL004832.
[134] *Id.*

Department rejected OIRA's changes and deleted "to rely on all," responding that "[n]ot all fee practices will be permitted by the exemptions" and explaining that, "[b]y deleting 'all' we slightly soften this by leaving it at 'common fee and compensation practices'"[135] This edit and the Department's explanation show that the Department envisioned the proposal as prohibiting some common fee and compensation packages.

The Labor Department's deletion of the word "all" raises questions about the Department's commitment to transparency. The language in the provision emphasizes that the Labor Department is committed to preserving existing models and to permitting the continuance of common fee and compensation practices. However, this language appears to be misleading because the Labor Department surreptitiously retained its ability to exclude some fee and compensation practices from the exemption. It is difficult to understand how the Labor Department sought to preserve and permit the current compensation structure in the industry when it explicitly envisioned the possibility of prohibiting some fee and compensation packages.

In another instance, OIRA questioned the Labor Department's use of the term "incidental advice" in connection with its discussion of the rule's seller's carve-out.[136] Regulatory experts at OIRA cautioned that exempting "incidental advice" could also "carve out advice given by a broker under the [guise] of being a mere order taker"[137] and noted, "[t]hat's where the SEC muddied the waters in the first place."[138] Documents received by the Committee contain no indication that the Labor Department fully responded to this concern.[139] Furthermore, this section of the preamble in the rule contains the same language as the draft rule,[140] showing that the Labor Department did not adjust the language to accommodate OIRA's concern, and further suggesting that the Labor Department did not thoroughly consider OIRA's comments.

d. The Labor Department Did Not Fully Consider Concerns Raised by the Treasury Department

The Treasury Department has enforcement authority over Individual Retirement Accounts (IRAs), which are a creation of the tax code, and thus the Labor Department's engagement with Treasury on the proposed rule is especially important. Given Treasury's authority and expertise in enforcing rules and regulations relating to IRAs, the Labor Department should have considered and remedied any concerns raised by Treasury officials about the proposed rule.

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[135] *Id.* (emphasis added).
[136] *Id.* SEC-DOL004858.
[137] *Id.*
[138] *Id.* (emphasis added).
[139] *Id.*
[140] Conflict of Interest Rule—Retirement Investment Advice § (b)(1)(i), 80 Fed. Reg. 21,928, 21,957 (proposed Apr. 20, 2015) (to be codified at 29 C.F.R. pts. 2509, 2510).

Treasury officials and other experts have raised concerns about the Best Interest Contract Exemption (BIC exemption), because it would impose new requirements on fiduciaries with respect to IRAs.[141] IRAs are governed by the Internal Revenue Code, not by ERISA. Unlike ERISA, the Internal Revenue Code "does not directly impose responsibilities of prudence and loyalty on fiduciaries."[142] The Labor Department's rule, however, would create such responsibilities by requiring fiduciaries "to act in accordance with the Impartial Conduct Standards in transactions governed by the exemptions."[143] The rule's background section acknowledges that the proposal would more significantly increase requirements for advisors with respect to IRAs than it would for advisors of accounts governed by ERISA (the Employee Retirement Income Security Act) because ERISA already requires those advisors to meet prudence and loyalty standards.

Former Assistant Secretary of Labor Bradford Campbell criticized this aspect of the rule as an effort by the Labor Department to sidestep Congress, stating that "[d]espite their simultaneous creation in 1974, Congress expressly chose not [to] apply the ERISA fiduciary standard to IRAs."[144] According to Mr. Campbell, "the Department is attempting to do something through [the proposed rule] that Congress explicitly chose not to do."[145]

Treasury officials similarly voiced concerns about the Labor Department extending the reach of the rule to IRAs. Treasury officials commented that earlier amendments were made "to reflect Congressional intent," on the basis that Congressional intent was "being undermined by rules that [were] not reflective of current market practices."[146] Treasury officials argued that this amendment, by imposing requirements with respect to accounts governed by a different statute and under the jurisdiction of a different federal agency, "seems to fly in the face of the logic . . . that these amendments are necessary to reflect Congressional intent."[147] The Labor Department responded by disagreeing and effectively dismissing the Treasury Department's concern. The Labor Department wrote:

> We think there's a difference here between the regulation and the exemptions. The purpose of the regulation expanding the definition of 'fiduciary' is to reflect Congressional intent. However, the purpose of this exemption is to say that if

[141] Appendix B, Ex. 7, Proposed Amendments to Class Exemptions, Apr. 21, 2015 Draft, Treasury Comments (Mar. 21, 2015), SEC-DOL005312.
[142] *Id.* (emphasis added).
[143] CONG. RESEARCH SERV., DOL'S 2015 PROPOSED FIDUCIARY RULE ON INVESTMENT ADVICE, IN FOCUS, IF10318, Nov. 12, 2015. The Impartial Conduct Standards require an advisor to act in the best interest of the client-investor and not to accept more than reasonable compensation.
[144] House Ways & Means Committee Hearing, *supra* note 47 (statement of Bradford Campbell).
[145] *Id.*
[146] Appendix B, Ex. 7, Conflict of Interest Rule, Treasury Comments, Mar. 21, 2015, SEC-DOL005312.
[147] *Id.*

> you're a fiduciary under the [Internal Revenue Code] (and Congressional intent), and want to receive variable compensation, then you have to comply with these conduct standards, even if they are not independently imposed by Congress.[148]

IRA advisors receive variable compensation, especially when providing advice to low- and middle-income investors.[149] Thus, IRA advisors would be subject to the rule's conduct standards. Despite Congress' intent to regulate IRA advisors under a different law, the Labor Department would regulate them using variable compensation as a proxy.

In a letter to Chairman Johnson on December 14, 2015, Treasury Department Assistant Secretary for Legislative Affairs, Anne Wall, stated that "Treasury believes that DOL appropriately considered Treasury's comments on the drafts during the OIRA process, including the comments specified in your letter" (and quoted above).[150] However, based on the documents, it is unconvincing that the Labor Department fully considered the comments of the Treasury Department experts. First, documents the Committee received provide no indication that the Departments discussed the Treasury Department's concern beyond the Labor Department's initial response to the Treasury Department, where it merely disagreed with Treasury's comment. Second, the Labor Department promulgated the proposed rule less than two weeks after circulating this draft and the accompanying comments, undoubtedly limiting the extent to which the Labor Department considered the comments it received from the Treasury Department experts on the draft. Finally, the promulgated proposal does not contain language signifying that the Labor Department edited the rule in accordance with the Treasury Department's stated concerns. For these reasons, it is difficult to conclude objectively that the Labor Department fully considered the Treasury Department's comments.

III. EXPERTS HAVE EXPRESSED CONCERNS ABOUT THE RULE'S ANTICIPATED HARM TO MIDDLE-INCOME AND SMALL BUSINESS INVESTORS

Chairman Johnson's inquiry raises concerns about both the process and the substance of the Labor Department's rulemaking. The Committee has received documents that demonstrate that the Labor Department prioritized expediting the drafting process at the expense of thoughtfully considering and addressing concerns from industry experts. In multiple instances, the Department disregarded advice from the SEC, OIRA, and Treasury, and failed to undertake a thorough cost-benefit analysis of the rule. The majority staff finds these actions especially

[148] *Id.*
[149] Appendix A, Ex. 27, Letter from Commonwealth Financial Network to DOL (July 21, 2015).
[150] Appendix A, Ex. 28, Letter from Hon. Anne Wall, Asst. Sec'y for Leg. Affairs, Dep't of the Treasury, to Chairman Johnson (Dec. 14, 2015).

troubling because of the concerns raised about the risk of the rule's anticipated harm to middle-income investors.

Generally, industry experts, including investment advisors, support a best interest standard, but have criticized the rule on the grounds that it is overly complex and burdensome. For example, Peter Schneider, the President of Primerica, testified to Congress that he "agree[s] that firms and their representatives should always act in their clients' best interests."[151] He explained that he is concerned "that the requirements and uncertainties of the [Best Interest Contract Exemption] are so complex and burdensome that the exemption is n either administratively nor operationally feasible."[152]

Similarly, former SEC Commissioner Daniel Gallagher has harshly criticized the rule, calling it a "mess," in part because advisors who adhere to a best interest standard still risk noncompliance with the rule because of its many complicated requirements.[153] Commissioner Gallagher has cautioned that the Labor Department's rule would result in the "elimination of an entire class of accounts" for investors and would subject advisors to "unlimited liability."[154] Other experts and observers have also raised concerns that the conditions and requirements the rule imposes are ambiguous and unworkable, which will increase litigation risk and regulatory costs. Experts anticipate that advisors will incur initial compliance costs of $21.5 million and annual maintenance costs of $5.1 million, resulting in increased costs for retail investment advice by 73% to 196% as a result of the Labor Department's proposal.[155]

Additionally, experts contend that the Administration has inflated the harm that results from investors relying on "conflicted advice." The White House and the Labor Department claim that conflicted advice from brokers costs investors $17 billion per year.[156] Former SEC chief economist Craig Lewis has explained that the $17 billion estimate is based on a calculation that failed to account for discrepancies in the data and that used outdated data from the 1990s

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[151] Senate HELP Committee Hearing, *supra* note 2 (statement of Peter Schneider); *see also id.* (statement of Robert Litan) ("[T]he notion that all retirement investment advisers should be held to a best interest of client standard is not controversial.").
[152] *Id.*; House Ways & Means Committee Hearing, *supra* note 47 (statement of Judy VanArsdale, Co-Owner, enrich Private Wealth Management).
[153] Mark Schoeff Jr., *SEC Commissioner: DOL Fiduciary Rule Would Create "a Mess"*, INVESTMENT NEWS (Aug. 4, 2015, 1:18 PM), http://www.investmentnews.com/article/20150804/FREE/150809978/sec-commissioner-dol-fiduciary-rule-would-create-a-mess.
[154] *Id.*; Speech to the Chamber of Commerce, Daniel Gallagher, Comm'r, SEC (Aug. 4, 2015), *available at* https://www.uschamber.com/event/discussion-sec-commissioner-daniel-gallagher.
[155] MILLOY, AM. ACTION FORUM, *supra* note 43; *see also* DELOITTE DEVELOPMENT LLC, REPORT ON THE ANTICIPATED OPERATIONAL IMPACTS TO BROKER-DEALERS OF THE DEPARTMENT OF LABOR'S PROPOSED CONFLICT OF INTEREST RULE PACKAGE (2015) (reporting similar findings).
[156] EXEC. OFFICE OF THE PRESIDENT, THE EFFECTS OF CONFLICTED INVESTMENT ADVICE ON RETIREMENT SAVINGS (2015).

and 2000s.[157] Mr. Lewis stated, "[y]ou don't have to be an economist to recognize the Administration's $17 billion talking point significantly overestimates the costs, if any, to investors relying on the 'conflicted advice' of brokers."[158]

Experts have focused, in particular, on the negative impact that the rule will have on small-account owners—small businesses and middle-income investors. The Small Business Administration has commented that the rule "would likely increase the costs and burdens associated with servicing smaller plans . . . [which] could limit financial advisers' ability to offer savings and investment advice to clients . . . [which] could ultimately lead advisors to stop providing retirement services to small businesses."[159] Similarly, former Assistant Secretary of Labor Bradford Campbell testified that the rule "likely will harm the very retirement investors it is intended to help."[160] Mr. Campbell echoed the Small Business Administration's concerns that the rule will increase the cost and reduce the availability of advice to small plans and small-account IRA owners.[161] Finally, experts have pointed to an "advice gap" that has developed in the United Kingdom (U.K.) as a result of a 2013 rule change in the U.K. that is effectually identical to the Labor Department's rule.[162] According to ERISA experts, it is "widely accepted in the U.K." that "middle- and lower- income savers in the U.K. are being cut off from investment advice."[163] The United Kingdom government has "launched a major review of exactly that advice gap."[164]

First, the rule contains a carve-out that will not apply to small businesses. The "Seller's Carve-Out" exempts an investment advisor from fiduciary duties when the advisor sells or markets materials, as long as the advisor discloses that the advisor is paid to sell proprietary financial product and is not providing fiduciary advice.[165] However, the proposal prohibits advisors to small businesses from using the Seller's Carve-Out based on the assumption that small businesses lack financial sophistication.[166] Small businesses and ERISA experts have voiced concerns that the rule will deprive small businesses of access to guidance on investment

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[157] Craig M. Lewis, *An Inflated $17 Billion Talking Point From the DOL*, FORBES (Dec. 16, 2015, 12:30 PM), http://www.forbes.com/sites/realspin/2015/12/16/an-inflated-17-billion-talking-point-from-the-dol/#782b028439e1.
[158] *Id.*
[159] Appendix A, Ex. 29, Letter from Claudia Rodgers, Acting Chief Counsel for Advocacy, and Dillon Taylor, Asst. Chief Counsel for Advocacy, Small Business Admin., to Hon. Phyllis Borzi, Asst. Sec'y, EBSA, DOL, at 5–6 (July 17, 2015).
[160] House Ways & Means Committee Hearing, *supra* note 47 (statement of Bradford Campbell).
[161] *Id.*
[162] KENT MASON, DAVIS & HARMAN LLP, U.K. LAUNCHES REVIEW OF "ADVICE GAP" FOR SMALL ACCOUNTS FOLLOWING A 2013 RULE CHANGE WITH EFFECTS IDENTICAL TO WHAT DOL NOW PROPOSES (2015).
[163] *Id.*
[164] *Id.*
[165] Conflict of Interest Rule—Retirement Investment Advice § (b)(1)(i), 80 Fed. Reg. 21,928, 21,957 (proposed Apr. 20, 2015) (to be codified at 29 C.F.R. pts. 2509, 2510) (Seller's Carve-Out); *id.* pmbl. § IV(C)(1)(a) at 21,941–42 (explaining the Seller's Carve-Out).
[166] Senate HELP Committee Hearing, *supra* note 2 (statement of Darlene Miller, President & CEO, Permac Industries, Board Member, U.S. Chamber of Commerce).

options that are otherwise permitted by the carve-out.[167] Small businesses have additionally refuted the Labor Department's flawed assumption that small businesses lack the requisite sophistication to engage with investment advisors without statutorily imposed protections.[168] At a hearing before the Senate Committee on Health, Education, Labor and Pensions, a small-business owner testified:

> I would not be able to run a successful business if I were not able to understand when I am involved in a sales discussion. . . . The assumption that small plans, participants and IRA owners cannot understand the difference between sales and advice does not match my real world experience. The [Labor] Department can protect participants, IRA owners and small plans with the same kind of disclosures that it requires of large plans under the large plan carve out, but without eliminating their right to choose the services and products that best fit their needs.[169]

Former Assistant Secretary Campbell similarly criticized the carve-out, stating "there is no clear basis to believe that plan size is a proxy for financial sophistication, and no basis to treat every IRA owner as if she is incapable of making informed choices."[170]

Additionally, experts have voiced concerns that the Best Interest Contract Exemption (BIC exemption) is unworkable and that firms will not use it. The BIC exemption allows certain broker-dealers and other fiduciaries to receive compensation that would otherwise be prohibited, such as commissions.[171] To take advantage of the BIC exemption, the investor and advisor must sign a contract acknowledging fiduciary status.[172] The advisor must act in the best interest of the client and must make numerous disclosures to the client and to the Labor Department.[173] Experts contend that the BIC exemption is unworkable and will increase the cost of investment advice and services and will, consequently, decrease access to investment services for small investors.[174] Experts explain that the BIC exemption imposes conditions and requirements for advisors that are ambiguous, creating uncertainty and putting advisors at risk for penalties and lawsuits, including class action lawsuits.[175] Industry participants caution that investment firms will consequently decline to use the BIC exemption.[176]

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[167] *Id.*
[168] *Id.*
[169] *Id.*
[170] *Id.* (statement of Bradford Campbell).
[171] CONG. RESEARCH SERV., DOL'S 2015 PROPOSED FIDUCIARY RULE ON INVESTMENT ADVICE, IN FOCUS, IF10318, Nov. 12, 2015.
[172] *Id.*
[173] *Id.*
[174] Senate HELP Committee Hearing, *supra* note 2 (statement of Darlene Miller).
[175] *Id.* (statements of Darlene Miller and Peter Schneider).
[176] *Id.*; House Ways & Means Committee Hearing, *supra* note 47 (statements of Judy VanArsdale and Bradford Campbell).

According to experts, the unworkability of the BIC exemption will inhibit middle-income, small-account owners' access to investment services. Experts explain that firms that do not use the exemption will likely convert their commission-based brokerage IRAs to fee-based accounts.[177] Fee-based accounts are more expensive to operate than commission-based accounts and, therefore, often require account minimums of $25,000 and higher annual fees.[178] Experts caution that these costs will inhibit access to investment services for small account owners and could result in losses in retirement savings of as much as $68–80 billion per year.[179] Even in the case of advisors who continue to provide services to small account owners, flat fees will present affordability challenges for middle-income investors who cannot afford to pay flat rates and currently rely on commission-based fees.[180]

Supporters of the rule have criticized large, publicly-traded investment firms for publicly predicting significant negative consequences, while simultaneously "assuring [investors] that the rule will have no significant impact on their companies" and that they "are well-positioned to 'adapt to any regulatory framework that emerges.'"[181]

However, these large investment firms are not the ones that will feel the most significant effects of the rule. Rather, the rule is likely to harm small- and mid-size investment firms. For example, Judy VanArsdale, the co-owner of a seven-employee wealth management company, testified before the House Committee on Ways and Means about her concerns about the rule.[182] As a small wealth management company, Ms. VanArsdale's company serves more than 2,500 accounts, with more than 800 accounts containing less than $25,000.[183] Ms. VanArsdale explained that the rule increases litigation risk because of its lack of clarity and its creation of state-law class action lawsuits.[184] Ms. VanArsdale stated that, as a small-business owner, she feels "great concern over subjecting [her] business to increased business and litigation risk."[185] According to Ms. VanArsdale, to avoid litigation risk, "small businesses . . . may not feel comfortable using the BIC exemption, and . . . would be restricted from serving retirement brokerage accounts."[186] While large firms may be better suited to withstand changes in the

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[177] Senate HELP Committee Hearing, *supra* note 2 (statements of Darlene Miller and Peter Schneider); House Ways & Means Committee Hearing, *supra* note 47 (statement of Bradford Campbell).
[178] Senate HELP Committee Hearing, *supra* note 2 (statement of Peter Schneider); House Ways & Means Committee Hearing, *supra* note 47 (statement of Bradford Campbell).
[179] QUANTRIA STRATEGIES, *supra* note 13, at 1.
[180] Senate HELP Committee Hearing, *supra* note 2 (statement of Peter Schneider).
[181] Appendix A, Ex. 30, Letter from Hon. Elizabeth Warren, U.S. Sen., and Hon. Elijah Cummings. U.S. House of Representatives, to Sec'y Perez, DOL, and Hon. Shaun Donovan, Dir., OMB (Feb. 11, 2016).
[182] House Ways & Means Committee Hearing, *supra* note 47 (statement of Judy VanArsdale).
[183] *Id.*
[184] *Id.*
[185] *Id.*
[186] *Id.*

regulatory regime, small- and mid-size investment firms—and the middle-class consumers they service—have less tolerance to weather such changes.

IV. THE ADMINISTRATION WAS PREDETERMINED TO REGULATE THE INDUSTRY AND SOUGHT EVIDENCE TO JUSTIFY ITS PREFERRED ACTION

The Labor Department refused to provide the Committee with its communications with the White House. However, the Committee obtained some of these communications from another party. The communications indicate that the Labor Department and the White House were predetermined to regulate the industry and sought evidence to justify their preferred action. The communications also suggest that the White House may have played an outsized role in the rulemaking, in conflict with the Administrative Procedure Act.

In an email to Brian Deese—a senior political advisor in the Executive Office of the President—a Labor Department policy advisor wrote of the "challenges in completing the [regulatory impact analysis]."[187] In particular, he noted, "we need to determine whether the available literature, our work with RAND, and any other data we have not yet identified can be woven together to demonstrate that there is a market failure and to monetize the potential benefits of fixing it."[188] In another email to Mr. Deese, a Labor Department policy advisor discussed plans for packaging the rulemaking re-proposal.[189] The email noted a GAO report that the Labor Department intended to use to "build[] the case for why the rule is necessary."[190]

EOs 12866 and 13563—enacted to reform and improve regulations and the regulatory process—require agencies to identify a market failure or other compelling problem that justifies regulation before the agency begins the regulatory drafting process. Specifically, EO 12866 provides that agencies should promulgate regulations only if they are "made necessary by compelling public need, such as material failures of private markets."[191] EO 12866 further provides that "in deciding whether and how to regulate, agencies should assess all costs and benefits of available regulatory alternatives, including the alternative of not regulating."[192] However, as evidenced by these emails, the Labor Department and the White House worked

[187] Appendix B, Ex. 8, E-mail from Zachary A. Epstein, DOL, to Brian C. Deese, Exec. Office of the President, et al. (Oct. 25, 2011, 7:30 PM), SEC-DOL005872–005873.
[188] *Id.*
[189] Appendix B, Ex. 9, Email from Chris Cosby, DOL, to Brian C. Deese, Exec. Office of the President, et al. (Nov. 2, 2011, 5:47 PM), SEC-DOL006041–006042.
[190] *Id.*
[191] Exec. Order No. 12866 § 1(a), 3 C.F.R. 638 (1994); *see also* Exec. Order No. 13563 § 1(b), 3 C.F.R. 215 (2012) (providing that an agency must "propose or adopt a regulation only upon a reasoned determination that its benefits justify its costs").
[192] Exec. Order No. 12866 § 1(a), 3 C.F.R. 638 (1994).

backwards—they first determined that they wanted to create the rule, then searched for evidence to justify it. The way in which the Labor Department and the White House approached the regulatory impact analysis is opposite to the methodology required by executive order.

The Administrative Procedure Act vests control of a rulemaking in the agency proposing the regulation. The Executive Office of the President—including OIRA, the National Economic Council, and other entities—exists to coordinate policy broadly across the executive branch, but ultimately each agency owns its particular rulemaking. With respect to the Labor Department's fiduciary rulemaking, it appears that the White House may have played an outsized role.

Documents that the Committee received suggest that the proposal was initially driven by political appointees in the Executive Office of the President. First, the level of detail in email communications between the Labor Department and the White House indicates that White House advisors may have exceeded their coordination function in drafting the rule. For instance, in the email discussing a GAO report that the Labor Department felt could build a case for the rule, a Labor Department official provided specific page numbers and direct quotations from the report to the White House's Brian Deese.[193] Such detail suggests that Mr. Deese, and other policy advisors within the White House, were involved in crafting the basis for the rule and the regulatory impact analysis on a granular and collaborative basis.

Additionally, in October and November 2011, the White House's National Economic Council convened a series of meetings among the Labor Department, the SEC, the Treasury Department, and the White House to discuss the rule's economic analysis.[194] These discussions appear to have been more than mere coordination meetings. Rather, it seems that White House officials were involved in developing material to justify the need for the Labor Department's proposal.

Moreover, Assistant Secretary of Labor Phyllis Borzi, who has been described as the "main architect" of the fiduciary rule,[195] ranks as the twelfth most frequent visitor to the White House during the Obama Administration.[196] Since 2009, Ms. Borzi has visited the White House

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[193] *Id.*

[194] Brian Deese, then-Deputy Director of the National Economic Council, and Adriana Kugler, then-Chief Economist to then-Department of Labor Secretary Hilda Solis, hosted meetings at the White House in October and November 2011. White House staff, Labor Department staff, SEC staff, and Treasury Department staff attended the meetings. *See* Appendix B, Ex. 10, Email from Jessica Schumer, Exec. Office of the President, to Brian C. Deese et al. (Oct. 12, 2011) (October 20, 2011 meeting), SEC-DOL005698; Appendix B, Ex. 11, Email from Jessica Schumer to Brian C. Deese et al. (Oct. 25, 2011) (October 27, 2011 meeting), SEC-DOL005861; Appendix B, Ex. 9, Email from Chris Cosby, DOL, to Brian C. Deese et al. (Nov. 2, 2011) (November 2, 2011 meeting), SEC-DOL006041.

[195] Melanie Waddell, *DOL to 'Simplify and Streamline' Fiduciary Rule: Borzi*, THINKADVISOR (Oct. 20, 2015)

[196] Jason Howerton, *Here Are the 25 People Who Have Visited the Obama White House the Most* (Feb. 8, 2016, 1:38 PM), http://www.theblaze.com/stories/2016/02/08/here-are-the-25-people-who-have-visited-the-obama-white-house-the-most-no-3-is-apparently-shrouded-in-mystery/.

338 times.[197] Two other senior Labor Department officials rank as the ninth and sixth most frequent White House visitors, with 369 and 376 visits, respectively.[198]

Finally, a White House memorandum entitled "Draft Conflict of Interest Rule for Retirement Savings" further illustrates the White House's significant involvement in the rulemaking process. The memorandum, circulated by White House Council of Economic Advisors Chairman (CEA) Jason Furman and CEA member Betsey Stevenson, to the President's senior advisors including John Podesta, Susan Rice, Jennifer Palmieri, and Valerie Jarrett, criticized current regulations relating to investment advice on retirement accounts.[199] The memorandum argued that aggressive regulatory action was necessary to remedy the inadequate existing consumer protections on investment advice.[200] The Department issued its proposal just four months later.

V. THE ADMINISTRATION OBSTRUCTED CHAIRMAN JOHNSON'S INQUIRY BY LIMITING THE INFORMATION THE COMMITTEE WAS ABLE TO OBTAIN

In the course of conducting oversight on the Labor Department's rulemaking, Chairman Johnson experienced tremendous opposition and noncooperation from the Administration. The Labor Department withheld documents and even went so far as to urge the SEC—an independent agency that is designed to be bipartisan—to do the same. OIRA also withheld documents. The Labor Department's and OIRA's refusals to fully cooperate with Chairman Johnson's oversight has prevented the Committee from obtaining relevant documents and has hindered the Chairman's overall inquiry.

a. The Labor Department Remains Uncooperative with Chairman Johnson's Requests for Information and Documents from February 2015

Chairman Johnson wrote a letter to the Labor Department on February 5, 2015, requesting information and documents relating to the Department's anticipated rule.[201] After the Labor Department failed to produce communications in response to his request, Chairman Johnson reiterated the requests in another letter on March 17, 2015.[202] Chairman Johnson requested communications about the Labor Department's rulemaking between the Labor

[197] *Id.*
[198] *Id.*
[199] Memorandum from Jason Furman, Chairman, White House Council of Econ. Advisors, and Betsey Stevenson, Member, White House Council of Econ. Advisors, to White House Senior Advisors (Jan. 13, 2015).
[200] *Id.*
[201] Appendix A, Ex. 1, Letter from Chairman Johnson to Sec'y Perez, DOL (Feb. 5, 2015).
[202] Appendix A, Ex. 2, Letter from Chairman Johnson to Sec'y Perez, DOL (Mar. 17, 2015).

Department and the SEC and between the Labor Department and the White House.[203] By its own admission, the Department has not produced all material responsive to Chairman Johnson's requests.[204]

Specifically, the Labor Department has not produced any material responsive to Chairman Johnson's request for communications between the Department and the White House.[205] In August 2015, Chairman Johnson signaled his objection to Adri Jayaratne's nomination to be the Labor Department's Assistant Secretary for Congressional and Intergovernmental Affairs because of the Department's failure—under Mr. Jayaratne's time as acting head of the Office of Congressional and Intergovernmental Affairs—to respond fully to the Chairman's requests. Subsequently, the Labor Department informed the majority staff that no responsive documents existed.[206] The Labor Department, however, refused to explain how the Department came to this conclusion or what type of search the Department conducted.[207] The Committee later received, from another source, some communications between the Department and the White House about the rulemaking.[208] Still, later, in December 2015, the Labor Department again refused to provide the requested materials and declined to confirm whether it had sought consent from the White House to produce the material.[209]

The Labor Department has not fully responded to Chairman Johnson's request for communications between the Department and the SEC. The Labor Department has produced only a limited subset of self-selected communications between the Department and the SEC and provided short briefings.[210] The communications the Labor Department produced are mostly

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[203] *Id.*

[204] Chairman Johnson did not request to conduct transcribed interviews with Labor Department officials. In light of the Labor Department's repeated refusals to produce requested information and documents, its interference with the SEC's response to the Chairman's separate request to the SEC, and the Department's overall obstructive posture with respect to the Chairman's inquiry, it is likely that requests for transcribed interviews would have proved futile.

[205] Email from Committee Staff, HSGAC, to Kathryn Garza-Ahlgren, DOL (Aug. 24, 2015, 2:00 PM) (on file with Committee).

[206] Phone Call between Committee Staff, HSGAC, and DOL (Aug. 5, 2015); *see also* Email from Committee Staff, HSGAC, to Nikki McKinney, DOL (Dec. 17, 2015, 1:19 PM) (on file with Committee) (referencing the phone call); Email from Committee Staff, HSGAC, to Kathryn Garza-Ahlgren, DOL (Aug. 24, 2015, 2:00 PM) (on file with Committee) (referencing the phone call).

[207] Phone Call between Committee Staff, HSGAC, and DOL (Aug. 2015); *see also* Email from Committee Staff, HSGAC, to Nikki McKinney, DOL (Dec. 17, 2015, 1:19 PM) (on file with Committee) (referencing the phone call); Email from Committee Staff, HSGAC, to Kathryn Garza-Ahlgren, DOL (Aug. 24, 2015, 2:00 PM) (on file with Committee) (referencing the phone call).

[208] The SEC produced to the Committee on November 23, 2015, documents containing communications between the Labor Department and the White House. *See* Email from Committee Staff, HSGAC, to Nikki McKinney, DOL (Dec. 17, 2015, 1:19 PM) (on file with Committee).

[209] Phone Call between Committee Staff, HSGAC, and DOL (Dec. 17, 2015); Email from Committee Staff, HSGAC, to Nikki McKinney, DOL (Dec. 17, 2015, 1:19 PM) (on file with Committee); Email from Committee Staff, HSGAC, to Nikki McKinney, DOL (Jan. 12, 2016, 12:52 PM) (on file with Committee).

[210] Appendix C, Dep't of Labor Document Production, DOL000001–002458; Emails between Committee Staff, HSGAC, and Elva Linares, DOL (Aug. 26–27, 2015) (on file with Committee). Mr. Jayaratne's staff, moreover,

related to scheduling meetings and do not address substantive aspects of the rule drafting process.[211] Moreover, the Department only produced these documents after the Chairman made a separate but similar request to the SEC for documents.[212] Additionally, during the briefings, Labor Department lawyers unilaterally limited the subject matter and timing of the briefings, leaving many questions unanswered.

Regarding the Labor Department and SEC communications, the Labor Department refused to certify that the communications produced to the Committee constituted the full universe of communications responsive to the Chairman's request.[213] Furthermore, the Labor Department refused to provide information about the total number of responsive documents, or the methods the Department used to identify responsive material.[214] The majority staff has confirmed that these communications, in fact, do *not* constitute the full universe of responsive communications. Rather, it appears that the Labor Department combed through its communications with the SEC and deliberately omitted the large majority of communications that would inform Chairman Johnson's inquiry. The Committee has obtained documents from another source that contain many communications between the Labor Department and the SEC that the Department omitted from its production. The Labor Department has acknowledged to the majority staff that additional responsive material exists, though it refuses to produce such material.[215]

In July 2015, Chairman Johnson spoke with Secretary Perez about the outstanding document requests. The majority staff has also communicated directly with Mr. Jayaratne about the Labor Department's unsatisfactory responses. Despite these interactions, and Chairman Johnson's continued objection to Mr. Jayaratne's confirmation by the Senate, the Labor Department still refuses to comply fully with the Chairman's requests. It seems that the Labor Department has only seriously engaged in discussions about fully satisfying Chairman Johnson's requests in an effort to advance Mr. Jayaratne's nomination. Ultimately, though, the Labor Department remains unwilling to produce all responsive documents to the Committee.

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placed unilateral time and content restrictions on these briefings, refusing to answer questions that they deemed outside the scope of the briefings. Emails between Committee Staff, HSGAC, and Elva Linares, DOL (Aug. 26–27, 2015) (on file with Committee).

[211] Appendix C, Dep't of Labor Document Production, DOL000001–002458.

[212] Email from Committee Staff, HSGAC, to Adri Jayaratne, Acting Asst. Sec'y, Office of Cong. & Intergovernmental Affairs, DOL (July 8, 2015, 6:56 PM) (on file with Committee).

[213] Email from Kathryn Garza-Ahlgren, DOL, to Committee Staff, HSGAC (Aug. 21, 2015, 5:14 PM) (on file with Committee).

[214] Email from Committee Staff, HSGAC, to Adri Jayaratne, Acting Asst. Sec'y, Office of Cong. & Intergovernmental Affairs, DOL (July 8, 2015, 6:56 PM) (on file with Committee); Email from Committee Staff, HSGAC, to Kathryn Garza-Ahlgren, DOL (Aug. 24, 2015, 2:00 PM) (on file with Committee).

[215] Email from Kathryn Garza-Ahlgren, DOL, to Committee Staff, HSGAC (Aug. 21, 2015, 5:14 PM) (on file with Committee).

Finally, despite repeatedly refusing to produce responsive material, the Labor Department has not asserted any claim of privilege on the withheld material, and has refused to provide basic information about the scope, nature, and contents of the withheld material.[216] The Labor Department's stated reasons for noncompliance are all the more concerning given that its regulatory authority derives from an express grant of legislative authority from Congress to the Department. Congress—and, in particular, this Committee—retain broad oversight authority over the Labor Department's regulatory process and procedures. Ultimately, Congress also retains the authority to reject the Labor Department's rule through the Congressional Review Act.[217] Accordingly, the Committee ought to have access—and the Labor Department should be completely willing to provide access—to all documents and communications related to the rulemaking.

With little cooperation from the Labor Department, Chairman Johnson wrote to other agencies to seek information about the rulemaking. Under pressure from Chairman Johnson and after the Chairman threatened to compel production of the material,[218] the SEC ultimately provided a number of documents to the Committee that offered tremendous insight into the rulemaking. Similarly, FINRA also voluntarily assisted in providing useful information.

b. The Labor Department Attempted to Interfere with the SEC's Cooperation with the Chairman's Requests

In addition to withholding information from the Committee, the Labor Department admitted to Chairman Johnson that it had urged the SEC—an independent commission set up to be free of political pressure from the Executive Branch—to disregard Chairman Johnson's requests that he made separately to the SEC for documents in the SEC's possession and control.[219] Chairman Johnson made those requests to the SEC precisely because the Labor Department had declined to fully respond to his initial requests.

The Labor Department's interference with Chairman Johnson's request to the SEC was inappropriate and is indicative of the Department's overall posture in responding to the Chairman's inquiry into the rulemaking.[220] The Chairman had made a separate request to the SEC for documents in the possession and control of the SEC—a request for which the

[216] Email from Committee Staff, HSGAC, to Adri Jayaratne, Acting Asst. Sec'y, Office of Cong. & Intergovernmental Affairs, DOL (July 8, 2015, 6:56 PM) (on file with Committee).
[217] *See* Congressional Review Act, 5 U.S.C. §§ 801-808 (2012).
[218] Appendix A, Ex. 5, Letter from Chairman Johnson to Chairwoman White, SEC (July 13, 2015) ("If the Commission fails to immediately provide the requested documents, the Committee may consider use of the compulsory process.").
[219] Appendix A, Ex. 14, Letter from Acting Asst. Sec'y Jayaratne, DOL, to Chairman Johnson (July 8, 2015).
[220] Email from Committee Staff, HSGAC, to Adri Jayaratne, Acting Asst. Sec'y, Office of Cong. & Intergovernmental Affairs, DOL (July 8, 2015, 6:56 PM) (on file with Committee).

Department had no standing to interfere.[221] For reasons unknown to the majority staff, the Labor Department was unwilling to produce—and went out of its way to attempt to prevent others from producing—documents to the Committee about its work on this important rulemaking.

c. OIRA Declined to Provide a Full and Complete Response to Chairman Johnson's Requests

Chairman Johnson wrote a letter to OIRA on May 1, 2015, requesting information and documents relating to OIRA's review of the Labor Department's proposal.[222] After OIRA failed to provide a complete response, Chairman Johnson again wrote to OIRA on December 3, 2015.[223] To date, OIRA has provided non-specific, cursory responses to the Chairman's requests for information and produced limited materials that do not fully satisfy the Chairman's request for documents.[224]

Chairman Johnson's request stemmed from concern about whether OIRA conducted a thorough and thoughtful review of the rule. OIRA expedited its review, as evidence by the fact that the Labor Department promulgated the proposed rule just fifty days after OIRA received the proposal for review.[225] Chairman Johnson sought to ensure that OIRA conducted a thorough and thoughtful review of the proposed rule and to understand how OIRA incorporated suggestions from other Executive Branch departments and agencies and from stakeholders.[226] Specifically, Chairman Johnson asked OIRA to provide the following information:

1. Please provide all drafts of the Labor Department's proposed rulemaking, *including comments and suggestions to the drafts.*

2. Please explain why OIRA required considerably less time to review the Labor Department's proposed rulemaking than the average review time for other Labor Department regulatory proposals and other economically significant rules.

3. Please explain how OIRA incorporates suggestions from other Executive Branch departments and agencies, as well as stakeholders, into its review of the Labor Department's proposed rulemaking.

4. Please explain how the version of the proposed rulemaking incorporated OIRA's suggestions.

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[221] *Id.*
[222] Appendix A, Ex. 7, Letter from Chairman Johnson to Admin'r Shelanski, OIRA (May 1, 2015).
[223] Appendix A, Ex. 8, Letter from Chairman Johnson to Admin'r Shelanski, OIRA (Dec. 3, 2015).
[224] Appendix A, Ex. 18, Letter from Admin'r Shelanski, OIRA, to Chairman Johnson (Jan. 20, 2016).
[225] Appendix A, Ex. 7, Letter from Chairman Johnson to Admin'r Shelanski, OIRA (May 1, 2015).
[226] *Id.*

5. Please explain how OIRA evaluated the Labor Department's proposed rulemaking with respect to Executive Order 13563's requirements for coordination with other agencies and consideration of flexible approaches.

OIRA's May 18, 2015 response to the Chairman provided general information about OIRA's review process that was not specific to OIRA's review of the Labor Department's proposal.[227] Regarding its review of the Labor Department's proposal, OIRA provided only vague information:

> OIRA devoted the time and resources necessary to ensure the review was consistent with EOs 12866 and 13563. This review included the participation of a number of relevant Executive Branch agencies. OIRA then concluded review of this draft on April 14, 2015. As background, EO 12866 provides OIRA up to 90 days to review significant regulatory actions, though the agency can request an extension. The amount of time needed to complete review on any given rule can vary, but OIRA does endeavor to complete the process as quickly as feasible while ensuring proper review.[228]

This answer lacked any specific information about the review process that Chairman Johnson requested.

OIRA's January 20, 2016 letter similarly lacked the specific information that Chairman Johnson requested.[229] OIRA simply stated:

> Regarding the length of time the draft proposed rule was under review, I can assure you that OIRA devoted the time and resources necessary to ensure the review was in accordance with EOs 12866 and 13563. The amount of time needed to complete review on any given rule varies, but OIRA endeavors to complete the process as efficiently as possible while ensuring proper review. The review of the *Conflict of Interest* draft proposed rule included the participation of relevant Federal agencies.[230]

Again, this response contains a conclusory statement void of any specific information about OIRA's review of the Labor Department's rule. OIRA's document production also failed to satisfy Chairman Johnson's request.[231] OIRA provided drafts of the proposal, but the drafts do not contain comments or suggestions, which Chairman Johnson had

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[227] Appendix A, Ex. 17, Letter from Admin'r Shelanski, OIRA, to Chairman Johnson (May 18, 2015).
[228] *Id.*
[229] Appendix A, Ex. 18, Letter from Admin'r Shelanski, OIRA to Chairman Johnson (Jan. 20, 2016).
[230] *Id.*
[231] *Id.* (document production on file with Committee).

requested.[232] OIRA also provided a list of meetings it took with members of the public related to the rule, and the materials provided to OIRA at the meetings.[233] The information and productions and that OIRA provided to the Committee fail to offer any insight into OIRA's review of the Labor Department's proposal.

VI. CONCLUSION

Chairman Johnson's inquiry into the Labor Department's proposed rule has revealed that the Labor Department prioritized an expedited rulemaking process at the expense of thoughtfully considering and incorporating advice and suggestions from industry experts. Additionally, career, non-partisan, professional staff at the SEC, career, non-partisan, regulatory experts at OIRA, and Treasury Department officials expressed concerns to the Labor Department about the rule. Yet, documents that the Committee received indicate that the Department failed to implement numerous recommendations from these government officials in other agencies.

Chairman Johnson also encountered opposition and noncooperation from the Labor Department throughout its examination of the rulemaking process, calling into question the Department's commitment to transparency and accountability to Congress. From the information that the Committee was able to uncover, the Labor Department's flawed process in issuing its proposed "Conflict of Interest" rule could ultimately hurt American retirement savers. Whether intentionally or not, the proposed rule threatens to restrict access to retirement advice for those Americans who need it the most.

[232] *Id.*
[233] *Id.*

Mr. GRAVES. Twenty-six some odd items of concern were raised by your career staff relating to the substantive content of the rule, with Labor failing to resolve all of these issues. And I think, as we all know, many of your staff, being career staff, are considered experts in what they do, and we hope that the appointees know the issues as well. But the folks that have dedicated their careers are those that we hope we can trust to take "just the facts" positions.

So, Chair White, does it concern you as much as it concerns me, and I know others on this panel that Labor seemingly ignored the concerns of your own career professional staff that they have raised, and have not addressed them? Of your staff, or of this committee, who have raised the very similar and same concerns also?

Ms. WHITE. I cannot comment on the specific report and the exchanges back and forth, but I can say what I have said before, which is that the staff of the SEC did provide substantial technical assistance to the Department of Labor, including bringing our perspective, the staff's perspective, and expertise on the broker-dealer model, including on, at least, their views about possible impacts as various permutations of a rule.

The Department of Labor also, in their notice and comment period, asked about those issues. Obviously, we have not seen the final rule yet, but I think—what I have also said about my own view for doing a fiduciary duty—uniform fiduciary duty in the SEC space is that it is not an easy task, and if we ended up at the end of the day really depriving particularly retail investors of reliable, reasonably priced advice, then I would consider us to have failed in our purpose.

But at the end of the day, we are independent agencies, and the Department of Labor does have responsibility for the very important ERISA space. And I think, perhaps, the particular exchange you are referring to occurred in maybe 2012. I cannot really add to what that meant or did not—I think that was on the prior proposal, though.

Mr. GRAVES. OK. Well, thank you, and we appreciate what your staff has provided and expert advice that they provide. And I think it is in all of our interests to make sure that all of our constituents have the most options available to them to invest wisely and affordably, and not options removed. And our concern is that this rule will remove many of those options, and if not remove them, make them more expensive, or put barriers in place in which people will not seek those options. And we believe it is just wiser to be investing in their future and in their retirement, and we want to make sure all those options are available, and can be made with individuals in their communities that they trust that might just be in downtown Main Street. So, thank you, Chair.

Mr. CRENSHAW. And just on that, as I understand it, Dodd-Frank specifically said, your agency was mandated to study the issue, and to propose a rule. Do you have any idea why the Administration has supported the DOL moving ahead of you?

Ms. WHITE. First, I think what Dodd-Frank did was to say—it mandated a study, which the staff did—it was a very good study—and gave the SEC the authority, if it decided to, to proceed with a uniform fiduciary duty for broker-dealers and investment advisers under Section 913 of that Act.

Again, the initial Department of Labor proposal was in 2010. They do have responsibility for the ERISA space, and even as we sit here today, there are—our broker-dealers which are subject to some Department of Labor regulations, and vice versa. So, I mean, there is a bit of overlap in those spaces before.

Mr. CRENSHAW. But, is the SEC going to look into developing their own rule?

Ms. WHITE. Without question, and I think I said, some time ago that my own view, after really extensive study—and the agency has been studying this for a lot of years, and I certainly spent a lot of time since I have been Chair; my conclusion is the SEC should proceed under 913 to do a uniform fiduciary duty for broker-dealers and investment advisers.

Mr. CRENSHAW. And who is going to figure out how to harmonize the two rules?

Ms. WHITE. Well, you try to make them at least compatible, if you can. The coordination, obviously, with fellow regulators, where we have overlapping jurisdiction, is enormously important. We have it in the Title VII, over-the-counter derivative spaces, with not only the CFTC, but foreign regulators. But again, I want to be clear. I think this is very hard and not quick to do this well.

Mr. CRENSHAW. Got it. Thank you. Mr. Quigley.

Mr. QUIGLEY. Thank you, Mr. Chairman. Welcome, Chair White. It was nice for Chairman Crenshaw to reference the Small Business Advocate Act. I am sure you are aware of it, and the fact that the House passed it on a bipartisan basis. I only assume the Senate will take it up. Can you tell us your stance on moving forward with this, and designating a small business advocate at the SEC?

Ms. WHITE. Again, we have not taken a position on the particular bill. I think we may have provided some technical assistance on it. I mean, look, there is no question—and this is true at the—certainly, true at the SEC, throughout the SEC, how important small businesses are, and that their different needs and different models be attended to very closely.

We have a small and emerging business advisory committee that I reinstituted shortly after I got to the Commission. We have in our Division of Corporation Finance an Office of Small Business Policy. They advise on all of our rulemakings, with the lens of small businesses, and comment on that. I think they responded to maybe 1,700 separate inquiries from small businesses, you know, last year.

So, we are extraordinarily focused on that, with a lot of expertise. In terms of having a small business advocate, the thing that I would worry about with that—because it is certainly good in concept; I think we all agree that we want to do everything we can for small businesses—is not to fragment the efforts that are carried out on behalf of small businesses, and certainly, that is true at the SEC. And we really have that concentrated, in a way, where there is a lot of expertise and a lot of work that goes on regarding small businesses. So, however the bill might develop, I would not want to lose that.

Mr. QUIGLEY. Let me reference another point. A recent study conducted by researchers at the University of Chicago and the University of Minnesota—seven percent of all active financial advisors

have been disciplined for misconduct or fraud. The study also found that the advisors who have engaged in misconduct, of those, 38 percent are repeat offenders. I am sure you are aware of the concerns about these things. Are you aware of these studies, and what is the SEC currently doing, proposing to prevent financial fraud like this, especially for repeat offenders?

Ms. WHITE. I am aware of the study. I have actually read it quickly. I have not read it with the care that I will in the next week or two. This is an area that I think is enormously important, because whether it is a broker-dealer or it is an investment advisor, if they are not serving their clients honestly, fairly, and I would say, in the best interests of the client, that is a big problem.

And one of the things that we have done at the SEC in particular—this is long before the study, is that we have a broker-dealer task force. And we have, in our OCIE exam area, a priority to really look for these repeat offenders, and frankly, look very closely at the firms where they tend to end up again.

In other words, I think one of the things the study referenced was not only do you have problems in the past with some of these advisors—and I think they are brokers. I think the study is on brokers, really. But they show up again at another firm, and they show up again at another firm.

So, our focus has been—FINRA tends to deal with registered representatives individually—not always, but certainly to a great degree. But we are really focused on the firms—where they seem to be residing.

We have one particular initiative, where we are looking at churning by brokers throughout various firms in order to try to crack down on that. So, it is an enormously important area.

Mr. QUIGLEY. I mean, how much of this is resources?

Ms. WHITE. Some of it is resources. You cannot get away from that. I mean, you cannot get away from that, because in the broker-dealer space—we have been talking about the investment advisor space—but in the broker-dealer space, FINRA does today about 80 percent of the examinations of broker-dealers.

That is really firms and individual brokers. But that does not really take into account all their various offices—branch offices, which are not examined with that kind of frequency. They do about 50 percent a year, which is better than 10 percent a year, in the investment advisory space.

But I think we cannot do enough. I mean, I think our techniques are better. I think our data analytics are better. We are identifying those patterns. And as I said, for the last two or three years, at least, we have been very focused on this at the SEC, really trying to identify where those brokers are going and getting them out of the industry.

Mr. QUIGLEY. I thank you for your service. Thank you, Mr. Chairman.

Mr. CRENSHAW. Thank you. Mr. Amodei.

Mr. AMODEI. Thank you, Mr. Chairman. Madam Chair, to the extent that the chairman is going to manage my time, please do not be offended if I endeavor to manage yours. I will try to be crisp with my questions. And so, with that in mind, initially, I know that you folks have been working on an update for Industry Guide 7,

which provides guidance for mining companies to report the value of mineral resources and reserves. The present stuff, that is 34 years old, is inconsistent with international reporting requirements. Could I have a point of contact in your staff, just to get an update on where that stands?

Ms. WHITE. Yes. I would call Keith Higgins who is the Director of our Division of Corporation Finance.

Mr. AMODEI. Great. Thank you very much. I want to go back a minute for the Department of Labor stuff. And I guess we will call this under the heading of Intermurals. Obviously, you will be able to tell from my question that I think your jurisdiction is unquestioned. I understand there is an issue there with ERISA and some of that stuff. But I am concerned, when you speak earlier about unintended consequences, and I hear you when you say, "Listen, it is hard and it is not quick."

But I think, ultimately, under Dodd-Frank, the section that you mentioned in your earlier testimony, there is in fact mandatory language under the Standard of Conduct stuff that says—it is under other matters, but it is under the Standard of Conduct section. Says that "The Commission shall examine and appropriate, promulgate rules prohibiting or restricting certain practices, conflicts of interest," blah, blah, blah.

There is also, I believe, a Supreme Court case out there that is not specific to the SEC, but generally says, "Hey, when Congress acts later in time, and specifically, that takes precedence over earlier acts, in terms of regulating that sort of stuff." So, I guess I am concerned about unintended consequences.

Clearly, the 800-pound gorilla issue in the room is, is DOL going to have one rule? Is SEC going to have another? Can you give me any comfort on how—on what you think your jurisdiction is ultimately when you get through this process, and how that is going to work, if it is, in conjunction with DOL?

Ms. WHITE. Well, I think there is no question, certainly, at least since Section 913 of Dodd-Frank was passed, that the SEC has the authority—not the mandate, but the authority—to impose a uniform fiduciary duty on broker-dealers and investment advisors. It also provides certain parameters if the Commission decides to go forward.

And again, as I am urged to say more often than I do, I am one member of the Commission, even though the Chair—and so, this is a Commission decision. But, I believe the SEC should exercise that authority to go forward.

But that is, again, not a quick and easy process. And it is not up to me alone as to whether or what the parameters of that rulemaking would be, although 913 sets some parameters. Were we to go forward—in terms of your question on consistency—assuming that there was a Department of Labor rule that preceded ours that overlapped, we would continue to talk about coordination and making our rules and the regime as compatible as possible. But they are not—they do not always land identically. And that is something that is—you try to make them land identically, if you can. But we are separate agencies with separate statutory mandates.

Mr. AMODEI. Time frame?

Ms. WHITE. For us? I cannot say that——

Mr. AMODEI. I mean, you have got some decisions, I know, to make, but it is like, so——

Ms. WHITE. I cannot give you a time frame, other than to say again what I have said before, that it is complicated and not fast by any means. And where it stands right now is essentially that the—you know, the staff's parameters of recommendation are being discussed with my fellow commissioners.

Mr. AMODEI. OK. I guess, final question is: So, if DOL comes out with a standard before you folks get through your process, you are going to enforce their standard?

Ms. WHITE. Again, they have some enforcement authority on their own. I mean, our enforcement authority is under the Federal securities laws. So we do not enforce the Labor Department rules per se. Obviously, again, the conduct can overlap with our jurisdiction. So it is not, as easy a situation as maybe my initial response would imply. But we enforce the Federal securities laws and our rules.

Mr. AMODEI. Well, and I appreciate that. I am just saying that you talking to the committee saying, "It is not easy as you might think," I get that. But the other problem is, somebody who is now the subject of an investigation based on whose rule it is and who is interpreting what is even less easy, if you will, than—I would much rather be the regulator than the person who finds out, "I thought I was in good shape with the SEC, but now I got the DOL bird swooping in on me, and we were compliance folks."

Ms. WHITE. And I think that is why we try, in all of our spaces where we overlap, and it is not just the Department of Labor, to be as consistent as we can. I will say again, though, that we have had parallel rules and do have parallel rules now that are not totally consistent. And we do our best to give guidance and clarity. But they are not identical and they do overlap.

Mr. AMODEI. Thank you. Thank you, Mr. Chairman. I yield.

Mr. CRENSHAW. Thank you. And I think we will have time for another round of questions. But now let me turn to Mrs. Lowey for either a statement or a question, or both.

Mrs. LOWEY. Well, thank you very much, Mr. Chairman. I appreciate your leadership and I do want to say how fortunate we are to have a chair who is so experienced. Your years and years of experience have contributed to your outstanding management of this very difficult agency. We thank you very much.

When I look at the numbers, the markets you are policing have a lot of new registrants—more than 2,300 private funded advisors have registered with the SEC since the effective date of Dodd-Frank, and more than 800 municipal advisors are expected to be registered in 2017. In the next two years, the number of new registrants are expected to be subject to examination, including swap execution facilities, security-based swap data, repository swap dealers, crowdfunding portals. How do you prioritize examinations, given how large your existing portfolio is? How much larger will it become with all of these new registrants? How many of those do you anticipate being able to examine?

How can investors have confidence that everything is being done to prevent another meltdown when so few of these entities are

being examined? And will your budget request help build that confidence?

Ms. WHITE. The budget request will help. I think there is no question that the SEC is a significantly under-resourced agency, despite the increases—which we are very appreciative of, that we have gotten in the last few years—to do the job we have been given to do.

I would say that unequivocally, even before we were given the additional responsibilities under Dodd-Frank and the JOBS Act. And your reference to the private fund advisors, which includes hedge fund advisors and municipal advisors, and the securities-based swap dealers who will be registered and come online; those are all add-ons, to our responsibilities.

And so, there is in our request this year a request for, really, limited positions for those that will come online. But clearly, there will be a gap there. What do we do about that? And we try to make as smart a use of the resources that we have. I certainly come in and try to be as eloquent as I can, for more resources, so I can do the job.

But we try to do more risk-based identification of where to go. We do desk reviews of data. When we got the private fund advisors, initially we did presence exams, which were more limited exams. But at least we had our arms around and a boot or two on the ground. But in order to carry out our investor protection mission, we need significantly more resources in all those spaces.

Mrs. LOWEY. I think it is important for my colleagues to note that in 2015, the work of your division of enforcement resulted in a record amount of sanctions—$4.2 billion. A record 507 standalone actions were filed, as were an additional 300 follow-on proceedings in delinquent filing cases. If you could share with us, what trends have you noticed in securities fraud? Are they just getting smarter? How will your budget request help you spot fraud and take action against those who perpetrate it?

Ms. WHITE. Yes, the markets we have to police are getting smarter, more complex, bigger, faster all the time. One of the ways that we try to meet that challenge is through smarter use of the data analytics that we have been talking about. We have a software tool, for example, called Artemis that actually was developed in-house, that basically allows us to identify insider trading—suspicious patterns, at least—among traders. You do not have to wait for an event and then look behind that and see who traded.

But it is also a budget issue. I am very proud of the record in enforcement. I mean, not just the numbers, which I think are very impressive, but the kinds of cases and how complex they are. But if you think about, where is the value-add when you are thinking about how much to fund an agency, enforcement alone last year obtained orders for returning $4.2 billion. Our request here is $1.7 billion. And think of all the other value-add that the SEC provides.

So, what are we seeing in terms of trends beyond just more and more complex? I think the complex financial instruments area is one, which clearly requires market experts. Again, we seek those in our budget request. More data analytics to analyze and identify those pyramid schemes and financial reporting frauds, which is also a place for more market experts and more data analytics.

When I said we thought out and tried to target our budget request—you will see, that is among who we have asked for.

Mrs. LOWEY. That is very helpful. And lastly, in fiscal year 2015, this committee asked for an update on the SEC's efforts to modernize corporate disclosure requirements, including cyber security. You informed us that in March 2014, the Commission held a roundtable to discuss cyber security in furtherance of the Commission's efforts to better inform itself, the marketplace, fellow agencies, and the private sector.

I would be interested to know what lessons you learned from that roundtable. Should companies that file with the SEC be required to disclose cyber-attacks, to engage with the private sector in other ways on cyber security? And I just want to say, Mr. Chairman, I remember years ago—when Ray Kelly was NYPD police commissioner, they were always behind the ball, because corporations were afraid their stock prices would go down if they admitted that they lost $7 billion or whatever in a cyber-attack. I would love to know where you stand on these issues.

Ms. WHITE. Yes. First of all, I do not think there is any greater risk that the financial sector, and really beyond the financial sector, faces than cyber risks. And that is private sector, the government, our spaces as well.

In terms of disclosure by public companies, and obviously, we are just talking about public companies, the SEC did do guidance to companies some time ago, really alerting them to the range of issues that would require disclosure if there is an attack, or simply the risk, to their business. If that is material, they must disclose it. We look at the disclosures every year in our annual reviews.

But we also are focused with our fellow agencies and the private sector on this really much deeper, broader risk than the SEC's jurisdiction really reaches to. We pay a lot of attention with respect to our registrants. And again, our examiners have gone out really ahead of the curve, I think; and good for them in going out and looking for cyber preparedness at investment advisors and broker-dealers, and then publishing, obviously not by name and chapter, but really, publicizing observations to that population what to look for, how to enhance what your system is, what are the best practices out there. We continue to have that as an exam priority.

We also, in our Trading and Markets Division and Investment Management Division, meet with our registrants, talk to them all the time about preparedness for the cyber-attacks that are going to come and how to report, and whether to report. But a lot of this has to go on a broader scale than even where the SEC can function. And it has got to be private sector, government, Department of Homeland Security, the Treasury Department. And we are very active in those inter-agency groups as well.

Mrs. LOWEY. Thank you, Mr. Chairman. I just want to say in conclusion, because we sit on many of the same subcommittees that cyber security is such a huge threat. In my discussions with many of these public companies and some large private companies, they all have their own systems in place.

So, how we all coordinate, how much disclosure—so we can learn from what has happened—there are so many issues involved here.

And I appreciate you are right in the middle of it. I thank you, Mr. Chairman.

Mr. CRENSHAW. Thank you. Mr. Yoder, and then Mr. Bishop.

Mr. YODER. Thank you, Mr. Chairman. Madam Chair, good to see you again. Thanks for your service. There is a pending rule before the Commission that would increase the number of firms that have to register with FINRA. I am hearing from market participants that the rule, as drafted, while well-intentioned, is overly broad. It would require some firms to register with FINRA with little regulatory benefit that could be achieved otherwise. I know you are studying that.

As you know, this committee is responsible for oversight of your budget, which is why we are here today, of course. But it got me thinking, who is responsible for oversight of the FINRA budget? The rulemaking, by definition, will increase their budget, increase their oversight. How can this committee be sure that they are using the resources effectively, efficiently, and not creating undue burdens on certain parts of the market?

Ms. WHITE. Well, the SEC does have oversight responsibilities over FINRA as an SRO. And we exercise that authority, including exam authority. But it is a membership organization, basically. I think you are talking about the 15b9 proposal, I think.

Mr. YODER. 15b9, yes.

Ms. WHITE. Yes. The 15b9. Yes. And I think that is one where it is a proposal, and we are in the comment period now. And so, we will certainly be considering all those comments very carefully and including the costs as well. And so, FINRA, many, if not most, if not nearly all of their rules have to be approved by the SEC. So that is a check. That is a safeguard, too.

Mr. YODER. And in terms of those dollars, you feel like the oversight that you are in charge of, that you can appropriately know that their budget grows, that we have, I guess, the understanding that that is being handled appropriately? How can we, as a Congress, do our oversight duty and trusting in your leadership, of course, but——

Ms. WHITE. One of the things that has been a focus since I have arrived as Chair of the SEC in 2013, is that I think we do need to enhance the oversight that we do at the SEC. Obviously, Congress has its, you know, separate responsibilities.

One of the things that we are trying to do in order to get greater coverage of these investment advisors I keep talking about, in terms of examinations, is also very soon to actually transition some of our broker-dealer resources to the investment advisor space. And that is because, in part, FINRA really does 80 percent of those broker examinations. But that means that we need to up our oversight over FINRA, if that is the move that we are going to make. And I think just in general, we are looking to enhance our oversight as well.

Mr. YODER. Well, I appreciate that. And I appreciate your studying the 15b9 rule and making sure you are finding that right balance and not over-regulating to where we do not actually receive the benefit, but cost folks that do not need to be registered and would do probably more harm than good. So, I appreciate your leadership there.

I want to ask you about the 30e-3 rule on printing. It sounds like the structure of the rule is getting a bit complicated. And I know that you have been studying this for some time, too. The process is pretty simple today. There are some concerns, I hear, from market participants, that replacing it with a series of steps might actually make it more complicated. And now even supporters of the rule are concerned about that as well. Where are you in that rulemaking process? And does it make more sense just to step back and start over rather than pushing the rule as it is now, in terms of the complication?

Ms. WHITE. Well, we have gotten a lot of comments on this aspect of the rule. And we are studying them very carefully. We will proceed, obviously. We do not hesitate, if it is called for, to re-propose something if that seems to make sense. I am not suggesting we are at that juncture now, but we are certainly seriously studying the range of the issues that have been brought to our attention and that we are aware of, from our own work.

Mr. YODER. OK. And then the ranking member brought up the topic of cyber security. And I wanted to associate myself with her remarks and then I wanted to just talk about your internal control.

So, certainly one thing is external threats. You know, I had a chance to deal—your counterpart with the CFTC was in the Ag Committee recently, which I serve on as well. And we talked about the Reg T rules. And there are concerns that I have heard from market participants that they might put their source code in the hands of CFTC, and nefarious actors, either within or without, could somehow release that. And that is sort of their secret sauce, so to speak.

You know, in light of the potential harm for data being released, internally, what are your internal controls that would help assure the committee that any of that sensitive data that might get into the hands of the SEC would not be released or somehow not be compromised?

Ms. WHITE. I think there is no more important an issue—I mean, we have to be able to regulate, but we also have to give the requisite assurances that can be given that we will be able to safeguard that very sensitive information. I think this particular budget request, just to bring it back to the budget for a second, requests $14.7 million to enhance our internal security system. And this is really coming up with us in a number of places, but including our proposals in the asset management space, where we are asking for additional information.

And one of the issues we are dealing with there is not only making sure we are enhancing our systems, which we are very, very focused on, but also how much can we say about how we are enhancing in order to give assurance and a confidence level. I mean, it is a bit of a balance, because you do not want to be too detailed about that, or you are giving a roadmap, right? So, that is one of the things. But I think we need to be able to get ourselves to a place where we can say more than we may have in the past about that.

Mr. YODER. I appreciate your leadership there, and I think, you know, the SEC, as well as the CFTC, they ultimately cross paths with a lot of sensitive information that could compromise, you

know, entities that they regulate. And so, the importance that you place on that, I think, is critical to, you know, maintaining that information. So, I appreciate it. Thank you. Thank you, Mr. Chairman.

Mr. CRENSHAW. Thank you. Mr. Bishop, and then Mr. Womack.

Mr. BISHOP. Thank you very much, Mr. Chairman. Thank you, Ms. White. According to a 2013 GAO report, which was three years ago, minorities accounted for only 19 percent of management positions in the financial industry, and even worse, minority women accounted for only 13 and a half percent. Can you tell me what steps the SEC has taken to improve this drastic disparity and what are the current stats? Hopefully they are improved. And tell me what steps you think Congress could take to give you additional tools to increase minority participation?

Ms. WHITE. I think there are at least two spaces to talk about there. One is within the industry in the private sector and our registrants and there, we, together with a number of our other financial regulators under Section 342 of Dodd-Frank, have focused on our registrants, focusing on the diversity of their staffing, among other things. In terms of our own agency, we basically look in three areas—our own staffing that we have.

Obviously, I have mentioned the registrants. We also have a certain amount of—not huge amounts—but amounts that are meaningful of contracting dollars. And so, one of the things that our OMWI office really focuses on, and has made a lot of progress in, is to make sure that minority and women-owned businesses know how to, ask to get in the procurement process, in order to be able to at least bid for or compete for those contract dollars. And we have had a lot of success there. We have challenges at the SEC, certainly, with respect to the number of minorities and women in our most senior positions, and we are very focused on that in terms of taking specific measures.

We have seen some improvement there, but we remain very much focused on that. But I think it is a public and private sector set of issues, not easy ones to solve, but I think we have to remain very focused on them and I think we have to use all the tools at our disposal.

Mr. BISHOP. Anything that we could do to help you in that regard?

Ms. WHITE. Budget? No, I mean, I do not mean to make light of this at all, because I do not, because I consider this enormously important. I think we are right now, at least at the SEC, kind of midstream in really seeing how some of our initiatives are working, some of our outreach is working. We have expanded——

Mr. BISHOP. I was going to ask you about recruitment.

Ms. WHITE. Yes, and in recruitment, that is one of the areas where, again, I think we have really made great progress, and I forget the number of outreach events that we did this past year. But it exceeds 150 or something, and it is in the right places with the right people at them. And I think I would like to see how successful those initiatives are before I would suggest what might be helpful from Congress.

Mr. BISHOP. OK. Let me change gears a second and follow on Mrs. Lowey's question. According to your budget request, the SEC

has never examined approximately 40 percent of all registered investment advisors. With the growing number of registered advisors, which you claim has been an increase of nearly 35 percent over the last decade, how do you plan to address the shortfall without impacting investigation of at-risk advisors?

Ms. WHITE. We have had, for the last 2 years, what is called our never-before examined initiative. And that really looks at registrants that have registered with us in the past 3 years, in order to ensure that we are at least covering that space.

We also do something as simple as this. It is a bit of a variant of our presence exam for the private fund advisors, which is to call up every registrant and just sort of say, Here are the rules. Here we are. We are present. Obviously, that is not boots on the ground. That is not a thorough exam. But it is more presence. And so, in every year we are devoting the resources we think are wise to making sure that we are at least covering as much of that space in one way or another as we can.

Mr. BISHOP. OK. Last week, the SEC approved for the first time, a lender to use funds from public investors to back loans for small businesses. This crowd lending is an innovative financial product established for the JOBS Act of 2012.

The company approved under Regulation A plans to initially offer the loans to veteran small business owners as an alternative to high-interest payday lenders. Allowing crowd lending is a positive development that could expand opportunities for small business owners and it is especially encouraging to me to see that veterans will be the first to utilize this. What other steps is the SEC taking to encourage liquidity for small businesses?

Ms. WHITE. Where we pass on issues like that is in our Regulation A space and our more traditional role of reviewing filings to make sure that the right disclosures are given, basically.

Among the things that we are looking at in terms of small business and small business liquidity, is that we are doing—it begins I think in October—the tick size pilot you may have heard about to see what the data shows about increasing secondary liquidity for smaller businesses. We continue to look at venture exchanges as possibly a way—I mean, we have approved venture exchanges before, but look at different variations of venture exchanges to see whether we cannot increase liquidity for small businesses. The crowdfunding mechanism, which becomes effective in May, is also a way to raise money.

Obviously, you have got to attend, after you raise money to the liquidity that needs to follow for investors. But we really are spending an awful lot of time on that issue for small businesses.

Mr. BISHOP. Thank you, and I think my time has expired.

Mr. CRENSHAW. Thank you. Mr. Womack.

Mr. WOMACK. Thank you, Mr. Chairman. Chairman White, always great to see you. Thank you for your service. Last year, when you were with us, I spoke briefly to market structure, particularly when it came to errors or glitches such as the "flash crash," which was then addressed through the working groups established by both the Depository Trust and Clearing Corporation and the New York Stock Exchange.

If I recall, you touched on the regulation SCI, but it is my understanding that industry group suggestions may have been more comprehensive. I would like to follow up by seeing if we could get the list that I had previously requested, noting which of these recommended changes by the DTCC and the Stock Exchange have been implemented by the SEC, and why or why not, if that is possible.

Ms. WHITE. It is possible, if we have that information. I will say that after our session last year, basically the staffs followed up with each other to try to identify precisely the space that you were intending for us to respond to. And we did respond as we thought the question was put. But I had a sense that there might be something else that we had not responded to.

Mr. WOMACK. Let's have a staff-to-staff follow-up.

Ms. WHITE. Yes, absolutely. Absolutely.

Mr. WOMACK. I appreciate that, still focusing on structure, particularly the National market system planned governance. You may know that there is a discussion draft in the House put forward by my colleague from Virginia, Mr. Hurt.

This legislation would install broker-dealer representation on the operating committees of the National market system plan, such as a consolidated audit trail, tick size pilot, and so on. What would be the downside of having broader industry participation in the development and operation of these critical market utilities?

Ms. WHITE. That is an issue that we have in our Equity Market Structure Advisory Committee and four subcommittees including an NMS subcommittee. And among the issues that the committee looks at, our staff is looking at, are those governance questions. I cannot get ahead of that analysis to give a view until I have gotten the full input. But it is an issue that we are very focused on.

Mr. WOMACK. Yeah, and then, just a parting comment. In your testimony, you note that volume and equity markets have drastically changed over the years, but so have other major aspects, such as exchanges moving from not-for-profit and member-owned-for-profit, and publicly-traded. This would seem to emphasize needs for reform, yet countering the exchange evolution, it is often cited that indirect participation in NMS governances available through advisory committee membership.

With that said, I would note that advisory committee members are most often given little actual voice, citing among other things, the fact that much meaningful business is done in executive sessions, from which, I know you are aware, advisory members are excluded. I believe that the SEC has the ability to positively affect this governance structure already, separate from broad reforms. But if need be, Congress, of course, will continue to weigh in. So, thank you very much for your testimony and again for your service. And Chairman, I yield back.

Mr. CRENSHAW. Thank you. We have time for another question or two. I will start. You and I talked, I think last year, about FSOC. And I mentioned you are a member of FSOC. It is a relatively new agency. One of my concerns has always been the transparency involved in the designations. I think it is fair to say if there are systemically important financial institutions, and they are designated as such, they have additional burdens, et cetera. It

seemed initially that the goal was to designate institutions as opposed to mitigate the risk involved with institutions.

And so my first question is: Would you agree with me that it would be more important to mitigate the risk to our system and that you ought to judge the success of that by the mitigation of risk as opposed to the number of designations that are made?

Ms. WHITE. I think you want to basically look at the most meaningful metric. The mission of FSOC is to identify and address risks to the financial stability in the financial system that are found. One tool is obviously the designation tool.

Mr. CRENSHAW. Let me ask you about the designations. There is some question that it seems like the big banks all got designated. Is that based on their size or based on their activity?

Ms. WHITE. That was largely, I think, it was before my time. But I think that is largely a size designation for them. But if you actually look at the number of designations certainly outside the banking context, there have not been that many, but I think your point is very well taken, nevertheless. I think FSOC is sensitive to that. Certainly I am, and I think other members are too, which is to be as transparent as one can be, in terms of the particular factors that may have driven a particular decision to designate.

Now, as I think we discussed before, that I think it is often a business model. So, it is not like you can kind of change this piece and you would not be considered under the analysis systemically important, but I think the more one can advise as to what those factors are. I mean, the idea is not to have the systemic risk in the system, right? And so, whatever tools or information FSOC and others can give to bring that about is what we should be doing.

Mr. CRENSHAW. I do not know if you are familiar, but last year at our full committee markup, I offered an amendment that I wanted to be sure everybody on the committee got to look at and discuss, and it was kind of an off-ramp, a way for companies to derisk prior to designation, particularly the non-banks, the asset managers, or insurance companies. It did not preclude FSOC from designating them, but it gave them an opportunity to be notified. Here is a problem with your business model. Can you tell us how you might cure it?

And still, if FSOC felt like that did not solve the problem, did not mitigate the risk enough, the designation could still occur. That seems like a commonsense, reasonable approach. I am wondering if that would simply add some flexibility, because again, the goal is not just to—and I know there have not been that many designations—but the goal is not to go out and find people to designate them. The goal is to keep our financial system safe, secure, orderly, et cetera. So, did you see that language? And what are your thoughts about that kind of flexibility?

Ms. WHITE. Well, I think I did see that language. It has been a while since I looked at it, so I should put that caveat in. And there is increased engagement, certainly, between FSOC staff, and the companies that are being looked at. So there is an awful lot of dialogue back and forth. We have obviously had a number—not a big number—but a number of designations now, including non-banks where the reasoning is quite detailed, actually, publicly, and then even more detailed in what is provided to the companies.

And companies are clearly free at any time prior to designation to change their business model, and then they would be analyzed as they were presenting to FSOC as they were considering them as changed. And so, I would hope if that was realistic—again, a lot of these are so intertwined in terms of the factors that lead to designation that it is not a simple "gee, if you were not doing that, or you did less of that you would not be systemically risky or you would not be systemically important."

But I certainly think that exchange of information ought to occur. And I think more of it is occurring now, actually. We also have the off-ramp or the review anyway. It is not an off-ramp, but as I said, it is not called an off-ramp, but it is the annual review of each entity that is designated to determine whether or not they should remain designated.

So, if there have been changes since the designation, and frankly that occurs even if the company does not seek it. So, that is an automatic review. We have done that only for 2 years now. I think this is the second year. And I think it is getting more exacting and becoming a better process.

Mr. CRENSHAW. Well, it is good to hear the process is becoming a little more transparent. Particularly when you get into the question of whether the designation is based on size or based on activities. When you move away from large banks, like asset managers, for instance, they are very large, but in terms of their activity, you can argue about how much systemic risk occurs when you are managing somebody else's money.

But, I think we will continue to have that dialogue, because as you point out, even at the end, to say if maybe we mitigated enough risk, they do not need to be designated specifically anymore, but at the front end, it might be appropriate to give more understanding to what the activities are, what the size is, before that designation occurs. So, I am encouraged to hear your thoughts on that. Mr. Serrano, do you have a question?

Mr. SERRANO. Yes, I do. Thank you. Chairman White, I want to bring you back to this issue of Puerto Rico, because in the 26 years that I have been here, I have never seen all the years focus in on something so quickly on both sides of the aisle and both Houses to try to deal with what they know has become a humanitarian issue. With that in mind, I am going to call an original co-sponsor of the Puerto Rico Investor Protection Act, which would terminate the exemption of companies located in the U.S. territory from coverage by the Investment Company Protection Act of 2015. And we thank you for your technical assistance that you gave us on putting that bill together.

Could you please speak to the effect of the bill and how it can help the situation there? Now, I realize, as you have told us before, you are not directly involved, but this one is about investors. And so, you might be more involved with that.

Ms. WHITE. Yes, this one is, I mean, at least in some aspects. Again, the Commission has not taken a formal position on the bill. But I think I have discussed my views on at least aspects of this publicly, which is that I think that exemption was born in another time and a different situation, where you based the exemption from the Investment Company Act.

And the requirement was, I think in part, based on the theory that the government did not have the resources or the ability to travel to the territories, including Puerto Rico, to do what they needed to do. So, I think it is a loophole. I think it ought to be plugged.

Mr. SERRANO. Just for the record, you know, the territories, and you do not see it more clearly and evident than in this committee, usually the attitude with the territories is whatever is left over. And I have stories, I tell you, that would make people laugh if they were not sad. That one is sad, that they did not think they could travel to the territories or whatever, so they did not include the territories—you know, American citizens.

I remember in front of me the FCC once, I asked them how come there is no satellite radio in Puerto Rico yet. They have it now. They said the satellite will get there. And I thought the whole essence of a satellite is it can get anywhere. So I said, "Borrow one from the CIA, and you will be able to get there and elsewhere." So, now they have it, and some people like me and some people do not like me, you know, terrestrial radio.

But let me ask you something. You have so many new responsibilities now, and one of them that always keeps coming up—and I know you have been asked this, but I just want to stay on it because it is important to me, and it is important to a lot of people—are you really keeping up fully at this point in the I.T. area? Because it seems to me, and I do not think this will ever end, I mean, it does not end in our own offices.

I mean, we buy equipment in our offices and the staff celebrates the fact they have all this new equipment, and a year later, the equipment is not that good anymore compared to other agencies. So, the banks out there have much better stuff and you have better equipment. What can we do about that, other than keep pumping money? And I am against pumping money. I do not want to sound like a Republican, but——

Ms. WHITE. It clearly is, you know, there is a significant resources component, right, of this? We talked about the $10 billion a year on the I.T. budget alone of some of our largest registrants. So there is no question about that, but it is also a matter of expertise and attracting that expertise and keeping that expertise at the government agencies.

And so, we are never going to be able to pay those experts as much as the private sector can pay them. But one of the heartening things that I have found since being at the SEC, particularly in the I.T. area and this applies to our economists as well, is how attracted they are—you have to pay them enough, which is a challenge—to coming to the SEC for public service, number one.

Number two is that they have access to data they find, particularly in the case of the economists, fascinating that they do not have outside because we, obviously, have access to some data that the public does not have. And so, you will see in our request, I say it over and over again how much more we are seeking out market experts and quants and other kinds of technical experts. But it is a real challenge. I mean, you are always playing catch up even with all the resources you can imagine, right? You must have the resources.

But it is also the talent and the people that both know how to use your tech systems but also to design them. I mentioned the Artemis software application, which has been tremendous. It has produced a number of important insider trading cases and was actually developed in-house. So it was not a big resources issue. It was a brain issue; right?

Mr. SERRANO. You know, and one of the things that I have noticed, Mr. Chairman, is that what she is talking about is really so true. We have young people in this country—not that I am knocking the experts who have been around a while—young people that are really whizzes when it comes to technology, and we have not found a way in government to attract them, to bring them in. You know, government is not something they understand.

I remember that I either sarcastically or very profoundly during the Obamacare roll out that created some problems, I said, "Why do you not just go to a college dorm? It will be resolved in a half an hour, if you get some of those kids in here." And I think that we are missing a disconnect in this country between the fact that we have a younger generation that understands technology well, that comes up with incredible inventions that they later sell for $1 billion to someone, you know, and we rely only on what we think we know. I have no problems at my office hiring someone who is 24 and say, "Fix that computer," because I know they know how to. And I think that that might sound simplistic, but I think it is something that we are missing and we—so I am glad to hear you say what you said.

And lastly, let me just follow up on something Mr. Bishop said, and then I will let you go for my part. There have been some questions recently about whether investors have enough information on the composition of the boards of publicly-traded companies. Numerous letters have been sent to you asking that the SEC act to require to disclose—disclosure of more information pertaining to the diversity of boards. Do you think that more needs to be done in this area and, if so, what sort of timeline is the SEC looking at?

Ms. WHITE. I spoke about this I think in late January where, basically, I share the concerns, at least some of the concerns that have been expressed. The SEC has a rule now and has for a number of years of requiring companies, if their nominating committees have a diversity policy to say what it is, how they use it, how they monitor it for effectiveness and so forth.

But there is also a fairly recent GAO study that shows how few companies have been disclosing anything in that space. The current SEC rule does not define diversity, and so one of the things that is urged is that we at least include in the definition of diversity race and gender and ethnicity, along with the other kinds of skill sets and experience that may figure into diversity when a nominating committee is deciding how to optimize their board.

And so, I have directed the Division of Corporation Finance to both look at the disclosures that have occurred over time with an eye to my concerns that we may need to provide more information to investors to make it useful, in terms of information about, gender and race and ethnicity.

There are a number of issues as there are with anything in this. What you do, for example, with board members who may not wish

to have that disclosed. But I think it is something that—my personal view is we should proceed on it and I am quite focused on it both in terms of reaching that conclusion on my part and then, if so, to moving it along.

Mr. SERRANO. Well, I want to take this opportunity, Chair White, in closing, to thank you for your service, you know. November is coming soon so we do not know where we are all going to be after November. But I want to thank you, and I want to ask you a personal favor on behalf of everybody.

It is a personal favor, and that is to try to continue to do what you have done, to put the SEC as that watchdog, that detective, that cop on the beat, that we need so that the Wall Street fiasco does not come back. If you put it on its road, it may be difficult for some people to undo it in the future, although some will try to go back to the days when we did not care what Wall Street was doing. Let's just try to get it on the road and I know you are the person to do it. Thank you.

Ms. WHITE. Thank you.

Mr. CRENSHAW. Mr. Bishop is recognized.

Mr. BISHOP. Thank you very much. Let's talk about flash crashes. In August of last year, fears of a slowdown in China's market prompted volatility in U.S. markets. Some investors were surprised to discover that ETFs were trading at much lower prices than their underlying investments on the morning of August 24. Parts of this resulted from delays in opening stocks and U.S. markets, while ETFs were immediately available for trading.

Additionally, the flash crash, like others before it, has been partially blamed on the application of automated investment tools on a large scale, without a sufficient safeguard against panic selling. While the flash crash of August 24th, 2015, was nowhere near the turmoil experienced in the flash crash of May 6th, 2010, it demonstrates that stock markets are still susceptible to human and computer errors and are largely unpredictable. What is the SEC doing to prevent flash crashes and their artificial instability in the U.S. stock markets?

Ms. WHITE. Quite a bit, and we have done quite a bit. I guess I would first say that I think what happened on August 24 was a—sort of unwelcome, mini-stress test. But I actually think that it showed the resilience of our critical market infrastructure.

I would take issue with saying it was a flash crash, sort of compounded by various kinds of errors. Having said that, however, clearly, it was a significant set of phenomena. The staff actually put out a research note on this in late last year. It was really very, very useful data and analytics.

We also have requested certain information from the exchanges and other participants on that day to see what measures should be taken to deal with some of the phenomenon that did occur. And among the issues obviously that are, under the microscope, so to speak, are the limit up/limit down rules that were put in after the flash crash in 2010. How do they operate? Market circuit breakers were actually not triggered but, clearly, limit ups/limit downs were particularly in certain ETFs, and you did have the phenomenon that you note in terms of underlying values departing from share value.

And so, there have been some adjustments already made, I think, in terms of the price collars and the size of the price collars. But there are other issues under consideration to try to make sure that the issues that did occur there, that really did not reflect fundamental values, at least fast enough of the stocks, the ETFs, are dealt with. And so I think you will see some measures taken in response to that. And we look at this all the time.

Our SCI rule that we talked about earlier is meant to increase the resiliency of our critical market infrastructures. When an incident does occur, it is reported to the SEC sooner rather than later so we can take action. So we are constantly dealing with issues like that, and with a great deal of seriousness. You want to optimize the markets, in terms of their functioning, as well as making sure they are reflecting fundamental value for investors and also serving the companies that seek to raise capital.

Mr. BISHOP. Thank you.

Mr. CRENSHAW. Well thank you, Chair White. We want to thank you for your service. I think everyone on this subcommittee appreciates the work you are doing. It is a big job, lots of responsibility, and we know how seriously you take that. So thank you for that, and we look forward to continuing to work with you so that you have the resources to do your job. So, thank you very much. This meeting is adjourned.

Ms. WHITE. Thank you very much.

Financial Services and General Government Subcommittee Hearing on the Securities and Exchange Commission for Chair Mary Jo White

Questions for the Record Submitted by Chairman Ander Crenshaw

Budget

Question: Since the FY 2016 Omnibus provided $117 million less than the Commission requested, how has the Commission prioritized the $105 million increase across the agency in FY 2016?

Response: With the additional funding provided in the FY 2016 Omnibus, the SEC has focused on covering cost increases associated with the agency's current service levels, and then hiring approximately 100 additional staff for key priorities, including:

- Bolstering examination coverage for investment advisers and other key entities who deal with retail and institutional investors;
- Strengthening our core investigative, litigation, and analytical enforcement functions;
- Strengthening the SEC's economic and risk analysis functions; and
- Hiring additional staff experts to help oversee rapidly changing markets, especially in new or expanded areas of responsibility such as derivatives, clearing agencies, private fund advisers, and municipal advisors.

Division of Economic and Risk Analysis (DERA)

The 2016 Omnibus requires DERA to report back to this Committee within a year of enactment on the combined impact that layers of regulations have had on access to capital and market liquidity.

Question: Do you believe there is an overall lack of liquidity, and is it a concern for you and the Commission?

Response: Liquidity is an important attribute of a healthy market. If the liquidity in a particular market were to diverge from historical experience, the Commission would certainly be interested in understanding why and determining if there is an issue that needs to be addressed. With respect to the status of liquidity in the fixed income markets, there are mixed results coming from DERA staff work, the work of other regulators, and academic studies. Certain metrics that relate to market liquidity show levels that are broadly consistent with historical experience and with a liquid market. By contrast, a

persistent decline in dealer inventory levels has also been documented. DERA staff will be examining these issues as part of the mandated study.

Question: Has the Commission discussed what sufficient liquidity is or should be?

Response: A threshold question in assessing the sufficiency of liquidity is the metric or metrics used to measure liquidity. I am committed to actively considering whether certain measures might evidence changes in market liquidity and, if so, what may be causing these changes and whether action might be necessary. More technically, liquidity can be assessed by first determining likely attributes of a liquid market — e.g., with respect to the secondary market, immediacy (how long it takes to execute an order), depth (how many orders above and below the current trading price there are), breadth (how numerous and sizeable orders are), tightness (how wide the bid-ask spread is), and resiliency (how long it takes for the market to correct imbalances). Measures can then be evaluated that relate to those attributes — e.g., for the attribute of immediacy, measures such as the number of market participants, quotes, and transactions. Thus, while no one measure conclusively demonstrates the presence or absence of liquidity, by surveying many individual measures in concert with respect to an individual market or component of a market we can obtain a sense of liquidity in that market.

Liquidity measures that may be useful for assessing liquidity on centralized trading venues or in markets with substantial volume may be less descriptive of liquidity in dealer-based/over-the-counter markets or in markets with limited volume. For example, corporate bonds are largely traded through dealers, without posted prices or an easily-observed order book. In such markets, post-trade measures of liquidity (e.g., transaction costs and markups, which proxy for the bid-ask spread) may be more informative than pre-trade measures of liquidity (e.g., immediacy, depth, and breadth).

The Commission has considered the effect of its regulations on liquidity in certain markets — for example, it has considered liquidity in the credit default swap and other security-based swap markets as part of its implementation of Title VII of the Dodd-Frank Act.

Question: Has the Commission, prior to this year, reviewed the overall impact of the multiple layers of regulation that have been implemented over the last several years to see if we got it right?

Response: The Commission considers the effects of multiple regulatory regimes as part of the rulemaking process. For example, we considered the effect of multiple/overlapping regulations on small business access to capital as part of adopting the JOBS Act-mandated Regulation A+ and Crowdfunding rules, and in proposing new rules to facilitate small offerings, including intrastate and regional offerings.

Beyond rulemaking, the Commission is continually actively monitoring the markets that it regulates. Specifically with respect to the fixed income markets, the Commission has been active in reviewing certain segments of those markets, including in conjunction with

the SEC's Report on the Municipal Securities Markets issued in 2012, and the Joint Staff Report on The U.S. Treasury Market on October 15, 2014, issued in 2015. Since 2014 we have also been actively monitoring liquidity metrics in the corporate fixed income markets (both primary and secondary) in conjunction with our fellow financial services regulators and reporting quarterly on the results to the House Financial Services Committee.

The Commission also has long had in place formal and informal processes for the review of existing rules to assess the rules' continued utility and effectiveness in light of the continuing evolution of the securities markets and changes in the securities laws and regulatory priorities. These processes include studies of broad program areas, such as the municipal markets study mentioned above and the receipt and review of feedback from outside the agency to help inform us as to how our current rules are functioning (including communications with investors, investor and industry groups, Congress, fellow regulators, the bar, and the public at large). The Commission's advisory committees, including the Advisory Committee on Small and Emerging Companies, also provide us with valuable insights as to the effects of our rules, including with regard to access to capital. Finally, Commission staff continuously assess how our regulations are working through the SEC's compliance inspection and examination functions, enforcement investigations, and receipt of requests for exemptive relief or Commission or staff guidance.

Department of Labor (DOL) Fiduciary Rule

The DOL released its fiduciary rule on April 6, 2016.

Question: Why do you think the Administration has supported DOL in moving forward with the fiduciary rule when the SEC was the agency expressly mandated by Dodd-Frank (Sec. 913) to study this issue and, potentially, propose a rule?

Response: DOL and the SEC are separate agencies with different statutory mandates. DOL's rulemaking is directed at an important concern for Americans – the standards that apply to the advice they get regarding their retirement accounts. Because the DOL has its own perspectives, jurisdiction, and statutes, DOL's rules may differ from any rules the Commission may consider pursuant to the authority provided by section 913 of the Dodd-Frank Act. As separate agencies, the Commission, in advancing a proposal, and the DOL can each proceed with the appropriate standards that apply to advice-giving with respect to particular investments, to the extent consistent with their individual statutes.

Question: Does the SEC plan to look into developing its own rule on this issue? If so, when? If so, how will you all harmonize the rules?

Response: I believe that broker-dealers and investment advisers should be subject to a uniform fiduciary standard of conduct when providing personalized investment advice to

retail investors. SEC staff is working on a recommendation for the Commission's consideration to require such a standard of conduct. This work builds on an extensive evaluation of the differences in the standards that apply under the federal securities laws, which underscores the many complex issues that would need to be addressed in proposing a uniform standard, including how to define the standard, how to address current business practices, and the nature of the potential effects of changes to existing standards on investors, particularly retail investors.

As part of its analysis, the staff is giving serious consideration to, among other things, the recommendations of the SEC staff's 2011 study under section 913 of the Dodd-Frank Act, the views of investors and other interested market participants, potential economic and market impacts, and the information we received in response to the Commission's request for data and other information in 2013.

I appreciate the views expressed about the interplay between the DOL's new rule and requirements under the federal securities laws, and the application of different standards to the provision of investment advice to retail investors. I also understand the importance of consultation among the agencies, and appreciate the impact that differences between standards put forth in any rulemaking by the Commission and DOL's new rule and related exemptions may have on regulated entities, investors, and the markets. It is important to achieve the right balance in addressing these issues, while making sure investors, particularly retail investors, are appropriately protected and have access to the type of investment advice and services they need and can afford. Consultation between the DOL and the Commission has been, and will continue to be, important as we move forward with this rulemaking.

The Senate Homeland Security and Government Affairs Committee released a report recently raising concerns that DOL failed to adequately consult with the SEC on the rule, and that DOL rejected or discounted SEC staff concerns and edits to the rule.

Question: How would you characterize the Commission's interaction with DOL on this rule?

Question: Do you believe the DOL properly consulted with the SEC staff in drafting this rule?

Question: Do you believe DOL carefully and fully address SEC staff concerns?

Response: Commission staff provided technical assistance in connection with DOL's rule. Specifically, Commission staff met and had calls with staff from DOL, providing technical expertise regarding the regulation of investment advisers and broker-dealers, including disclosure requirements and our approach to the conflicts that surround, among other things, principal trading, differential compensation, and receipt of commissions. I also discussed issues related to the rulemaking with Secretary Thomas Perez on the phone or in person on several occasions between late 2013 and early 2015, and with his predecessor on one occasion in mid-2013. In addition, prior to the proposal, Commission

staff economists also discussed with DOL staff economists cost-benefit related issues as well as relevant academic literature. Finally, Commission staff provided technical comments on the draft rulemaking in response to requests from staff from the Office of Management and Budget.

The DOL and the SEC are two separate agencies with separate statutory mandates. The consultations among DOL staff and SEC staff were not intended to reach agreement between the agencies on every aspect of the DOL's proposed rule. As is the case with any rule, changes were made throughout the rulemaking process. Ultimately, following a period of public notice and comment, DOL determined what changes to incorporate in its final rule.

Question: Do you believe the DOL engaged in a comprehensive cost-benefit analysis while drafting the rule?

Question: Has SEC staff conducted an independent review of the DOL rule?

I am particularly concerned the DOL rule will create more confusion and costs for retail investors. One study states over 7 million IRA accounts would not qualify for an advisory account due to the balance being too low to be profitable for the adviser. An unintended consequences this rule may be to price out middle and low-income investors.

Question: Could the potential compliance costs, as a consequence of this rule, result in firms letting go of smaller clients?

Response: As noted above, Commission staff met and had calls with staff from DOL and provided technical assistance in connection with DOL's rule. As part of these discussions, Commission staff shared their experiences with how services are provided in this area of the market and the potential economic and market impacts that policy changes the DOL was considering could have on SEC registrants and retail investors. In addition, prior to the proposal, Commission staff economists also discussed with DOL staff economists cost-benefit related issues as well as relevant academic literature. Since DOL just adopted its new rule at the beginning of April, and compliance with the rule is not required until next year, it is too early to assess the rule's impact, including any impact on services provided to middle and low-income investors.

Financial Stability Oversight Council (FSOC)

Last year, I offered an amendment in our full Committee markup to allow companies to de-risk prior to Systemically Important Financial Institutions (SIFI) designation. This language would not prohibit SIFI designations themselves, but would give non-banks the ability to address FSOC's concerns prior to a designation. This is common sense language that I thought was very reasonable.

Question: Have you see the language I proposed in FY 2016?

Response: I am generally familiar with the language you proposed in the FY 2016 appropriation bill related to FSOC.

Question: Do you think giving FSOC more flexibility in this area is a good thing?

Response: I agree that flexibility in the designation process is valuable. FSOC is designed, in part, to identify risks to the financial stability of the country that could arise from the distress or failure of large interconnected bank and nonbank financial companies. Designating a nonbank financial institution for heightened prudential supervision is one of the tools FSOC has at its disposal. If an entity that has been designated through the SIFI process is able to reduce its size so its potential material financial distress would no longer threaten the financial stability of the U.S., then it would seem the system would be better off for it. These are complex issues, and I think the Council has been, and should remain very focused on them.

Question: Would you say, in designating SIFIs, FSOC focuses on an entity's size or on its activities?

Response: In making a determination that a nonbank financial institution poses a material threat to the financial stability of the United States, the Council is bound by the statutory factors laid out in Section 113 of Dodd-Frank and the framework in the rule and guidance the Council promulgated after three rounds of public comment. Under these authorities, FSOC is required to consider an entity's size and its activities, as well as other factors in making this determination. In conducting this inquiry, I believe it is important to be data-driven and to conduct rigorous analysis throughout the process.

Under the Dodd-Frank Act, if FSOC determines that a nonbank financial company's material financial distress, or the nature, scope, size, scale, concentration, interconnectedness, or mix of the activities of the company, could pose a threat to U.S. financial stability, FSOC can designate the company for consolidated supervision by the Federal Reserve and enhanced prudential standards. Factors FSOC must consider include, among others, the company's leverage, size, interconnectedness, and existing regulatory scrutiny.

In 2012, after soliciting public comment three separate times, FSOC published its final rule and interpretive guidance on nonbank designations. The guidance describes how FSOC intends to apply the statutory standards and considerations and lists examples of the types of metrics that FSOC would assess as part of its analysis.

Question: Have you heard concerns from stakeholders that FSOC is not looking at activities-based risk and is merely targeting entities based on size? What is your response to these concerns?

Response: Although I am aware that some have expressed concern that FSOC is merely targeting entities based on size, I do not believe that is the case. As described above, the Council may only designate non-bank financial institutions for heightened prudential supervision if they meet the standards laid out under the relevant authorities, for which size is only one element. For example, in the first stage of the process described in the Council's rule and guidance, FSOC applies six quantitative thresholds to a broad group of nonbank financial companies to identify a set of companies that merit further evaluation. The Council then proceeds to review existing public and regulatory information and information submitted by a company, and if the Council decides to evaluate the company further, it conducts a detailed, in-depth analysis that includes a review of confidential information provided by the company. In light of the nature, size, and complexity of companies under consideration and as directed by the Dodd-Frank Act, FSOC conducts its analysis on a company-by-company basis in order to take into account the potential risks and mitigating factors that are unique to each company.

You sit on the FSOC with other Council members who seem to have more experience with prudential regulation than securities regulation.

Question: Do you believe your colleagues on FSOC understand the inherent differences between securities and prudential regulation?

Response: FSOC was specifically designed to bring together regulators from many different areas to broaden the perspective and expertise that can be brought to an issue. Those varied perspectives have been very helpful. Of course, the SEC is one of two capital markets regulators represented on the Council and does bring subject matter expertise to certain topics, like asset managers, that cannot, nor should be expected to, be replicated at other agencies.

Question: As the primary securities regulator, do you believe your views with regard to non-banks are given added weight within the Council?

Response: As required by the Dodd-Frank Act, FSOC consults with the primary financial regulatory agency, if any, for each nonbank financial company or subsidiary of a nonbank financial company that is being considered for designation, before FSOC makes any final designation. For example, for the three insurance companies that FSOC has designated, FSOC consulted with multiple state insurance regulators of the companies' insurance subsidiaries.

Further, as a voting member of FSOC, I voice my views on these and other issues. As you are aware, the Council is in the process of studying the activities and products of the asset management industry. In this effort I supported directing FSOC staff to undertake a focused analysis of industry-wide products and activities to assess any potential systemic

risks they may pose, and the SEC staff has been an active and key contributor throughout this ongoing process. As the Council's work progresses, I expect that SEC staff will continue to be full contributors, bringing their professional expertise and knowledge of the law and the asset management industry to bear.

Financial Stability Board

You are a member of the global Financial Stability Board. I have heard concerns related to the Board about a lack of transparency, a lack of due process, and the potential for U.S. companies to be unfairly disadvantaged.

Question: How do you respond to those concerns?

Response: The FSB is a coordinating body aimed at promoting dialogue among national financial authorities and international standard setting bodies. In order to encourage open discussion about issues affecting financial stability, its committee meetings are restricted to member representatives and are confidential. Nevertheless, there are several mechanisms that provide transparency into the FSB's activities. For example, after each Plenary meeting, the FSB issues a press release to the public summarizing key issues discussed, and any decisions reached by members. In addition, twice a year the FSB Chair publishes his or her letter to the G-20 presidency outlining the FSB's priorities and agenda.

The FSB also publishes information regarding individual initiatives. For example the FSB generally seeks feedback on its draft reports from the public and relevant stakeholders by issuing consultation drafts of reports mid-way through the lifecycle of a workstream. In addition, the FSB generally publishes the final reports of individual workstreams.

With respect to due process, the FSB and its committees are governed by the FSB Charter, Articles of Association, and Procedural Guidelines, all of which are published on the FSB website. The Articles of Association make clear that no decision is binding on its members and that no member assumes any legal obligation by being an FSB member. Membership in the FSB thus does not constrain the SEC's independence or appropriate exercise of its jurisdiction. No decision of the FSB is binding on the SEC, nor can the FSB cause the Commission to act in a manner contrary to its legal and policy frameworks. The FSB is an advisory entity and has no enforcement power over the policy recommendations it issues, which are implemented by individual FSB members at the discretion of the members. The FSB makes its decisions, including the publication of reports, via consensus. If there are concerns regarding a report or draft publication, including that it would be inconsistent with U.S. law or would disadvantage U.S. companies, several steps can be taken to address such concerns, including: (i) suggesting language changes to reports, including caveats and exceptions, that would seek to ensure that the report reflects the SEC's position and is consistent with the SEC's views on particular topics; and (ii) participating in meetings and calls with FSB members where

SEC staff clarifies the SEC's position and requests that any relevant report accommodate this view and address concerns raised.

If necessary, the Commission can register an official objection with respect to a particular FSB publication.

Question: How can the U.S. representatives on the Board better protect U.S. companies?

Response: The SEC, the Federal Reserve Board, and U.S. Treasury are the U.S. representatives on the FSB, and I, of course, can only speak on behalf of the SEC. Through the SEC's participation in the FSB, SEC staff seeks to further the SEC's mission of maintaining fair, orderly, and efficient markets and facilitating capital formation. I believe that by pursuing international activities that further these goals, we also can assist U.S. companies. For example, ongoing dialogue in the FSB and other international forums can assist the Commission with preventing or addressing gaps, duplication, and conflicts between U.S. and foreign regulations in the securities sector that may prohibit or limit U.S. financial firms' and other companies' ability to operate or raise capital across borders, or increase costs for such companies operating in multiple jurisdictions.

The FSB provides a forum where the SEC and other financial regulators can work together with other jurisdictions to foster an international regulatory structure that encourages global economic growth and innovation, while mitigating risk and maintaining the integrity of the financial markets. In addition, regular engagement with other regulators through the FSB and other international forums can facilitate the development of robust and effective foreign regulatory regimes that offer enhanced safeguards for U.S. companies seeking to invest and offer services abroad. At FSB meetings, authorities from jurisdictions across the world may discuss emerging risks to the financial system, exchange views about issues of mutual concern, share best practices for addressing these issues, and at times, develop policy recommendations to assist jurisdictions seeking to develop or enhance their regulations in particular areas. SEC staff participation in FSB initiatives helps to ensure that any FSB policy recommendations related to the securities markets are informed by the SEC's significant expertise and experience in regulating these markets, and that such recommendations are consistent with U.S. law.

Question: How much influence do Board decisions have over FSOC decisions?

Response: While the FSB and the FSOC are both focused on financial stability issues, their mandates and authorities are distinct. The FSB's designation of a firm as a global systemically important financial institution (G-SIFI) does not have legal effect in the United States or any other country. In the United States, FSOC is the only entity that can designate nonbank financial companies for enhanced prudential standards and Federal Reserve supervision. FSOC designations can be made only pursuant to a super-majority vote of its 10 voting members based solely on the standards and processes set forth in U.S. federal law, after a robust analysis that reflects extensive interaction with the

company. FSOC is under no obligation to consider a firm identified by the FSB for designation.

The SEC Small Business Advocate Act (H.R. 3784)

In February, the House overwhelmingly passed the SEC Small Business Advocate Act (H.R. 3784). Despite the important role that small businesses play in driving economic growth and job creation in the United States, at times they are underrepresented and there are concerns they may not always be appropriately heard at the Commission.

Question: Has the Commission heard these concerns that small businesses may be underrepresented in the regulatory process?

Question: Do you believe the Commission could do more to encourage small business capital formation?

Question: What type of reforms could the Commission pursue to improve the outcomes for small business?

Response: The Commission is committed to fulfilling all aspects of its three-part mission, including, of course, facilitating capital formation. As the avenues for capital raising change and evolve, it is critical to be continuously looking at what is working, how capital formation by small and emerging companies may be improved, and how investors are faring and being protected in these new markets.

The Commission endeavors to facilitate capital formation for small businesses and does so in a variety of ways. For example:

- The Office of Small Business Policy within our Division of Corporation Finance responds personally and individually to anyone who calls or emails with a small-business related inquiry. In FY 2015 they responded to approximately 1,700 such inquiries. This office also provides interpretive advice on the SEC's website and participates in SEC rulemaking and other actions that affect small businesses.

- The Office of Small Business Policy had primary responsibility for drafting the Regulation A and Regulation Crowdfunding rules that the Commission adopted in March 2015, and October 2015, respectively. The office carefully considered comments from the small business community as part of the rulemaking process.

- The Office of Small Business Policy took the lead in preparing a report reviewing the accredited investor definition as it relates to natural persons to determine if the definition should be modified or adjusted for the protection of investors, in the public interest and in light of the economy. A provision of the Dodd-Frank Act requires the Commission to conduct this review every four years. The Commission published the report summarizing the staff's first review on December 18, 2015. Based on this

review, the staff is working to develop recommendations for the Commission for a rulemaking proposal.

- The Commission's Advisory Committee on Small and Emerging Companies helps to ensure that the views of small business owners, investors, and other stakeholders in this important segment of our economy are clearly heard at the SEC. In September 2015, the Commission renewed the Committee for a new two-year term, and the Committee has already taken up some very important issues this year, including the accredited investor definition. The Office of Small Business Policy coordinates, and provides support for, the Advisory Committee's activities.

- The SEC also hosts an annual "SEC Government-Business Forum on Small Business Capital Formation." Participants typically include small business officers, venture capitalists, government officials, trade association representatives, lawyers, accountants, academics and small business advocates. The Forum results in open and direct discussions that give the Commission critical insight into the impact of our rules on small businesses and on their efforts to raise capital.

- The Office of Small Business Policy, along with the SEC's Office of Minority and Women Inclusion, partnered with the U.S. Small Business Administration to jointly host events to inform small business owners and entrepreneurs about new options available for capital raising under the Jumpstart Our Business Startups Act.

- As a specific example of the Commission's current efforts to facilitate capital formation for smaller companies while maintaining investor protections, in October 2015 the Commission proposed changes to modernize Securities Act Rule 147 to help facilitate intrastate offerings. The proposal also would update Rule 504 of Regulation D to raise the offering cap from $1 million to $5 million in a twelve-month period and would make it consistent with other provisions of Regulation D by including a bad actor disqualification provision. In proposing these changes, the Commission took into consideration the concerns and observations of market participants, including those of the North American Securities Administrators Association and the SEC's Advisory Committee on Small and Emerging Companies, as to the utility of the existing rules and the areas in which they could be updated. Another example is our work with the SROs to build a pilot program to widen the minimum quoting and trading increments – or tick sizes – for stocks of some smaller companies. The SEC plans to use the pilot program to assess whether wider tick sizes enhance the market quality of these stocks for the benefit of issuers and investors.

- The Commission also makes continuous efforts to address areas of interest or concern for smaller companies, and we have a variety of mechanisms for doing so. For example, when engaging in rulemaking, the Commission generally considers whether rules should apply to smaller companies or entities in the same way as larger companies or entities, or whether an exemption, delayed implementation, or scaled requirements may be appropriate.

Liquidity Management Rule

I understand that the SEC recently voted to move forward with proposed rules related to liquidity risk-management for open-end funds, like mutual funds and exchange-traded funds (ETFs). While there have been a few examples of funds suspending redemptions or failing, these seem atypical. I think the industry is generally in favor of establishing formal risk management proposals, but believes perhaps the SEC's proposed rules go too far with regard to the proposed liquidity levels.

Question: What has the Commission learned from the comments on this proposal?

Response: The Commission and its staff are still in the process of evaluating the comments that were received on the liquidity-risk management proposal. I have been informed that a few general themes have become apparent. Many commenters recognized the benefits of requiring open-end funds to implement comprehensive liquidity-risk management programs, acknowledging the risks that may be posed by inadequate liquidity risk management practices by funds. Commenters generally welcomed Commission action in improving fund liquidity risk management practices, considering that meeting redemption requests by open-end funds is a core concern of the Investment Company Act. However, many commenters argued that certain elements of the proposal, such as the proposal's liquidity classification framework and the three-day minimum liquidity requirement, may pose difficulties for funds and suggested that the Commission examine alternative approaches in these areas. Several commenters also acknowledged that swing pricing could be a worthy endeavor, since it holds the promise of a more equitable allocation of transaction costs, as well as the possibility of enhanced fund performance over the long term, although many also recognized the operational difficulties of implementing swing pricing in the near term. We are taking these comments very seriously and are carefully considering how best to move forward with improvements to the regulation of open-end funds' liquidity practices.

Question: How will this proposal affect investors within these funds? Do you believe costs will increase for investors?

Response: I believe that the liquidity-risk management proposal will provide a number of benefits to investors. These include elevating the overall quality of liquidity risk management across the fund industry, increasing transparency of liquidity risks and risk management practices, and mitigating potential dilution of existing shareholders' interests. As part of every rulemaking process, we undertake a comprehensive evaluation of the costs and benefits of the rule. I recognize that the costs of any rulemaking may be borne, at least in part, by investors, and therefore we are careful to design any regulatory reforms with that in mind while also taking into account the benefits of the rule. Any final rulemaking will include a careful and comprehensive evaluation of these costs and benefits.

Market Volatility

In August last year, the Dow briefly dropped by more than 1,000 points which triggered trading halts. In an ever connected world, global policies and economic slowdowns can affect U.S. markets dramatically.

Question: Is the SEC actively looking at ways to further mitigate market volatility?

Response: Yes. And I am committed to ensuring that the U.S. equity markets remain the most robust in the world. Commission staff has issued publicly detailed studies concerning the trading on August 24 and continues to analyze that event and other such periods of market volatility. The staff also continues to make progress on a recommendation to the Commission concerning an anti-disruptive trading rule that would address the use of aggressive, destabilizing trading strategies in vulnerable market conditions. Additionally, the Equity Market Structure Advisory Committee is considering market quality issues and recently received a report from one of its subcommittees highlighting potential recommendations concerning the Limit Up/Limit Down Plan (LULD), circuit breakers, and the market openings.

The Commission recently approved the extension of the pilot period of the LULD Plan, which is designed to address extraordinary volatility. The extension of the pilot period of the plan will allow the plan participants to conduct further analysis regarding the operation of the plan, including how it operated during the market volatility on August 24. In particular, the Commission understands the Participants are conducting additional reviews of certain aspects of the operation of the Plan and expects that the Participants will provide additional recommendations, as necessary, relating to:

- Harmonization of the SRO clearly erroneous execution rules with the plan such that trades that occur within the LULD price bands would not be broken absent legitimate technical failures;
- Adjustments to account for the particular trading characteristics of exchange traded products (ETPs);
- Other changes deemed warranted in light of the market volatility on August 24, including the impact of double-wide price bands during the opening period, and the advisability of coordinated reopening procedures; and
- Potential enhancements to the categorization of securities into different tiers.

Question: Do you think these are mostly outlier events and do not indicate a widespread problem within U.S. markets?

Response: The levels of volatility experienced by some ETPs and corporate stocks in the U.S. equity markets on August 24 have been rare. In recent years, the Commission and SROs have taken a variety of actions to help moderate volatility, including adopting the

LULD Plan, tightening the market-wide circuit breakers that apply to both the securities and futures markets, and adopting market access requirements to address the potential for erroneous orders that might lead to volatility events. We continue to consider initiatives to further optimize our market structure.

Question: How can U.S. markets better respond to changes in global economic policies?

Response: As noted above, the Commission and SROs have taken a variety of steps to moderate volatility in recent years and continue to assess steps that might further strengthen the stability and integrity of the U.S. markets, including in light of global economic policies.

Question: Do you think all or only certain securities products are more susceptible to these market fluctuations than others?

Response: The unusual levels of market volatility that occurred on May 6, 2010 in the equity markets, on October 15, 2014 in the U.S. Treasuries market, and August 24, 2015 in the equity market affected a variety of different types of products, including corporate stocks, U.S. Treasury securities, and ETPs. In the two equities events, ETPs experienced higher levels of volatility than corporate stocks. The Commission staff continues to analyze market volatility in the context of different types of securities, including by reviewing responses to the Commission's June 12, 2015 Request for Comment on Exchange Traded Products. Furthermore, the SROs are studying this issue in the context of the LULD Plan to assess whether specific provisions related to ETPs are necessary. Finally, as noted above, the Equity Market Structure Advisory Committee is also considering potential recommendations regarding market quality.

Municipal Securities

The Commission has been especially active in the municipal securities area since initiating the self-reporting program—the MCDC (Municipalities Continuing Disclosure Cooperation) Initiative. This is an almost $4 trillion market, often used by investors looking for safe investment and returns.

Question: How much of a priority is it for the Commission to make sure these securities are a safe, high quality investment option for investors?

Response: The municipal securities market is critical to building and maintaining the infrastructure of our nation. The Commission is committed to protecting investors in municipal securities and to maintaining a fair, orderly, and efficient municipal securities market through both regulatory and enforcement initiatives. Pursuant to Section 979 of the Dodd-Frank Act, the Commission established the Office of Municipal Securities (OMS), reporting directly to the Chair. One purpose for this legislative mandate was to focus attention on the significant municipal securities market. OMS is responsible for overseeing the municipal securities market to keep the Commission informed of current market issues, advising the Commission on policy matters relating to the municipal securities market, and providing technical assistance in the development and implementation of SEC initiatives in the municipal securities market. OMS also administers the Commission's rules pertaining to municipal securities brokers and dealers, municipal advisors, investors in municipal securities, and municipal issuers, including implementing the rules governing municipal advisor registration with the Commission. Currently, over 650 municipal advisors have registered with the Commission and are subject to Commission examination and enforcement. OMS engages in oversight of the Municipal Securities Rulemaking Board (MSRB) and coordinates with the Board and its staff on rulemaking.

The Commission has pursued over the past two decades a significant number of enforcement actions involving municipal securities. In addition, in 2010, the Enforcement Division established a specialized unit to investigate potential securities law violations involving municipal securities. Since that time, the staff in that unit has developed expertise associated with issues unique to the municipal securities market and has investigated matters that involve potential harm to investors in municipal securities, issuers, and taxpayers. For example, in 2014, the Commission instituted settled proceedings against 13 firms for improper sales of Puerto Rico bonds. The Commission found that these firms violated an MSRB investor protection rule that prevents the sale of higher risk municipal bonds in increments below a specified minimum. These specified minimums are set for bonds that have a higher default risk that may make the investments inappropriate for certain retail investors. In the first two quarters of 2016, the Commission has brought enforcement actions against three different municipal issuers, the City of Ramapo, New York, Westlands Water District, and the Rhode Island Commerce Corporation, involving alleged material misrepresentations or omissions in municipal disclosure documents, demonstrating the Commission's commitment to protect investors in this area.

Question: To what extent is the underwriter responsible for making sure the financial disclosures that accompany muni offerings are accurate?

Response: In light of the national scope of the municipal securities market and its importance to the economy and state and local governments, there is an overriding federal interest in assuring that there is adequate disclosure of all material information by issuers of municipal securities. The antifraud provisions of the federal securities laws prohibit any person, including issuers and underwriters, from making any untrue statement of material fact, or omitting any material facts necessary to make statements made, in the light of the circumstances under which they were made, not misleading, in connection with the offer, purchase, or sale of any security, including municipal securities. The Commission has emphasized through interpretive guidance and its enforcement program the duty of underwriters to the investing public, under the antifraud provisions of the federal securities laws, to have a reasonable basis for recommending any municipal securities. An underwriter's responsibility in fulfilling that obligation is to review in a professional manner the accuracy of statements made in connection with the offering. In addition, underwriters are subject to rules adopted by the Commission and the MSRB, including those rules adopted to define and prevent fraud.

Question: Do you believe SEC actions are encouraging a more thorough review of disclosure documents prior to muni offerings?

Response: I believe that recent SEC enforcement actions involving violations of the antifraud provisions by municipal issuers have raised awareness about the need for accurate disclosures in municipal offerings and are encouraging more thorough review of those disclosures. For example, market participants have reported that the Municipalities Continuing Disclosure Cooperation (MCDC) Initiative has resulted in a significant change among issuers and underwriters with regard to the need to accurately disclose material failures to comply with prior continuing disclosure undertakings. SEC staff has heard anecdotally from underwriters that, as a result of the attention, market participants are now keenly aware of the issue and it has become standard practice to affirmatively consider whether disclosure is necessary. Indeed, a recent media report of a study conducted by the National Federation of Municipal Analysts indicated that, in a poll of 200 member analysts, participants agreed that disclosure has improved dramatically, in part as a result of MCDC.[1] Similarly, recent actions involving the Town of Ramapo, NY, Rhode Island Commerce Corporation, Westlands Water District, City of Harvey, Illinois, and City of Allen Park, Michigan have each involved alleged material misrepresentations or omissions in offering documents by municipal issuers and issuer officials, in various factual contexts. Those matters were widely reported in national and industry publications and have brought much needed attention to the obligations of those parties.

[1] *See* Jack Casey, *MCDC Has Improved Disclosure But Issues Remain*, The Bond Buyer, April 22, 2016.

Question: What, if any, are your concerns going forward in this area?

Response: As you know, despite its size and importance, the municipal securities market has not been subject to the same level of regulation as other sectors of the U.S. capital markets. With respect to disclosure, municipal securities are exempt from certain registration and reporting provisions of the Securities Act and the Exchange Act. In the absence of a statutory scheme for municipal securities registration and reporting, the Commission's investor protection efforts in the municipal securities market have been accomplished primarily through regulation of broker-dealers and municipal securities dealers, including through Exchange Act Rule 15c2-12, Commission interpretations, enforcement of the antifraud provisions of the federal securities laws, and Commission oversight of the MSRB. In the Commission's 2012 Report on the Municipal Securities Market, the Commission made several recommendations on two key areas of concern in the municipal securities market: disclosure and market structure. With respect to disclosure, the Report identified the timeliness of financial information in primary offerings of municipal securities and on an ongoing basis as areas of concern. With respect to market structure, the Report noted that the municipal market is relatively opaque and illiquid, with substantially less price transparency than the equities market, particularly on a pre-trade basis. Price transparency is vital for assuring that markets are fair and efficient and providing meaning to fair pricing and best execution obligations.

Puerto Rico

Creditors purchased Puerto Rican debt with the expectation that this debt was precluded from Chapter 9 bankruptcy authority.

Question: If the terms of Puerto Rico's debt are changed ex-post, could that also change the expectation of other States and their creditors?

Response: Under current federal law, as I understand it, state governments are not permitted to use the federal bankruptcy regime to restructure their debts due to the prohibition against state governments impairing the obligation of contracts under the contracts clause of the U.S. Constitution. Only municipalities may voluntarily file petitions under the existing federal bankruptcy regime, Chapter 9 of the U.S. Bankruptcy Code.

Question: Do you believe this would create an undesirable precedent within this market?

Response: Chapter 9 of the U.S. Bankruptcy Code provides a process for a financially-distressed municipality to obtain protection from its creditors while it develops and negotiates a plan to adjust its debts. In order to access this federal bankruptcy regime, a municipality must be specifically authorized to file a petition for bankruptcy under State law. The municipal securities market is large and extremely diverse. For example, issuers of municipal securities include States, their political subdivisions (such as cities, towns, counties and school districts), and their instrumentalities (such as housing,

healthcare, airport, port, and economic development authorities and agencies). State and local laws, including State constitutions, statutes, city and county charters, and municipal codes govern these public bodies and States have taken different approaches on whether to allow municipalities to file for Chapter 9 relief. Once a municipality has filed a bankruptcy petition, the municipality typically negotiates with its creditors to draft a plan to adjust its debts. Ultimately, a federal bankruptcy court must approve the adjustment plan. As demonstrated by the recent bankruptcy cases of Detroit, Michigan and Jefferson County, Alabama, the final adjustment plan will vary depending on the outcome of the negotiations with creditors.

Question: How important are settled expectations in the municipal market?

Response: Historically, municipal securities have had significantly lower rates of default than corporate and foreign government bonds. Although relatively rare, municipal bankruptcies can occur, but the number of municipalities that have filed for bankruptcy protection pursuant to Chapter 9 of the U.S. Bankruptcy Code remains low due in part, I believe, to the negative reputational risk and cost associated with entering into bankruptcy. Financially distressed municipal issuers typically will seek other mechanisms to restructure its debt and only turn to Chapter 9 as a last resort. If a municipality files for bankruptcy protection pursuant to Chapter 9, it still must develop and negotiate a plan to adjust its debts. Investor expectations can be best established through robust disclosure, both in connection with the initial offering and on a continuing post-issuance basis.

Standards for Covered Clearing Agencies

In March 2014, the SEC put forth a proposed rule on Standards for Covered Clearing Agencies (Release No. 34-71699). This rule implements the Principles for Financial Market Infrastructure, or PFMIs, that were first published by CPMI-IOSCO in 2012.

Question: How much progress has the SEC made in finalizing the rulemaking establishing standards for the operation and governance of registered clearing agencies?

Question: When will the rule be finalized?

Question: Absent a final rule, will the European Commission move forward in deeming the SEC's regulatory regime for clearing agencies equivalent, as it has recently done for the CFTC?

Question: Is the SEC working with the European Commission to deem the U.S. system equivalent?

Question: As new European capital requirements begin phasing in this summer, will it increase the costs of participating in jurisdictions that have not been deemed equivalent?

Question: What are the potential impacts on liquidity and costs for foreign investors in these domestic markets if European member institutions exit the clearinghouses?

Response: The CCA Proposal, which would impose new standards for the operation and governance for certain types of registered clearing agencies that operate as central counterparties (CCPs), is an important set of proposals given the central role CCPs play in the securities markets. As such, the adoption of the CCA Proposal is one of the Commission's highest priority rulemaking initiatives for 2016, and Commission staff is working expeditiously to deliver a final recommendation for the Commission to consider.

Additionally, Commission staff continues to be actively engaged in discussions with staff from the European Commission with respect to an equivalence decision and are focused on reaching a positive outcome. The European Commission recently extended its deadline to December 16, 2016. Commission staff believes this extension should assist the Commission staff and staff of the European Commission and the European Securities and Markets Authority (collectively EU Authorities) to reach a positive outcome concerning the equivalence negotiations. If the EU Authorities do not grant an equivalence decision and disposition by December 16, 2016, or if they do not extend the deadline beyond that date, U.S. clearing agencies operating as CCPs would be prohibited from providing clearing services to EU entities. In addition, U.S. clearing agencies operating as CCPs would not be deemed a qualifying central counterparty (QCCP) under EU regulations, and those EU entities that are participants of U.S. clearing agencies through U.S.-based subsidiaries (e.g., broker-dealers) would face higher capital charges that could deter ongoing economically viable access to the U.S. clearing agency. In response, EU entities may choose to move their clearing activity to other CCPs, including non-U.S. clearing agencies, that may clear the same, or competing, financial products.

The decision to impose higher costs on those EU entities participating in non-EU CCPs in a jurisdiction that has not been deemed equivalent by the European Commission is with the EU Authorities. In discussions with staff from the European Commission, Commission staff has emphasized the importance of avoiding any market disruption, including the possibility of imposing higher capital costs for clearing activity at U.S. clearing agencies that operate as CCPs. Commission staff remains constructively and actively engaged in ensuring that discussions with the European Commission on equivalence negotiations reach a positive outcome with legal certainty and no market disruption.

Investment Company Reporting Modernization

In May 2015, the SEC put forth a proposed rule, the Investment Company Reporting Modernization (Rule 30e-3), regarding delivery of semi-annual mutual fund investment reports from paper to electronic.

Question: When will the rule be finalized?

Response: The comment period for the proposed rule initially closed on August 11, 2015. The Commission reopened the comment period in connection with its proposed rules concerning liquidity risk management and swing pricing, and it closed again on January 13, 2016. The Commission received a number of comment letters discussing the aspect of the proposal that would permit funds to satisfy their requirements under the Investment Company Act and the rules thereunder to transmit periodic reports to their shareholders if the funds make the reports and certain other materials publicly accessible on a website. Although I am not able to specify a timetable, the staff is actively working to develop recommendations for the Commission's consideration in 2016.

Question: How will the rule ensure investors have the option to choose to receive reports either by paper or e-statements?

Response: The Investment Company Act and rules thereunder require funds to transmit shareholder reports to their investors at least semi-annually within 60 days after the close of the period for which such report is made.[2] Historically, these reports have been printed or mailed to shareholders. However, under the Commission's existing guidance on electronic delivery, funds may transmit documents electronically provided a number of conditions related to shareholder notice, access, and evidenee of delivery are met.[3]

In the proposing release, the Commission recognized that some investors prefer to receive paper shareholder reports and, under the proposed rule, those investors would be able make to an election at any time to continue to receive all of their reports in paper as they do today. Specifically, the rule as proposed includes a number of safeguards for investors who wish to continue to receive shareholder reports in paper. For example, under the proposal, a fund would be required to transmit a separate written initial statement at least 60 days before it relied on the proposed rule with respect to an investor. In addition to this initial statement, the fund would be required to send investors written notices each time a new shareholder report is made available. These periodic notices would not only alert investors to the electronic availability of a particular report, but also inform investors how they can receive paper shareholder reports in the future. In both the initial statement and the ongoing notices, the fund would be required to make available, in addition to the pre-addressed, postage-paid reply card, a toll-free telephone number, and the shareholder could use either of those two methods to express his or her

[2] *See* Section 30(e) of the Investment Company Act [15 U.S.C. 80a-29(e)]; rule 30e-1; rule 30e-2.

[3] *See generally* Use of Electronic Media for Delivery Purposes, Investment Company Act Release No. 21399 (Oct. 6, 1995) [60 FR 52458 (Oct. 13, 1995)].

preference for paper reports in the future. Under the proposal, a shareholder can request paper copies of individual shareholder reports from the fund at any time, and the fund would be required, as a condition to reliance on the proposed rule, to send the shareholder reports, at no cost to the requestor and by U.S. first class mail or other reasonably prompt means.

Question: Do you expect the rule to save investment companies resources in this area? Do you have an estimate of how much?

Response: The Commission analyzed the expected benefits and costs of the proposed rule prior to issuing the proposal. The Commission's analysis is excerpted and attached as Exhibit A. As noted in Exhibit A, "[a]lthough the proposed rule would not have a significant effect, if any, on the expenses associated with the preparation of reports, the Commission expects that the expenses associated with printing and mailing of shareholder reports would be substantially reduced if the rule is adopted." The staff is carefully reviewing comments received on the proposed rule, including comments on the analysis of benefits and costs.

Questions for the Record Submitted by Congressman Steve Womack

National Market Systems (NMS) Plans

U.S. equity markets have evolved significantly since the implementation of the existing regulatory framework, principally the amendments made to the Securities Exchange Act (1975) and introduction of Regulation NMS (2005). There are potential changes to be addresses with regard to the governance of NMS Plans.

Chair White, as you are aware, Section 11A of the Securities Exchange Act of 1934 ("Exchange Act") provides the authority for self-regulatory organizations ("SROs") to establish National Market System Plans ("NMS Plans"). Rule 608 of Regulation NMS under the Exchange Act sets for the SEC's process for approving NMS Plans. Neither Section 11A nor Rule 608 prohibits the inclusion of industry participants (i.e., broker-dealers and asset managers) from having voting rights in the governance of NMS Plans. In fact, Section 6 of the Exchange Act specifically requires the SROs to include industry participants as voting members in their own governance.

Question: In light of those factors, and assuming that any ancillary jurisdiction issues were addressed, does the SEC currently have the legal authority to approve the addition of industry participants as voting participants in the governance of NMS Plans?

Response: The Commission has existing authority to take action in this area. Section 11A of the Securities Exchange Act of 1934 (Act)[1] directs the Commission to facilitate the establishment of a national market system for securities. In so doing, the Commission, by rule or order, may authorize or require the SROs to act jointly with respect to matters as to which they share authority in planning, developing, operating, or regulating the national market system or facility thereof.[2] Pursuant to Rule 608 under Regulation NMS,[3] the Commission may authorize any two or more SROs, acting jointly, to file an NMS plan with respect to the operation of a national market subsystem or facility.

NMS plan governance is one of the many important topics the Commission currently is assessing as part of its broad-based review of equity market structure. As part of this review, the Equity Market Structure Advisory Committee is studying a number of recommendations relating to trading venues regulation. At its upcoming July 8, 2016 telephonic meeting, that committee is scheduled to consider, among other things, specific recommendations concerning the rule of advisory committees in NMS plans. NMS plans serve important regulatory purposes, such as ensuring that accurate and reliable consolidated market data is widely available to investors, that our markets have robust mechanisms to protect against excessive volatility, and that SROs can effectively surveil

[1] 15 U.S.C.78k-1.

[2] *See* Section 11A(a)(3)(B) of the Act.

[3] 17 CFR 242.608.

the markets. At the same time, I recognize the importance of incorporating the views of broker-dealers and other stakeholders in the operation of an NMS plan at an early stage of the decision-making process. Early stage engagement may, among other things, enhance the quality of the proposals developed by the NMS plans as well as facilitate more swift adoption and implementation. Accordingly, enhancements to the governance of NMS plans designed to ensure that the views of key stakeholders are taken into account deserve serious consideration.

Questions for the Record Submitted by Congresswoman Jaime Herrera Beutler

Rulemakings

Chair White, I understand your agency has completed sixty-one mandatory rulemakings as required by Dodd-Frank with remaining mandatory rulemakings left outstanding. By some estimates you have approximately 30% of the remaining mandatory rulemakings left outstanding. You recently mentioned that it was your intention to complete much of the outstanding mandatory rulemakings, especially those in Title VII, this year. As you know, in addition to its mandatory obligations, Congress also gave the Commission authority to engage in a variety of other rulemakings. During our hearing you mentioned your personal belief that one such authority the Commission should pursue is the creation of a unified fiduciary rule under section 913 of the law.

Question: Are there any other specific authorities given to the SEC by Dodd-Frank that you believe the Commission should be acting on as it works to complete its Dodd-Frank work? If so, please outline them for us and explain how you intend to complete them in conjunction with the Commission's intention to complete its mandatory rulemakings.

Response: The Commission has taken action to address virtually all of the mandatory rulemaking provisions of the Dodd-Frank Act, and will continue in 2016 to work towards completing its remaining mandates. Of particular focus and priority will be to finalize the remaining security-based swap rules required of the SEC by Title VII of the Dodd-Frank Act. Toward that end, in February the Commission adopted the last set of rules for cross-border dealer activity. Likewise, in April we finalized rules implementing a comprehensive set of business conduct standards and chief compliance officer requirements for security-based swap dealers and major security-based swap participants. Beyond Title VII, the Commission has proposed the full suite of rules regarding executive compensation practices mandated by the Dodd-Frank Act. SEC staff also is considering recommending that the Commission re-propose a rule under the Securities Act to implement the prohibition under section 621 of the Dodd-Frank Act on material conflicts of interest in connection with certain asset-backed securities transactions.

The Commission also has exercised its discretionary rulemaking authority under Dodd-Frank in a number of important areas. To date, the SEC has adopted rules under about a dozen of the approximately 40 provisions in the Dodd-Frank Act that give the Commission discretionary rulemaking authority. In addition, as reflected in the SEC's Regulatory Flexibility Act agenda, the Commission has proposed rules under three provisions that relate to establishing segregation requirements for security-based swap dealers and major security-based swap participants. SEC staff also is working on a recommendation related to the discretionary rulemaking provisions in the Dodd-Frank Act that authorize the SEC to establish a uniform fiduciary standard of conduct for broker-dealers and investment advisers when providing personalized investment advice about securities to retail customers.

Questions for the Record Submitted by Congressman Mark Amodei

IEX

IEX is currently an SEC-registered "Alternative Trading System" – i.e., an electronic trading platform that is not a registered stock exchange. SEC rules limit the daily volume of an ATS. Because ATS offers a platform where "buy side" investors like mutual funds and pension funds can trade without interference from certain predatory high frequency traders ("HFTs"), ATS has grown rapidly. IEX needs to become an Exchange in order to continue to grow. Their application has been pending before the SEC since September due to opposition from some of the HFT firms and the established Exchanges that are dependent on HFTs. The deadline on the application has been extended twice.

IEX's exchange application has now been pending since September of last year, and the time for action was extended once again to June of this year.

Question: Are you committed to taking final action by this new deadline?

Response: On June 17, 2016, the Commission approved Investors' Exchange LLC's application to register as a national securities exchange.

Questions for the Record Submitted by Ranking Member José E. Serrano

Information Technology

Question: How do these technological improvements that you are requesting funding for help your staff spot possible misconduct and trends that might be devastating for the economy?

Response: The technology improvements we hope to implement in FY 2017 should help Commission staff to identify possible misconduct and trends in a number of ways across the Commission. The SEC will continue to expand its data analytic tools to better integrate and analyze huge volumes of financial market data, employing algorithms and quantitative models that can lead to earlier detection of fraud or suspicious behavior. SEC staff has begun to use data analytics (including pattern recognition) tools to detect potential fraudulent or manipulative trading, identify financial statement outliers or unusual trends indicative of possible accounting fraud, discover possible money laundering, sift through massive volumes of trading data to detect suspicious trading patterns, and flag higher risk registrants for examination prioritization. This enables the agency to allocate its resources more effectively. Some of the technology projects being employed for these purposes are set out below.

Investments in new and expansion of existing technologies which will allow the Division of Enforcement (ENF) to keep pace with the market, and better enable ENF to identify potential misconduct include:

- The Enterprise Data Analytics Platform (EDAP) -- a centralized analytics platform, which integrates multiple data sources and allows for cross-data search and analysis to more proactively identify potential wrongdoing. The tool has already proven useful in insider trading, Microcap Fraud, and collections investigations, and the SEC is seeking funding in FY 2017 to expand the use of this tool for these and other types of investigations.

- Enhancement and integration of ARTEMIS and RedTiger. Both systems have proven highly effective in advancing Enforcement Division trading investigations; extending and integrating the two systems will enhance investigative capabilities of ENF staff.

The Office of Compliance Inspections and Examinations (OCIE) technology improvements directly relate to assisting examiners in identifying potential misconduct as well as industry trends and emerging fraud risks. For FY 2017, these include:

- Modernizing TRENDS, the primary business systems that track our examination work, will help improve the way in which the SEC tracks examination results including the identification of findings and emerging issues.

- The Visual Analytics and Dashboard for Registrants (VADR) tool, which will provide the examination staff with a more comprehensive understanding of the registrant's business attributes through the collection and aggregation of regulatory filings. VADR will include analytics such as risk models, text analytics, and data visualizations.

- Implementing the High-Frequency Analytics Lab (HAL) will advance the Commission's capabilities in high-frequency trading examinations and oversight. HAL will produce reports and visualizations (*e.g.*, Profit and Loss analysis, liquidity provisions, and message traffic) to help identify registrants engaging in potentially unfair market practices.

- The National Exam Analytics Tool (NEAT) automates the review of registrant trade blotters. This tool generates reports by compliance area (e.g., insider trading, churning, front-running, etc.). Future versions will continue to add enhancements, as well as create a new module for Anti-Money Laundering.

- Deployment of an improved asset verification tool to support the Asset Verification reconciliation process and to enhance examination efficiency. As of March 2016, the Asset Verification team has supported 240 exams in the review of over 336,000 accounts with total assets valued at $647B USD.

- The Technology Controls Program (TCP), enabling OCIE's examiner staff through new equipment and dashboard technology that displays and combines key risk data associated with registrants and our examination findings.

The Division of Economic and Risk Analysis (DERA) risk analytics programs also benefit from technologies that can deliver more, higher-quality data in a timelier manner. These programs include:

- The Investment Company Risk Assessment tool, which is DERA's newest tool. This tool seeks to detect anomalous investment company characteristics and activities that are most related to an increased likelihood of violations of the federal securities laws. DERA is working with Enforcement staff to use the tool to detect possible misconduct (*e.g.*, dividend juicing and closet indexing).

- The Corporate Issuer Risk Assessment tool, which was developed in collaboration with Enforcement staff to help detect financial reporting irregularities that may indicate potential fraud. The tool includes over 200 custom metrics that help the Enforcement Fraud Group and disclosure reviewers in the Division of Corporation Finance assess the risks associated with corporate issuers' financial reporting and disclosures.

- The Broker-Dealer Risk Assessment tool, which was developed in close connection with OCIE staff to help prioritize inspections and to help direct

examiners' attention during inspections. The model detects outlier activities or certain changes over time at a broker-dealer relative to its peers. It is fully integrated into OCIE's exam planning process.

Question: Please give us an update on www.SEC.gov.

Response: The SEC.gov modernization effort is expected to be completed in calendar year 2018. All web publishing will be consolidated onto a modernized platform, greatly expanding service to the public and the marketplace. After the modernization is complete, as with all large web platforms, additional development as appropriate will help to ensure that SEC.gov can continue to meet public demand and comply with federal requirements.

Question: How much traffic does the SEC website have per day in comparison to other popular websites, such as www.weather.com ? Who are the users of the site and what information are they looking for on it?

Response: The demand for the information on SEC.gov continues to increase, with 6.83 billion page views in 2015, a 43% increase from 2014. In February 2016 alone, the SEC received 651 million page views. Page views represent users actually viewing webpages or documents on SEC.gov to get to information.

Users most frequently come to sec.gov for EDGAR, the IAPD Investment Adviser database, litigation releases and news releases.

Question: What is the status of the Enterprise Data Warehouse platform?

Response: The SEC's Enterprise Data Warehouse (EDW) was implemented in 2014 with the goal of creating a secure platform for big data analytics while promoting data sharing across offices. It is fully functional and currently supports all of the SEC's analyses of very large data sets. .

As the current Enterprise Data Warehouse nears its end of vendor support in 2017, the SEC is actively investigating a hybrid solution that combines on-premises and cloud processing to build a cost-effective next generation Enterprise Data Warehouse that is both powerful and scalable to meet the agency's growing need for big data storage and analytics.

Question: What are the enhancements you're planning to make to the Tips, Complaints and Referral System (TCR)?

Response: The TCR system is undergoing a modernization effort to improve the user experience in the submission of TCRs, enhance search capabilities across SEC information systems, and update the system to an out-of-the-box IT platform that will make future enhancements easier to implement. These improvements will ultimately

allow SEC investigators and examiners the capability to cross reference more information systems during the various phases of a TCR's lifecycle, allowing for a more informed triaging of an alleged wrongdoing, a deeper examination of matters under investigation, and a more accurate disposition overall. Additionally, the modernized system will enable analytic capability to help Commission staff better assess trends, emerging risks, and threats of market misconduct. We will continue to improve the search capabilities of information from within and around the TCR system to provide more complete results with a less labor-intensive website, leading to the continued ability to properly handle the growing number of TCR leads.

Annual and Semi-Annual Statement Notification

Question: Regarding the recently proposed rule to allow registered investment funds to change how their shareholders receive annual and semi-annual statements; what has been the response to this proposal and what impact do you think this will have on shareholders?

Response: The Commission and its staff are still in the process of evaluating the comments that were received on the investment company reporting modernization rule proposal. A few general themes have emerged from the comments. Many commenters supported the proposal, highlighting, for example, the disclosure benefits to investors, the rule's consistency with Internet usage trends and the reduction in printing and mailing costs that accrue to investors. However, the Commission also received a number of comment letters opposing this aspect of the proposal. Many commenters, for example, expressed concern regarding Internet access and use by certain demographic groups and on the change to the current framework that would require investors to opt-out to receive paper reports. The staff is evaluating these comments and developing a recommendation for Commission consideration.

Questions for the Record Submitted by Congressman Mike Quigley

XBRL (Structured Data Formats for Public Company Disclosures)

Chairwoman White, an item I have focused on for some time has been the SEC's efforts to embrace structured data. Structured data, such as XBRL, allow investors to make better decisions, allow markets to more quickly digest information, and let smaller public companies reach a broader range of investors.

The SEC currently requires companies to submit two versions of every financial statement –once as searchable XBRL data and again as an old-fashioned, non-searchable document.

We have been told that SEC staff is working on a proposal to move to the "inline XBRL" format; a format that is both human-readable and machine-readable. This would allow companies to submit just one version of each financial statement. I believe that this change could improve the data quality for investors and also reduce compliance costs for companies.

Question: Do you intend to submit this proposal to the Commission for formal approval?

Response: The Commission recently issued an order to allow filers to voluntarily file financial statement data currently required in XBRL data inline as part of their core filings, rather than filing XBRL data in an exhibit. The staff is also finalizing recommendations for the Commission's consideration for a proposal to require filers to submit their financial statement data using inline XBRL. Use of an inline format has the potential to improve the quality of structured disclosures and ease filer burden. It may also facilitate review of XBRL data by SEC staff, preparers, and investors by enhancing the ability to view XBRL-enabled analytics and rendered XBRL data within the core filing. Any rule changes undertaken by the Commission as a result of the staff's recommendations would be subject to the notice and comment rulemaking process of the Administrative Procedure Act.

Question: If so, can you tell me when the Commissioners will have a chance to consider this proposal?

Response: I am not able to provide a specific timeframe for the Commission's consideration of the proposal, given the need to balance the time and workload demands related to XBRL amendments with the other rulemaking work that the Commission is undertaking. As you know, the Commission has included proposed XBRL amendments on its most recent Reg. Flex agenda, which reflects those items that the Commission expects to accomplish during the next 12 months.

SEC Small Business Advocate Act

Chairwoman White, I want to discuss an important issue that Chairman Crenshaw touched upon earlier, and it's the need for regulators to take the concerns of small businesses seriously and to make small business growth a top priority.

Small businesses and small business investors were not the cause of the financial crisis and do not pose a significant risk to the rest of the economy. Therefore, they should not be treated as such.

That's why I was proud to co-author the SEC Small Business Advocate Act, and co-lead the bill along with Chairman Crenshaw. This legislation will not only improve the regulatory process for small business owners, but also for the everyday investors and consumers that depend on them.

In February, the House passed the bill by voice vote.

Question: Clearly, there is broad bipartisan support for designating a Small Business Advocate at the SEC. Is this something that the Commission has considered implementing on its own?

Response: We have not, given our dedicated Office of Small Business Policy, which I describe below, and the input we receive from our advisory committee and other small business constituents. Small businesses play a crucial role in the growth of our nation's economy and the creation of new jobs. At the Commission, we are constantly working to facilitate capital formation and to ensure that the views of small business owners, investors, and other stakeholders in this business community are clearly heard at the Commission. The Commission has an Office of Small Business Policy within our Division of Corporation Finance. Since formation of this office several decades ago, staff has worked diligently to help address the capital-raising needs of small businesses, as well as the disclosure needs of small business investors. Examples of the work performed by the Office of Small Business Policy include the following:

- The Office of Small Business Policy responds personally and individually to anyone who calls or emails with a small-business related inquiry. In FY 2015, they responded to approximately 1,700 such inquiries. This office also provides interpretive advice on the SEC's website and participates in SEC rulemaking and other actions that affect small businesses.

- The Office of Small Business Policy had primary responsibility for drafting the Regulation A and Regulation Crowdfunding rules that the Commission adopted in March 2015, and October 2015, respectively. The office carefully considered comments from the small business community as part of the rulemaking process.

- The Office of Small Business Policy took the lead in preparing a report reviewing the accredited investor definition as it relates to natural persons to determine if the

definition should be modified or adjusted for the protection of investors, in the public interest and in light of the economy. A provision of the Dodd-Frank Act requires the Commission to conduct this review every four years. The Commission published the report summarizing the staff's first review on December 18, 2015. Based on the review, the staff is working to develop recommendations for a rule proposal for the Commission's consideration.

- The Commission's Advisory Committee on Small and Emerging Companies, which the Commission this year renewed for a two-year term, and the Annual Government-Business Forum on Small Business Capital Formation, provide valuable input to the Commission regarding areas of interest and concern for smaller companies. The Office of Small Business Policy coordinates, and provides support for, the Advisory Committee's activities.

- The Office of Small Business Policy, along with the SEC's Office of Minority and Women Inclusion, partnered with the U.S. Small Business Administration to jointly host events to inform small business owners and entrepreneurs about new options available for capital raising under the Jumpstart Our Business Startups Act.

- As an example of the Commission's current efforts to facilitate capital formation for smaller companies while maintaining investor protections, in October 2015 the Commission proposed changes to modernize Securities Act Rule 147 to help facilitate intrastate offerings. The proposal also would update Rule 504 of Regulation D to raise the offering cap from $1 million to $5 million in a twelve-month period and would make it consistent with other provisions of Regulation D by including a bad actor disqualification provision. In proposing these changes, which were not mandated by Congress, the Commission took into consideration the concerns and observations of market participants, including those of the North American Securities Administrators Association and the SEC's Advisory Committee on Small and Emerging Companies, as to the utility of the existing rules and the areas in which they could be updated. Another example is our work with the SROs to build a pilot program to widen the minimum quoting and trading increments – or tick sizes – for stocks of some smaller companies. The SEC plans to use the pilot program to assess whether wider tick sizes enhance the market quality of these stocks for the benefit of issuers and investors.

- We also make continuous efforts to address areas of interest or concern for smaller companies, and we have a variety of mechanisms for doing so. For example, when engaging in rulemaking, we generally consider whether rules should apply to smaller companies or entities in the same way as larger companies or entities, or whether an exemption, delayed implementation, or scaled requirements may be appropriate.

In considering whether the Commission should have a separate office of a Small Business Advocate, I think it is important to consider carefully the full range of potential benefits and impacts. For example, while the intent behind creating a new, standalone office would be to bring additional focus to matters of importance to small businesses, it

has the potential to fragment the consideration of some small business issues away from the divisions and offices that are charged with writing, reviewing, and providing interpretive guidance on a wide variety of our rules. It could also be duplicative of offices and programs that already exist.

Question: In your opinion, what else should we be doing to mitigate systemic risk within the derivatives market?

Response: As you know, the Dodd-Frank Act gave the Commission and the CFTC, and the federal banking regulators, new responsibilities for, among other things, over-the-counter derivatives. These include measures designed in part to promote financial stability and strengthen our financial system. Tackling systemic risk in most areas, of course, requires a broader program beyond any particular agency's jurisdiction and authority as risks that could cascade through our financial system could impact a range of market participants, many of whom, for example, the Commission does not oversee. To that end, the Financial Stability Oversight Council, established by the Dodd-Frank Act, provides an important forum for studying and identifying systemic risks across different markets and market participants.

In those areas where the Commission has regulatory authority, we are seeking to address systemic risk and other concerns that may arise from activity in our markets, making full use of the tools we have to address risk within the U.S. financial system. In particular, the Commission's rules under Title VII are designed to mitigate significant risks to the U.S. financial system, bring transparency to previously opaque bilateral markets, and provide critical new protections for security-based swap customers and counterparties without unnecessarily burdening smaller participants. For example, the Commission's rules requiring registration as a security-based swap dealer under Title VII of Dodd-Frank focus on the relatively small number of large firms in which security-based swap dealing activities are concentrated and that are most likely to pose risks to the financial system as a whole. Under the final rules, market participants are required to count certain security-based swap dealing transactions towards thresholds that, if reached, will require them to then register with the Commission as either a security-based swap dealer or a major security-based swap participant. These rules are designed, in part, to identify market participants that may be systemically important or that may significantly impact the U.S. financial system.

A number of additional requirements will apply to these entities once they register with the Commission. In April, we adopted rules requiring security-based swap entities to comply with various provisions designed to enhance transparency, facilitate informed customer decision-making, and heighten standards of professional conduct, which should serve some risk-mitigation function in these markets. Our near-term focus is on standing up the remainder of the regulatory regime for these entities, including several requirements that are key to reducing risks in the U.S. financial system, such as rules establishing capital and margin requirements and comprehensive books and records requirements.

Another near-term focus is completing the regulatory reporting and public dissemination regime for security-based swaps, including considering amendments to Regulation SBSR, and considering taxonomy and data access rules. Regulatory reporting requirements, in particular, will give the Commission and other regulators a much-needed view of the security-based swap markets, including of developments that may indicate risk-related issues that warrant careful monitoring and/or regulatory or supervisory action.

Financial Advisor Misconduct

I'm concerned with the results of a recent study conducted by researchers at the University of Chicago and University of Minnesota, which found that 7 percent of active financial advisers have been disciplined for misconduct or fraud. The study also found that of the advisers who have engaged in misconduct, 38 percent are repeat offenders.

Question: Chairwoman White, are you aware of this findings from this study, and can you please explain in detail what the SEC is currently doing or is proposing to do to prevent financial advisers with a history of misconduct from continuing to provide financial advice?

Response: I am aware of the findings of this study. The SEC has taken several steps to prevent financial advisers with a history of misconduct from continuing to provide financial advice. Identifying misconduct by brokers and holding them accountable continues to be an enforcement priority for the SEC, and we regularly investigate and bring actions against individual brokers and their firms for misconduct that violates the federal securities laws. In these cases, the SEC routinely obtains orders barring or suspending these brokers from the industry. We also regularly bring follow-on actions in administrative proceedings to bar or suspend brokers from the industry based on criminal convictions, civil injunctions and other orders.

In addition, the Enforcement Division's Broker Dealer Task Force is working to proactively identify misconduct by firms and brokers by using big data to find churning and excessive trading patterns, which are often practices engaged in by dishonest brokers. We expect to see cases resulting from this initiative soon. In addition to deploying new tools to help identify churning and excessive trading, the task force is helping to lead a joint working group with the Office of Compliance Inspections and Examinations to share investigative strategies, research, and potential new approaches in these matters.

OCIE also has identified "Recidivist Representatives and their Employers" as a key examination priority in 2016, committing to assess the compliance oversight and controls of investment advisers that have employed such individuals after they have been disciplined or barred from a broker-dealer. In addition, FINRA is on the front lines of this issue, and OCIE oversees FINRA to help it effectively police misconduct by financial advisers.

Short Position Transparency

Nasdaq and NYSE have filed petitions for rulemaking asking the SEC to promulgate rules that would require disclosure of short positions in parity with the existing required disclosure of long positions. While appropriate shorting can support stable, liquid markets, it is also important that there is adequate transparency around short positions so that growing companies and investors are not harmed.

Question: What are your thoughts on the current state of transparency with regard to short positions?

Response: Short sale data that is currently publicly available, free or on a fee basis, includes daily short sale volume and transaction data, short interest data, and fails to deliver data. Several SROs publish on their web sites aggregate short selling volume in each individual equity security for that day and, on a one-month delayed basis, information regarding individual short sale transactions in all exchange-listed equity securities. The SROs also publish statistics on short interest twice a month in securities that trade on their markets. The Commission publishes on its web site fail to deliver information twice per month for all equity securities. It is important that short sale data strikes the right balance between disclosure necessary to protect investors while preserving the benefits of price discovery and liquidity that short selling brings to the market, and staff continues to carefully consider, as part of Dodd-Frank Act Section 929X in conjunction with the recent Commission staff study of real-time short sale disclosure required by Dodd-Frank Act Section 417, whether additional transparency may be warranted.

Question: How do you believe the SEC can act to ensure an equitable disclosure regime for short and long investors?

Response: In comparing disclosure regimes for short and long investors, it is important to consider the different purposes that such requirements would seek to address. For example, public disclosure of long positions provides information regarding persons that may have potential influence over, or control of, the issuer. Similar disclosure of short positions would not provide such information. As part of Dodd-Frank Act Section 929X, staff is considering issues related to short sale disclosure, including, but not limited to, those addressed in the Commission staff study required by Dodd-Frank Act Section 417 that reviewed, among other things, real-time short sale position reporting.

Precision of Form PF

In July of last year, the Office of Financial Research issued a working paper, *Gauging Form PF: Data Tolerances in Regulatory Reporting on Hedge Fund Risk Exposures*, which examined the precision of Form PF as an instrument for measuring market risk exposures in the hedge fund industry.

It found that funds with identical Form PF filings could have vastly different risk exposures. Because Form PF allows such significant tolerance for risk exposures to differ among funds, the form does not adequately reflect these differences. It also found that the reporting of value at risk (Form PF Question 40) helps significantly to narrow the measurement tolerances. However, reporting value at risk calculations are currently optional.

Question: What percentage of hedge funds currently report value at risk (VaR) calculations on their Form PF?

> **Response:** Form PF only requires "Qualifying Hedge Funds" to report VaR, and generally defines a Qualifying Hedge Fund as "[a]ny hedge fund that has a net asset value (individually or in combination with any feeder funds, parallel funds and/or dependent parallel managed accounts) of at least $500 million as of the last day of any month in the fiscal quarter immediately preceding your most recently completed fiscal quarter." As of September 30, 2015, there were 1,625 Qualifying Hedge Funds reporting on Form PF, but not all of these funds reported VaR.

Question: What are your thoughts on setting a standard for acceptable methodologies for VaR calculations on Form PF, and making the reporting of VaR mandatory for all hedge funds?

> **Response:** When the Commission and the U.S. Commodity Futures Trading Commission (CFTC) jointly adopted Form PF in 2011, the commissions considered mandating a standard VaR methodology for private funds, but ultimately declined to do so. The adopting release noted that "in order to minimize the reporting burden associated with [Form PF Question 40], we are not requiring that all advisers calculate VaR using a standardized set of assumptions. Although this approach may, as the commenter suggested, reduce the ability of regulators to make comparisons across hedge funds using this data, we believe that it will also provide valuable risk information with respect to individual funds."[1] Some commenters to the Form PF proposal noted that hedge fund advisers that rely on VaR to help manage their risk exposures tend to use quite different methodologies to calculate their VaR. The staff continues to evaluate the information collected on Form PF filings and is considering whether to recommend amendments to the Form.

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[1] *Reporting by Investment Advisers to Private Funds on Form PF*, Investment Advisers Act Release No. 3308 (Oct. 31, 2011), 76 FR 71128, 71150 n.267 (Nov. 16, 2011) (S7-05-11).

Question: How effective do you think Form PF is in assessing systemic risk in the private fund industry, and do you have any suggestions for improving the form?

Response: As I have said, "one of the most fundamental post-crisis changes for all of the financial regulators, including the Commission, has been an emphasis on addressing risks that could have a systemic impact on the securities markets or the financial system as a whole."[2] To that end, the Commission and the CFTC "designed Form PF . . . to provide FSOC [Financial Stability Oversight Council] with information important to its understanding and monitoring of systemic risk in the private fund industry."[3] Form PF provides important and necessary information for regulators to consider when assessing potential systemic risks. For example, Form PF data provides information about leverage across the private funds industry and can identify private funds that appear to be outliers in their degree of reported leverage.

As the staff has continued to work with and analyze the data we collect from Form PF filings, the staff also considers whether to recommend amendments to the Form. For example, in 2014, the Commission adopted Form PF amendments, in conjunction with the amended rules that govern money market mutual funds, which require a large liquidity fund adviser to report substantially the same portfolio information on Form PF as registered money market funds are required to report on Form N-MFP. In considering whether potential changes to the form could enhance its effectiveness as a regulatory tool for monitoring systemic risk and protecting investors, the staff also considers, among other things, the costs of any amendments to the form for the private fund advisers who have devoted resources to developing and implementing systems to report the data sets required by the form.

[2] Chair Mary Jo White, Enhancing Risk Monitoring and Regulatory Safeguards for the Asset Management Industry (Dec. 11, 2014), *available at* https://www.sec.gov/News/Speech/Detail/Speech/1370543677722.

[3] Investment Advisers Act Release No. 3308, 76 FR 71128, 71131.

EXHIBIT A

EXCERPT FROM INVESTMENT COMPANY REPORTING MODERNIZATION PROPOSING RELEASE

Economic Analysis: Option for Website Transmission of Shareholder Reports

a. *Introduction and Economic Baseline*

As discussed above, the Commission is proposing new rule 30e-3 under the Investment Company Act, which would permit, but not require, a fund to satisfy requirements under the Act and rules thereunder to transmit reports to shareholders if the fund meets certain requirements. These requirements include making the reports and certain other materials accessible on its website and periodically notifying investors of the materials' availability.[1] Funds that do not maintain websites or that otherwise wish to transmit shareholder reports in paper or pursuant the Commission's existing electronic delivery guidance would continue to be able to satisfy the transmission requirements by those transmission methods.

The current set of requirements under which funds transmit shareholder reports to investors is the baseline from which we will discuss the economic effects of proposed rule 30e-3. The baseline also includes the current practice of many funds to make some or all of these reports—or other materials listing portfolio investment information such as reports on Form N-Q—accessible on their own websites. The baseline also reflects that some funds transmit these materials electronically today, pursuant to Commission guidance that permits such a transmission method on a shareholder-by-shareholder "opt in" basis, provided that certain other conditions are met.[2] The parties that could be affected by new rule 30e-3 are funds that currently are or would be required to transmit shareholder reports under rule 30e-1 or 30e-2, and other current and future users of fund portfolio investment information, including investors and third-party information providers.

Today, most funds are required to disclose their portfolio holdings on a quarterly basis, with holdings as of the end of the second and fourth fiscal quarters disclosed in the fund's semiannual and annual reports, respectively, and holdings as of the end of the first and third fiscal quarters disclosed in reports on Form N-Q. Funds are generally required to transmit reports to shareholders on a semiannual basis, and these reports have historically been paper copies mailed to shareholders.[3] As of December 31, 2014, about 11,957 funds could rely on proposed rule 30e-3 if it were in effect.[4] As discussed in detail below, we estimate that these funds—and their shareholders—bear aggregate annual paperwork expenses of about $616 million in connection with the required preparation and transmission of shareholder reports (or about $51,539 for each

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1 *See supra* Part II.D.

2 *See supra* note 289 and accompanying text.

3 *See supra* note 288 and accompanying text.

4 *See infra* note 799 and accompanying text.

portfolio).[5] Of those estimated expenses, we estimate that about $116 million are associated with the printing and mailing of shareholder reports.[6] Reports on Form N-Q are available on EDGAR.[7] Some funds choose to make some or all of these reports—or other materials listing portfolio holdings at particular times—accessible on their own websites, but funds do not do so uniformly.

As technology has developed, so has the need to modernize the manner in which shareholder reports and portfolio investment information are delivered to investors. As discussed above, recent investor testing and Internet usage trends have highlighted that investor preferences about electronic delivery of information have evolved, and that many investors would prefer enhanced availability of fund information on the Internet.[8] In addition, investor testing has suggested that fund investors are much more likely to seek out fund information on the fund's own website than they are to seek it out on EDGAR.[9] Moreover, searching for and retrieving individual reports on Form N-Q on EDGAR may, in many cases, be more difficult than navigating a website with which the investor is likely to be already familiar. We therefore believe that many investors may not view the information that is available in reports on Form N-Q. Shareholders also pay, *pro rata*, the expenses associated with printing and mailing reports by default to shareholders, who may nonetheless prefer electronic transmission.

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5 As discussed below, we previously estimated 994,960 aggregate annual internal burden hours associated with rules 30e-1 and 30e-2. *See infra* notes 853 and 855 (estimating 903,000 hours for rule 30e-1 and 91,960 hours for rule 30e-2). The Commission estimates the wage rate associated with these burden hours based on salary information for the securities industry compiled by the Securities Industry and Financial Markets Association. The estimated wage figure is based on published rates for attorneys and intermediate accountants, modified to account for an 1,800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead, yielding an effective hourly rate of $268.50. This estimate is based upon the following calculation: ($380 per hour for Attorneys × 0.5) + ($157 per hour for Intermediate Accountants × 0.5) = $268.50. *See* Securities Industry and Financial Markets Association, Report on Management & Professional Earnings in the Securities Industry 2013. Based on the Commission's estimate of 994,960 burden hours per year and the estimated wage rate of about $268.50 per hour, the total annual paperwork expenses for funds associated with the internal hour burden of rules 30e-1 and 30e-2 are approximately $267,146,760. This estimate is based upon the following calculation: 994,960 hours × $268.50 per hour = $267,146,760. We have also estimated aggregate annual external cost burden of $349,105,750 associated with rules 30e-1 and 30e-2. *See infra* notes 854 and 856 (estimating $333,905,750 for rule 30e-1 and $15,200,000 for rule 30e-2). Therefore, we estimate that the total estimated aggregate annual paperwork expenses associated with rules 30e-1 and 30e-2 are $616,252,510. This estimate is based upon the following calculation: $267,146,760 expenses associated with internal burden hours + $349,105,750 external cost burden = $616,252,510. Using this estimate and our prior estimate of 11,957 funds, we estimate that annual paperwork expenses associated with rules 30e-1 and 30e-2 are about $51,539 on a per-portfolio basis. This estimate is based upon the following calculation: $616,252,510 aggregate annual paperwork expenses ÷ 11,957 funds = $51,539.

6 We estimate that one-third of the external costs attributed to rules 30e-1 and 30e-2 relate to printing and mailing expenses. *See infra* notes 857–858. Therefore, we estimate aggregate annual printing and mailings costs associated with those rules of about $116,368,583. This estimate is based upon the following calculation: $349,105,750 aggregate external cost burden ÷ 3 = $116,368,583.33.

7 *See supra* notes 637–642 and accompanying text.

8 *See supra* note 292 and accompanying text.

9 *See supra* note 292 and accompanying text.

The economic effects of proposed rule 30e-3 are dependent on a number of factors, including the number of funds that would rely on the rule, the number of funds which currently rely on Commission guidance to transmit shareholder reports electronically, and the extent to which shareholders become more aware of the availability of portfolio investment information, view the information, and use the information to make investment decisions. Due to the optionality of the rule, we would expect that, in general, each fund would only rely on the rule if the benefits to that fund exceeded the costs. We have provided estimates of the costs associated with printing and mailing shareholder reports. However, information that would allow the Commission to quantify the other economic effects of the rule, such as how the availability of shareholder reports online will affect investors' use of the information, is not known to us.

Funds can transmit shareholder reports electronically today pursuant to Commission guidance. However, funds wishing to rely on this Commission guidance must satisfy certain conditions, including that shareholders agree to electronic transmission on a shareholder-by-shareholder "opt in" basis. We recognize that express shareholder consent can be difficult to obtain even for practices that many shareholders may prefer.[10] The number of funds that transmit shareholder reports electronically today is unclear to us, because funds are not required to report their reliance on the Commission's electronic delivery guidance or the number of investors that have given opt-in consent to receive electronic delivery. Commission staff is also not aware of information that describes the prevalence of electronic delivery of disclosure documents and other information. In addition, although survey evidence describes certain investor preferences regarding electronic delivery of shareholder report information,[11] we are not aware of information that would describe the effect of this rule on investor ability to choose between funds and allocate capital across all investments. For these reasons, much of the discussion below is qualitative in nature.

b. *Benefits*

The proposed rule, to the extent that it is relied upon by funds and alters the current transmission of reports, would increase the accessibility of portfolio investment information including information from the first and third fiscal quarters that might otherwise be only available on EDGAR. The proposed rule would thereby increase the awareness of fund shareholders of the availability of portfolio investment information, and therefore also increase the likelihood that fund investors review portfolio investment information. The proposed rule would also increase the likelihood that fund shareholders view the portfolio investment information in their preferred format, and thereby increase their use of the information to make investment decisions.[12] Similar to the introduction of Form N-PORT and the amendments to Regulation S-X, greater investor use of shareholder reports could result in more informed investment decisions, particularly for individual investors, and an increase in competition among funds for investor capital. A greater understanding of the investment strategy of the fund, its

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[10] *See* Investment Company Act Release No. 22884 (Nov. 13, 1997) [62 FR 61933, 61935 (Nov. 20, 1997)] (concerning implied consent to delivery of disclosure documents to households).

[11] *See supra* note 292 and accompanying text.

[12] *See supra* notes 291–296 and accompanying text (concerning investor Internet usage statistics and transmission method preferences).

portfolio composition, and its investment risks could also result in a more efficient allocation of capital across funds and other investments, and could thereby promote capital formation.

Funds and their shareholders would also benefit from a reduction in expenses related to the physical distribution of shareholder reports. Although the proposed rule would not have much of an effect, if any, on the expenses associated with the preparation of reports, we expect that the expenses associated with printing and mailing of shareholder reports would be substantially reduced if the rule is adopted. As discussed in detail below, of the estimated $116 million in annual paperwork expenses associated with the printing and mailing of shareholder reports,[13] we estimate that about $105 million would be eliminated if the proposed rule were adopted.[14] The actual reduction in paperwork expenses would depend, in part, upon reliance on the proposed rule by funds and the extent of shareholder consent to electronic transmission of reports, each of which is uncertain.

The expected benefits would not necessarily be distributed uniformly across funds and across a fund's shareholders. Some funds already transmit materials electronically to some or all of their shareholders, and these funds would experience fewer benefits from electing to rely on the proposed rule. Some funds, such as funds that do not currently maintain websites, may choose not to rely on the proposed rule.

c. *Costs*

Although we believe that permitting electronic delivery "by default" would improve overall alignment of transmission method with investor preferences,[15] there may be some investors who would prefer to receive print copies that do not notify their fund of that preference and may be others that would benefit from print copies even though they prefer electronic transmission. These investors, depending on their ability and preference to access shareholder reports and

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[13] *See supra* notes 5–6 and accompanying text.

[14] We estimate that about 90% of the $116,368,583 in paperwork expenses associated with printing and mailing shareholder reports pursuant to rules 30e-1 and 30e-2 would be eliminated if rule 30e-3 were adopted. *See supra* note 6; *infra* notes 857–858. Therefore, we estimate that about $104,731,725 of annual paperwork expenses associated with rules 30e-1 and 30e-2 would be eliminated if rule 30e-3 were adopted. This estimate is based upon the following calculation: $116,368,583 in aggregate annual printing and mailing expenses × 0.90 proportion eliminated = $104,731,724.70 eliminated annual printing and mailing expenses.

[15] *See supra* note 292. We believe that the change from requiring shareholders to "opt-in" if they wish to receive electronic instead of print copies of shareholder reports, to—as under the proposed rule—"opt-out" if they wish to receive print copies instead of electronic copies would increase the ability of funds to transmit shareholder reports electronically. Although the preferences of shareholders would not change dependent on the form of consent, behavioral economic theory and empirical evidence suggest the likelihood that shareholders receive electronic transmissions of fund reports would be greater under opt-out consent rather than opt-in consent. *See, e.g.*, Richard H. Thaler and Shlomo Bernatzi, *Save More Tomorrow™: Using Behavioral Economics to Increase Employee Saving*, Journal of Political Economy, Vol. 112:1, S164-S187 (2004); Richard H. Thaler and Cass R. Sunstein, *Libertarian Paternalism*, The American Economic Review, Vol. 93:2, 175- 179 (2003). Thaler and Sunstein argue that a "status quo" bias results in the continuance of existing arrangements even if better options are available. The authors illustrate their argument with higher rates of initial enrollments in employee savings plans when enrollment is automatic as compared to when employees must first complete an enrollment form.

portfolio investment information electronically, could overlook electronic deliveries or otherwise experience a reduction in their ability to access portfolio investment information, and could result in a decrease in their ability to efficiently allocate capital across funds and other investments. We have endeavored, through the consent and notice provisions of the proposed rule, to mitigate the potential costs associated with this possibility by requiring a fund wishing to rely on the proposed rule to alert an investor before beginning to transmit reports electronically and to notify the investor around the time each report is made accessible on the website. Although, as discussed above, an increase in investor use of shareholder reports could increase competition among funds for investor capital, funds that do not rely on the rule could be placed at a competitive disadvantage depending on whether investors choose funds based on their preference for website transmission.

As discussed above, reliance on proposed rule 30e-3 would be optional, and funds that rely on the rule would incur costs to adhere to the rule. Relying funds would incur paperwork expenses associated with satisfying the conditions of the proposed rule, such as making the materials publicly accessible; preparing, reviewing, and transmitting a notice to shareholders; soliciting the consent of each shareholder by sending them an initial statement; and printing and mailing shareholder reports and other materials upon request. As discussed in detail below, we estimate that these paperwork expenses would be, in the aggregate, about $32 million each year.[16] Relying funds would also incur initial one-time costs associated with establishing systems

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[16] Below, we estimate that 10,761 funds would choose to rely on proposed rule 30e-3. *See infra* note 799 and accompanying text. Below, we estimate that funds that elect to rely on rule 30e-3 will, on average, incur 0.76 burden hours per fund per year to comply with the website accessibility conditions of rule 30e-3. *See infra* note 808 and accompanying text. Therefore, in the aggregate, we estimate that such funds would incur about 8,178 burden hours to comply with these requirements. This estimate is based upon the following calculation: 0.76 burden hours per fund × 10,761 funds expected to rely on rule 30e-3 = 8,178.36 hours. The Commission estimates the wage rate associated with these burden hours based on salary information for the securities industry compiled by the Securities Industry and Financial Markets Association. The estimated wage figure is based on published rates for senior programmers, modified to account for an 1,800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead, yielding an effective hourly rate of $303. *See* Securities Industry and Financial Markets Association, Report on Management & Professional Earnings in the Securities Industry 2013. Based on the Commission's estimate of 8,178 burden hours per year and the estimated wage rate of about $303 per hour, the total annual paperwork expenses for funds associated with the internal hour burden imposed by the website accessibility conditions of rule 30e-3 are approximately $2,477,934. This estimate is based upon the following calculation: 8,178 hours × $303 per hour = $2,477,934.

Below, we also estimate that funds that elect to rely on proposed rule 30e-3 would incur average annual external costs of $500 per fund in connection with the requirement to provide a complete shareholder report upon request of a shareholder. *See infra* note 816 and accompanying text. We estimate that aggregate external costs to funds in connection with this requirement would therefore be about $5,380,500. This estimate is based upon the following calculation: $500 per fund × 10,761 funds = $5,380,500.

Below, we also estimate that funds that elect to rely on proposed rule 30e-3 would incur about 0.38 annual burden hours in connection with the initial statement conditions of the rule. *See infra* note 829 and accompanying text. Therefore, in the aggregate, we estimate that such funds would incur about 4,089 burden hours to comply with these requirements. This estimate is based upon the following calculation: 0.38 burden hours per fund × 10,761 funds expected to rely on rule 30e-3 = 4,089.18 hours. The Commission estimates the wage rate associated with these burden hours based on salary information for the securities industry compiled by the Securities Industry and Financial Markets Association. The estimated wage figure is based on published rates for compliance attorneys, modified to account for an 1,800-hour work-year and multiplied by 5.35 to

and procedures for compliance. We estimate that these expenses would be, in the aggregate, about $16 million.[17]

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account for bonuses, firm size, employee benefits, and overhead, yielding an effective hourly rate of $334. *See* Securities Industry and Financial Markets Association, Report on Management & Professional Earnings in the Securities Industry 2013. Based on the Commission's estimate of 4,089 burden hours per year and the estimated wage rate of about $334 per hour, the total annual paperwork expenses for funds associated with the internal hour burden imposed by the initial statement conditions of rule 30e-3 are approximately $1,365,726. This estimate is based upon the following calculation: 4,089 hours × $334 per hour = $1,365,726. Below, we also estimate that these funds will incur annual cost burden of about $216 per fund to comply with the initial statement conditions. This estimate is based upon the following calculation: $49 per fund per year for services of outside counsel + $333 per year per fund to print and mail initial statements = $382 per fund per year. *See infra* notes 837 and 844. Such funds would therefore incur about $4,110,702 in aggregate annual cost burden to comply with the initial statement conditions. This estimate is based upon the following calculation: $382 per fund per year × 10,761 funds = $4,110,702 per year. Thus the total estimated annual paperwork expenses associated with the initial statement conditions are $5,476,428. This estimate is based upon the following calculation: $1,365,726 associated with internal burden + $4,110,702 external cost burden = $5,476,428.

Below, we also estimate that funds that elect to rely on proposed rule 30e-3 would incur about 1.5 annual burden hours in connection with the notice conditions of the rule. *See infra* note 832 and accompanying text. Therefore, in the aggregate, we estimate that such funds would incur about 16,142 burden hours to comply with these requirements. This estimate is based upon the following calculation: 1.5 burden hours per fund × 10,761 funds expected to rely on rule 30e-3 = 16,141.5 hours. Based on the Commission's estimate of 16,142 burden hours per year and the estimated wage rate of about $334 per hour, the total annual paperwork related expenses for funds associated with the internal hour burden imposed by the website accessibility conditions of rule 30e-3 are approximately $5,391,428. This estimate is based upon the following calculation: 16,142 hours × $334 per hour = $5,391,428. Below, we also estimate that these funds will incur annual cost burden of about $1,190 per fund to comply with the notice conditions. This estimate is based upon the following calculation: $190 per fund per year for services of outside counsel + $1,000 per fund per year to print and mail notices = $1,190 per fund per year. *See infra* notes 840 and 845 and accompanying text. Such funds would therefore incur about $12,805,590 in aggregate annual cost burden to comply with the notice conditions. This estimate is based upon the following calculation: $1,190 per fund per year × 10,761 funds = $12,805,590 per year. Thus the total estimated annual paperwork expenses associated with the notice conditions are $12,816,518. This estimate is based upon the following calculation: $5,391,428 associated with internal burden + $12,805,590 external cost burden = $18,197,018.

Thus, we estimate that the total annual paperwork expenses associated with satisfying the conditions of proposed rule 30e-3 would be $31,531,880. This estimate is based upon the following calculation: $2,477,934 associated with website accessibility conditions + $5,380,500 associated with provision of print report upon request condition + $5,476,428 associated with initial statement condition + $18,197,018 associated with notice condition = $31,531,880.

[17] Below, we estimate that funds that elect to rely on rule 30e-3 will, on average, incur an additional 0.08 one-time burden hours per fund in the first year to comply with website accessibility conditions. *See infra* notes 807–808 and accompanying text. Therefore, in the aggregate, we estimate that such funds would incur about 861 one-time burden hours to comply with these requirements. This estimate is based upon the following calculation: 0.08 hours per fund × 10,761 funds = 860.88 hours. Based on the Commission's estimate of 861 one-time burden hours and the estimated wage rate of about $303 per hour for senior programmers, the total annual paperwork expenses for funds associated with the internal hour burden imposed by the website accessibility conditions of rule 30e-3 are approximately $260,883. This estimate is based upon the following calculation: 861 hours × $303 per hour = $260,883. Below, we also estimate that about 113 funds that wish to rely on proposed rule 30e-3 but that do not currently have a website will incur one-time cost burden of $2,000 per fund to comply with the website accessibility conditions. *See infra* notes 804 and 811 and accompanying text. Such funds would therefore incur about $226,000 in aggregate one-time cost burden to comply with the website accessibility conditions. $2,000 per fund × 113 funds = $226,000. Thus the total estimated one-time

We have endeavored to mitigate the costs associated with compliance with the rule's conditions by, for example, requiring that the required schedule of portfolio investment information as of the end of the first and third fiscal quarters be presented consistent with the reporting requirements of Regulation S-X. Most funds would have established procedures in place to prepare and review such disclosures and would be familiar with the disclosure requirements. Because reliance on the proposed rule would be optional, a particular fund would not be expected to rely on the proposed rule if the costs of the rule to that fund would exceed its benefits. Funds that do not rely on the proposed rule would therefore not incur compliance costs.

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paperwork expenses associated with the website accessibility conditions are $486,883. This estimate is based upon the following calculation: $260,883 associated with internal burden + $226,000 external cost burden = $486,883.

Below, we also estimate that funds that elect to rely on rule 30e-3 will, on average, incur an additional 0.92 one-time burden hours per fund in the first year to comply with the initial statement conditions. *See infra* notes 828–829 and accompanying text. Therefore, in the aggregate, we estimate that such funds would incur about 9,900 one-time burden hours to comply with these requirements. This estimate is based upon the following calculation: 0.92 hours per fund × 10,761 funds = 9,900.12 hours. Based on the Commission's estimate of 9,900 one-time burden hours and the estimated wage rate of about $334 per hour, the total annual administrative expenses for funds associated with the internal hour burden imposed by the initial statement conditions of proposed rule 30e-3 are approximately $3,306,600. This estimate is based upon the following calculation: 9,900 hours × $334 per hour = $3,306,600. Below, we also estimate that these funds will incur one-time cost burden of $762 per fund to comply with the initial statement conditions. This estimate is based upon the following calculation: $95 per fund for the services of outside counsel + $667 per fund to print and mail initial statements = $762 per fund. *See* notes 836–843 and accompanying text. Such funds would therefore incur about $8,199,882 in aggregate one-time cost burden to comply with the initial statement conditions. This estimate is based upon the following calculation: $762 per fund × 10,761 funds = $8,199,882. Thus the total estimated one-time paperwork expenses associated with the initial statement conditions are $11,506,482. $3,306,600 associated with internal burden + $8,199,882 external cost burden = $11,506,482.

Below, we also estimate that funds that elect to rely on rule 30e-3 will, on average, incur an additional 0.8 one-time burden hours per fund in the first year to comply with the notice conditions. *See infra* notes 831–832 and accompanying text. Therefore, in the aggregate, we estimate that such funds would incur about 8,609 one-time burden hours to comply with these requirements. This estimate is based upon the following calculation: 0.8 hours per fund × 10,761 funds = 8,608.8 hours. Based on the Commission's estimate of 8,609 one-time burden hours and the estimated wage rate of about $334 per hour, the total annual paperwork expenses for funds associated with the internal hour burden imposed by the notice conditions of proposed rule 30e-3 are approximately $2,875,406. This estimate is based upon the following calculation: 8,609 hours × $334 per hour = $2,875,406. Below, we also estimate that these funds will incur one-time cost burden of $95 per fund to comply with the notice conditions. *See infra* notes 839–840 and accompanying text. Such funds would therefore incur about $1,022,295 in aggregate one-time cost burden to comply with the initial statement conditions. This estimate is based upon the following calculation: $95 per fund × 10,761 funds = $1,022,295. Thus the total estimated one-time paperwork expenses associated with the notice conditions are $3,897,701. This estimate is based upon the following calculation: $2,875,406 associated with internal burden + $1,022,295 external cost burden = $3,897,701.

Thus, we estimate that the total one-time paperwork expenses associated with satisfying the conditions of proposed rule 30e-3 would be $15,891,066. This estimate is based upon the following calculation: $486,883 associated with website accessibility conditions + $11,506,482 associated with initial statement condition + $3,897,701 associated with notice condition = $15,891,066.

WEDNESDAY, MARCH 16, 2016.

DEPARTMENT OF THE TREASURY

WITNESS

HON. JACOB J. LEW, SECRETARY, DEPARTMENT OF THE TREASURY

Mr. CRENSHAW. Well, if everybody is ready, we will get started. This hearing will come to order. Good morning. I would like to welcome our witness, Secretary Jack Lew, Secretary of the Treasury.

Today, we look forward to discussing the Department's own budget request, as well as, some of the assumptions and policies included in the President's overall request for fiscal year 2017.

Last month, we had a very loud discussion with OMB Director Shaun Donovan about the debt generated by the President's budget. While there is more than one way to measure the size and the effect of debt on the economy, in the simplest terms, the President's budget spends more than it takes in, and that results in more debt.

This debt is an economic burden that must be repaid by our grandchildren and their grandchildren because the President's final budget does not address the unavoidable question of how to distribute the economic cost of an aging population across the generations.

The Federal debt, in gross terms, exceeds $20 trillion for the first time in our Nation's history. It took 233 years to get to this first $10 trillion in debt, and it only took 8 years to get to the next $10 trillion. And because of this, Mr. Secretary, I wanted you to think back to your first tenure as the OMB director, when you predicted that the United States would be debt free by 2013.

Now, obviously, a lot has changed since then, but the formula for retiring debt has not. Spending as a percentage of GDP must be lower than its historical average, and revenue as a percentage of GDP must be higher than its historical average. The budget before us, however, projects that both spending and revenue, as a percentage of GDP, will remain above the historical averages through 2026. In other words, this budget is a permanent source of debt.

Growing along with the debt is Treasury's own budget request for the fiscal year 2017. The Treasury Department is requesting a massive 12 percent increase, including $1 billion, or a 9 percent increase for the IRS. Instead of making some tough choices, it seems that Treasury proposes unrealistic increases, budget gimmicks, and new mandatory spending.

I believe the IRS request is unrealistic. They have not received either a dollar or a percentage increase of that magnitude in the last 20 years. The IRS request assumes a discretionary cap adjustment that the budget committees have rejected for 5 consecutive years.

In addition, the Treasury seeks to spend an additional $8.5 billion outside of the appropriations process. The request also proposes a new cybersecurity enhancement account to the tune of $110 million. Without a doubt, cyber threats are real and they are serious, and the committee has been continually supportive of funding for cybersecurity as a part of the agency's annual budget request. However, I would caution the administration against the temptation to create an endless number of new accounts across government spending, and calling that a cybersecurity plan in order to get new funding for an old problem.

Make no mistake, we must harden our Nation's information technology infrastructure, but it should be done with a critical eye. New programs with new names aren't going to solve the Federal Government's perpetually out-of-date, over budget, behind schedule, information technology.

I hope, with further discussion today, we can find some common ground to work on together. As you know, a matter of great interest to me, and concern to me, is the Financial Stability Oversight Council's process for designating systemically important financial institutions and, in particular, nonbanks.

Following up on our conversation from last year, I hope we can shed some light on how FSOC has improved transparency with regard to entities under consideration for SIFI designation as we adopted last year.

Another issue that was important, I would like to bring to your attention, is that in the 2016 Omnibus, we required the SEC's division of economic and risk analysis to report back to this committee within a year of enactment on the combined impact of the Volcker rule, Basel III, and other financial regulations, what kind of impact they have had on access to capital for consumers, investors, and businesses, and the impact on market liquidity.

I look forward to reading that report later this year, but in the meantime, I hope we can talk a little bit about how you will work with the SEC economists, if and when asked. I have serious concerns that the cumulative effect, of these layers of regulations, have resulted in an alarming lack of liquidity in U.S. markets, particularly in fixed income markets.

I believe we need to continue to monitor this issue closely, and I look forward to discussing these concerns with you today.

And finally, let me say one thing about the Omnibus last year. We included an additional $5 million for Treasury's Alcohol and Tobacco Tax and Trade Bureau. That was to expedite the label and formula processing. And I believe that by appropriating these funds for the Bureau, we can help countless small businesses that depend on the Treasury for approval of their labels and formulas to get their products to market.

Mr. Secretary, I hope this funding makes it clear that this is a priority for Congress. I know it is a priority of our full committee's chairman, and I hope the Department will assist the Bureau in accomplishing their mission.

So again, I want to thank you for taking the time to meet with us, Secretary Lew. I look forward to your testimony, but first let me turn to the ranking member, Mr. Serrano, for any opening statement he might make.

Mr. SERRANO. Thank you, Mr. Chairman. And I would like to join you once again in welcoming Secretary Lew before the subcommittee to discuss the Department's budget request for fiscal year 2017.

The Treasury Department plays a broad and important role in guiding our economy, ensuring a fair Federal tax code, managing our Nation's finances, promoting economic opportunity, and conducting important international activities. You provide assistance and leadership in a number of diverse roles, and I thank you for all your efforts.

One area where your continued leadership is desperately needed is on the island of Puerto Rico. The Treasury Department has been playing a leading role in helping to address the fiscal and economic crisis on the island. Last year's Omnibus bill included language allowing Treasury to provide technical assistance to Puerto Rico to help it work on ways to balance its books and improve its economy.

While this is a good step, and I hope we will discuss it today, it is clear that more needs to be done by Congress on this issue. The humanitarian toll this is taking on American citizens is truly appalling. The Speaker has committed to action, and I expect him to keep his word.

Let me just mention that again, Mr. Chairman, because unfortunately, there are too many Members of Congress and the American people who don't know that everyone who was born in Puerto Rico is an American citizen.

A significant contributor to the island's fiscal woes is its continued inequitable treatment under numerous provisions of both the Federal tax code and the Federal grant programs. Your budget request proposes to remedy one of these issues by creating a mandatory funding stream that would essentially allow working families in Puerto Rico to receive the Earned Income Tax Credit, something that no one living on the island is currently eligible for. I commend you for this proposal and believe it will provide some relief for families on the island.

Beyond this vital issue, your fiscal year 2017 budget request includes new funding for the Community Development Financial Institutions fund. The CDFI fund has helped entities invest billions of dollars in economically underserved areas, including, in my district in the Bronx. I commend you for a new initiative proposed within this program this year, the small dollar loan, which will help reduce reliance on the payday lenders. Access to mainstream financial services is a serious problem in the Bronx and elsewhere, so I think this new effort is a great program and a great potential.

Now, as I have said to you privately and publicly, this CDFI is a great program, and to strengthen it is really going in the right direction. Your budget request also builds on last year's increases for the IRS providing for further investment and to try and better address enforcement and service priorities.

Although I am pleased that we were able to get a significant increase for the agency, the IRS has still lost thousands of employees over the past several years, and its budget is still 19 percent below fiscal year 2010. These reductions have made it significantly more difficult for the agency to help those with questions and to go after

tax cheats. Your budget request helps restore capacity at the IRS, which is important in ensuring the fiscal health of our Nation.

Lastly, I do, also want, to mention the Department's central role in reforming our policies towards Cuba. Treasury issued new travel regulations yesterday in advance of the President's trip there, and I hope we will get a chance to discuss these further.

The impact of your Department's policies, in all of these areas, show just how central the Treasury Department is to our Nation's economy, our government's fiscal health, and our communities' economic opportunities. I think the Department has done a great job in all of these areas in the past 8 years, and I want to commend you, Secretary Lew, for a job well done over the past 3.

If I had the ability to keep people around for the next administration, you would be at the top of my list for many, many reasons, but I didn't win any of the primaries, so I am not involved in this.

But I just want to finish up by saying you have been a great friend of the Commonwealth of Puerto Rico, and any, any help that you can continue to lend, because it is sad, and it is sad that the public is not aware of what is happening, and as you know, anything that happens in Puerto Rico affects Wall Street, affects New York, affects the United States, where there are 5 million Puerto Ricans living, and they are part of who we are. They are part of the system.

I was born there, as you know, and the most important point to me is that the suffering is affecting veterans in Puerto Rico at the veterans' hospitals and elsewhere. And at the minimum, we should stick to our word that we never turn our back on veterans, and those veterans in Puerto Rico are as much veterans as they are anywhere else in the country.

So I thank you for your help to the whole island and especially to the veterans. Thank you. Thank you, Mr. Chairman.

Mr. CRENSHAW. Thank you. And our chairman of the full committee, Mr. Rogers, is en route, and when he arrives, if he wants to make an opening statement, we will recognize him.

But right now, Mr. Secretary, we recognize you for your opening statement. If you could keep your remarks in the neighborhood of 5 minutes and you can submit your full statement for the record, but please proceed.

Secretary LEW. Thank you very much, Chairman Crenshaw, Ranking Member Serrano, members of the committee. I appreciate this opportunity to testify on the Treasury's 2017 budget request.

Thank you for the kind words, Congressman Serrano, but as I hope you can understand, I look forward 10 months from now living full-time in the Bronx again.

Since my testimony last year, our economy has continued its record breaking streak of private sector job creation, which has reached 6 consecutive years, and 14.3 million jobs. Over the last 2 years, we have experienced the strongest job creation since the late 1990s. At 4.9 percent, the unemployment rate is half of its 2009 peak, and we continue on a sound fiscal path from fiscal year 2009 to 2015. The deficit as a share of gross domestic product (GDP) fell by almost three-quarters from roughly 10 percent to 2-and-a-half percent.

And Mr. Chairman, I appreciate your comments about the performance of the budget during the years that I was OMB director in the 1990s, and I did, in 2001, project a surplus of over $5 trillion for the upcoming 10-year period. Obviously policies changed after that, and when I came back to the Office of Management and Budget (OMB), it was a very different situation because the money had been spent on things like tax cuts, and new benefits, and wars, and then we had a financial crisis. What this administration has done is put our country back on a path of fiscal responsibility, and I look forward to having a chance to discuss that.

The passage of the Omnibus spending bill in December has helped really build on the momentum in our economy now. It has really contributed to economic growth, and it has also helped us rebuild our international leadership. The agreement, I think in another way, demonstrates that we still have the capacity of finding common ground on difficult issues. It lays the foundation for addressing some of our long-term challenges, but there is a lot of work that still remains, and that is why this year's budget includes critical investments in both our domestic and national security programs.

Treasury's 2017 budget makes investments in cybersecurity and infrastructure and financial intelligence activities, including efforts that are directed at ISIL. It also includes strategic investments in the IRS so that the agency can return to providing the level of customer service and privacy protection that Americans expect and deserve. It is important to investments in America's small businesses, in distressed communities, to help grow the economy and ensure that all Americans benefit from growth.

Finally, the 2017 Treasury budget makes a number of investments to support the ability of both our domestic and international offices to further Treasury's mission.

Cybersecurity is an urgent challenge facing the country and the Treasury Department. Our budget proposes a new $110 million department-wide cybersecurity investment account to enhance information technology (IT) management across our bureaus and improve our ability to protect against, and respond to, cyber threats.

The proposed investments will enhance electronic authentication procedures for access to Treasury digital services, expand existing security systems on internal networks and public websites, and safeguard data across the Department.

The fiscal year 2017 budget also includes strategic investments in the Internal Revenue Service (IRS) to improve service to tens of millions of taxpayers, to reduce the deficit through more effective tax administration, and to provide privacy protections that Americans expect and deserve.

I appreciate the increase provided by Congress in fiscal year 2016, but as many of you are aware, the IRS remains severely underfunded. Despite its crucial role and growing responsibilities, the IRS budget is nearly $1 billion lower than it was in fiscal year 2010, while the volume of income tax return filings has increased by nearly 7 percent. Budget reductions at the IRS cost the country billions of dollars each year in lost revenue, contribute to inadequate customer service for taxpayers, and leave necessary cybersecurity protections underfunded.

A sustained deterioration in taxpayer service, combined with diminished enforcement capacity, could create serious long-term risks for the U.S. tax system. Our request provides a $530 million increase above the 2016 enacted levels. With these investments, the IRS will increase staffing for traditional taxpayer services, improve the quality of assistance available to taxpayers, who call the IRS, and bolster defenses against stolen identity refund fraud.

In fiscal year 2015, full year telephone level of service plunged to just 38 percent. With the additional funding that we received in 2016, we expect to reach 47 percent this year, and with full funding in the 2017 budget, we could bring that level back to 70 percent.

The budget also invests in new IT architecture that will enable the IRS to continue to modernize and secure its online services, and provide taxpayers with an experience comparable to what they have come to expect from financial institutions. Treasury's request also proposes an additional $515 million increase through a program integrity cap adjustment, to increase enforcement of current tax laws, investigate transnational organized crime, root out abusive tax schemes, and enforce the Foreign Account Tax Compliance Act (FATCA).

These targeted investments are expected to return roughly $6 to the government for every $1 invested and reduce the deficit by $46 billion over a 10-year budget window. In fiscal year 2017, Treasury outlined key investments in evidence-based programs that will support America's small businesses, working families, and distressed communities.

I would like to focus on one in particular. I share the concerns that Congressman Serrano raised with regard to Puerto Rico. I very much appreciate the committee's inclusion of technical assistance authority for Puerto Rico in last year's funding bill, but more does need to be done. Puerto Rico's economy continues to suffer. Its unemployment remains above 12 percent. Its debt is unsustainable, and out migration continues to accelerate.

The administration has proposed a comprehensive plan to address Puerto Rico's financial challenges, and we encourage Congress to act with the haste that this crisis requires with legislation that will allow financial restructuring along with new oversight, neither of which cost any taxpayer dollars.

The budget also proposes a $600 million annual allotment index to inflation to create a refundable locally administered Earned Income Tax Credit for residents of Puerto Rico. Unlike Americans living in the 50 States and the District of Columbia, residents of Puerto Rico are not eligible for the Earned Income Tax Credit (EITC), and it would increase employment in Puerto Rico's formal economy, as well as improve the Commonwealth's tax compliance and tax revenue.

Finally, the fiscal year 2017 Treasury budget makes a number of investments to support the ability in both our domestic and international offices to further Treasury's mission. While not under this subcommittee's particular jurisdiction, I want to highlight Treasury's international programs budget request. It provides a cost-effective way to promote international financial stability and to continue U.S. leadership in international development, advance na-

tional security, and expand export markets for American businesses.

In closing, I want to take the opportunity to thank the talented team of public servants at the Treasury Department. I am proud to represent them here today, and on behalf of these hard working men and women, I want to say how much we appreciate the continued support of this committee.

Thank you very much, and I look forward to your questions.

[The information follows:]

EMBARGOED FOR DELIVERY

Jacob J. Lew
Secretary, United States Department of the Treasury
Testimony before the House Committee on Appropriations
Subcommittee on Financial Services and General Government
March 16, 2016

Chairman Crenshaw, Ranking Member Serrano, members of the subcommittee, thank you for inviting me to speak about Treasury's Budget Request for fiscal year 2017.

I want to begin by acknowledging the bipartisan passage of the omnibus spending bill in December, which is already contributing to our economic growth and rebuilding our leadership internationally. This agreement demonstrates that we have the capacity to find common ground on difficult issues and lays a foundation for addressing some of our long-term challenges. Over the past seven years under the President's leadership, we have seen a sustained economic recovery and an unprecedented decline in the federal budget deficit. But more work remains to make sure we are upholding the basic American belief that everyone who works hard gets a fair shot at success. In recognition of this, the FY 2017 President's Budget puts forward the building blocks of a social compact for the 21st century and creates the conditions for sustained economic growth. The budget also makes critical investments in our domestic and national security priorities while adhering to the bipartisan budget agreement signed into law last fall, and it lifts sequestration in future years so that we continue to invest in our future.

Within these constraints, the FY 2017 Treasury Budget supports key Administration priorities to (i) further our national security interests, (ii) to invest in Treasury's cybersecurity infrastructure and financial intelligence activities—including efforts directed at ISIL—and (iii) to make strategic investments in the IRS to provide the level of customer service and privacy protections that Americans expect and deserve. And it supports investments in America's small businesses and distressed communities to help grow the economy and ensure that all Americans benefit from growth. Finally, the FY 2017 Treasury Budget makes a number of investments to support the ability of both our domestic and international offices to further Treasury's mission.

Investing in Cybersecurity

Cybersecurity is one of the most urgent challenges facing the Treasury Department and the country. Treasury's Budget Request proposes a new $110 million department-wide cybersecurity enhancement account to focus Treasury's cybersecurity efforts, improve IT management across our bureaus, and increase our ability to protect against and respond to cyber threats. The proposed investments will enhance electronic authentication procedures for access to Treasury digital services, expand existing security systems on internal networks and public websites, and safeguard data across the department.

Investing in National Security and Protecting the Financial System

Treasury's financial intelligence, sanctions policy, and enforcement activities support U.S. national security interests and help protect the financial system from illicit use. Treasury's request provides $117 million for the Office of Terrorism and Financial Intelligence (TFI) to

oversee and marshal Treasury's intelligence, enforcement, and economic sanctions functions. The request reflects Treasury's continued efforts to combat rogue nations, terrorist facilitators, money laundering, drug trafficking, and other threats to our security. These efforts include disrupting ISIL's finances, enforcing sanctions against Iran and North Korea, and enhancing global financial transparency.

The request also includes $115 million for the Financial Crimes Enforcement Network (FinCEN) to support Treasury's efforts to safeguard the financial system from illicit use, combat money laundering, and support national security interests through the collection, analysis, and dissemination of financial intelligence and the strategic use of FinCEN's authorities.

Investing in the IRS and a Fairer Tax System

Treasury's request includes strategic investments in the IRS that will improve service to tens of millions of taxpayers and reduce the deficit through more effective tax administration. I appreciate the increase provided by Congress in FY 2016; however, the IRS remains severely underfunded.

The IRS collects more than 90 percent of federal revenue and interacts with millions of Americans every day. Despite its crucial role and growing responsibilities, the IRS budget is nearly one billion dollars lower than it was in fiscal year 2010, while the volume of income tax return filings has increased by nearly 7 percent. Budget reductions at the IRS cost the country billions of dollars each year in lost revenue, contribute to inadequate customer service for taxpayers, and leave cybersecurity protections necessary to protect taxpayer data underfunded. A sustained deterioration in taxpayer services combined with diminished enforcement capacity could create serious long-term risk for the U.S. tax system.

Our request provides a $530 million increase above the FY 2016 enacted level to protect the integrity of the tax system, fairly enforce the tax code, and provide adequate levels of taxpayer services. With these investments, the IRS will increase staffing for traditional taxpayer services, improve the quality of assistance available to taxpayers who call the IRS, and bolster defenses against stolen identify refund fraud. In FY 2015, full-year telephone level of service plunged to just 38 percent. With the additional funding received in FY 2016, we expect to reach 47 percent this year and with full funding in FY 2017, we could bring that level back to 70 percent. The budget also invests in new IT architecture that will enable the IRS to continue to modernize and secure its online services and provide taxpayers with an experience comparable to what they have come to expect from financial institutions.

Treasury's request also proposes an additional $515 million increase in FY 2017 through a program integrity cap adjustment to support efforts aimed at increasing enforcement of current tax laws, investigating transnational organized crime, rooting out abusive tax schemes, and enforcing the Foreign Account Tax Compliance Act (FATCA). Targeted investments to fully fund enforcement initiatives through the cap adjustment are expected to return roughly six dollars to the government for every dollar invested and reduce the deficit by $46 billion over the ten-year budget window.

EMBARGOED FOR DELIVERY

Investing in Economic Growth and Opportunity

The President's Budget lays out a vision for what we need to do as a country to grow the economy and ensure that all Americans share in the benefits of economic growth. Treasury's request outlines key investments in evidence-based programs that will support America's small businesses, working families, and distressed communities. These investments will help drive economic growth, create jobs, and provide access to essential financial services.

Treasury's request includes $246 million for the Community Development Financial Institutions (CDFI) Fund to promote economic development investments in America's low-income and underserved communities. Included in this request is $10 million for a new Small Dollar Loan Program, which will support broader access to safe and affordable financial products and encourage community institutions to provide alternatives to predatory lenders. The request also proposes to extend the CDFI Bond Guarantee program to facilitate the provision of long-term capital to financial institutions operating in underserved communities, at no cost to taxpayers.

The budget also includes a series of mandatory proposals to facilitate private investment in our nation's infrastructure, investments in small business job creation, and partnerships with private industry and local governments to promote stable income and sustainable savings practices for working families.

Investing in Infrastructure

The budget establishes a new Financing America's Infrastructure Renewal (FAIR) program within Treasury that would provide direct loans to U.S. infrastructure projects developed through public-private partnerships. Eligible projects under the program will encompass the transportation, water, energy, and broadband sectors, as well as certain social infrastructure, such as educational facilities, and must meet all applicable environmental and labor standards. The program is estimated to provide $15 billion in direct loans over 10 years at no cost to taxpayers.

Supporting Small Businesses

The budget includes a new authorization of $1.5 billion for the State Small Business Credit Initiative (SSBCI) to build on the momentum of the program by strengthening the federal government's relationships with state economic development agencies and providing capital to America's diverse community of entrepreneurs. Since enacted in 2010, SSBCI has supported over 12,400 private-sector loans or investments in small businesses and helped create or retain over 140,000 jobs.

Encouraging Projects that Pay for Success

The budget includes a $300 million one-time mandatory appropriation for a new Pay for Success (PFS) Incentive Fund administered by Treasury. This program will support the growing number of state and local governments seeking to establish projects that use PFS financing. These

projects leverage private investment to provide preventive social services that measurably improve outcomes for families and communities while generating value to the government, including savings. The PFS Incentive Fund will help to strengthen the ability of state and local governments to achieve measurable impact for people and communities.

Financial Innovation for Working Families Fund

The budget includes a $100 million mandatory fund for Treasury to encourage the development of innovative private-sector financial products and services that would help low- to moderate-income workers build up "rainy day" reserves. The reserves would provide these workers and their families with a buffer against shocks to income and spending needs.

Allotment for Puerto Rico EITC Payments

I appreciate the committee's inclusion of technical assistance authority for Puerto Rico in last year's funding bill; however, more needs to be done. While the economic health of our nation has improved dramatically since President Obama took office, Puerto Rico's economy continues to suffer. Their unemployment remains above 12 percent. Outmigration continues to accelerate. And the Commonwealth's debt is unsustainable. As a result, the Administration proposed a comprehensive plan to address Puerto Rico's financial challenges, and we encourage Congress to act with the haste this crisis requires. This must begin with legislation to permit a financial restructuring along with new oversight, neither of which cost any taxpayer dollars.

The budget proposes a $600 million annual allotment, indexed to inflation, to create a refundable, locally-administered Earned Income Tax Credit (EITC) for residents of Puerto Rico. Unlike Americans living in the 50 states and the District of Columbia, residents of Puerto Rico are not eligible for an EITC. Given Puerto Rico's low labor force participation rate, the existence of an EITC should increase employment in Puerto Rico's formal sector by providing higher incomes to workers who file taxes. This added incentive for participation in Puerto Rico's formal economy should also increase Puerto Rico's tax compliance and tax revenues.

Other Investments in Support of Treasury's Mission

The request includes new investments in Departmental Offices to support Treasury's economic and financial policy, and general management. These targeted investments will allow Treasury to improve risk management, enhance Treasury's analysis of complex tax and economic data sets, and effectively implement the Digital Accountability and Transparency Act (DATA Act).

Finally, while not under this subcommittee's jurisdiction, I also want to highlight Treasury's International Programs Budget Request. The request provides a cost-effective way to continue U.S. leadership in international development, advance national security, and expand export markets for American businesses. The request promotes international financial stability and supports key global initiatives such as economic development, poverty reduction, improved food security, and climate change mitigation and adaptation.

EMBARGOED FOR DELIVERY

Conclusion

In closing, I want to thank the talented team of public servants at the Treasury Department. They are dedicated to the work of the department and committed to the American people. I am proud to represent them here today, and on behalf of these hard-working men and women, I want to say how much we appreciate the support of this committee.

Thank you, and I look forward to answering any questions that you have.

Mr. CRENSHAW. Well, thank you, sir. And we will start with the questions, and we will observe the 5-minute rule if we can, just so we can have everybody ask a series of questions. And I think we will have time for another round after that.

But let me start, Mr. Secretary. I mentioned in my opening statement about this new agency called FSOC, which you are the chairman of, and as you and I talked last year about one of my concerns that there is not a lot of transparency in this whole designation process, and I think your point last year was, well, it is really—it is kind of a binary decision. We either designate somebody or we don't designate somebody.

And I guess the question becomes, isn't it more important to mitigate the risk than it is to simply designate someone. And so this subcommittee, last year, adopted some language that I proposed to say, before you go out and designate someone, you would maybe let them know what FSOC thought the potential problem was, give them an opportunity to understand what the problem is, and give them an opportunity to actually derisk or cure that problem, and still, FSOC would have the final authority as to whether to designate that institution as a SIFI or not.

And particularly in terms of nonbanks. It is understandable, more so, in the big banks, the Too Big to Fail concept, I think that is what gave rise to this whole SIFI designation, but when you get into nonbanks, life insurance companies, or asset managers, this lack of transparency is still a concern, I think, to me and to this subcommittee.

So talk a little bit about that. I mean, isn't it more important? We want to have an economy, we want to have capital markets that are safe and secure, and that is more important, mitigating the risk there than simply designating people either SIFI or not a SIFI. Wouldn't you agree that that really is the goal?

Secretary LEW. Mr. Chairman, the goal of FSOC is to keep an eye on risks to financial stability and to, when necessary, designate firms for a level of scrutiny that is appropriate to the level of risk that they present.

Since we talked last year about this, and we have had some conversations in the middle, we have actually taken steps to provide more information earlier in the process to entities that are being reviewed. We have very intense back and forth conversations with them. They know exactly what the analysis is. They present a lot of information, and there are not dozens or hundreds of nonbank designations.

There is less than 10, and they are firms that are very large firms. They are amongst the largest financial institutions in the world. And I think we ought to remember that the financial crisis didn't begin exclusively in regulated banks. It actually had its roots, in part, in some nonbank financial institutions like AIG, which was designated early on in the process.

We have gone through the process listening and learning as we go along. I think we have been very prudent and made only a very small number of designations, because this is not an authority that should be seen as potentially a risk to small institutions that do not present the kind of financial stability risks that FSOC was meant to keep an eye on.

I am happy to continue the conversation. Obviously, FSOC is still a young organization. I think it has performed very well and very prudently, and I think we are in a better place today because we have more visibility into these very significant institutions that are now scheduled to be reviewed in an appropriate way.

Mr. CRENSHAW. You mentioned that you are having those conversations, and particularly, in terms of the nonbanks, and there was, I know life insurance companies have been designated. There was some concern that some of the asset managers, and the question would become, what risk they posed overall, in terms of there are other people's money that is being invested. They don't seem to pose the same kind of risk, but if you are having those kinds of conversations, do you agree that the language we added last year, does that make sense that as you move forward in these discussions, that you would come to a point where you would give credence to that language to say we will sit down with you, if you are having those discussions.

And if these are areas of concern, I want to make you aware, Mr. Institution, of those concerns, give you an opportunity to look at them and say, maybe we can help mitigate that risk, and if so, does that make sense to have that kind of process so that before you just designate them, you at least let them know—it sounds like you are trying to do that now.

Secretary LEW. Yeah, that——

Mr. CRENSHAW. But why not codify that so that it gives them some—I guess some comfort, that they are just not going to wake up one morning and somebody says, well, you are now a SIFI?

Secretary LEW. So I think the way the process works, there is a great deal of visibility into what the analysis is, and in each of the firms that have been designated, the issues are core to what the businesses are. So it is not as if they are small kind of bolt-on businesses that if you sold this small business, it would change the fundamental shape of the firm.

I do not think that there is a mystery as to why the firms were designated. Some firms may choose to restructure their business activity because it is in their business interest to do so. We already have seen one of the designated firms, though they have made the case that it is not at all because of a desire to get out of the SIFI designations, but because of a core business decision, to separate, become a manufacturing company, not a financial services company. That will be reviewed by FSOC fully and transparently to the company in the next year's review, if those transactions go forward.

So I do not think there is a lack of transparency or lack of information. What I think we do have to be careful about is creating more procedural hoops and potential delays. It is roughly a 4-year process from the beginning to the end for a designation.

I think that a financial crisis does not give you 10 or 20 years of warning. I think we have a process that is very deliberative, very thoughtful, very iterative, and interactive with the parties that are being reviewed, and I would be very cautious before putting any overlay of new procedural requirements that become the basis for delay or prolonging the process.

There is one party that has challenged the designation in court. That will be resolved by a court. That is how the law was set up, and the court will decide. But I think to add additional procedural hoops would frankly put us at risk of missing a target for designation when it is timely to prevent a problem.

As I said in my initial response, it is not like there are dozens or hundreds of firms that are on the edge of being designated. This has been used very judiciously for only the very largest firms, and it is a very long process that permits a great deal of visibility by the party that ultimately is subject to review.

Mr. CRENSHAW. Well, it seems like then, we tend to agree, that it gives you, both FSOC and the institution, an opportunity to mitigate that risk. Now, it sounds to me like that is what you would like to see happen. You may not want to write that down, but that is what you are doing today, and again, it is important to mitigate risk, not just to designate. You would say, look, if you can mitigate the risk, that is probably better than just getting designated and staying there forever, which brings up another question, just very briefly.

After somebody has been designated a SIFI, is there any way to get undesignated a SIFI?

Secretary LEW. Yeah.

Mr. CRENSHAW. Because once again, it seems to me, from your standpoint, as the regulator, what you would want to do is to say if there is some risk involved, we want to tell you about it, we will designate you, but we would really rather you mitigate the risk and not be designated, and so I wonder, will there ever be a way to get undesignated if all the mitigation takes place and the risk has gone away?

Secretary LEW. There is an annual review of each designation based on submissions made by the designated firm, and that is a real review, so——

Mr. CRENSHAW. Has anybody ever been undesignated?

Secretary LEW. No one has been undesignated, but I think that there is a full understanding that if there is a material change in the business plan, then the basis for being reviewed and for the designation being reviewed is very real. We have not seen something come up for review where there has been a significant change in the business plan. I anticipate that that may well happen in the coming period of time.

It is not our job to decide what the size of the firm should be. That is a business decision the firm makes. If their level of risk goes down, on review, and they don't meet the threshold, that is a basis for deciding the designation should not go forward.

So we do not start out with a desire to have more firms designated. We start out with the mission mandated by the act, for us to look at whether there are significant risks to the financial stability, and if so, to make the appropriate designations.

I think that it has been used in a very cautious way, and it is something that we can be proud that we have now created the ability to see what is going on at firms that are large and have that kind of systemic impact. If firms change their business plan and they are no longer presenting that kind of a profile, we would re-

view it and make a different judgment, but that is really—that is the process.

It exists, and I don't know whether it will be in my tenure, because we are in the last year, but I have full expectation that if there is a major change of business plan, it would be reviewed, and that determination could go one way or the other.

Mr. CRENSHAW. I am encouraged to hear that I think when FSOC got created and you became the chairman, nobody knew exactly what was going to happen. And I think some of the early indications, early actions were that all you can do is say yes or no, and now it sounds to me like there is an evolution of a process, and we are just trying to help bring that along. And if the proposal is to write that down, that doesn't get in the way of the overall regulation. We hope we can move in that direction. So thank you for that.

And now I would like to turn to Mr. Serrano.

Mr. SERRANO. Thank you, Mr. Chairman. To your surprise, I actually understood that argument. It got a little interesting for awhile. I thought we were talking about designating minor league ballplayers back to Triple A or something.

But Mr. Secretary, let me bring you back to what, you know, is taking so much time, and rightfully so, in my community, both in New York and in the Commonwealth of Puerto Rico. In trying to help in the omnibus bill, we gave some technical assistance language, including economic forecasting, budgeting, cash management, spending controls, information technology upgrades, multiyear fiscal planning, revenue, and expenditure projections, improving tax collections, and grant management.

What are you doing with that new authority? What progress has been made? And is there any new authority the administration needs and is looking for?

Secretary LEW. Congressman, as you know, before that authority——

Mr. SERRANO. And I want to take this opportunity again to thank you for all you have done. You have understood and, I think, you have made many, in the administration, understand the importance of not letting one of the territories fall apart. In the past, I can tell you as an appropriator, and this chairman happens to be very good at it, and the full committee chairman in helping us, but the territories are seen as something else.

This morning I was watching one of the major stations, and they are saying, well, Hillary has won this, and Trump has won that, and Bernie has won that, of course, we are not counting the territories. I say, well, why not, they have delegates, too, and they gave delegates to the candidates, and that is part of the attitude. We never count the territories.

Secretary LEW. Congressman, my view, and the view of the President is that we are talking about what happens to 3-and-a-half million American citizens, many of whom are veterans, many of whom have served their country, all of whom deserve the same attention that Americans living on the mainland do, and that is how I have approached it, in terms of what resources we put into dealing with it.

Before the law was passed, we were working closely with Puerto Rico for quite a period of time, informally advising them, but doing

it within the limits of what we could do with an authority that did not give us the ability to provide them, kind of in-place technical advisers. I think that was helpful to them, but frankly, they had a need for more.

Since the law was enacted, we have assigned technical advisers, the kinds of people that we use in our international programs in the Office of Technical Assistance who are very skilled at going into a government, seeing where problems are, helping to design solutions, train people to do the work, and then leave, and leave in place an infrastructure that is stronger.

As I travel around the world, I cannot tell you how much praise I hear for the work that those folks do. Now, Puerto Rico is part of our country, so this is not an international program. We did not have the authority to send people into a subdivision of the United States. The law gave us that ability. We now have a team there that is working on a range of issues, including revenue collection, including keeping their books in a way that is more straightforward, and we are looking for opportunities of how to expand it.

In general, these are small teams. You know, you go to a foreign country and we will have 2 or 3 people there, and they do an enormous amount of work. This is something we are dedicating the resources that we need, and we will find the people as the needs expand.

I have a lot of confidence that we will do good constructive work, but I do not want to suggest that technical assistance alone can solve the problem. There is a deep problem in Puerto Rico right now, which is one of insolvency. There is more debt than the Commonwealth can repay. The Commonwealth's budget is heavily burdened by debt payments and healthcare payments, and that is why the proposals we made on Medicaid reimbursement are so important.

The time-critical issue right now is that in May and July, Puerto Rico faces very large bond payments, which they do not appear to us to be able to meet. Action needs to be taken in a timely way, so that in the May, June, July period, we do not see a disorderly unwinding of Puerto Rico. Not only will that endanger the well-being of 3.5 million Americans, but it puts at risk all the bondholders who will not benefit if the island does not have money to pay back their obligations.

So an orderly workout process, with an oversight authority, is critically important. I appreciate the Speaker's commitment to have action taken in the first quarter of the year. We have been working closely with everyone on this, but the time to act is now.

Mr. SERRANO. Well, you personally answered one of my other questions, which was, within which you are allowed to tell me in public, what you are allowed to tell us in public, what role are you playing in the Speaker's promise, which we know he will hold and keep, to have something ready by the end of March, or the beginning of April?

Secretary LEW. Well, since the end of last year, we have provided technical assistance to any committee of Congress that was looking to deal with the problem, the crisis in Puerto Rico. I just have to say, the crisis is not a future one. It is a present one. Right now schools are closing, hospital wings are closing, millions of people

are looking at whether they can leave the island. It is at a rate that is not sustainable. The economy will just be destroyed if people leave at the rate that they are leaving, and we are providing technical support.

We cannot write the law. The committees will have to write the law. I certainly hope that the process leads, in the next weeks, to the kind of process that all stakeholders can trust as being fair. We have never advocated a one-size-fits-all approach. We understand that there are different interests that have to be balanced, but it has to be informed by legislation because there is no structure for the orderly restructuring of Puerto Rico's debt.

It does not have bankruptcy protection. There is nothing in the contracts that provides for it. This would go through the courts, and it would take 5 or 10 years to be resolved, and in that time, Puerto Rico's economy would just be destroyed.

Mr. SERRANO. Mr. Chairman, just in closing, am I to gather, from your information, from what you told us, that there is a sense of urgency on the part of many Members of Congress, some who, perhaps in the past, were not engaged with Puerto Rico in any way, that this is an important issue that has to be dealt with?

Secretary LEW. I have to say, Congressman, having talked to probably over 100 Members of Congress, since November, on Puerto Rico, the level of urgency that I perceive today is much broader on both sides of the aisle. There is an understanding that these May and June payments are just not manageable. Obviously, the challenge is getting through the congressional process with something that can get bipartisan support. I hope that that can be achieved within the next few weeks.

Mr. SERRANO. Thank you. Thank you, Mr. Chairman.

Mr. CRENSHAW. Thank you. Mr. Yoder is recognized.

Mr. YODER. Thank you, Mr. Chairman. Mr. Secretary, welcome to the committee. I appreciate your testimony. I certainly appreciated the dialogue you were having with the chairman regarding SIFIs, in particular, mutual funds. And I think the point that, you know, I would like to associate myself with comments the chairman made and just add to that. You know you hold, Mr. Secretary, and you know, government regulators hold the power.

Over 90 million Americans have funds invested in mutual funds. If you have got a pension or a 401(k), this could affect you, and it is a pretty significant impact on a lot of folks' retirements. Wall Street Journal wrote last year that it could have a 25 percent reduction of your ultimate retirement benefits. I mean, that is huge, to knock down someone's retirement benefits by 25 percent. And you also end up making those mutual funds, which many of us believe aren't banks and aren't going to cause a meltdown, you make them now back up other SIFIs that might actually cause a problem. Now those mutual funds are potentially at risk.

So I think one could argue, Mr. Secretary, that you could actually make our constituents' retirement accounts more at risk, not only less, and so I just want to reiterate that.

Secretary LEW. Congressman, if I could just——

Mr. YODER. Yeah, please.

Secretary LEW [continuing]. Respond quickly.

Mr. YODER. Real quickly.

Secretary LEW. We have been working on asset managers for quite a while now in FSOC. We started out by reviewing individual firms. We made the decision that what we really needed to do was look at activities that presented risk. We are continuing that. The Securities and Exchange Commission (SEC) has some draft rules out. Our analysis is obviously going to take cognizance of the work that the SEC is doing.

But the questions that we have to ask are: Is the migration of enormous amounts of financial resources into whether it is, mutual funds, or hedge funds, or other kinds of nontraditional financial institutions, creating the kinds of risks that could lead to real financial stability questions? That is the question we are asking.

Mr. YODER. And I think that is a very appropriate question to ask, and I think many, Wall Street Journal and others, have analyzed that and said the answer is no, and that actually by burdening 90 million Americans with these new regulations, and capital requirements, potentially, you actually lessen their retirement outcomes. Right, so that is a cost that they are going to bear if you go forward because——

Secretary LEW. The financial crisis was not good for people's——

Mr. YODER. Well, but—

Secretary LEW [continuing] Retirement accounts.

Mr. YODER. Right, but——

Secretary LEW. And that is probably——

Mr. YODER. But punishing people——

Secretary LEW. And that is what we have to try to avoid.

Mr. YODER. But punishing people that weren't part of it, you know, our——

Secretary LEW. We are not trying to punish anyone——

Mr. YODER. Well, it would be——

Secretary LEW. We are trying to make sure they do not get punished——

Mr. YODER. Well, if you punish my constituents by making them have to back up other risky transactions, and their transactions aren't risky, you put them in that same pool, now 90 million Americans, their retirement accounts are at risk because they are backing up other SIFIs, number one, and number two, the capital requirements then, according to the Wall Street Journal, could reduce their net retirement benefits by 25 percent, so we can agree to disagree, but I want——

Secretary LEW. We do not have a plan, so it is not like——

Mr. YODER. I understand. I understand.

Secretary LEW [continuing]. I am sitting here advocating something. The question is when we have to ask——

Mr. YODER. Too many other things to make sure you are taking in consideration.

Secretary LEW. Yeah.

Mr. YODER. OK. Mr. Secretary, it is my understanding the Treasury Department has failed to comply with the House Financial Services Committee's May 11, 2015, subpoena for records pertaining to the administration's debt ceiling contingency plan, which records were first requested in December 2013, and the House Financial Services' Too Big to Fail investigation first requested in June 2013.

It is my understanding the Treasury Department has also failed to comply with several of the Financial Services Committee's information requests, including those pertaining to FSOC designation processes.

Is the Treasury Department withholding subpoenaed and requested records from the Financial Services Committee?

Secretary LEW. There are conversations going on now, as there always are, when there are subpoenas' between counsel, and they are trying to work through these issues.

Mr. YODER. So Mr. Secretary, you have not denied that you are withholding documents, and so will you——

Secretary LEW. No, I said we are engaged in a process with the committee.

Mr. YODER. Will you commit to our committee, to this Financial Services Committee today to promptly producing all the subpoenaed requested records?

Secretary LEW. As always, there are questions of what is appropriate, and that is what the counsels are working through.

Mr. YODER. So you won't commit to producing all the documents?

Secretary LEW. Well, we only commit to doing what is appropriate.

Mr. YODER. Well, part of the requirement is that the committee's request require, either your counsel to either certify that you produced all the records located, or after conducting a search, reasonably calculated to locate all responsive records, have you and your counsel made the required certification?

Secretary LEW. I will have to check with counsel where we are right now in the process.

Mr. YODER. Do you as Secretary, do you intend to ever certify completion?

Secretary LEW. Congressman, there are conversations going on now, as they always do, when there are requests like this, and when there are subpoenas. I am not going to answer a hypothetical. We hope——

Mr. YODER. That is a very direct question. Will you ever respond to the Financial Services Committee subpoena?

Secretary LEW. Well, we have discussions going on.

Mr. YODER. I understand there is discussion. We are having a discussion right now.

Secretary LEW. Right.

Mr. YODER. And I am asking you a direct question.

Secretary LEW. The outcome——

Mr. YODER. Can you tell this committee will you comply?

Secretary LEW. Based on the outcome of those conversations, we will take appropriate actions.

Mr. YODER. So you won't tell us whether you will comply.

Secretary LEW. Well, I——

Mr. YODER. Even if you are not going to comply, you still certify—I mean, when does this end? When will you resolve this issue? I mean, this has been going on since 2015. Some of these requests are 2013.

It is very hard for the House and the administration to work together if we can't get cooperation in responding to congressional subpoenas.

Secretary LEW. Yeah. And that is why——

Mr. YODER. It is very frustrating to the process. It breaks down trust and the ability to do our jobs.

Secretary LEW. The appropriate place for that conversation to take place is where it is taking place. We are trying to resolve these issues. I certainly am hopeful that we will be able to resolve them. I just cannot respond to a hypothetical.

Mr. YODER. Well, they are not hypotheticals. They are direct questions. I wish, on behalf of the Financial Services Committee and our efforts, to understand these issues, that you would comply with these subpoenas and do so in a timely fashion so we can do our job, and I appreciate your testimony. Thank you, Mr. Chairman.

Mr. CRENSHAW. And I think you know, we expect you to do this, and we appreciate it.

Mr. Quigley.

Mr. QUIGLEY. Thank you, Mr. Chairman. Welcome, Secretary Lew.

Secretary LEW. Good to be here.

Mr. QUIGLEY. Deep breath. In January, Secretary Kerry said that—he indicated that if Iran is found to be funding terrorism, they are, quote, "going to have a problem in the U.S. Congress." Can you provide an update on Iran's current terror finance apparatus and speak to what the Treasury is doing to monitor and follow up with sanctions on Iran?

Secretary LEW. So, Congressman, we, as you know, have continued to maintain all the non-nuclear sanctions, even after Iran complied with the nuclear agreement, so the sanctions on terrorism, the sanctions on regional destabilization, the sanctions on human rights violations remain in effect.

Treasury has the responsibility to implement many of those sanctions, and we have continued to review, in each area, to identify and designate parties. We have designated a number of parties involved with Hezbollah. We are continuing to look at these activities. As we build a record that warrants designation, we will continue to take actions.

The nuclear agreement was very important. It set back Iran's development of a nuclear weapons program, and I think, has greatly added to the security of both the United States and the world. But Iran still engages in very malign activities, including support of terrorists. We will continue to find the places where we have the ability to take action.

I would just note that even when the most severe nuclear sanctions were in place, it was very difficult to stop the flow of all money to terrorists and to regional destabilization, and we are going to continue to work on it as we did before.

Mr. QUIGLEY. Yeah, I mean, can you evaluate, to the extent you can publicly, the agency's ability to monitor this? It is a complicated world. Iran is elusive.

Secretary LEW. Well, look, we have an excellent group of intelligence analysts and investigators who, I think, do just an incredibly good job. They punch way above their weight. They are broadly respected in the national security community for that. They can only operate based on information that they have access to.

It is hard information to get. It requires a cooperation with our broader intelligence community, which is very good, very strong, and people work day and night and weekends. They are committed. There is a passion in our team.

Mr. QUIGLEY. I assume that after the Iran deal, and the first level of compliance, that there was a lot more work to be done, given the anticipation. It wasn't as much money as most had said that was going to be released or made available because it was tied up in so many other things, but are you gauging more activity after this compliance in effect, that resources, or more resources, are available to Iran?

Secretary LEW. Well, actually very little of the money has flowed back to Iran at this point. It is something that we hear from both Iran and other countries about, that banks around the world are being very slow to respond to requests for money that is freed up. So the pace has not been a rapid one.

The amount, as you noted, is much smaller than the kind of headline number because there is only about $58 billion of the roughly $100 billion that is theoretically available that could go back to Iran, because it is tied up overseas in ways that it cannot be released. Iran's own estimate is more like $30 billion than $50 billion, and very little of that has flowed back at this point.

They have enormous domestic needs in Iran. When they talk about resuming oil production at historic levels, they are going to have to spend a huge amount of money rebuilding their infrastructure for them to get back even close to old levels of production. They have been withholding salaries in sensitive areas like military salaries because they have been strapped for cash.

All evidence we have is that they are still under enormous financial stress. So I think, that the first dollars that go back, there are going to be a lot of domestic demands, so the money will not just flow into malign purposes. But I have to go back to what I said. Even when they were under the most severe nuclear sanctions, they were still finding resources to put in to support terrorism and regional destabilization, so I do not think we can assume that is going to stop, but I do not think it is going to grow to a level that is materially different than where it was, and we are going to do our level best to shut down the way the money flows to support terrorism as we have been doing over time.

Mr. QUIGLEY. Very good. Thank you. My time is expired. Thank you, Mr. Chairman. Thank you, Mr. Lew.

Mr. CRENSHAW. Before we turn to Mr. Amodei, we have been joined by the chairman of the full committee, Mr. Rogers, and I would like to ask him if he would like to make a statement.

Mr. ROGERS. Thank you, Mr. Chairman. I apologize for being late. We have got simultaneous hearings going on with these subcommittees, and I just left one across the hall.

Mr. Secretary, it is good to see you. It is good to have you here, and I apologize, Mr. Chairman, again for running late here.

Treasury's budget, perhaps more than any other agency, should be viewed through the lens of the President's entire budget request and the state of our Nation's economy. As has been highlighted in recent months, deficit reduction and the reduction of our national debt is critical to our long-term economic and national security in-

terests. The annual deficit reached a high water mark at $1.4 trillion in fiscal year 2009, has since fallen to under $439 billion in fiscal year 2015, largely, I might say, due to the hard work of this committee and this Congress.

Since 2009, we worked to reduce discretionary spending by around $195 billion. Of note, mandatory outlays, including debt interest, has continued to increase significantly during the same time period. If we want to continue to reduce our deficit and chart a course for long-term economic security, we have got to get the mandatory side of the ledger under control.

The President's 2017 budget request proposes an increase of $2.5 trillion in Federal spending and $3.4 trillion in tax increases over the next decade. Unfortunately, once again, there is sadly no leadership in addressing the challenges associated with ballooning mandatory spending.

If we were to blindly follow the President down this path, by 2020, our country would spend more money on interest payments on the national debt than we would on protecting and defending our Nation. This threatens to squeeze out all of the worthwhile programs that many of our constituents care for, from transportation projects and medical research, to housing assistance, and homeland security.

Mr. Secretary, I hope that you can shed some light on the administration plans to address what, I think, is a looming crisis.

The 2017 budget request for Treasury is $13.1 billion. That is a $1.2 billion increase over current levels. The majority of that proposed increase would be utilized by the IRS to implement Obamacare and the Foreign Account Tax Compliance Act for program increases and relies on a discretionary cap adjustment. There are a number of issues with this request, but two, in particular, stand out.

First, the bipartisan budget agreement does not allow for a discretionary cap adjustment for the IRS. As you know, that would require a statutory change outside the jurisdiction of this committee that has been rejected by both the House and Senate Budget Committees for 5 consecutive years.

If the activities funded by the discretionary cap adjustment are important to the administration, then they should operate within the amount allowed under the bipartisan budget agreement. Mr. Secretary, the IRS needs to prioritize its spending like every other Federal agency.

Second, I am very disappointed to see that the IRS budget proposal eliminates three administrative provisions that have been enacted on a bipartisan basis for several years. Since the IRS targeting and spending scandals, appropriations bills have included prohibitions against targeting U.S. citizens for exercising their First Amendment rights, targeting groups for regulatory scrutiny based on their ideological beliefs, and making videos without advance approval. We are dealing with taxpayers' dollars here, and these provisions lay out what most people would consider commonsense policies.

Finally, let me end my remarks, Mr. Chairman, on a positive note, by thanking you for maintaining the $5 million increase Congress provided last year to the Alcohol and Tobacco Tax and Trade

Bureau, as you mentioned, I think, in your earlier statements. This relatively small office at Treasury does great work on behalf of the many distilleries in my State and around the country which support a booming industry nationwide. This additional funding will help reduce the average processing time of distilled spirits' labeling applications.

So Mr. Secretary, it is good to have you here. Thank you for being here.

Mr. CRENSHAW. Thank you, Chairman Rogers. And now let's turn to Mr. Amodei, and after that Mr. Rigell.

Mr. AMODEI. Thanks, Mr. Chairman.

Mr. Secretary, I want to talk with you just for a minute about the health of community banks and CFPB and all that other sort of stuff. We have never met, so you have no reason to be familiar, but I represent the part of Nevada that isn't Las Vegas, which translates to pretty rural neck of the woods, which translates to community banks, small credit unions, kind of an important part of our financial infrastructure.

And I have got some information here that indicates that after the passage of Dodd-Frank, we have had a pretty rapid decline in the number of community banks in the country and that some of this is attributed to the actions of CFPB, which hasn't, as you know better than I do, the folks that are on that, interesting groups of folks, but I am looking at a study here that is by the Harvard Kennedy School, the "State and Fate of Community Banking," which was February of last year that it came out and talks about some of the things they attribute it to. And a lot of it, a lot of the stress they attribute in the industry is to a regulatory one-size-fits-all policy, if you will, that is centered in CFPB.

And so you are saying, well, OK, so they are not in touch or whatever, what is the problem, that sort of thing, but yet when you look at the information, in the report and who it is attributed to, community banks have lost market share at a rate double that before the bureau's existence. Information is in the Harvard Kennedy study. The study is based on data provided by the FDIC whose chairman sits on FSOC. According to CFPB itself, community banks are, quote: A lifeline to hard working families paying for education, unexpected medical bills, and homes.

The loss of FSOC voting board, Federal Reserve Board of Governors, the loss of community banks could result in total loss of credit in some rural and small markets.

And I will just do one more: Interpersonal relationships are the backbone of community bank lending, according to all of the above authorities, and CFPB promulgates one-size-fits-all rules that remove the flexibility for community banks and credit unions to use judgment and work with their neighbors on lending. They do this, and this is, I think, the important part, in spite of the fact that community bank default rates hover around 3 percent, as opposed to larger bank rates of 10 percent.

And so I am sitting here trying to process all this, and it is like—I guess first question is—I mean, when FSOC talks about significant economic harm and you talk about what has happened with community banks, even if you say, well, they are consolidating, it is OK. It is like, hey, that is a trend that for those of us who care

about small banking available, and other than the major financial centers, that appears to be going on without concern by the institutions that are below you. Tell me, how am I wrong in that analysis?

Secretary LEW. Congressman, we share the view that community banks are very important to our communities, and I think the history here goes back before the financial crisis. There had been a pattern of consolidation beginning, and it has continued. Some of it has to do with the structure of the industry.

I think if you look at the whole range of prudential regulators, they have each taken a view that there should not be a one-size-fits-all approach, that where there are differences that are material because of size, there ought to be a recognition of that, and the flexibility that is built into many of the statutes should be exercised.

I think that when it gets to issues of consumer protection, some of them are not size specific. I mean, to the extent that there is a clear way to put into plain English what a mortgage looks like so people know what they are signing, it is not a big or a small bank issue.

The capital requirements for small banks, community banks are not the same as they are for large institutions, and we have been open to ideas like having less frequent reviews of smaller banks because we do understand that there are differences.

I have to say, in all candor, that there are a lot of large financial institutions that kind of present themselves as if they are community banks, and they are not. There have been proposals, for example, to change the threshold for enhanced prudential standards to $500 billion. That is not a small bank, and I think you know that. So we have to be really talking about small banks when we are talking about community banks.

Mr. AMODEI. Thank you for that. And I apologize for not managing your time the same way the chairman is getting ready to manage mine.

So where I would like to end it, if I might, Mr. Chairman, is just to say I would like the ability to return to you outside of the committee process and say, here are some examples of what we think——

Secretary LEW. Sure.

Mr. AMODEI [continuing]. And some of it may be just communications between CFPB and the others, and kind of get your response to those.

Secretary LEW. I would be happy to respond.

Mr. AMODEI. Thank you very much, Mr. Chairman. I yield back.

Mr. CRENSHAW. Thank you.

Mr. Rigell.

Mr. RIGELL. Thank you, Mr. Chairman.

And, Secretary Lew, thank you for being here and for your testimony today.

I appreciate Chairman Rogers bringing up, though, our overall fiscal condition. It caused me to seek this office about 6½, 7½ years ago, my first, because of my concern about our fiscal trajectory and our condition. And that is what I want to discuss with you briefly here.

Let me first say that I believe that both sides have contributed to this. I think the evidence is pretty clear on that. As a fiscal conservative and as a Republican, I believe that we fought for this a lot harder, though, and I want to walk through that just a little bit.

If I look at where we are on this growth, about 6 years of growth, our economy is cyclical, we are probably due for some type of correction here in the future. And then interest rates, I am convinced, can only go one way, they can only go up.

And all of this is really troubling to me. I think the consequences of us not addressing this are far more severe than, I think, most leaders in Washington. And I don't say that with any hubris, like I have got some special insight into it. In fact, I hope I am wrong on all of this. But the evidence, I think, doesn't point to that.

Here is a quote by then Senator Obama in 2006: "America has a debt problem and a failure of leadership." I mention that because I am mindful of the feeling that I had when I left the State of the Union address not long ago, and I thought about what he didn't say. He didn't really address our fiscal situation. I think he has failed to grasp our fiscal situation. I don't say that in a partisan way. He is my President right now, right, and I was really disappointed in my President. I don't think history is going to be kind to us.

And I am going to give you time to respond to this and maybe you can tell me: Congressman Rigell, it is not as bad as you think it is. I am not sure how you can work through that, though, because every trend is going the wrong direction. And I am convinced that your administration, the administration, and I would respectfully submit that you as the Secretary of the Treasury have a duty to raise the alarm level here and put more a sense of urgency about this.

And I want to give you some time to respond. And thank you for being here.

Secretary LEW. Congressman, I think the economy is in far better shape than you have just described. I think that we are seeing very strong consumer demand, we are seeing housing come back, we are seeing job growth at very sustained, strong levels.

We have a lot more work to do, but when it comes to our fiscal condition, you cannot compare where we are today to where we were 7 years ago, when we had a financial crisis and a recession driving the deficit, after a period of just building it up through policy decisions, and we have reduced the deficit from 10 to 2.5 percent of GDP.

Mr. RIGELL. Let me say this. And I only cut you off because our time is so limited. Every administration official that has testified here, at least the ones that I have heard, there is always a backward looking—and, look, let's just say I—let's just even say hypothetically—I don't—let's just say I agree with that. What I am not seeing is this really fighting for mandatory spending reform. It is just not happening. It just isn't.

Secretary LEW. So, Congressman, if you look at the trajectory under our budget, even under the baseline for the next 10 years, we have restored stability to a situation that was out of control.

There is much more policy that needs to be discussed. It is not all mandatory spending. There are tax issues as well. We have done a lot to reduce the deficit. We have reduced discretionary spending. We have solved some of the tax problems, though not all of them. While I know we do not agree on the Affordable Care Act, through the Affordable Care Act we reduced spending on healthcare programs.

So we have done a lot over these 7 years. We now have a foundation to work together. If we could get into a space for a bipartisan conversation like we had in the 1990s, perhaps we can make more progress——

Mr. RIGELL. Well, part of this, the President has got to lead and make the case with every American that for us to get out of this, that there has to be the thoughtful and substantive reform on the mandatory side. I have not seen it.

Look, I had an opportunity to speak to him once privately. I did. He said: Scott, what is on your mind? I said: Mr. President, we are not doing enough on this, we are not doing right by our children. And he is not fighting for it. I just haven't seen it.

And I know that the clock is ticking on the administration's time, but I would implore you, just as a fellow American, to make this case, because if we don't, we get on the flip side of debt, and we are about there right now, and then your lender starts telling you what to do.

I thank you. And out of respect for my chairman, I think I will yield back.

But thank you, Mr. Chairman.

Secretary LEW. If I can just take 30 seconds.

Mr. CRENSHAW. Please.

Secretary LEW. I have spent most of my professional life trying to point this country in the right direction on a fiscal path. I presided over three surplus budgets. No other living budget director, no past budget director can say that. I understand the importance in the right time of having a balanced budget.

Right now if you asked me what is the most critical thing for the economic future of this country, it would be getting a bipartisan consensus on things like building infrastructure, dealing with immigration reform, doing the things that would build the foundation of our economy. Those are immediate pressing needs. I actually think we have some time to deal with these other issues.

Certainly there is more work to do on the entitlement side, there is more work to do on the tax side. I think we have gone too far on the appropriations side. It was meant to trigger action on the other issues. It has incrementally had that effect. That is how we got an agreement last year and 2 years ago.

So I think if you look at where we have come over the last 5 years, in pieces we have put together many of the elements of what was once called a grand bargain. We have more work to do. We do have more work to do. But I think we are in a very strong place going forward.

Mr. RIGELL. I thank you for your testimony.

And I thank the chairman for giving you that extra time. Thank you.

Secretary LEW. Thank you.

Mr. CRENSHAW. Thank you.

And now I would like to recognize Ms. Herrera Beutler.

And we are glad to see you back, your smiling face.

She has been dealing with some family health issues.

And we welcome you. And please proceed.

Ms. HERRERA BEUTLER. Thank you, Mr. Chairman. It is good to be back. And everything is going well at home. So it is exciting to get to come back and be a part of this hearing this morning, although I will tell you, some of these issues seem like repeats, like a little bit like Groundhog Day. I am going to switch gears a little bit and see if I can't break myself out of the Groundhog Day feel.

Thank you, Mr. Secretary, for coming. A number of my colleagues have written you and Ambassador Froman about concerns relating to the data localization provisions of TPP that exclude the financial services industry, and I know you have commented on this. I understand you are working with the Trade Representative and regulators in the industry on the issue, and I just wanted to see if you could update the committee on where your efforts are.

Secretary LEW. I am happy to.

Data localization is something that as a general principle we have opposed in trade agreements. In things like electronic payments, I put an enormous effort into making sure there were not data localization provisions, because it was pure and simple a trade barrier. It was either making it more expensive for a firm from the United States to do business there or it was a way to create local jobs, but it was not appropriate.

In the case of financial services and prudential regulation, there is a very difficult issue, and it is one that I think there is a reason to be cautious on. That is, that prudential regulators need access to information in a timely way, and our experience has been that there have been moments, particularly in moments of crisis, when prudential regulators could not get the information they needed from international sources.

Because we have a principled position that data localization in general is bad, we are working to see if there is a way to thread this needle to make sure that the prudential concerns can be addressed without having it become something that could become a real problem for financial services companies.

It is a hard needle to thread. The regulators are focused on it. We are trying to find a pathway there. And I have put a fair amount of my own effort into trying to make sure that it is taken very seriously.

Ms. HERRERA BEUTLER. So you think we could be somewhat close to reaching——

Secretary LEW. So, first we have to separate TPP from some kind of future policy. TPP is locked, and what you can do to change TPP, obviously, is very limited. There is the possibility of having some kind of side agreement, but I do not want to exaggerate what can be done with the 11 countries in TPP.

We are looking to see is there something, particularly going forward, that would inform future discussions on things like the Transatlantic Trade and Investment Partnership (TTIP) and any other binational trade agreements, and that is where the vast number of countries would come into play.

It is a complicated issue, so I am going to be cautious rather than being overly optimistic. But I can tell you that I have gotten the attention of all the regulators, they are looking at this, they are trying to find a way to thread the needle, and we are going to do the very best we can to work it through.

Ms. HERRERA BEUTLER. Good. Thank you.

Switching again, recognizing the importance of protecting the financial services sector from cyber attack, which is a tall task. Do you agree there should be a coordinated approach among the regulatory agencies and key stakeholders to cybersecurity regulation across the financial services sector? Because what we are seeing is siloed efforts, everybody's coming up with their own solution, and with technology that is not going to work. So I would like your comment on that.

Secretary LEW. Well, I actually do not think that it is true that they are all coming up with their own solution. There has been a broad embrace of the National Institute of Standards and Technology (NIST) standards as being best practice, and there is a lot of coordination and discussion not to have conflicting standards.

I think where the question comes up is each prudential regulator has its own supervisory approach, and how you take the standards and apply them in a supervisory context is something that is historically a challenge to coordinate, because each has slightly different parameters.

There are conversations going on to try and do as much as can be done to deconflict there. I have asked my deputy secretary, Sarah Bloom Raskin, to take the lead for Treasury coordinating the cyber issues across the Department. She has put an enormous amount of time and energy into working both within the Department, where we have very substantial concerns, but also across the regulatory community. We get very senior-level participation in these coordinating meetings, and we now have legislation that gives us the ability to work more with the community outside the private sector.

So it is a concern that we share. I cannot tell you that there will be no differences between how different prudential regulators do their oversight of banks, but there is very much an attempt to get best practices.

Ms. HERRERA BEUTLER. So it seems like you are saying that they are going to approach it from a different side from the oversight position, not that they are going to talk about creating their own standards. Is that the clarification?

Secretary LEW. That is certainly where the goal is, to have as close to single standards as possible. We do not get to impose on prudential regulators their standards. It is really what they do by reference to a single standard like the NIST standard.

Ms. HERRERA BEUTLER. Got it. Got it.

Secretary LEW. It is a serious question, and I appreciate it.

Ms. HERRERA BEUTLER. I think some of my challenges is we have heard, like, whether it is futures trading or whether it is the standards—we have heard talk of different actual standards, not we are going to approach the way we administer it differently. And as you can imagine, it is hard enough in industry, but if the Federal Gov-

ernment can't within one agency have the same standards, we're going to have challenges.

Secretary LEW. Part of the challenge is there is not a one-size-fits-all approach, because different platforms have different characteristics and requirements. So I think there will be inherent differences. The question is, do they all reference back to the same kind of core principles, which I believe they do, and if they do not, we need to keep working on it.

There will be differences. Securities and banks have different systems because they do different things. So I do not want to suggest that we would have some arbitrary one-size-fits-all approach, that would not make sense. But the goal is to have as little conflict as possible.

Ms. HERRERA BEUTLER. Thank you. I yield back.

Mr. CRENSHAW. Thank you.

Mr. Graves.

Mr. GRAVES. Thank you, Mr. Chairman.

Mr. Secretary, good to see you. Thank you for appearing before us. We are always grateful for your thoughtful and thought-provoking responses each and every time.

I have about six questions. Most of them are very redundant and I suspect your responses may be redundant as well, but that is OK. I think it is important for the record.

Following up on Mr. Yoder's thoughts as well and our role as providing some accountability and assisting the Financial Services Committee as well in some of their responsibilities, could you just answer for us, why are you withholding subpoenaed internal Treasury records pertaining to the administration's debt ceiling contingency plans?

Secretary LEW. So, again, as I responded earlier, we have conversations going on with the committee, our counsel and their counsel, and we are continuing to hope to resolve these issues.

Mr. GRAVES. Thank you. And then the same, why are you withholding subpoenaed records pertaining to the Financial Services Committee's "Too Big to Jail" investigation?

Secretary LEW. So I do not want to pretend to be deeply familiar with every request. I have to get back to you on that.

Mr. GRAVES. OK.

Secretary LEW. I mean, our general approach is always to work with the committee and try and find an appropriate accommodation. But I will check on that.

[The information follows:]

Treasury is committed to working with Congress, including the House Financial Services Committee to provide the information needed to fulfill its oversight role. We have been working with the Financial Services Committee for several months to understand and accommodate its priorities related to its inquiry into criminal prosecutions of large financial institutions. We have made responsive documents available to the Committee.

Mr. GRAVES. OK. Thank you. And very similar, why are you withholding the records the committee has requested pertaining to the processes the FSOC uses to designate and de-designate nonbank financial institutions as systematically important financial institutions?

Secretary LEW. Well, obviously, I have testified widely on the subject, including here this morning, and we work with the committees to try and provide appropriate information.

Mr. GRAVES. Thank you. And then one other. On what legal basis—and this is maybe just sort of bringing it to an end—what legal basis are you withholding these records from the Financial Services Committee?

Secretary LEW. So I am really going to have to just say we are leaving these discussions to the appropriate conversation between lawyers.

Mr. GRAVES. Understand. And then one other related. On what legal basis of withholding the subpoenaed records relating to the $5 billion in unlawful payments to insurance companies that has been requested by the Ways and Means Committee?

Secretary LEW. I am sorry. I did not understand that last question.

Mr. GRAVES. On what legal basis have you been withholding subpoenaed request of records relating to the $5 billion in unlawful payments to insurance companies as requested by the Ways and Means Committee 1 year ago?

Secretary LEW. So, Congressman, all of these requests are going through a process where lawyers are working through them. I will have to check on that specific request. I have not looked at it recently.

[The information follows:]

Treasury is committed to working with Congress, including the House Committee on Ways and Means, to provide the information needed to fulfill its oversight role. We have been working with the Ways and Means Committee for several months to understand and accommodate its priorities related to its inquiry into the cost-sharing reduction payments. We have made, and will continue to make over the next few months, responsive documents available to the Committee.

Mr. GRAVES. Understand. And I just had a duty to ask those questions.

Secretary LEW. Yeah.

Mr. GRAVES. And I know you have a response there and a duty to respond as you have. And I guess for this committee's sake, just trying to help us understand, what are the consequences of noncompliance or nonresponse to a subpoenaed request by standing committees of the House of Representatives?

Secretary LEW. Well, look, I have always endeavored in my many decades of doing this to try and be responsive and to reach an accommodation that gives committees material that is appropriate. There are some materials that are not appropriate to be provided, for a variety of reasons. It depends on what the particular material is. So that is why I am avoiding giving an answer that would be very general.

Mr. GRAVES. But is there a consequence to the agency, to you as Secretary or to the agency if you just choose never to respond? And this is a fair question.

Secretary LEW. I think congressional oversight is an important function. We endeavor to provide appropriate information to support congressional oversight and we certainly look for a relationship of comity with the committees that we deal with. So we always endeavor to work through these issues.

Sometimes there is a request for information that is not appropriate to provide, and we have in the past always been able to work through those issues. Obviously, Congress has some remedies of its own, and then there are issues of privilege that can sometimes be invoked. But it always depends on the circumstances, so there is not a general answer.

Mr. GRAVES. Understand. And so just let me point out to the committee here that many of these subpoenaed requests of records have been 1 year, 2 year, if not almost 3 years in the waiting from the Secretary and his associates, and the discussions, I guess, have been ongoing for that long as well.

But one of the remedies to this as a committee, I would hope, is that we take this into consideration, that duly elected and appointed committees of the House of Representatives have rightfully asked for records and have been denied those, because discussions are ongoing. But as we consider the request by the Secretary, I hope we take that into consideration.

Thank you, Mr. Chairman.

Mr. CRENSHAW. Thank you.

Now I would like to turn to Chairman Rogers for a question or two.

Mr. ROGERS. Mr. Secretary, since we divided off Secret Service into Homeland Security, does your Department retain any concerns about counterfeiting or is that solely with the Secret Service?

Secretary LEW. We have very much direct responsibility. We and the Fed together work on the design of our currency to make sure that it is as difficult as possible to counterfeit. That is where the technology comes in. We work with the Secret Service, who do the principal investigation when there are counterfeiting events. I think it is at the highest level of importance that we maintain the integrity of our currency and we put all the attention that it requires into it.

Mr. ROGERS. Well, I should ask this of the Secret Service, and I will, but I was recently, last week, in Peru, the counterfeiting capital of the world, I am told.

Secretary LEW. I wish there were only one.

Mr. ROGERS. But anyway, it is apparently wholesale big time there. We have only got one person there that I am told to work with the Peruvian Government to try to stop it. But could you check into that?

Secretary LEW. I would be happy to, Mr. Chairman.

Obviously, when the Secret Service was under the Treasury Department we had more direct accountability for their resources and they would do the investigations.

I can tell you that we are trying to stay ahead of counterfeiters. As we look at the next generation of currency, we are looking at new kinds of technology that will make it even harder to counterfeit. We obviously are going to have to stay a step ahead, because it is a world where counterfeiters are out there.

Mr. ROGERS. Well, Peru apparently is the real hot spot, and I hope that you could work with Secret Service to get some more effort going there with the people——

Secretary LEW. I will follow up on that.

[The information follows:]

The U.S. Secret Service is responsible for enforcing U.S. counterfeiting laws, please direct your questions to the U.S. Secret Service's Office of Government and Public Affairs. U.S. Secret Service, Office of Government and Public Affairs, 245 Murray Ln., Washington, DC 20223, 202–406–5708.

Mr. ROGERS. Thank you.

Quickly, Bitcoin. The Office of Terrorism Financing and Intelligence within your Department is the only Federal agency solely devoted to tracking and disrupting of the financial means of our enemies for the purpose of ultimately defeating them, and the head of that office said last year: "What keeps me up at night when I am thinking about digital currency, the real threats out there these days, we are thinking a lot about ISIS."

And the use of digital currencies, Bitcoin, to be used by groups like ISIS seems to me to be a real threat. It is an unregulated form of online currency, circumvents the traditional banking system. Is it on the government's radar since it could serve as an ideal placeholder for terrorist assets and provide a way for terrorists to exchange money?

The Bitcoin website, Bitcoin.org, describes the ease with which anyone can send and receive virtual funds. I quote it: "Sending bitcoins across borders is as easy as sending them across the street. There are no banks to make you wait 3 business days, no extra fees for making an international transfer, and no special limitations on the minimum or maximum amount you can send."

It is the first worldwide decentralized currency, can be sent person to person without any third-party involvement, and can be used by groups like ISIS to spread their evil worldwide.

What do you think about it?

Secretary LEW. So, Congressman, we obviously are looking at many ways that ISIL will get money and we are trying to shut down every path that we can identify.

Let me take a more general approach to the question of Bitcoin. It is in that area of financial technology that captures people's imagination because it has the possibility of creating easier ways to do business in the future. We have from the start said that we do not want to be anti-technology. The things that will create the right platforms for the 21st century will come out of disruptively changing ideas.

On the other hand, we have to hold a new system, a new platform like Bitcoin to the same standards we hold traditional financial products. We track cash because cash can be used anonymously to support illegal or malign activities. Our Financial Crimes Enforcement Network (FinCEN), which is part of the Office of Terrorism and Financial Intelligence (TFI), right from the beginning laid out criteria that we need to keep an eye on what is going on in Bitcoin that is fully consistent with the way we approach both formal banking and cash.

It is challenging, and I am not going to suggest that there are not threats there. There are real threats there. But our team is on top of it and, I think, very much looking to see what do we need to do to make sure that it does not become a funding stream to support bad actors.

With regard to ISIL, we have taken dramatic actions to try and shut down formal banking in areas that they control, working with

the Government of Iraq. We have taken military action to set back their ability to generate revenue through oil development and shipping. We have worked to shut down the flow of salaries into territories they control.

So we are doing everything we can. They are stressed. You can see it in the fact that they are having trouble paying their soldiers. But that is not good enough. We have to keep at it until we really dial back their ability to promote the kind of terror that they are all about.

Mr. ROGERS. Well, you are exactly right. And your Department is the leading edge of that effort on the financial strangulation of these organizations. So we wish you well and urge you on.

Secretary LEW. Thank you. We, in just December, had a meeting at the U.N. Security Council, the first time in the history of the Security Council that finance ministers met in the Security Council. I chaired the meeting, because it was our Presidency, and we unanimously passed a resolution to treat ISIL the same way we treat Al Qaeda and to get the whole world to say they are going to cooperate.

A lot of countries do not have the kind of resources that we have in TFI. One of the things we have to do is help them build that, and our technology assistance and technical assistance program and working with international organizations to do that is part of what this is about.

Mr. ROGERS. Thank you.

Secretary LEW. Thank you, Mr. Chairman.

Mr. CRENSHAW. Thank you, Mr. Chairman.

We have got a few minutes left. I have a couple more questions. I think Mr. Serrano might, too.

So let me ask you, Mr. Secretary I mentioned in my opening statement my concern about the lack-of-liquidity in the economy. After the crisis, an awful lot of new rules and regulations were put into effect, and I have always had a concern that they might somehow impact this liquidity issue that deals with our economy. A lot of other people have that same concern. Just recently, I think, a couple of members of the Fed said they believe there is a linkage between the post-crisis regulatory framework and liquidity.

So my first question is, do you think that was by design or do you think that was an unintended consequence?

Secretary LEW. Well, first, I want to go back to first principles. I am not sure that the linkage is as clear as some people have argued that it is. We are at a time of an inflection point, in many ways, in the economy. We are leaving a period of historically low interest rates and low volatility. We are seeing markets evolve in a way that there are more and more nontraditional and electronic participants in the market with huge volumes. We have also seen corporate bond issuance surge in recent years, and there has been quite rapid growth of the asset management industry. So there is a lot changing in the financial landscape.

Now, on top of that, we have had new regulatory requirements put in place, and I have said before that we will continue to look at whether there are unintended consequences there. I think that many have jumped prematurely to a conclusion that that is the case.

I will give you an example. When there was the round trip on October 15, a year and a half ago, where the market went up and down very quickly, for weeks people were saying that was a result of liquidity caused by regulation.

We went back and did very careful analysis. We had all the different regulators who had different pieces of visibility work together, and that is not the conclusion that you reach when you study the data. You see that there were very dramatic moves in high-frequency trading that had a distorting effect.

You are seeing things happen, which I do not have the full explanation for, but in asset management funds closing positions at the end of the day algorithmically.

So there is a lot going on.

What we have done through financial reform is we have put a foundation that is solid underneath our financial system. So right now when you have a period like January and February with volatile markets, there was a lot of confidence in the integrity of the U.S. financial system. That is of enormous benefit.

So we have to keep an eye on whether there is spillover effect. To the extent that there is a lack of liquidity for high-risk products, that is different than if there is a more general liquidity issue for prime corporate——

Mr. CRENSHAW. Because that is really what I am talking about, wild market fluctuations. You hear Mr. Amodei talk about the community banks going out of business.

Most people, maybe not everybody, but if you got people in the Fed saying: Look, I think there is a linkage here when you have got all this new regulation, and clearly there is a little bit of lack of liquidity just in everyday business startups, things like that. And you might say: Well, I don't see the linkage and I don't——

Secretary LEW. There are also different ways of defining liquidity.

Mr. CRENSHAW. And that is what I was going to ask you, because if you don't think that that really is impacting, maybe—you said you have done some studies. As I mentioned in my opening statement, we asked the SEC to do a study, and they might coordinate with you, but it would be interesting to see what the results of a more formal study would produce in terms of lack of liquidity. So you would say, A, I am not sure that there is a linkage, and, B, then you would certainly say——

Secretary LEW. I am not dismissing the question.

Mr. CRENSHAW. No, but you don't think anybody sat in a room and said: Look, if we do all these new regulations, we can take some of the liquidity out of the market. Nobody thought——

Secretary LEW. No. I think it was a general proposition that was the case. There were some things during the pre-crisis period, one could argue there was too much liquidity in some high-risk markets, there was overleverage. But that is not what you are asking about.

Mr. CRENSHAW. No, no. When you all sit down and talk about liquidity, what would you argue is the right mix of liquidity?

Secretary LEW. So, look, I think that in terms of markets, the question is can you match up buyers and sellers in real time for securities, for stocks and bonds.

Mr. CRENSHAW. But also in business startups, small banks, all the lending, it seems to me you hear a lot that these community banks are all going out of business, big banks are getting bigger, but it is harder and harder for somebody to go start a business or buy a home. It seems to me that has some sort of impact, and maybe that is at a lower level than you look at.

Secretary LEW. No, we look very much particularly at home ownership. I have said many times that the credit box shrunk more than regulators meant for it to. You look at what banks are doing, they are not operating at the outer limits of what regulators think is a comfortable place to lend. You look at the FICO scores for loans, they are too high, where you kind of gap out and you cannot get mortgages.

The Federal Housing Administration (FHA) is looking at some things that they can do to try and provide some clarity there. I believe they may have even put out something this week.

So those issues are very much in our focus. That is different than a broad question of market liquidity. So it is important to define what it is, which piece you are talking about.

Mr. CRENSHAW. I am glad to hear you say that—it would seem fairly obvious—that you are concerned about liquidity in the market.

Secretary LEW. I think creditworthy individuals and businesses should have access to credit.

Mr. CRENSHAW. Exactly. I think we all want to say we want reasonable regulation, but we want to be careful that if too much regulation creates problems, then we want to be sensitive to that. Not enough regulation also creates problems. There is a balance somewhere.

Secretary LEW. There are some issues that have arisen in terms of how legal matters are resolved, the aftermath and the derisking that is taking place in the financial sector, where we are seeing financial businesses withdraw from areas that they are just deciding are not worth being in because they see risk and they do not see a lot of benefit.

We are putting a lot of attention into that, frankly, whether it is individuals in the United States or countries that we want to have commercial relationships with the United States. We are not in a better place if people and countries are cut out of the formal financial system, but firms do have to have an idea of what do they need to do to comply reasonably with all of the standards that are out there. That is something we are putting a great deal of effort into in our last year.

Mr. CRENSHAW. Thank you. Thank you.

Mr. Serrano.

Mr. SERRANO. Thank you.

Mr. Secretary, the President's announcements on Cuba and Cuba travel have been met with great support from a lot of people, and I am happy to see that the outcry we all expected from 10 years ago didn't take place.

What have you seen as changes affecting what you have to do? What needs to be done still? And can you talk to us about the new announcement that was made just yesterday?

Secretary LEW. Congressman, we have as recently as yesterday taken a series of actions to try, within the fairly tight boundaries of law, to open up more contact between the American people and the Cuban people, to create a basis for driving change in Cuba by having the influence that we have when people get to know us and our values and our standards.

Yesterday, we eased up on some travel restrictions, we eased up on some financing restrictions. We have done everything consistent with the laws that, as I say, circumscribe how much we can do. So I would not describe where we are as normal commercial relations, normal in any way.

We are seeing an increase in activity. That is a good thing. I believe that if you look at the history of the last 50 years, it has not worked, cutting Cuba off has not worked. It has put us at odds with most countries in our own hemisphere and it has left the Cuban people cut off.

The most positive thing we can do is demonstrate by our example what it is our values are, to have the freedom of business and the freedom of ideas start seeping into a system that has not seen that kind of freedom.

So I do not think there is a disagreement between us and those who oppose our policies on the fact that there is a need for change in Cuba. There is a difference in what we think are the effective means to accomplish that. I think the history does prove that the path we have taken has not worked.

We believe the path that we are embarked on now, subject to the limitations of an embargo and the Libertad Act and all kinds of restrictions, is going to help. With changes of law, it could be done in a much more normal way.

Mr. SERRANO. I am trying to remember who it was, and I can't at this moment, but someone before this committee told us that the biggest change they saw was when the President went to Latin America and he was meeting with a group of leaders from Latin America. Was that you that told us that?

Secretary LEW. Well, I may have. It happened to him.

Mr. SERRANO. The point was how excited they were.

Secretary LEW. It happened to him. It happens to me on a regular basis when I interact with my counterparts from Latin America. This has been an issue where they have had to be at odds with us, and they are not at odds with us, as much or even at all, because of the changes. I think it is a good thing for the U.S. to be a leader in our hemisphere, and part of being a leader is figuring out how to address issues like this.

There is a lot that needs to change in Cuba, so nothing about this policy embraces practices that need to change. It is really a question of what is the most effective way to accomplish that change, and I think our leadership role in the world and the Western Hemisphere is very important as well.

Mr. SERRANO. One last question. One of my favorite programs is the CDFI program, and we notice that you asked for a relatively small increase compared with some of the other numbers that we have discussed today. I hope we are not putting them at risk in any way, because that is an agency that has been very effective in my community. It has a lot of fans on both sides of the aisle.

Secretary LEW. Urban and rural.

Mr. SERRANO. Yeah.

Secretary LEW. Yeah. I am a big fan of the CDFI program. I feel like I was present at the creation in the 1990s. I have tried to in my period of time at Treasury nurture it and help it to grow. We have tried to be responsive in areas like the Bank Enterprise Award Program and request the funding level for that important program. I think we have requested a level of funding that will give CDFI the ability to grow and to do well.

Something that we did last year that is very important is we worked to have credit unions qualify as CDFIs, tremendously expanding the base of institutions that are eligible for participation.

As I have traveled around the country and visited CDFIs, one of the things that has been striking to me is that it is not just the direct activities that we fund. We create anchors to bring together a variety of Federal services, local services, to coordinate an economic development engine in a community to help young people find training and jobs. You have to have an anchor, and in a lot of these communities the CDFI-funded organization can be that anchor.

Mr. SERRANO. Well, they have done a great job.

And let me just in closing say that this will be the last time you come before us, I think, in an official capacity. We will keep talking on different issues and working on Puerto Rico and so on. I want to thank you for your service.

Secretary LEW. Thank you, Congressman.

Mr. SERRANO. And like I said, I didn't win any primaries for President, so I can't reappoint you. I would have loved to do that. And if you come back to the Bronx, as you have stated before, we welcome you again as always. That is your home?

Secretary LEW. I vote in the Bronx, I pay taxes in the Bronx, I look forward to living there again.

Mr. SERRANO. OK. Thank you.

Mr. CRENSHAW. Thank you.

Mr. Yoder has another question or two.

Mr. YODER. Thank you, Mr. Chairman.

Mr. Secretary, Treasury and other agencies recently put out a broad request for information on the changing structure of the market for U.S. Treasury securities. This comes on the heels of a joint report on the October 2014 flash rally and numerous public discussions on the changing profile of the market in terms of participants and overall structure.

Are the particular areas within the market where Treasury is particularly focused concerned that either new structures or new participants may be impacting the overall efficiency and liquidity of this important and unique market?

Secretary LEW. Yeah. Thank you for the question. I, while you were out, addressed it, so I apologize for repeating.

But if you look at the report we did on October 15 and the request for information, it outlines the kinds of questions that we have. These are questions. We do not have certainty about what the answers are. And it is quite an important process.

What we have seen is a change in where the level of activity is by kind of firm, kind of activity. The amount of activity that is

algorithmically generated, high-frequency trading, for example, it is a very large part of the market.

We are also seeing that funds that move large amounts of securities have activities at the open of the day, the close of the day, that have patterns that seem to be having potentially some impact.

This is important to understand, because this is the plumbing of our financial markets. If the system is changing, we have to ask, whether the things that we have done in the past to make sure you maintain an orderly market and liquidity are appropriate and working.

So we do not start out with an idea that there is something, like, bad that needs to be addressed. We start out with a very complicated evolution of our financial markets that needs to be fully understood. I think Treasury has a responsibility for driving that kind of questioning, which is why we have the request for information out there. I very much look forward to the responses to it.

This is not a case where we are starting out with an answer and looking for a record to support it. This is saying we have now observed a lot of things that suggest there has been dramatic change in the structure of the market. We need to understand that in order to know how to respond.

Mr. YODER. I appreciate your answer.

I would be remiss if I didn't take a moment to talk about the budget a little bit. I know there has been extensive testimony and we have differences as parties about this, but numbers are numbers.

Do you know what the projected debt is under the current budget projections for the next decade, in additional debt?

Secretary LEW. I have not added it up, but I know that we have reduced the growth rate of the debt for 3 quarters.

Mr. YODER. I respect that. I know. And we have a debate about what we have done.

Secretary LEW. We can get back to you with the answer.

[The information follows:]

In its *Mid-Session Review of the FY 2017 Budget* released on July 15, 2016, the Office of Management and Budget projected that debt subject to the statutory limitation would increase from $19.4 trillion at the end of FY 2016 to $26.7 trillion at the end of FY 2026, an increase of $7.4 trillion over the next decade. (Ref: Mid-Session Review of the FY 2017 Budget, Table S-11, page 61) Note: As of August 15, 2016, actual debt subject to limit was $19.386 trillion.

Mr. YODER. Yeah. I mean, just a basic, you are the Secretary of the Treasury, what is the projected debt over the next 10 years? I know you know this answer.

Secretary LEW. I walk around with a lot of numbers in my head.

Mr. YODER. You don't know the answer to that question?

Secretary LEW. I do not have the number in my head——

Mr. YODER. Come on.

Secretary LEW. I know that we have reduced the annual accumulation of debt to a level that is——

Mr. YODER. With all due respect, Mr. Secretary, I know that is the sort of company answer and I respect that that is what you have got to go with, but I just—I want to have a discussion.

Secretary LEW. It has the virtue of being true.

Mr. YODER. I want to have a discussion about where we are going, not a debate about the past.

Secretary LEW. There is no doubt that the debt will continue to——

Mr. YODER. Our projection, I think your projection, since you are not coming forth with it, the debt is going to continue to grow. You agree with that, right?

Secretary LEW. It definitely grows and——

Mr. YODER. Would you say $7 or $8 trillion over the next decade?

Secretary LEW. Obviously, GDP is very large and growing. So if your debt as a percentage of GDP is even flat, it is going to grow by a large number.

Mr. YODER. Fair discussion.

Secretary LEW. The question is, what is it as a percentage of GDP that is sustainable?

Mr. YODER. Right. So do you know that answer?

Secretary LEW. It stays in the 70s, which is higher than it was, but it is not at a record level. And we have long-term challenges ahead of us. But we are not looking at it breaking through a level that is a crisis level.

Mr. YODER. And I appreciate that you know the debt-to-GDP ratio, but you don't know the total debt number.

Going forward, I think we have concerns about the solvency of Medicare. Your own folks, the Medicare trustees, have concerns about the solvency of Medicare, and I know we are going to talk about how we have made it better, and we have in some regards.

Secretary LEW. We have more work to do.

Mr. YODER. But we have more work to do.

Secretary LEW. Absolutely.

Mr. YODER. You know, 10,000 seniors retire every day. My grandmother is 104, right. We have longevity. These are great things.

Secretary LEW. I wish her a healthy and long life.

Mr. YODER. Thank you very much. I will pass that on to her. Thank you. One hundred five in June.

But the question, I guess, for you, I will just give you 30 seconds here, you oversaw a balanced budget in the 1990s, Republican House and Senate, Democratic President, you have bipartisan workings together on that. If you could balance this budget over the next 10 years, what would you recommend?

Secretary LEW. Well, I think that the time to balance the budget is not now, because I think we have——

Mr. YODER. I mean, over the next 10 years, over the future.

Secretary LEW. Yeah. There is a reason that we did not present a balanced budget in the 10-year window. Coming out of the deep, deep recession, we have other much more immediate challenges that I think would help our economy if we dealt with. If you gave me a choice of balancing the budget or rebuilding our infrastructure, it is a more immediate challenge to rebuild our infrastructure.

The ability of our economy to meet the needs of the 21st century is going to be undermined if we do not do that. We have a bit of time to deal with entitlement spending and to deal with taxes in a bipartisan way.

Look, I have been part of bipartisan budget deals over a period of four decades. The right way to do this is through a bipartisan conversation where we agree on the need to protect senior citizens, where we agree on the need to have a fair and more simple tax system, and where we have an honest discussion about what the tradeoffs are.

The last few years have not given rise to the kind of grand bargain, but over a period of years we have taken incremental steps that have gotten us a long way there. We went a little too hard on discretionary spending. I thought so at the time. Now I think things like the budget agreement put some mandatory savings in to back out some of the discretionary savings.

We did the Affordable Care Act, which did reduce our healthcare spending dramatically, and we did raise taxes, which we thought was necessary, on the people who were most able to pay.

That does not mean we have did it all, but we have done a lot over the last 7 years, and I think there is more to do. I hope that my successor is able to work in an environment where there can be the kind of bipartisan discussion that, frankly, I have tried very hard to foster and have enjoyed being part of in the past.

Mr. YODER. Well, I think invariably this conversation, when we had the OMB Director in as well, turns to a discussion about what the administration has done. And I think Congress and the administration both have an obligation to engage in adult conversations, and you outlined the premise by which that would occur in terms of bipartisan discussions, protecting Medicare for seniors, reforming and flattening out this tax code. I mean, the principles are there.

And I just throw out for the sake of conversation, it is March, we have about a year. I would love to see the administration lead those efforts and see while you are Secretary and while we are here working under the current framework, why not try to address some of these long-term problems now. Because I think you agree that the longer we wait to address them, the harder they will be and the more difficult it will be for your successor and for ours. And so we just—I have got young girls, we all have children.

Secretary LEW. I have young grandchildren.

Mr. YODER. Yeah. So I think you should be—I mean, I know you are as concerned about this as we are, and so I just offer that I am ready to engage, I think we are all ready to engage. We would love to.

Secretary LEW. I have always been ready to engage.

I would say that on the tax side, if we could figure out a way to work together to stop inversions, that is something that the American people are offended by on the Democratic and the Republican side alike. We find it wrong, and we know how to stop it. I hope we can at least come together on that.

Mr. YODER. Thank you, Mr. Chairman.

Mr. SERRANO. Mr. Chairman.

Mr. CRENSHAW. Yeah. We can fix the tax code. That is the way we will stop it, right?

Go ahead. I have a question, but you have a comment?

Mr. SERRANO. Just a quick comment. I really respect the gentleman's comments about balancing the budget. I think that is so important and something everybody wants and so on and so forth.

The Secretary has made it clear that sometimes you get into a little debt by building highways and you create a million jobs at the same time, and it is something you should look at.

But I have been around here long enough to remember when we cut taxes when we weren't supposed to cut taxes and when we got into a war we weren't supposed to get into. We had a surplus and then we blew the money away, along with a lot of our respect throughout the world. We are still looking for those weapons of mass destruction, but they cost billions of dollars.

So I think if we learn anything from that it is to be careful about the future, protect our country, try to give the working class people in this country less of a tax burden. But we made some serious mistakes at that time, and we are all guilty of it. We cut taxes when we shouldn't have and we threw away a surplus on a war that we shouldn't have been involved in.

And now we hear the gentleman speak honestly, but I think we have to revisit that every so often to remember how we got into this mess.

Thank you.

Mr. CRENSHAW. Let me ask one final question, Mr. Secretary, about mandatory spending, because I know, your agency has a lot of bureaus that are funded through mandatory funding that are outside the appropriations process. And I understand, that FSOC, which we have talked a lot about, are going to have a 23 percent increase in their budget. And so I wanted to ask you why you think that is.

But in a broader sense, I read a report that said this new Consumer Financial Protection Bureau had an independent performance audit and it was recommended that the CFPB expand their transparency of their funding and expenditures, which kind of brings up that broader question about these agencies that aren't under the appropriations process: how much scrutiny goes into those budgets? For instance, it used to be the OMB Director.

I wonder in those days how much attention did you pay or does the OMB today pay to some of those agencies that are funded outside the appropriations process. What kind of critical review do they get? Can you talk a little bit about that? Because I think that is a concern to everybody.

For instance, that 23 percent increase, you say, well, tell us about that. But in general, since they are not under the process that the public sees with every other agency, are you comfortable with the amount of scrutiny they get before they spend the dollars that they spend even though they are mandatory?

Secretary LEW. Congressman, with regard to FSOC and OFR, they are funded through the Financial Research Fund, which was established as part of Dodd-Frank as a permanent source of funding. As part of each budget cycle, OFR and FSOC provide the public with detailed information that justifies planned expenditures during the upcoming year. The Financial Research Fund is subject to appropriate internal controls and has been subject to periodic audits.

I think it is important to have these independent regulatory activities funded the way they are funded. That has been a tradition with bank regulators. And I also think it is important that they provide the public with detailed information that shows how they are using the money. We would look forward to working with you to make sure that that happens.

Mr. CRENSHAW. Great. Well, thank you very much. And I think—Mr. Graves has no more questions.

Again, I want to thank you personally for your long career in government. Not that you are going away, I know you are going to the Bronx, you may come back. But thank you for your service to the country. Thank you for working with us. And we look forward to continuing to work together to make things better in this country.

Secretary LEW. Thank you, Mr. Chairman.

Mr. CRENSHAW. So, again, thank you so much.

Secretary LEW. And thank you for the cooperative way that you have worked with the Treasury Department to start meeting some of these very important needs.

Mr. CRENSHAW. Thank you.

This meeting is adjourned.

House Financial Services and General Government Subcommittee
Questions for the Record for Secretary Jacob J. Lew
Hearing on the United State Department of Treasury Budget
Hearing held March 16, 2016

Questions for the Record Submitted by Chairman Ander Crenshaw

The Alcohol and Tobacco Tax and Trade Bureau (TTB)
Trade practices

The Alcohol and Tobacco Tax and Trade Bureau (TTB) is responsible for enforcing the Federal Alcohol Administration Act (FAA Act).

Question 1:

How much in resources—FTE and dollars—does TTB expend on trade practice enforcement responsibilities?

Answer:

TTB currently has one Special Operations Investigator (SOI) who is responsible for overseeing trade practice investigations in addition to assisting in diversion investigations and providing support to criminal enforcement operations. Other investigators and attorneys assist this SOI on trade practice investigations on an as-needed basis.

An effective trade practice enforcement program, however, does not rely on investigations alone. TTB also regularly responds to individual industry member inquiries relating to trade practice prohibitions and has regularly issued guidance to the industry as a whole, which requires the involvement of regulations specialists and attorneys.

In FY 2015, TTB spent approximately $160,000 on direct program costs for trade practice enforcement, although this cost does not capture the full range of supporting activities by regulations specialists, attorneys, and others who contribute to the bureau's trade practice regulation and enforcement.

Question 2:

Would additional FTE's result in stronger trade practice enforcement investigations?

Answer:

Trade practice investigations are among the most difficult and labor-intensive investigations TTB conduct, typically requiring one to two years to complete. With our currently available resources, TTB completes between one and three investigations per year. The President's Budget does not seek an expansion of this program.

Question 3:

How has the Bureau carried out enforcement responsibilities and actions regarding the FAA Act since the Bureau was created?

Answer:

In 2005, within two years of being established as a bureau, TTB re-invigorated the FAA Act trade practice enforcement program it inherited from the Bureau of Alcohol, Tobacco and Firearms. The program was initially staffed with two experienced SOIs, who have since retired. Specialized training was developed and then provided in 2005, 2006, 2008, and 2013 to field personnel.

Since 2008, TTB has successfully pursued 19 trade practice investigations. We use our resources to investigate cases that we believe will have the greatest impact on conduct in the marketplace. These investigations have also resulted in Offers in Compromise totaling over $3.5 million, though this result is secondary to the importance of deterring illegal conduct. Additionally, TTB has issued public guidance regarding trade practices on six occasions since 2011 and has engaged in ongoing outreach to the industry.

Label and Formula Application Processing Time

The 2016 Omnibus provided an additional $5 million to the TTB to help accelerate the processing times for formula and label applications that are required by the Federal Alcohol Administration Act (FAA Act).

Question 4:

How has TTB used these additional funds and does this include new hires?

Answer:

With the $5 million provided in the 2016 Omnibus, and assuming the current funding level is continued through next year as proposed in the President's Budget, TTB anticipates achieving 10-day turnaround times for the vast majority of beverage alcohol label and formula applications as well as lab analyses by the end of FY 2017. To achieve these performance improvements, TTB is employing a multi-pronged approach that includes making IT enhancements, streamlining regulatory requirements, and hiring.

Approximately $3 million of the FY 2016 funding is being dedicated to enhancing our online application systems, Certificates of Label Approval (COLA)s Online and Formulas Online, to build system checks and add additional help features to assist industry members in submitting more compliant applications. Given that more than 40 percent of all initial label and formula applications are returned for correction, an increase in this compliance rate could significantly decrease the overall number of label and formula applications that require TTB specialist review, which supports faster processing. There are multiple new releases for these systems scheduled for deployment throughout this fiscal year. Improvements to Formulas Online are currently in prototype testing with industry members and are expected to go live this year

In the coming months, we intend to publish guidance documents that will eliminate the formula approval requirement for certain distilled spirits and wine products (similar to the removal of formula approval requirements for certain malt beverage products through Ruling 2015-1). The

elimination of these requirements should help to reduce the overall workload associated with the formula approval process, resulting in improved turnaround times for all formula approvals. We also intend to proceed with publishing a notice of proposed rulemaking to modernize the alcohol beverage labeling requirements, which should further facilitate the submission of compliant label and formula applications. Beginning this year, we are reviewing and updating our online guidance to address areas of frequent non-compliance, also with the goal of increasing the compliance rate of initial label and formula applications submitted to TTB to support improved processing times.

Finally, we are currently in the process of hiring 23 new employees, who will be primarily dedicated to processing label and formula applications and conducting lab analyses. Vacancy announcements have already closed for most of the positions, and TTB is in the process of making selections and extending offers.

As our new hires become proficient, they will be cross-trained to process label and formula applications for all three commodities, thereby giving us the flexibility to respond quickly to changes in workload and meet the needs and expectations of our regulated industry members.

Trans-Pacific Partnership (TPP) and Data Localization

The Treasury Department serves as the lead financial services negotiator in trade agreements, including the recently completed Trans-Pacific Partnership (TPP) agreement.

Question 5:

Has Treasury undertaken an analysis on the risks to these firms from data localization?

Answer:

The significant increase in data localization barriers to trade around the world is of serious concern to the Obama Administration. We are advancing efforts to reduce and prevent the proliferation of localization barriers to trade, including restrictions on data flows and requirements to establish infrastructure domestically, through the full range of bilateral, regional and multilateral fora, including the WTO, APEC, and the OECD.

With respect to financial services, over the last few months, Treasury and USTR have worked to develop a new approach for addressing concerns about the treatment of financial services under data localization obligations in our trade and investment agreements through extensive consultation with U.S. financial regulators, as well as feedback from Congress and stakeholders. Treasury and USTR have been working to achieve two important policy objectives: eliminating protectionist and trade-distorting data localization measures imposed by foreign governments in the financial services sector and ensuring that U.S. financial regulators have access to the information they need for regulatory and supervisory purposes.

We believe we have reached a good path forward and are looking to address concerns about data localization in the financial sector through a comprehensive multi-pronged approach. For

ongoing and future negotiations, we would propose an obligation that broadly prohibits all forms of data localization when financial regulators have access to information stored abroad. We would also propose obligations that provide companies with the opportunity to address potential access concerns before regulators impose data localization requirements.

Question 6:

Aren't trade agreements a potential forum for securing reasonable data storage agreements from trade partners?

Answer:

See answer to question 5 above.

Question 7:

As the lead representative for financial issues in bi-lateral economic talks and trade negotiations, what is Treasury's strategy to advocate for protections similar to those won for other sectors in TPP?

Answer:

See answer to question 5 above.

Financial Stability Oversight Council (FSOC)
Systemically Important Financial Institutions (SIFI) Annual Review Process

Many have voiced concerns about the FSOC's statutorily mandated annual review process. Stakeholders with insurance expertise, including voting and non-voting members of FSOC, have stated that reform of the processes for FSOC designations and de-designations are needed.

Question 8:

What requirements, if any, are there for FSOC to constructively engage with firms on how they can de-risk post-designation to get on the path towards shedding SIFI designations?

Answer:

FSOC provides each designated company with a lengthy and detailed explanation of the basis for its designation. These explanations provide a company-specific analysis that identifies specific potential risks arising from factors such as counterparty exposures and asset liquidations. This information allows each company to make informed decisions regarding potential changes it could make to mitigate the risks FSOC has identified. Following a designation, a company's management is in the best position to take information provided by FSOC and make decisions about how to move forward.

The FSOC reevaluates each of its designations annually based on a process set forth in the Dodd-Frank Act and in guidance FSOC has issued publicly. FSOC has also made clear that it may consider a request from a company for a reevaluation before the next annual reevaluation in the case of an extraordinary change that materially decreases the threat the nonbank financial company could pose to U.S. financial stability.

As part of each reevaluation, the company is provided an opportunity to meet with FSOC staff to discuss the scope and process for the review and to present information regarding any change that may be relevant to the threat the company could pose to financial stability, including a company restructuring, regulatory developments, market changes, or other factors. If a company contests its designation during FSOC's annual reevaluation and FSOC does not rescind the designation, FSOC provides the company with a detailed explanation of the primary basis for any decision not to rescind the designation. The notice addresses the material factors raised by the company in its submissions to FSOC contesting the designation during the annual reevaluation. In addition, FSOC provides each company subject to a designation an opportunity for an oral hearing before FSOC once every five years at which the company can contest the designation.

Question 9:

What requirements, if any, are there for FSOC to constructively engage with firms on how they can de-risk pre-designation?

Answer:

As described above, each of FSOC's designations has followed a lengthy period of analysis and extensive interaction with the company. Each company had many months and extensive opportunities to engage with FSOC and its staff, and the opportunity to understand and respond to the key factors underpinning FSOC's analysis before FSOC's vote on a final designation. For one of the companies that was designated, the FSOC and its staff engaged with the company for almost a year and a half, considered more than 21,000 pages of materials submitted by the company, and met with representatives of the company over a dozen times.

FSOC has been data-driven and deliberate in its work to evaluate nonbank financial companies for potential designation. FSOC established a robust and transparent process for designations. It issued a rule and guidance on the designations process that included three separate rounds of public comment, even though FSOC was not required to conduct a rulemaking. FSOC has also provided to Congress and posted on its website an explanation of its basis for each final determination, and has provided each of the designated companies with lengthy analyses describing FSOC's evaluation of that firm.

Question 10:

Has FSOC considered changes to the annual review process to require more formalized procedures for constructive engagement with firms on how they can de-risk and be un-designated?

Answer:

As described above, FSOC has a well-established process for annual reevaluations of its designations of nonbank financial companies. The procedures FSOC follows are set forth in section 113 of the Dodd-Frank Act, in the rule and interpretive guidance regarding nonbank financial company designations that FSOC issued in 2012, and in supplemental procedures related to nonbank financial company designations that FSOC issued in 2015.

The supplemental procedures FSOC adopted last year address the three key themes highlighted by stakeholders: earlier engagement with companies under review for potential designation, increased transparency to the public about designations, and stronger engagement with designated firms during FSOC's annual reviews of their designations. Those changes also provide each designated company with an opportunity to meet with staff every year to discuss the FSOC's annual reevaluation of the company's designation.

Safeguarding Sensitive Information Among FSOC Regulators

The Dodd-Frank Act bestows upon the FSOC and other financial regulators new authorities to collect and share information, including collecting on a routine basis an unprecedented level of sensitive and proprietary information. Regulators need to ensure that they have robust policies and controls to protect such sensitive data during its collection, storage and handling.

Question 11:

How are Treasury and other FSOC members safeguarding the sensitive information they collect, store, and share as part of their regulatory duties, from the financial institutions they regulate?

Answer:

FSOC takes seriously its obligation to protect sensitive, confidential information. FSOC has a secure portal that serves as the primary mechanism for the exchange of nonpublic information among member agency staff. The portal provides a secure platform for sharing sensitive information, and was designed to handle information considered to be at a FISMA impact level of "high."

Treasury staff engaged in the Council's work are required to adhere to the security protections and compliance obligations in place at Treasury. Treasury has policies and procedures governing the behavior of personnel with access to confidential information. These include, but are not limited to, rules that prohibit the misuse of confidential information.

Question 12:

What policies and procedures are in place among the FSOC regulators to protect the highly sensitive data they are collecting from the financial institutions they regulate?

Answer:

FSOC takes seriously its obligation to protect sensitive, confidential information. FSOC has a secure portal that serves as the primary mechanism for the exchange of nonpublic information among member agency staff. The portal provides a secure platform for sharing sensitive information, and was designed to handle information considered to be at a FISMA impact level of "high." FSOC and its member agencies have entered into memoranda of understanding that mandate the protection of confidential information shared among the agencies. FSOC's bylaws also include a provision relating to the protection of confidential and other forms of non-public information.

As described above, Treasury staff engaged in the Council's work are required to adhere to the security protections and compliance obligations in place at Treasury. Treasury has policies and procedures governing the behavior of personnel with access to confidential information. These include, but are not limited to, rules that prohibit the misuse of confidential information.

Oversight of the 1603 Treasury Grant Program

Senate Finance Chairman Orrin Hatch posed a number of questions in a letter sent on March 15, 2016 to both the Department of Treasury and the Internal Revenue Service, regarding the oversight of the 1603 Treasury grant program. The Section 1603 Treasury grant program of the 2009 American Recovery and Reinvestment Act allowed taxpayers the ability to receive a cash grant in lieu of claiming the investment tax credit (ITC) under section 48(d) of the Internal Revenue Code. In the case of a qualified solar property applying under the 1603 Treasury grants program, this conversion would equate to a cash equivalent of 30 percent of the upfront costs for a specified system.

In the letter, Chairman Hatch cited the apparent lack of oversight of such a large program – approximately $24.9 billion has been granted to date – and I too share these concerns. The Treasury Inspector General for Tax Administration (TIGTA) began an internal review of the 1603 program in 2012 upon questions of mismanagement. Within its findings, TIGTA flagged that the Internal Revenue Service (IRS) did not have a system in place to properly identify taxpayers who have taken advantage of the 1603 program so that those certain taxpayers cannot in turn also double-dip by taking advantage of the Section 48 ITC. While investigating this potential abuse, reports surfaced that several prominent solar leasing companies were being subpoenaed by TIGTA with respect to a *second* avenue of 1603 program abuse: these firms were apparently also over-inflating the cost of the solar energy system in order to receive a larger 1603 grant amount than entitled.

Question 13:

If there was found to be abuse of the 1603 program, both from the perspective of those double-dipping and those over-inflating the costs of the solar energy system that were installed, what are the Departments plans for recapturing those funds? Is there going to be a larger/separate investigation into the issue of whether or not applicants were

overstating the fair market value of these solar energy systems in order to increase their grant amount?

Answer:

Treasury carefully reviews applications received under the Section 1603 program before payments are made, including a review of the applicant's claimed basis, taking into account the specifics of the application in question and supporting documentation provided by the applicant. Where Treasury concludes that an applicant's claimed basis was not properly calculated, Treasury will adjust the Section 1603 payment to a more appropriate level. This includes applications where the Section 1603 program finds that an application includes ineligible costs in the claimed qualified cost basis or where that claimed cost basis is otherwise overstated. As of March 31, 2016, out of 104,724 awarded Section 1603 applications, 29,249 awards have been reduced from the amounts requested by a total of $1.3 billion. Treasury also supports the vigorous prosecution of fraud and, where appropriate, makes referrals to its Office of the Inspector General (TIG), which provides oversight of the 1603 program. At this time, based on referrals from the Section 1603 program office, there are ongoing investigations of whether or not certain applicants have knowingly overstated the fair market value of their solar energy systems. We refer you to TIG for more information about the status of its work. In addition, the Section 1603 program provides information to the Internal Revenue Service (IRS) so that the IRS can determine whether a taxpayer that has claimed a tax credit for a property has received a Section 1603 payment for the same property. In cases where "double-dipping" is found, i.e., where a taxpayer seeks an investment or production tax credit under the Internal Revenue Code for an energy property for which it has received a Section 1603 payment, the tax credit will not be allowed.

A five-year extension of the section 48 ITC was a made part of the final omnibus appropriations bill that Congress passed at the end of last year.

Question 14:

If potential abuses were found within the investigation of the 1603 program, are there plans by your department to monitor and investigate whether these solar companies are potentially abusing the section 48 ITC through the over inflation of the costs of the qualifying projects? If companies are still abusing the system, taxpayers could potentially be on the hook for billions of dollars. This is issue we need to be diligent on.

Answer:

We are aware of potential issues of possible overclaims associated with the Section 1603 program. IRS has a Compliance Initiative Project (CIP) that examines taxpayers that received Section 1603 grants. An initial examination of 21 taxpayers found no significant adjustments related to overvaluing qualifying projects, except for certain rooftop solar leased projects. The CIP has been extended to December 31, 2016, in order to allow for a second phase of audits focusing on rooftop solar leased projects. We are further aware that the recent extension of the section 48 ITC for solar property creates the need for ongoing diligence and controls related to these issues. IRS and Treasury are currently working on guidance to implement the extension of

the section 48 ITC. In addition, included as an item on IRS and Treasury's Priority Guidance Plan is a project to update the regulations under section 48. These guidance projects provide an opportunity to better tailor the applicable rules to current industry practices and also to provide safeguards against potential abuse.

U.S.-China Bilateral Investment Treaty (BIT)

The U.S.-China Bilateral Investment Treaty (BIT) should substantially open China's market to allow U.S. companies, including financial services firms, to compete on a level playing field with local firms, while putting in place important investor protections.

Question 15:

What is the Treasury Department doing to secure a high standard BIT for American firms?

Answer:

The Treasury Department is actively working with USTR and State, and other U.S. agencies, to negotiate a high standard BIT with China that will help create a wide range of opportunities for U.S. firms to participate in the Chinese market and provide critical protections to U.S. investors and investments in China. In addition, we use our bilateral engagement, such as the Strategic & Economic Dialogue (S&ED) and Secretary Lew's regular calls with Chinese Vice-Premier Wang Yang, to encourage progress in the BIT. For example, at the 2013 S&ED, China agreed for the first time to negotiate a BIT that would cover all phases of investment and all sectors of the Chinese economy, except for a set of limited and transparently negotiated exceptions (the so-called "negative list"). This was critical for moving forward with BIT negotiations.

Question 16:

Will the BIT establish a roadmap to hold China accountable for the commitments made under the agreement, including timelines for making market access improvements?

Answer:

The BIT investment protection obligations and market access commitments would be enforceable once the United States and China have ratified the BIT.

Total Loss Absorbing Capacity (TLAC)

Since the passage of Dodd Frank, U.S. regulators have been increasing the amount and quality of capital and liquidity in the financial system.

Question 17:

How much capital and liquidity will be enough to balance the need for financial stability with the imperative to provide credit to the U.S. economy?

Answer:

Improving the capital and liquidity position of our institutions has not impeded capital and credit availability, particularly for large firms. In fact, institutions with stronger capital and liquidity positions are better positioned to provide credit to support the economy when it is most needed.

Since the financial crisis, regulators have crafted new, stronger rules to ensure that banks have enough capital and liquidity to withstand periods of stress without negatively affecting financial stability. Notably, the Basel III capital rules have improved both the quantity and quality of capital for large, internationally active banks. The largest banks have more than doubled their capital levels from 2009 to today, adding nearly $700 billion of additional capital. U.S. banking regulators have also strengthened liquidity risk management through rules like the liquidity coverage ratio and the proposed net stable funding ratio, which require banks to have ample liquidity to survive an acute period of financial stress.

Over the past six years, we have seen that lending continues to grow, asset quality continues to improve, and the banking sector has generally shifted to more stable funding and stronger liquidity buffers. This material reduction in financial system risk promotes both financial stability and long-term economic growth.

Question 18:

When will this goal be achieved?

Answer:

Regulators still need to finish important outstanding rules, such as the Federal Reserve's Total Loss Absorbing Capacity Rule, that would make it easier to resolve our largest and most complex banks.

On October 30, 2015, the Federal Reserve Board (Fed) issued Proposed Rules requiring the largest U.S. banks and the largest U.S. subsidiaries of the largest foreign banks to maintain minimum levels of what is known as Total Loss Absorbing Capacity (TLAC) which must include a mandated amount of long-term unsecured debt.

Question 19:

With the recent adoption of capital surcharges and the TLAC proposal, what do all of these changes mean on a cumulative basis for the U.S. banks and the U.S. economy?

Answer:

Both of these rules are designed to make our financial system more resilient. The risk-based capital surcharge required of our largest and most complex banks was designed to make these firms bear the costs that their failure would impose on others. These firms must either hold substantially more capital or shrink their systemic footprint, reducing the harm that their failure would do to our financial system. The TLAC proposal, if finalized, would require further

issuances of capital and long-term debt by these firms in order to improve their resiliency and resolvability.

Though the additional capital and debt requirements impose additional costs on these firms, benefits of these measures include a reduction of the risks that the failure of these firms would impose on our broader economy.

Question 20:

What actions is the industry taking to comply with these new requirements?

Answer:

Some large U.S. banks have been reducing their systemic footprint in response to rules like the risk-based capital surcharges. The TLAC standard has yet to be finalized as a U.S. rule. Once adopted as a final rule by U.S. regulators, the Federal Reserve has estimated that firms would issue additional capital and long-term debt.

Question 21:

What impact have these actions had on the cost structure of the industry and its ability to attract capital?

Answer:

By design, these rules have increased the costs associated with a financial company's size and to require our largest and most complex banking organizations' equity and debt holders to bear the costs of the firms' failure. By some estimates, the financial crisis cost the U.S. economy trillions of dollars.

Question 22:

Has Treasury discussed with the Fed potential for disparate treatment of covered U.S. subsidiaries of foreign banks?

Answer:

Treasury staff is aware of this concern and is working with the Federal Reserve in considering the issue.

Cumulative Impact of Regulations

There is considerable discussion about the impact of post-Dodd-Frank financial regulations on the markets and the broader economy.

Question 23:

Has Treasury considered assessing the cumulative impact these regulations are having on the economy? If not, why not?

Answer:

Reforms adopted following the financial crisis have created a stronger, more resilient financial system. Treasury continues its work analyzing financial markets and market structures. For example, Treasury is engaged in the official sector's most comprehensive review of the Treasury market since 1998. In 2015, Treasury, together with the Federal Reserve Board, the Federal Reserve Bank of New York, the CFTC and the SEC, issued the Joint Staff Report on the events of October 15, 2014. Earlier this year, Treasury issued a request for information on the evolution of Treasury market structure and has recently reviewed the public comments received. We are also working with FSOC-member agencies to identify and address potential risks to financial stability arising from changing market structures and shifts in the composition of market participants.

The European Commission has issued a "call for evidence" in which it is seeking empirical evidence and concrete feedback on the impact of financial rules, to include the ability of the economy to finance itself and grow, unnecessary regulatory burdens, inconsistencies, gaps and unintended consequences.

Question 24:

Is Treasury considering doing a similar analysis?

Answer:

In addition to the aforementioned work at Treasury analyzing financial markets and market structures, Treasury supports the efforts of the independent regulators, working with industry, advocates and Congress to continue to adjust and improve regulatory approaches to better tailor rules to an institution's size, complexity and riskiness. For example, federal regulators are diligently executing the statutory Economic Growth and Regulatory Paperwork Reduction Act of 1996 (EGRPRA) mandate to eliminate outdated, unnecessary or unduly burdensome regulations applied to insured depository institutions. The federal banking agencies through their comprehensive decennial EGRPRA review, as mandated by Congress, are reviewing all of their regulations, including those adopted to implement the Dodd-Frank Act.

Question 25:

Does Treasury believe the cumulative effect of all the new and enhanced regulation - such as the leverage limit, the G-SIB surcharge, the liquidity coverage ratio and TLAC play a contributing role in the changes to the liquidity of global financial markets?

Answer:

Post-crisis financial reform has made the financial system safer and more resilient. Financial reform has created more resilient financial intermediaries, more stable funding profiles, and sounder market structures, providing the foundation for deep, liquid, and resilient capital markets.

Despite repeated claims to the contrary, there is no compelling evidence of a broad-based deterioration in liquidity. In fact, most traditional measures of liquidity across U.S. fixed income sectors are well within historical levels. Market participants point to a number of measures as proxies for liquidity, including bid-ask spreads, trading volume, market depth, and the price impact of trades. Each of these measures captures some aspect of liquidity, but none is comprehensive.

Housing Finance Reform

Fannie Mae and Freddie Mac remain in conservatorship.

Question 26:

In 2016, how does Treasury intend to reform housing finance?

Answer:

After more than seven years, Fannie Mae and Freddie Mac are still in conservatorship, and taxpayers remain at risk. The best way to responsibly end conservatorship of the GSEs is through comprehensive housing finance reform legislation. We believe such a reformed system should require more private capital in the system; end the Fannie Mae/Freddie Mac duopoly business model in order to improve system stability and better protect taxpayers; ensure broad access for all creditworthy families to sustainable products like the 30-year fixed rate mortgage in good times and bad; and help ensure sustainable rental options are widely available . The Administration remains committed to supporting comprehensive, bipartisan housing finance legislation that supports these principles.

Question 27:

What incremental progress can be made by Congress, short of comprehensive reform?

Answer:

The Administration remains committed to enacting bipartisan comprehensive housing finance legislation. In the interim, we appreciate the important transition efforts made to date by the Federal Housing Finance Agency with respect to reducing the GSEs' retained investment portfolios, cultivating their respective credit risk transfer programs, and building a common securitization platform. Additionally, we are encouraged by FHFA's progress in defining important obligations for the enterprises' duty to serve underserved markets.

U.S. Treasury Market

Treasury and the other agencies recently put out a broad request for information on the changing structure of the market for US Treasury securities. This comes on the heels of the Joint Report on the October 2014 flash rally and numerous public discussions on the changing profile of the market in terms of participants and overall strueture.

Question 28:

Are there particular areas within the market where Treasury is focused and concerned that either new structures or new participants may be impacting the overall efficiency and liquidity of this important and unique market?

Answer:

One of the key observations of the Joint Staff Report on the events of October 15, 2014 was the increased prevalence of principal trading firms (PTFs) as market-makers in the cash Treasury markets. Treasury's request for information asked several questions about the implications for market structure and market functioning, as well as liquidity provision, in Treasury markets. The growth of PTFs has been driven by technological developments that have reshaped the structure of all standardized securities markets, including on-the-run Treasury securities. Another observation from the JSR is the increase in high-frequency trading, which is increasingly prevalent in Treasury markets and is used by an array of firms, ranging from owner-operated start-ups to the largest hedge funds and broker-dealers, reshaping an entire industry structure. It has exerted competitive pressure on traditional players by tightening pricing parameters and creating informational advantages.

As with any major technology disruption, there are potential benefits and risks arising from the growth of PTFs and high-frequency trading. The key for policymakers is to recognize that the technology is here to stay, and we need to be forward thinking about its effects on market functioning. At Treasury, we are engaging with market participants, academics and other policy makers to better understand the new market structure.

Questions for the Record Submitted by Congressman Mark Amodei

Financial Stability and Oversight Council authority over the Consumer Financial Protection Bureau

The Consumer Financial Protection Bureau (CFPB) was created under Dodd-Frank as an independent agency run by a director as opposed to a commission. Because there is no commission, the director may begin rulemakings and operate the Bureau with no system of voting or check by commission members with alternate view-points. The CFPB operates off transfers from the Federal Reserve and does not answer directly to any oversight authority other than the Financial Stability and Oversigbt Council's (FSOC) ability to veto a rule. Though the CFPB must follow Administrative Procedures Act policies for rulemakings, they are not subject to Office of Management and Budget (OMB) review process. The CFPB under the direction of one, unelected director (subject to Senate confirmation) is able to collect data, examine financial institutions, issue guidance, and develop policy with essentially no oversight.

Since the Dodd-Frank bill passed and CFPB inception, community banks have lost market share at a rate double that of before the bureau's existence. They lost market share at a rate of 6% between 2006 and 2010 (the financial crises) but at a rate of 12% from 2010 to 2014 (Dodd-Frank enactment). This information is credited to a study done by fellows at the Harvard Kennedy School of Government. The study finds that the community banks are losing share in real estate and business loans. The study is based on data provided by tbe FDIC whose chairman serves on the FSOC voting board. According to the CFPB itself, community banks are "a lifeline to hardworking families paying for education, unexpected medical bills, and homes." According to the Federal Reserve Board of Governors, who also are represented on the FSOC voting board, the loss of community banks could result in the total loss of credit in some rural and small markets.

Interpersonal-relationships are the backbone of community bank lending (according to all of the above entities) and the CFPB promulgates one-size-fits all rules that remove the flexibility for community banks (and credit unions) to use judgement and work with their neighbors on lending. They do this in-spite of the fact that community bank default rate hovers around 3% as opposed to the larger bank rate of 10%.

Though the FDIC has claimed that the declining number of community banks is overstated because often the failing banks are consolidated and bought out by other banks, the FDIC fails to consider bow regulatory burden has impacted these failures. In 2014, studies conducted by universities and state fed branches found that 1/3rd of community banks would have to hire new legal staff to help them comply with new regulatory burden and 1/3rd of community banks had already done so. The study found that hiring just two additional staff members would make 1/4th of these institutions unprofitable.

In 2012, former FDIC chair, Sheila Bair said that community banks have gotten out of the business of consumer lending because its too hard and too expensive to comply with CFPB rules. The Federal Reserve System held a conference of State Bank Regulators in 2014 where they stressed that community banks are deeply concerned about looming CFPB regulations.

FSOC is directed by Dodd-Frank to facilitate information sharing and coordination amongst member agencies and state and local agencies when in the context of financial regulations, rulemakings, examinations, and enforcement actions. However in its 150 page 2015 report, FSOC hardly mentions small financial institutions and does not address community bank closure impact at all.

Question 1:

What do the members of FSOC believe to be "significant economic harm" if not the rapid closure and consolidation of small banks across the country?

Answer:

FSOC's responsibility is to identify and address threats to financial stability and as part of its work, regularly assesses macroeconomic and financial market developments. FSOC members have noted that community banks play a critical role in providing credit and banking services for households and businesses across communities throughout the United States. As a result, FSOC members have supported tailored approaches to regulation. For example, the CFPB relaxed the Qualified Mortgage ("QM") standards for small and rural originators and also for smaller mortgage servicers. The banking agencies have also taken numerous steps to tailor their rules, including efforts to streamline regulatory reporting, expand the universe of well managed community banks subject to examination every 18 months instead of every 12 months, and make it easier for new banks to be chartered. Moreover, banking agencies have been undertaking a review of the rules and regulations they have issued over the past 10 years as required by the Economic Growth and Regulatory Paperwork Reduction Act (EGRPRA). The agencies have held multiple public outreach sessions around the country, have collected written public comment on a wide range of rules, and plan to submit a final report on the EGRPRA review by the end of this year.

The consolidation of small banks across the country, however, does not appear to be a post-crisis development but part of a longer-term trend that has been going on for several decades. Banks have sought to merge or acquire other banks in order to grow services across a wider geography, lower operating costs and spread credit risk over a larger, more diversified customer base. Moreover, while community banks face some pressure on earnings because of the current low interest rate environment and their heavy reliance upon net interest income, the FDIC reports that community banks are broadly profitable and, as a group, are outpacing the industry in terms of both earnings and loan growth. The CFPB recently noted that number of community banks and credit unions that originated home-purchase mortgages last year was higher than the year before.

Question 2:

What methodology does FSOC use when determining which rules should be considered for veto?

Answer:

Section 1023 of the Dodd-Frank Act provides that a member agency may petition the Council to set aside a final regulation of the Bureau if the Council decides that it would "put the safety and soundness of the United States banking system or the stability of the financial system of the United States at risk." Section 1023 also sets forth certain procedural requirements, including that the agency filing the petition has in good faith attempted to work with the Bureau to resolve concerns. The Dodd-Frank Act appropriately sets a very high standard for FSOC to take action regarding the Bureau's independent rulemaking process.

Question 3:

Considering that multiple members of FSOC's voting board have identified community banks as economically significant, but has not yet take any action to prevent CFPB rules from buckling the industry: What communication coordination policy does FSOC have to make sure that its voting members are sharing information as directed by Dodd-Frank?

Answer:

FSOC has written protocols for consulting on rules for which coordination is required under the Dodd-Frank Act. Further, FSOC's Deputies Committee and its other staff-level committees provide fora in which agencies can coordinate or consult. The Government Accountability Office has studied how federal financial regulatory agencies have coordinated the implementation of rulemakings required under the Dodd-Frank Act, and has found that agencies recognize the importance of interagency coordination and exceeded the coordination and consultation requirements of the Dodd-Frank Act by engaging in numerous instances of voluntary regulatory coordination.

Questions for the Record Submitted by Ranking Member José E. Serrano

Impact of Budget Cuts

Regarding the impact of the deep cuts in the IRS budget, when inflation is taken into account the IRS was down to 1998 levels in 2015 and only recently received an increase (which still has them down almost 19% below 2010 levels).

Question 1:

What are the short and long-term ramifications of reducing the ability of the IRS to accurately and efficiently collect tax revenue?

Answer:

Budget reductions since FY 2010 have had a significant impact on IRS performance and create long-term risk for tax administration. Between FY 2010 and FY 2015, the IRS budget was reduced by $1.2 billion (9.9 percent) even as the filing population continued to grow with over 7 million additional individual filers. Despite an additional investment of $290 million this year (FY 2016), the IRS budget is 17 percent lower than it was in FY 2010, accounting for inflation.

As a result of these cuts, IRS staffing has declined by nearly 15,000 through FY 2015, including over 5,000 fewer key enforcement positions. These cuts have had a dramatic impact on taxpayer service and tax law enforcement efforts. In FY 2015, telephone level of service declined to 38 percent, an unprecedented and unacceptable low. At the same time, individual examination coverage declined from 1.1% in FY 2010 to 0.8% in FY 2015 (representing 350,000 fewer audits), while rates for small and large corporations declined as well. Declining enforcement activity is estimated to have cost the government over $20 billion in lost enforcement collections over the last five years.

Moreover, although level of service has improved somewhat thanks to additional funding this year, the implications of reduced service and enforcement on voluntary compliance over the long run is concerning. The success of the nation's voluntary compliance taxation system depends on compliant taxpayers being able to receive the assistance they need to accurately determine their tax liability and conveniently pay what they owe while reassuring those taxpayers that non-compliance by others will be identified and rectified. Over time, the declines in both service and enforcement activity threaten to undermine the nation's high levels of voluntary compliance if compliant taxpayers change their behavior because they cannot get the help they need or they no longer believe the system is fair. Based on historical data, a one percent decline in the voluntary compliance rate would result in a $30 billion decline in tax revenue.

Besides voluntary compliance, reduced staffing and resources have significant ramifications for effective tax administration going forward. The following examples are not intended as an exhaustive list but identify some of the most serious risks.

- As a result of the ongoing hiring reductions, the IRS faces a significant loss of expertise as experienced employees retire and there is insufficient funding to replace them. Delays in hiring mean that accumulated knowledge cannot be transferred to new staff, and some skills may be irretrievably lost. Although the IRS recently initiated an enforcement personnel hiring effort, this will replace less than a third of the 2,400 enforcement staff that the IRS expects to lose this year alone.
- IRS information technology infrastructure is unacceptably aged, with nearly 60 percent of the hardware inventory in need of updates. Aged hardware and software is more costly to maintain and increases the risk of a critical failure that could threaten the filing season or other aspects of IRS operations.
- The ability to address emerging tax administration demands is severely limited by reduced funding. New demand may come in a variety of forms, including: delivering new services (online account access or taxpayer digital communications), addressing emerging threats to privacy and the tax system (cybersecurity, identity theft and refund fraud), and implementing new legislative mandates (private-debt collection, the Affordable Care Act or the ABLE Act). While the IRS has been able to make headway in each of these areas, that progress at times has been slow and the lack of new resources has required that these demands be met at the expense of other base activities.

Community Development Financial Institutions (CDFI)

You are also proposing legislative changes to the Bond Guarantee program, such as reducing the minimum bond issue size from $100 million to $25 million.

Question 2:

How will these changes enhance the program?

Answer:

The CDFI Bond Guarantee Program addresses a fundamental challenge in revitalizing communities, creating jobs, and expanding economic opportunity: many low-income and underserved communities require long-term, fixed-rate financing that the private market does not generally offer. The program provides a long-term, fixed-rate source of capital so CDFIs can provide the financing communities need.

Despite receiving $2.75 billion in authority for FYs13 to 16, the CDFI Fund was able to issue just $852 million in bonds over those periods. In reviewing the rounds, our research suggests many CDFIs have limited equity to support the minimum size bond loan that Qualified Issuers find cost effective to participate in the program.

Reducing the Bond Issue minimum to $25 million would enable a Qualified Issuer to assemble smaller pools of CDFIs that do not have the capacity to lend or manage $100 million bond issue but still have a need for long-term capital in their communities.

We anticipate broader participation as a result of the decrease in the minimum Bond Issue size which would increase the likelihood that the Bond Loan proceeds would be disbursed to a larger geographic area and across multiple business sectors and low-income communities. This change would particularly benefit CDFIs in rural communities and those with smaller-scale projects.

A legislative change that authorizes the adjustment of the Risk-Share Pool requirement from zero to four percent would provide flexibility for Qualified Issuers to structure pools of Eligible CDFIs and diversify risk across the portfolio. In instances of a very strong CDFI, the Risk-Share Pool requirement could be reduced to zero or one percent, resulting in lower cost to the Eligible CDFI. Conversely, Eligible CDFIs that score with a positive subsidy could be required to provide a higher payment to the Risk-Share Pool of up to four percent to offset the positive subsidy.

To diversify risk across the program, the CDFI fund is also requesting legislative authority to assess a one percent fee on each Bond Issue.

You've requested an increase of $2.4 million in the CDFI Administrative budget—this is relatively small compared with some of other numbers that we will discuss today, but it has an outsized impact.

Question 3:

What will this money allow you to do and what will happen if you do not receive the increase?

Answer:

The CDFI Fund administrative budget supports a variety of purposes including staffing, administration of non-monetary programs and activities, and the enhancement of existing management and information systems. At the FY16 level of funding CDFI Fund is forced to use staff from other federal programs to supplement existing staff. The $2.4 million increase will allow the CDFI Fund to effectively staff programs, continue program evaluations and research efforts, and develop the Community Development Impact Measuring Estimator (CDIME) modeling tool, which will standardize the reporting of job and social impact performance measures.

This relatively small increase will have a huge impact on the CDFI Fund's operations. If the additional funding is not received, the CDFI Fund will continue to manage programs using staff from other federal programs where feasible to supplement existing staff. Lack of additional funding will also delay critical infrastructure and support projects such as the development of the CDIME and timely completion of program evaluations which would support and inform planned improvements to the Fund's award and management processes.

DATA Act

Congress passed the Digital Accountability Transparency Act of 2014 and now the agencies have to implement it at the same time that budgets are under a lot of pressure.

Question 4:

You're requesting an additional $6 million at Treasury to comply—what will you be doing with that funding?

Answer:

Treasury's DATA Act implementation activities will continue into FY 2017. The $6.2 million that Treasury requested in the FY 2017 President's Budget includes $3 million for the Administrative Resource Center (ARC),$3 million as a portion of the Department-wide Systems and Capital Investments Programs (DSCIP), and $237,000 in Departmental Offices Salaries and Expenses (S&E). ARC will use its funding to upgrade ARC's financial management system platform to meet DATA Act reporting requirements for ARC's shared services customer agencies. This funding will also support ARC in improving business processes supporting FPDS reporting and other award reporting to USASpending.gov in preparation of the new DATA Act reporting. ARC will also prepare for and provide ongoing DATA Act reporting services to federal agencies using ARC's system platform. Separately, Treasury's $3 million DSCIP request will be used to support bureau development, modification, and integration of attributes to address gaps at the transaction level for affected systems and will help mitigate any reporting service costs. Treasury's request will also be used to automate and build upon disparate interfaces of Treasury systems across financial management, procurement, grants, and loans. Finally, Treasury's S&E request will be used to establish a DATA Act Program Management Office (PMO) within the Office of the Deputy Chief Financial Officer to oversee and coordinate Treasury's DATA Act implementation.

Cybersecurity Enhancement

You're proposing to create a cybersecurity enhancement program that would be a centralized account funded at $109.8 million.

Question 5:

Are these activities currently funded? What is the benefit of this new centralized account? Is this increasing the amount of spending on cybersecurity? What will actually be done differently?

Answer:

The following two activities are currently funded under the Departmental Offices Salaries and Expenses Account, but the President's Budget proposes transferring them to the Cybersecurity Enhancement Account (CEA) for the purpose of consistency:

- IT Cybersecurity Enhancements with $1.1 million.
- Digital Infrastructure Security Team with $2 million.

Other than those two items, the proposed new cyber spending is in addition to the substantial current Treasury efforts to protect the Department and taxpayers from cyber-attacks.

Cybersecurity is a top priority for Treasury and the Administration. Centralizing increased spending in the CEA will help Treasury leadership direct funds as appropriate to achieve cybersecurity objectives. The CEA will provide a platform that will enable and encourage information sharing across Treasury bureaus at the direction of the CIO, thereby supporting the goals of the Federal Information Technology Acquisition Reform Act (FITARA). Establishing a dedicated cybersecurity account will also provide the flexibility between bureaus to fund unforeseen critical cybersecurity needs without sacrificing scheduled work. Finally, the three-year authority requested for the CEA will enable Treasury to plan multi-year investments in cyber defenses, and take a more holistic view in protecting information systems that are critical to the national economy.

The Cybersecurity Enhancement Account begins to centralize cybersecurity investments to fully leverage leadership and expertise across the Department. The CEA will enable better allocation of cybersecurity resources, identification, and promulgation of best practices, and improved visibility among senior leadership into cybersecurity spending and activities.

Corporate Inversions

Undoubtedly a major issue facing the Treasury is the problem of corporations renouncing their American citizenship to dodge taxes, while claiming benefits paid for by other business and individual taxpayers. Both House and Senate members urged you last month to apply more fully every tool at your disposal to stop these inversions and stem the flow of revenue that we are losing as a result of these tax-motivated deals. One form of tax avoidance is what tax lawyers call a "hopscotch" transaction – a move that one of the prior Treasury Notices addressed. But these narrow notices have been circumvented, and the problem has only worsened. The Wall Street Journal counted the Johnson Controls-Tyco deal as the 12th expatriation since the first Treasury Notice in September 2014. Just lowering the threshold in that prior notice would prevent the Pfizer merger from going through or, if it proceeded, result in tens of billions more to the U.S. Treasury.

Question 6:

Will Treasury be responding positively to those requests and adopting regulations that will prevent Pfizer and other multinationals from dodging their responsibility to help pay for our national security and other vital public services?

Answer:

On April 4, 2016, the Treasury and the Internal Revenue Service (IRS) issued temporary regulations that both limit the ability of U.S. companies to undertake a corporate inversion and reduce the potential tax benefits of inversions. In addition to formalizing Treasury's two previous actions contained in Notices released in September 2014 and November 2015, these temporary regulations take additional actions to limit inversions and to reduce the potential tax benefits of inversions. In particular, the temporary regulations prevent a foreign company (including a company that has recently undergone an inversion that acquires multiple U.S. companies in stock-based transactions over a short period of time from using the resulting increase in size to avoid the statutory inversion ownership thresholds for a subsequent U.S. acquisition. Furthermore, on April 4, 2016, the Treasury and the IRS also issued proposed regulations to curb the use of earnings stripping by focusing on transactions that some multinational firms use to generate large interest deductions in the United States by simply transferring financial instruments that they characterize as debt between subsidiaries without financing new investment in the United States.

We will continue to explore additional ways to limit inversions. But only Congress through legislation can stop these transactions. Until that time, creative accountants and lawyers will continue to seek new ways for companies to move their tax residences overseas and avoid paying taxes here at home. We urge Congress to take action, and we believe the best way would be to enact comprehensive business tax reform with specific anti-inversion provisions. These proposals are detailed in our FY 2017 Budget submission. The Administration has been working with Congress for several years in an effort to reform our business tax system, and make it simpler and more pro-growth.

WITNESSES