Questions for the Record to George W. Madison

Nominee for General Counsel, US Department of the Treasury

Questions from Chairman Baucus

Question 1:

Executive compensation is an issue of great importance to me, this Congress, and the American public. I fought hard to include executive compensation limits in the TARP, and I expect Treasury to quickly and fully implement these limits. Will you commit to implementing these executive compensation limits? What are your thoughts generally on the current limitations, and how do you think Treasury should handle this issue going forward?

Answer: I agree that executive compensation is a very important issue in the TARP. TARP recipients must be good stewards of the money they have received from the American public and the compensation limitations established in the American Recovery and Reinvestment of 2009 (ARRA) must be followed. You have my commitment that, if confirmed, under my leadership, the Treasury Legal Division will provide the necessary legal oversight to implement this important law.

I understand that the Department has been working diligently to draft the regulations called for in the ARRA to implement these executive compensation provisions as quickly as possible. These regulations will require the appropriate limitations on compensation, and also establish standards for compensation structures to eliminate the incentives for excessive risk that may have contributed to the economic turmoil we are facing. If confirmed, I look forward to engaging directly on this important issue.

Question 2:

In your role as General Counsel you will oversee the Office of IRS Chief Counsel. In the past, the IRS and Treasury have been criticized for failing to issue timely guidance that would give taxpayers certainty in how to treat complex tax matters. Concerns also exist that the choice of guidance projects may be unduly influenced by lobbyists and other self-interested stakeholders. Timely and well-chosen public guidance promotes effective tax administration, fairness among similarly situated taxpayers and helps reduce the tax gap.

1) What principles and factors will you follow when considering and deciding which guidance projects are undertaken?
2) How can the guidance process be improved so that necessary guidance is issued in a more timely way?

The IRS Office of Chief Counsel ("Counsel") is responsible for interpreting the tax laws through its published guidance program, which is closely coordinated with the Department of the Treasury Office of Tax Policy ("OTP"). A strong published guidance program will help taxpayers understand and meet their tax responsibilities and help the IRS apply the tax laws fairly and consistently.

Each year, the Assistant Secretary (Tax Policy), the IRS Commissioner, and the IRS Chief Counsel publish a Guidance Priority List to identify and prioritize the tax issues that should be addressed through regulations, revenue rulings, revenue procedures, notices, and other published administrative guidance. Additional projects arise throughout the guidance plan year depending on various factors, including legislation passed by Congress, changes in economic conditions, and other events, such as the creation of new transactions or instruments by the private sector.

OTP and IRS seek input from the public, the IRS Operating Divisions, and their own staffs to formulate an annual Guidance Priority List that focuses resources on guidance items that are most important to taxpayers and tax administration.

A significant factor in determining guidance priorities is tax legislation. Whenever significant legislation is enacted the Treasury Department and the IRS dedicate substantial resources to publish guidance necessary to implement the provisions of the legislation. In recent years, the list has included projects addressing a multitude of tax acts including, but not limited to, the American Jobs Creation Act of 2004; the Pension Protection Act of 2006; the Economic Stimulus Act of 2008; the Housing Assistance Tax Act of 2008; the Emergency Economic Stabilization Act of 2008; the Energy Improvement and Extension Act of 2008; the Tax Extenders and Alternative Minimum Tax Relief Act of 2008; and the American Recovery and Reinvestment Tax Act of 2009.

A recent notice requesting recommendations for the annual priority guidance plan states that in reviewing recommendations and selecting projects for inclusion in the Guidance Priority List, the Treasury Department and the IRS will consider a number of factors in determining whether a proposed project should be prioritized. These include whether the guidance will resolve significant issues relevant to many taxpayers; whether it will promote sound tax administration; whether it can be drafted in a manner that will enable taxpayers to easily understand and apply the guidance; whether it can be administered by the IRS on a uniform basis; and whether it will reduce controversy and lessen the burden on taxpayers or the Service. I agree that these are generally the appropriate criteria on which to formulate a plan that identifies and prioritizes tax guidance that should be issued.

Recommendations for guidance from taxpayers, tax professionals, Members of Congress and their staffs, and the public in general are accepted and considered at any time during the year, but the annual Priority Guidance List helps to organize a starting point for priorities and to provide an estimate of the capacity of the various organizations involved to provide guidance.

The process for issuing guidance is a complex one that involves many parties within the IRS and Treasury. On March 4, 2008, the Treasury Inspector General for Tax Administration issued a report, "The Published Guidance Program Needs Additional Controls to Minimize Risks and Increase Public Awareness" making recommendations for improving the process. I understand that many of those recommendations have been adopted but that improvements are still possible, including enhanced coordination among the many offices that are required to approve guidance before it is published.

I too am concerned about the timeliness of IRS guidance documents and share the concerns of constituency groups that such guidance needs to be timely in order to be both an effective tool for taxpayers and a valuable tax administration tool for the IRS. If confirmed, I am committed to studying this process to identify procedures to streamline the issuance and legal review functions. One of my top initiatives will be to coordinate my activities in this area with the IRS Commissioner.

You have my commitment that, if confirmed, I will carefully review the ways in which the General Counsel's Office can contribute to an improved process that produces prompt and useful tax guidance. I will also review and evaluate the degree to which lobbyists and other outside groups may influence the legal review of IRS guidance and ensure that any input by such groups is in compliance with Administration policy.

Question 3:

At your hearing, we discussed the problem of banks improperly freezing and garnishing protected federal benefits, such as Social Security and Veterans benefits. This committee held a hearing on this issue in September of 2007. It became apparent at that hearing that Treasury, working with the involved federal agencies and the banking institutions, needed to issue regulations with clear guidance on how these benefits are to be protected. We have been working with Treasury since that time to assist them in issuing this guidance. But to date, they have not been issued.

On May 13 of this year, Michael S. Barr, Assistant Secretary of the Treasury for Financial Institutions, said in his confirmation hearing that he is fully committed to ensuring that Federal anti-garnishment statutes are given full force and effect, and that it will be one of his first priorities to complete the issuance of a joint regulation to solve this problem.

Will you also commit to make this one of your top priorities and to issue this regulation before the end of June?

Answer: I too am fully committed to ensuring that Federal anti-garnishment statutes are given full force and effect as soon as possible, and will make it one of my top priorities. I am eager to be confirmed so that I can begin work on the solution to this problem.

I understand that Treasury has been working with the Federal benefit agencies on a regulation that the benefit agencies and Treasury would jointly issue to implement the protections afforded to beneficiaries under the Federal benefit statutes. I am committed to having Treasury lead the inter-agency process.

Let me explain my state of mind when I indicated at my confirmation hearing that the Social Security Administration was responsible for garnishment regulations and that a regulatory solution could be accomplished in 6 months. All of the Federal anti-garnishment provisions are in program statutes that the Federal benefit agencies, including SSA and VA, administer, and not in Treasury statutes. As such, it was my understanding, which I have since confirmed with counsel at the Treasury, that the benefit agencies have the statutory-based authority in the area.

I will work to publish a joint regulation as soon as possible, and believe that a notice of proposed rulemaking could be issued as early as this summer, given the work already done by Treasury staff. I know that they have worked with the Federal benefit agencies, Federal banking agencies, consumer advocates, and banking industry associations, to develop a consensus solution to this problem that protects the lifeline funds of beneficiaries without shifting financial liability to banks.

If confirmed, you have my commitment to use my position and authority as General Counsel of the Treasury to ensure the fastest possible execution of the regulatory process in accordance with Federal administrative procedure, from drafting of regulatory language, obtaining inter-agency clearance of the proposed rule, providing the public with an opportunity to comment, and ending with inter-agency clearance of a final rule. I understand the importance of this issue to some of the most vulnerable members of our society, to whom we have a special responsibility as senior policy officials and decision makers. I am eager to, if confirmed, contribute to the solution of this serious problem and keeping Committee staff fully informed of our progress.

Questions from Senator Grassley

Question 1

Do you commit to respond quickly and completely to any requests made by myself or my staff for information?

Answer: If confirmed, I will seek to work closely with Congress and Committee staff to address the important financial issues within Treasury's purview and to perform its oversight role. I agree with Executive Branch policy that seeks to accommodate whatever legitimate interests Congress may have in obtaining information while at the same time preserving Executive Branch interests in maintaining essential confidentiality. Within these parameters, if confirmed, I intend to respond promptly to reasonable requests for information.

Question 2

The Internal Revenue Service is the largest agency under Treasury's jurisdiction – at close to 100,000 FTEs, it is one of the largest government agencies period. As a result, you can expect a significant amount of work related to tax law. Please describe your experience with and knowledge of tax law.

Answer: Although I am not a tax law specialist, as general counsel to two large financial services companies I have both supervised in-house tax lawyers and managed lawyers retained to handle various tax matters. In order to provide supervision to the staff and direction for the company, I had to understand both the context and importance of tax issues. To explain complicated tax matters to management and boards of directors not necessarily well-versed in tax-related issues, I learned to communicate complex concepts in straightforward terms and without resorting to jargon. It is my understanding that many previous Treasury General Counsels have not been tax law experts. Indeed, specialized tax expertise would be duplicative of the expertise possessed by the IRS Chief Counsel and his staff. If confirmed as General Counsel, my role will be to translate agency policy initiatives into concrete action. My experience has prepared me to work both with Treasury's tax experts and agency management on tax law issues.

Question 3

Prior to 1998 IRS restructuring, the Assistant General Counsel for Tax/IRS Chief Counsel reported to the IRS Commissioner. This position now reports directly to the Treasury General Counsel, even though the Chief Counsels of the other Treasury offices and departments report to the Deputy General Counsel. One of the reasons for this change was to ensure that there was high level Treasury oversight of this office and to ensure a unified position on tax issues within Treasury. However, I am concerned that, in recent years, the Treasury Secretary and Treasury General Counsel have not taken

such oversight seriously. For example, the most recent Chief Counsel, when speaking in his official capacity, would publicly state positions that were not Treasury's positions. What will be your strategy to ensure that the IRS Chief Counsel is working to further both Treasury policy and legislative goals while supporting IRS service and enforcement actions?

Answer: The Chief Counsel of the IRS is also an Assistant General Counsel of the Treasury Department under 31 USC Section 301(f)(2). That section provides that the President may appoint, by and with the advice and consent of the Senate, an Assistant General Counsel who shall be the Chief Counsel of the Internal Revenue Service. The Chief Counsel is the chief law officer for the Internal Revenue Service and shall carry out duties and powers prescribed by the Secretary.

The IRS Restructuring and Reform Act of 1998 altered the relationships of the Chief Counsel within Treasury by enacting IRC Section 7803(b), which states that the Chief Counsel reports to the IRS Commissioner, with two exceptions. Specifically, the Chief Counsel is to report to both the Commissioner and Treasury General Counsel regarding legal advice or interpretation of the tax law not relating solely to tax policy, and regarding tax litigation; and to the Treasury General Counsel with respect to legal advice or interpretation of the tax law relating solely to tax policy, such as legislation and treaties.

Although Treasury General Counsel Directives contain a number of formal requirements for coordination between the General Counsel and the Chief Counsel, appropriate and effective oversight and coordination is often a matter of judgment and good practice. In addition to formal coordination rules and requirements, it is at least as important to build strong relationships and lines of communications between the General Counsel's office and the IRS so that meeting oversight and reporting responsibilities is a natural outgrowth of practices that enhance the offices' performance.

I am strongly committed to ensuring that the IRS Chief Counsel works to further both Treasury policy and legislative goals while supporting IRS service and enforcement actions. If confirmed, I will work to build a strong relationship and ensure open and frequent communication with the Chief Counsel so the office can fully meet these responsibilities.

Question 4

Treasury annually releases a Guidance Plan listing the tax guidance that Treasury and IRS expect to issue for the coming fiscal year. In recent years, such self-imposed deadlines have proved meaningless as whatever items are not completed are carried forward to the following year's guidance plan. In addition, Treasury seems to consider Congressional mandates for studies and guidance as suggestions rather than mandates. For example, there are currently three studies mandated by the Pension Protection Act in addition to several guidance items that are past due. Issuing guidance in a timely

manner is critical to ensuring tax compliance. What will you to do hold the IRS Chief Counsel accountable for issuing guidance in a timely manner?

Answer: As you stated, each year, the Assistant Secretary (Tax Policy), the IRS Commissioner, and the IRS Chief Counsel jointly publish a Guidance Priority List to identify and prioritize the tax issues that should be addressed through published administrative guidance. The Guidance Priority List serves several functions, including reaching internal consensus about priorities, notifying the public about the existence of projects on which to comment, ensuring transparency, and establishing goals to which the agency can be held accountable. But accomplishing the initial plan, to the exclusion of other work, would not be prudent. Additional projects arise throughout the guidance plan year depending on various factors, including legislation passed by Congress, changes in economic conditions, and other events. In some cases the personnel or resources necessary to complete a project are unavailable, or a project becomes larger and more difficult than it first appears.

I share your concern about the timeliness of IRS guidance and share the concerns of constituency groups that such guidance needs to be timely in order to be both an effective tool for taxpayers and a valuable tax administration tool for the IRS. If confirmed, I am committed to studying this process to identify procedures to streamline the issuance and legal review functions. One of my top initiatives will be to coordinate my activities in this area with the IRS Commissioner.

You have my commitment that, if confirmed, I will carefully review the ways in which the General Counsel's Office can contribute to an improved process that produces prompt and useful tax guidance.

Question 5

As the champion of changes to the whistleblower provisions for tax whistleblowers, I remain concerned that advice provided by the IRS Chief Counsel regarding the handling of whistleblower cases is placing unnecessary and cumbersome restrictions on the operation of the whistleblower office. What is your opinion of the IRS Whistleblower program? Do you have any experience working with whistleblowers at TIAA-CREFF or other places of employment? If yes, please describe in detail. Also, I would like your commitment that you will work to ensure the effectiveness and efficiency of the IRS whistleblower program.

Answer: During my tenure TIAA-CREF maintained a robust whistleblower protection program that ensured that complaints were promptly reviewed by a special office within the company and whistleblower anonymity was protected. TIAA-CREF retained an

outside company that provided a toll-free number for whistleblowers to call day or night. Complaints were forwarded to internal auditors within the Legal Services and Human Resources offices who conducted independent investigations. Additional contact with the whistleblower was handled by the outside contractor, thereby preserving the whistleblower's anonymity if desired. TIAA-CREF also had a strong policy prohibiting any form of whistleblower retaliation with punishment up to and including termination from employment. After a full investigation, written reports and dispositions were provided to the appropriate Audit Committees.

The purpose of the December 2006 amendment to the whistleblower provisions of the Internal Revenue Code was to provide strong incentives for persons with knowledge of significant tax noncompliance to provide that information to the IRS. While the program is still, relatively speaking, new, initial results suggest that whistleblowers are coming forward with productive information which the IRS is utilizing in its efforts to recover unpaid taxes. It is my understanding that, from the time of the 2006 changes, the IRS Office of Chief Counsel has worked closely with the operating units of the IRS to build a strong and credible whistleblower program that also assures the protection of taxpayer privacy and taxpayer rights. If confirmed, I am fully committed to this vital program and to providing my support to the IRS in continuing to build and improve its effectiveness and efficiency.

Question 6

The Treasury General Counsel, through the Deputy General Counsel, has responsibility for policy and oversight of the chief counsels for Treasury offices varying from the U.S. Mint to FMS. Please describe your familiarity with the issues worked by these various agencies and how you intend to manage such a diverse set of issues.

Answer: As the question rightly acknowledges, the authority and functions of the Bureaus of the Department of the Treasury encompass a wide range of financial issues involving the Federal Government. As you know, the Internal Revenue Service is the largest of Treasury's bureaus and is responsible for determining, assessing, and collecting internal revenue in the United States. The Alcohol and Tobacco Tax and Trade Bureau (TTB) is responsible for enforcing and administering laws covering the production, use, and distribution of alcohol and tobacco products. TTB also collects excise taxes for firearms and ammunition. The Bureau of Engraving & Printing designs and manufactures U.S. currency, securities, and other official certificates and awards. The Bureau of the Public Debt borrows the money needed to operate the Federal Government. It administers the public debt by issuing and servicing U.S. Treasury marketable, savings, and special securities. The U.S. Mint designs and manufactures domestic, bullion, and foreign coins as well as commemorative medals and other numismatic items. The Mint also distributes U.S. coins to the Federal Reserve banks as well as maintains physical custody and protection of our nation's silver and gold assets. The Financial Management

Service receives and disburses all public monies, maintains government accounts, and prepares daily and monthly reports on the status of government finances. The Financial Crimes Enforcement Network supports law enforcement investigative efforts and fosters interagency and global cooperation against domestic and international financial crimes. It also provides U.S. policy makers with strategic analyses of domestic and worldwide trends and patterns. The Community Development Financial Institutions Fund was created to expand the availability of credit, investment capital, and financial services in distressed urban and rural communities. The Office of the Comptroller of the Currency charters, regulates, and supervises national banks to ensure a safe, sound, and competitive banking system that supports the citizens, communities, and economy of the United States. The Office of Thrift Supervision is the primary regulator of all federal and many state-chartered thrift institutions, which include savings banks and savings and loan associations. However, the General Counsel does not directly manage the Chief Counsels of OCC and OTS.

If I am confirmed, I will use my lengthy experience managing large legal offices to adjust the reporting structure as necessary to ensure that I am immediately aware of all important legal issues confronting the Bureaus. I also intend to meet with the Chief Counsel and staff of each Bureau to establish close working relationships and ask that they keep me fully informed regarding their work. I am heartened by the fact that although the legal issues facing Treasury's bureaus are numerous and complex, I will have at my direction considerable legal expertise both at the Bureaus themselves and within the Office of General Counsel.

Question 7

Section 382 of the Internal Revenue Code limits the ability of acquiring companies that acquire target companies to offset the taxable income of the acquiring company with the Net Operating Losses of the target. Section 382 was enacted after extensive scholarly reflection by the staffs of the Senate Finance Committee and the Joint Committee on Taxation, as well as after reflection by the House Ways & Means Committee. It has been an established part of the law ever since 1986.

On September 29, 2008 the House said no to the first bail-out bill; on September 30, 2008 the Treasury virtually waived section 382 for banks in Notice 2008-83; and on October 2, 2008, Wells Fargo acquired Wachovia, which took advantage of millions of dollars in Net Operating Losses.

In the opinion of many tax scholars, Treasury simply lacked the authority to issue Notice 2008-83. This is not a minor issue – this unauthorized waiver of an act of Congress likely had a revenue cost to the government of, at a minimum, several billion dollars. Congress found Treasury's action so egregious that Notice 2008-83 was rapidly overturned.

In your role as General Counsel you will be asked to review Treasury's authority to issue guidance. In your opinion, did Treasury have authority to issue Notice 2008-83? Please fully explain your answer. If you disagree with the Treasury Secretary or any of the Deputy, Under, or Assistant Secretaries about Treasury's authority to issue guidance, how will you resolve such conflicts? Will you notify the appropriate Congressional Committees if you believe that an action by Treasury may be illegal?

Answer: It is my understanding that Notice 2008-83 was issued under the authority of Internal Revenue Code (Code) Section 382(m), which authorizes the Secretary of the Treasury to issue such regulations as may be necessary or appropriate to carry out the purposes of the section. The issues raised by that notice are complex and concern issues such as the underlying purposes of Code Section 382, as well as Treasury's authority to issue such guidance and the transparency of the guidance process itself. I have not reviewed the prior Administration's determination that the notice was necessary or appropriate to carry out the underlying purposes of Code Section 382. I understand that you have asked for an Inspector General's report on the issue, and I look forward to reviewing that report when it is completed. If confirmed as General Counsel, I will respect the limits on the Treasury Department's authority to interpret statutory provisions, including tax provisions, and will ensure that authority issues such as those raised by Notice 2008-83 are fully vetted and debated before such guidance is approved for publication.

Question 8

In the stimulus bill, the section 25C credit for windows, doors, and skylights was modified as of the date of enactment so that such items do not qualify "unless such component is equal to or below a U factor of 0.30 and SHGC of 0.30." However, the IRS issued guidance saying that windows, doors, and skylights qualify under section 25C if they meet the old Energy Star standards through May 31, 2009. In your view, did the IRS have the authority to issue such guidance, which appears to contradict the language of the statute? If yes, please explain what you think is the source of the IRS' authority.

Answer: Prior to amendment by the American Recovery & Reinvestment Act of 2009 (ARRA), Section 25C of the Internal Revenue Code provided a credit for windows, skylights, and doors that met the requirements of the 2000 International Energy Conservation Code (IECC). In the case of windows and skylights, the IECC requirements and Energy Star requirements were the same, so IRS Notice 2006-26 provided that purchasers of windows and skylights could rely on an Energy Star label. Thus, under this arrangement homeowners are generally relieved of the obligation to determine independently whether a particular item qualified for the credit.

The ARRA amended Section 25C to provide that, in addition to meeting the IECC requirements, windows, skylights, and doors must have a U factor and an SHGC equal to or below 0.30 to qualify for the credit. As a consequence of that amendment, taxpayers could no longer rely on Energy Star labels on windows and skylights to verify eligibility for the credit.

The amendment took effect for items placed in service after the date of enactment on February 17, 2009. I understand that the IRS was concerned that immediate implementation of the amendments to Section 25C would have had the perverse effect of discouraging homeowners from purchasing energy efficient products. Until the IRS issued guidance to provide an alternative way to confirm that items would qualify for the credit, homeowners likely would find it difficult to determine whether a particular energy efficient property qualified, even though many of those products would have met the new standards.

I understand that in this case the IRS determined that providing transition relief to homeowners purchasing windows, skylights, and doors until a new certification mechanism could be implemented was a reasonable exercise of its responsibility and authority to administer the tax laws and was consistent with congressional intent in the ARRA to stimulate spending on energy efficient property. I have not reviewed this determination, but you have my commitment that, if confirmed, I will work closely with the Office of Tax Policy and the Commissioner of the IRS to ensure that the law is always administered appropriately.

Question 9

In your experience at TIAA-CREFF or elsewhere, have you disagreed with senior executives or board members on legal issues? If yes, please describe and explain how such conflicts were resolved.

Answer: I served as the chief legal officer of TIAA-CREF. In that capacity, I was ultimately responsible for the legal positions of the firm on all matters. I supervised a team of expert lawyers and compliance professionals who worked directly with the client groups. The legal services provided by my staff were augmented by the retention of various outside legal advisors. This structure enabled me to work directly with the board of directors and senior management on the most significant legal issues and gave me first-hand experience dealing with senior executives and board members on a myriad of complex issues.

During my tenure, I had no fundamental disagreement with management or the board of directors on the resolution of legal issues. As in every corporation, the board of directors oversaw management through its collective meetings and also through its committee structures. Specialized legal issues were addressed with the board committees both in

terms of the status of projects and the provision of advice. Board and committee meetings are interactive and members frequently expressed their views and challenged various viewpoints in an open and candid manner. The end result was a constructive exchange of ideas and a respect for adherence to legal requirements in making the final decision.

Question 10

As part of the Troubled Asset Relief Program (TARP) Treasury is partnering with the Federal Reserve under the Term Asset Backed Loan facility (TALF) to unfreeze the securitization markets for student loans, small business loans, credit cards, and other financial products. In working with the Federal Reserve on TALF, what steps should Treasury be taking to ensure that collateral requirements and other risk management practices followed by the Federal Reserve are sufficient to protect Treasury's and the taxpayer interests?

Answer: TALF is a lending facility established by the Board of Governors of the Federal Reserve System and the Federal Reserve Bank of New York (FRBNY) in which the FRBNY loans funds for the purchase of asset-backed securities by private borrowers. In connection with this lending facility, the FRBNY has developed a robust compliance regime, and Treasury has been consulted in that process. That compliance regime includes such measures as (i) primary dealer gatekeeper function and "know-your-customer" diligence practices, (ii) representations, warranties, and indemnification from the sponsors and issuers of the underlying securitizations, (iii) accounting firm review of the securities to be used as collateral, and (iv) review of data received from borrowers. For specific classes of collateral, such as legacy commercial mortgage-backed securities, the FRBNY has engaged a collateral monitor to independently evaluate the risk of each security proposed as collateral.

In the event that a borrower under TALF fails to repay the TALF loan, Treasury has agreed to purchase the first $20 billion of those loans, and the ABS collateral backing such loans, from the FRBNY. This is accomplished by Treasury lending to a special purpose vehicle (TALF LLC) owned and managed by FRBNY. Treasury has developed a list of financial metrics to track and is currently discussing those metrics with the FRBNY. It is anticipated that Treasury will receive periodic information about securities used as collateral in an attempt to properly gauge the possible expenditure of Treasury funds. Treasury also has complete inspection rights with respect to this second part of TALF (over both the FRBNY and TALF LLC), and the FRBNY and Treasury have been working collaboratively to ensure that the appropriate information is received by Treasury. Finally, Treasury has regularly consulted with SIGTARP and GAO regarding proposed expansions of TALF and has worked to incorporate recommendations from those oversight bodies into the compliance regime for TALF.

Question 11

Another major program under TARP is the Public-Private Investment Program which is being designed to remove troubled assets from the balance sheets of banks. It is intended that Treasury and the private sector would purchase these "legacy assets" and that Treasury would rely on asset managers to manage and dispose of these assets, as appropriate. In your view, what potential conflicts could arise in the utilization of asset managers for this purpose and how should Treasury ensure that such conflicts of interest are effectively dealt with?

Answer: The Public Private Investment Program ("PPIP") has two parts, legacy securities and legacy loans. Treasury is involved in selection of Fund Managers ("FMs") for the legacy securities part (the FDIC is administering the legacy loans part). The potential conflicts of interest include situations where an FM is trading for its own account, or for the account of other clients in similar securities as the Public Private Investment Fund ("PPIF") that the FM forms as well as conflicts that could arise if FMs transact with certain of their affiliates. The procedures to deal with potential conflicts of interest involving such FMs will be substantial and are being developed now in consultation with the SIGTARP, the Fed and others. These policies and procedures requirements are expected to include the following:

- FMs must have a fair policy on allocation of investment and disposition opportunities that complies with analogous relevant requirements of federal securities laws;
- FM's must invest a significant amount of their own firm capital in the PPIFs that they will manage, which will further align incentives between FMs and the investors in the PPIFs (including Treasury);
- FMs will acknowledge that they owe a fiduciary duty of loyalty and care when performing services for the PPIF;
- FMs must provide reports on all positions in Eligible Assets (in PPIF and non-PPIF funds) to Treasury on an on-going basis;
- FMs must have conflicts of interest and ethics policies satisfactory to Treasury;
- FMs must abide by restrictions on their other activities;
- FMs must observe restrictions on transactions with their affiliates ;
- FMs must permit Treasury, SIGTARP and GAO access to all records of the PPIF;
- FM's must make their key persons available to discuss the PPIF and its activities with Treasury;
- FMs must permit Treasury to conduct annual and ad hoc audits of compliance with all policies;
- FMs must maintain a document retention policy acceptable to Treasury;

- FMs must maintain an independent Compliance Department that keeps an Eligible Assets Watch List to ensure compliance with allocation and valuation policies;
- FMs must disclose to Treasury all information in its possession regarding the beneficial owners of PPIF equity in their capacities as such;
- FMs must report the 10 largest positions of the PPIF on a quarterly basis;
- FMs must comply with all "Know Your Customer" regulations, Office of Foreign Asset Control statutes and regulations, and all relevant federal securities screening laws and anti-money laundering obligations; and
- FMs must obtain a Type II SAS 70 report and ensure independent third-party verification of its valuations, returns calculations, and internal controls.

Question 12

Treasury was appropriated $700 billion last October for the Troubled Asset Relief Program to address the financial crisis. Since then, Treasury has made considerable investments in hundreds of financial institutions. Though it appears that the worst of the crisis may be behind us, there are still concerns that the credit markets have not fully recovered.

a) What would trigger the need for additional funds beyond the initial $700 billion?

Answer: While we see some initial signs of economic improvement and the financial system is beginning to heal, our country continues to face substantial economic and financial challenges. Treasury programs are designed to meet these challenges and set a path to economic recovery. Under EESA, Treasury is allowed to purchase up to $700 billion in assets outstanding at any one time. Treasury does not currently foresee that additional funds will be needed.

b) In the President's budget proposal, there is an estimate that suggests the President could ask for as much as $750 billion in additional funds. How likely do you think it is that Treasury will have to ask for additional funds?

Answer: As I understand it, the President's FY 2010 Budget includes a $250 billion contingent reserve for further efforts to stabilize the financial system. (The reserve, which reflects a net cost to the Government, would support $750 billion in asset purchases.) The existence of this reserve in the Budget does not represent a specific request. Rather as events warrant, the Administration will work with Congress to determine the appropriate size and shape of any such efforts, and as more information becomes available the Administration will define an estimate of potential costs.

Question 13

Treasury has invested these funds with the intention that taxpayers will get a return on this investment. To date, Treasury has reportedly received almost $6 billion in dividend payments. Furthermore, some institutions who received funds through the Capital Purchase Program have redeemed their preferred stock and repurchased warrants. However, it is still unclear whether the taxpayers are really getting the best price.

a) How will Treasury's approach to allowing financial institutions to repurchase warrants be designed to maximize the benefit to the taxpayer? What analysis, if any, should Treasury consider for the alternative mechanisms (e.g., auctions) for the liquidation of warrants?

Answer: It is my understanding that Treasury has developed a robust process for arriving at a determination of fair market value, using internal modeling approaches, external advisers, and market quotes.

b) What steps should Treasury take to ensure that it is transparent with regard to the prices agreed upon for the warrant repurchases? Should Treasury disclose exactly how it determined that the offer from the financial institution was reasonable?

Answer: While I have not been directly involved in discussions surrounding warrant repurchases, I understand that Treasury is in the process of releasing additional information about the warrant repurchase process, including a summary of the various inputs used in arriving at a fair market value determination.

c) How should Treasury determine whether to hold certain warrants, particularly those that an institution does not seek to repurchase? Should it plan to liquidate any warrants in the market before institutions offer to repurchase them?

Answer: Treasury holds several different types of warrants depending on the institution. Our key objective is to balance the need to avoid market timing, minimize liquidity discounts, and maximize value for the taxpayer. Treasury does not have an ability to liquidate its warrants before institutions have an opportunity to offer to repurchase them.

d) When and how should Treasury make public the dividends and interest received through TARP?

Answer: Beginning in June 2009, Treasury will publish a monthly report that will reflect dividends received by institution for each TARP program. The report will include the dividend or interest payment date, the type of dividend (cumulative or noncumulative), the dividend or interest frequency, a life-to-date dividend or interest amount received by TARP, and the date of the next scheduled payment. The first report will cover payments received in May 2009. All reports will be posted to *www.financialstability.gov*.

Question 14

One of the Administration's key selling points for the American Recovery and Reinvestment Act was its potential to save or create between 3 million and 4 million

jobs. On January 10, 2009, Christina Romer and Jared Bernstein, from the President's own economic team asserted, "In light of the substantial quarter-to-quarter variation in the estimates of job creation, we believe a reasonable range for 2010Q4 is 3.3 to 4.1 million jobs created." On February 9, 2009, President Obama emphasized that "the single most important part of this Economic Recovery and Reinvestment Plan is the fact that it will save or create up to 4 million jobs, because that's what America needs most right now." However, on March 10, 2009, in a closed door meeting with House Speaker Nancy Pelosi and Democratic House leaders, Mark Zandi of Moody's.com and Allan Sinai of Decision Economics, Inc. estimated that the stimulus bill would save or create only 2.5 million jobs in the first two years.

The Administration's job creation forecast was based on the faulty assumption (articulated in the President's Budget) that the unemployment rate would peak at 8.2% in the second and third quarters of 2009. With reports last week that the unemployment rate has already jumped to 9.4%, what, if any, revisions would you make to the Administration's estimated number of jobs created or saved by 2010 as a result of the American Recovery and Reinvestment Act?

Answer: The work by Christina Romer and Jared Bernstein forms the basis of the projected effects on jobs. Their work indicated that 3-4 million jobs would be created or saved. A later version of the analysis, based on the package of spending and taxes that were included in the American Recovery and Reinvestment Act (ARRA), produced results similar to those published in early January. Like their earlier analysis, I understand that it was not based on a formal, specific macroeconometric model but was informed by the results from several of these models. I am advised that this approach is prudent, given that empirical macroeconomic models cannot deal with all the complex features of the current crisis.

When Romer and Bernstein talk about creating or saving jobs, they are comparing what we think will happen with the ARRA to the economy without the ARRA. They agree with private forecasters and the CBO, which have indicated that the downturn would be significantly larger without the ARRA, although opinions are evolving about the size. For example, in January, the CBO projected real GDP would decline 2.2 percent in 2009 without the ARRA. In March they predicted roughly a 4.5 percent decline without the ARRA. Nearly all analysts agree that the economy would be much worse off without the ARRA, and, given the state of financial markets, many are concerned that a much longer and severe downturn would occur without significant stimulus. The economy tumbled further than many economists predicted early in the year. However, the decline is more an indication of the state of the economy before the ARRA, and does not fundamentally change the view of how the economy would be affected by the stimulus from the ARRA. Private analysts have made a number of estimates of the effects of the ARRA. They agree that it will raise employment and GDP in the short run, although it is clear that there is a range of estimates.

Question 15

According to the Department of Labor, over 2 million American jobs have been lost since February. However, on April 29, 2009, at his "100 Days in Office" press conference, President Obama stated that the American Recovery and Reinvestment Act has "already saved or created over 150,000 jobs." On May 27, 2009, President Obama said, "In these last few months, the American Recovery and Reinvestment Act has saved or created nearly 150,000 jobs." On June 8, 2009, President Obama reiterated, "We've created or saved…at least 150,000 jobs." Please explain the specific criteria used by the Administration to designate a job as being "saved." In addition, please provide the source data upon which the White House estimate of 150,000 jobs "created or saved by the stimulus bill" was based. Finally, please explain why the Administration's estimate of jobs created or saved by the stimulus bill has not changed since April 29?

Answer: The estimates of the number of jobs created or saved by the American Recovery and Reinvestment Act (ARRA) was informed by the results of several macroeconometric models. To use these results, a baseline path was established that showed how the economy would evolve without the stimulus package. Then the ARRA stimulus was factored in, which resulted in a simulated path for the economy. Finally, the results of the two paths for the economy are compared. The difference in the number of jobs between these two paths is the number of jobs created or saved. The estimate of the number of jobs created or saved so far simply indicates the number consistent with amount of stimulus that has already been applied (to that date) from the ARRA. The estimates of jobs created or saved are the result of using a conventional economic modeling approach, and they are not the result of actual job counts.

Question 16

In a radio address on January 10, 2009, then President-Elect Obama asserted that, according to analysis done by Christina Romer and Jared Bernstein, the stimulus bill would likely create or save three to four million jobs, and that "90 percent of these jobs will be created in the private sector." Today, President Obama and Vice-President Biden announced an initiative to accelerate federal spending into hundreds of public works projects in order to create or save 600,000 jobs over the next 100 days. Of the 150,000 jobs created or saved by the stimulus package so far, and of the 600,000 jobs promised over the next 100 days, please provide an estimate of the percentage of these jobs that are/will be from the private sector. Does the Administration continue to anticipate that 90 percent of the stimulus jobs will be created in the private sector?

Answer: The Treasury Department's best estimate is that 90 percent of the jobs created or saved by the recovery package will be in the private sector. The components of the package – tax cuts, grants to states, and infrastructure spending – are geared toward raising private employment. There are no new large federal agencies created in the American Recovery and Reinvestment Act of 2009, which would raise the share of

government jobs. Federal jobs are only about 2 percent of the total number of jobs in the U.S. State governments account for about 4 percent of the total number of jobs in the U.S. and localities account for about 11 percent of jobs.

Question 17

During your hearing, in response to questions from Senator Bunning on "recycling" of TARP funds, you stated that if funds were repaid, more "head room" would be available under the $700 billion cap. Do you mean that the total amount of money available for Treasury to lend for the TARP program is capped at $700 billion, or that Treasury could potentially lend out additional amounts of money as long as the amount outstanding at any one time was no more than $700 billion? Are dividends paid back to the Federal government about to be recycled and re-lent to other institutions? If a company buys back stock from the Federal government, how are those payments treated? Can those payments be recycled by the government and be lent to other institutions?

Answer: As I stated in my testimony, when Treasury has purchased a troubled asset under the Troubled Asset Relief Program (TARP) and that TARP investment is repaid, I understand that the proceeds are deposited into the Treasury general fund for reduction of the public debt. This is consistent with the mandate in section 106(d) of the Emergency Economic Stabilization Act of 2008 (EESA), which requires that revenues and the proceeds from the sale of troubled assets purchased under that law be paid into the general fund of the Treasury for reduction of the public debt. However, I understand that other applicable provisions of EESA also govern the use of TARP funds.

Section 115(a) of EESA authorizes Treasury to purchase troubled assets having aggregate purchase prices up to $700 billion "outstanding at any one time." When a recipient of a TARP investment buys back its stock from Treasury, the total amount of troubled assets that are held by Treasury and count against the $700 billion cap is reduced. This reduction in the total amount of assets "outstanding" frees up headroom under the cap. Section 106(e) of EESA authorizes Treasury to continue to purchase troubled assets under commitments that Treasury has entered into before the purchase-authority sunset date in EESA. To be clear, the funds used to pay for any new purchases under the freed-up headroom under the cap are not the same as the funds received from the sale or repayment of the troubled assets. Instead, new funding is made available under section 118 of EESA from the Treasury general fund for any new purchases, and any new purchase is recorded as a new, current-year outlay.

In contrast, dividends and interest payments paid by recipients of TARP investments do not reduce the total amount of outstanding troubled assets held by Treasury and therefore do not free up any headroom under the cap. Those dividends and interest payments are deposited into the Treasury general fund.

I also understand that section 123(a) of EESA requires that any cash flows associated with certain activities, including sales of troubled assets, have to be determined as provided under the Federal Credit Reform Act of 1990. I am informed that, for accounting purposes, when a TARP investment is repaid, and when any dividends or interest is paid, those proceeds and revenues have to, first, be recorded in the Federal Credit Reform Act "financing account" for the respective TARP program, and then get deposited into the Treasury general fund.

Questions from Senator Olympia Snowe

Question 1

Although Treasury's Office of General Counsel has traditionally been charged with supplying policy advice and interpreting the law for other Treasury divisions, it is now also responsible for closing TARP transactions. As of June 2, Treasury has disbursed $402.8 billion of TARP funds, and with respect to banks alone, to date, $199.4 billion has been obligated to over 600 institutions. I find it noteworthy that the March 2 edition of the Legal Times quotes Former General Counsel Robert Hoyt, who stepped down in February, as saying that his former office is "cranking out a higher deal volume that, I would guess, any institution in the entire world." Additionally, although the article notes that Treasury is looking to recruit lawyers with transactional experience and contracting with a number of private law firms to complete the work, the bulk of TARP work has been done by the eight-lawyer banking and finance section.

Given that TARP continues to make investments in financial institutions, is handling a complicated auto bailout, and will shortly launch the Public Private Investment Partnership to help institutions to cleanse their balance sheets of toxic, illiquid assets, do you believe that the Office of General Counsel has sufficient resources to complete all the TARP-related work accurately and effectively? Put another way, while I am aware that the Office of General Counsel manages the activities of approximately 2,000 attorneys Department wide, are there enough resources being devoted to TARP?

Answer: The Office of the General Counsel has significantly increased the number of lawyers on its staff to handle the various transactions. Under the oversight of Treasury's Banking and Finance Legal Team which was critical to launching the TARP programs and managing many of the most complicated transactions, Treasury has hired a Chief Counsel for TARP as well as ten additional lawyers. The lawyers that have been hired have expertise in equity and debt transactions, securitization, bankruptcy, executive compensation, and litigation. Together, the Banking and Finance team and the robust new TARP legal team ensure that all the requirements of EESA and other applicable laws as well as Treasury policies are complied with as transactions occur. Treasury also continues to use law firms to advise on and prepare documentation for the transactions. At present, Treasury is in the process of conducting a full and open competition for firms to provide legal services for TARP on a longer-term basis under an omnibus contract. Treasury re-evaluates its legal staffing for TARP on a regular basis and will continue to hire qualified experienced lawyers and retain law firms as needed. Ensuring that TARP programs are conceived and executed with the highest quality legal advice is a top priority for the Office of General Counsel. If confirmed, I will make sure that sufficient resources are available and committed to this effort.

Question 2

The Treasury Department's Office of General Counsel has a critical role to play when it comes to helping to draft agreements necessary to administer TARP. Indeed, Duane Morse, TARP's former interim chief counsel and now Treasury's Chief Compliance and Risk Officer, told the Legal Times on March 2 that, "Our role is to make sure that there are appropriate protections for the TARP money that are built into the loan agreements." That said, I am concerned that some of the agreements, such as the one between Treasury and the Federal Reserve to establish the Term Asset Backed Securities Loan Facility (TALF) to spur consumer and small business lending, may be deficient. Referring to TALF, Special Inspector General for TARP (SIGTRP) Neil Barofsky wrote in his April 21 Quarterly Report to Congress that "In SIGTARP's view, Treasury did not receive sufficient oversight-enabling provisions in the agreements, nor has it established a sufficient compliance protocol with the Federal Reserve."

With $700 billion in taxpayer dollars at stake for TARP alone, I am deeply troubled by Mr. Barofsky's conclusion. The fact is that Mr. Barofsky has been a tireless champion in identifying the significant potential for the abuse of TARP funds across the gamut of TARP-funded programs. Notably, I worked with Senators Boxer, Pryor, and Ensign to add language to the Helping Families Save Their Homes Act of 2009 (S. 896) to require the Treasury Secretary and Mr. Barofsky's office to work together to draft regulations to avoid conflicts of interest in the Public-Private Investment Program (PPIP) that will use up to $100 billion to purchase toxic, illiquid assets. We added that language after Mr. Barofsky concluded in his quarterly report that "Many aspects of PPIP could make it inherently vulnerable to fraud, waste, and abuse."

Mr. Madison, given the complexity of each of the individual TARP programs and that one of your missions will be to ensure taxpayer funds are protected, will you pledge to this Committee that you will work with and take Mr. Barofsky's recommendations very seriously as you draft regulations and additional resources are obligated? Although I will not hesitate to act legislatively in cases where Mr. Barofsky's recommendations are warranted but ignored, I would rather this be done on a voluntary basis. What assurances can you offer in that regard?

Answer: Treasury maintains an active and open working relationship with Mr. Barofsky and his staff and gives serious and careful consideration to SIGTARP's recommendations. It is the practice of Treasury staff to provide briefings to SIGTARP as new programs such as the Public-Private Investment Program are developed, announced, and structured, as well as in response to specific requests from SIGTARP. Treasury staff interacts with SIGTARP staff on a regular basis, answering questions, providing information, and making themselves available for meetings to discuss topics of interest or address audit inquiries. Herbert M. Allison, Jr., the nominee to be Assistant Secretary of Financial Stability, intends to continue his predecessor's practice of meeting weekly with the Special Inspector General to discuss any issue or concern that either party wishes to

raise. To facilitate the SIGTARP's work, Treasury has added provisions to TARP contracts explicitly granting SIGTARP inspection rights.

If confirmed, I will work to ensure that Mr. Barofsky's comments and recommendations are given serious consideration in drafting TARP contracts and regulations and obligating TARP funds.

Questions from Senator Debbie Stabenow

Question 1

Currency

Member countries of the IMF took an obligation to not manipulate exchange rates, and the IMF charter states that the IMF shall exercise, "… firm surveillance over the exchange rate policies of member countries…" But it seems to me the IMF hasn't acted as the global umpire of exchange rate policies. Do you believe IMF members are obligated not to manipulate their exchange rates and that the IMF should exercise "firm surveillance"?

Answer: IMF members have a clear obligation not to manipulate their currency. Article IV, Section 1(iii), of the IMF Articles of Agreement states that each member shall "… avoid manipulating exchange rates or the international monetary system in order to prevent effective balance of payments adjustment or to gain an unfair competitive advantage over other members." The Treasury Department consistently urges the IMF to exercise "firm surveillance" over its members' exchange rate policies. In particular, the Treasury Department seeks to ensure that the IMF's analysis of its members' exchange rate policies under Article IV is consistent with accepted methodologies and IMF guidelines, and that IMF staff assessments are credible and candidly presented.

In the past Treasury Department has refused to say that the Chinese are manipulating their currency. As general counsel at the Treasury, what role would you have if any in determining whether China manipulates their currency?

Answer: As General Counsel, I would be responsible for ensuring that Treasury is in compliance with its statutory requirements under sections 3004 and 3005 of the Omnibus Trade and Competitiveness Act of 1988. One of these requirements is that the Secretary of the Treasury analyze the exchange rate policies of foreign countries and consider whether countries manipulate the rate of exchange between their currency and the United States dollar for purposes of preventing effective balance of payments adjustments or gaining unfair competitive advantage in international trade. The issue of currency manipulation is an important one, and, if I am confirmed as General Counsel, I will give very considered advice to the Secretary of the Treasury and other Treasury officials concerning its application.

Question 2

Customs

The problem of illicit and counterfeit trade has reached epidemic levels. The FDA has linked contaminated Chinese heparin, the blood-thinning drug, to nearly 150 deaths in the United States. That's the latest in a long line of illegal and unsafe Chinese exports that includes poisonous toothpaste, lead-painted toys, toxic pet food, and tainted fish. These deadly products somehow got through CBP's examination process at the borders.

Counterfeit products not only endanger Americans' safety, but also our economic security. Counterfeiting has lead to a loss of more than 200,000 good-paying jobs in the automotive industry alone. American auto parts manufacturers lose about $3 billion a year because of counterfeit imports. Your agency, working with other federal agencies, is supposed to catch these imports long before they reach our stores and homes.

CBP appears to have assessed penalties on a significant number of violators of our intellectual property laws but according to a GAO report, you collected less than one percent of intellectual property rights penalties assessed from 2001 through 2006.

What should Treasury and CBP do to improve the collection record of intellectual property rights penalties?

Answer: CBP enforces intellectual property rules (IPR) under authority delegated to DHS from the Secretary of the Treasury. Under the terms of that delegation CBP has responsibility for day-to-day enforcement operations. Treasury has been working closely with CBP and IPR rights holders through the IPR Subcommittee of the COAC (the Advisory Committee that provides advice to Treasury and DHS on the commercial operations of CBP) to examine possible regulatory changes that might simplify IPR enforcement procedures or that would otherwise make IPR enforcement more effective. The Treasury Department stands ready to work with Congress to make IPR enforcement more effective.

Questions from Senator Mike Crapo

Question 1

Can I have your assurances that you will look into making sure that the Federal Home Loan Banks are sufficiently strong to continue to achieve their core mission of providing liquidity and supporting community banks and thrifts?

Answer: The Federal Home Loan Banks have played an important role of providing a stable source of funds to their member institutions throughout the recent disruptions in credit markets. The Federal Home Loan Banks have access to a credit facility that the Treasury Department established under the Housing and Economic Recovery Act of 2008. The Treasury Department works closely with the Federal Housing Finance Agency in evaluating the financial condition of the Federal Home Loan Banks. If confirmed, I will look forward to continuing this work with my colleagues at the Treasury Department.