

EXCERPT FROM 111th CONGRESS ACTIVITIES REPORT:
ACTIVITIES OF THE PERMANENT SUBCOMMITTEE ON INVESTIGATIONS

112TH CONGRESS }
2d Session }

SENATE

{ REPORT
112-193

ACTIVITIES OF THE COMMITTEE ON
HOMELAND SECURITY AND
GOVERNMENTAL AFFAIRS

R E P O R T

OF THE

COMMITTEE ON HOMELAND SECURITY AND
GOVERNMENTAL AFFAIRS
UNITED STATES SENATE

AND ITS

SUBCOMMITTEES

FOR THE

ONE HUNDRED ELEVENTH CONGRESS



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¹ Senator Robert F. Bennett served on the Committee from 7/31/2009 to 3/9/2010.

² Senator Michael F. Bennet left the Committee on 9/29/2009.

³ Senator Paul G. Kirk, Jr. served on the Committee from 9/29/2009 to 3/9/2010.

⁴ Senator Edward E. Kaufman served on the Committee from 3/9/2010 to 11/15/2010.

⁵ Senator Scott P. Brown joined the Committee on 3/9/2010.

⁶ Senator Christopher A. Coons joined the Committee on 11/15/2010.

⁷ Senator Roland W. Burris left the Committee on 11/29/2010.

⁸ Senator Mark Kirk joined the Committee on 12/7/2010.

PERMANENT SUBCOMMITTEE ON INVESTIGATIONS**CHAIRMAN: CARL LEVIN****RANKING MINORITY MEMBER: TOM COBURN**

The following is the Activities Report of the Permanent Subcommittee on Investigations during the 111th Congress:

I. HISTORICAL BACKGROUND**A. SUBCOMMITTEE JURISDICTION**

The Permanent Subcommittee on Investigations was originally authorized by Senate Resolution 189 on January 28, 1948. At its creation in 1948, the Subcommittee was part of the Committee on Expenditures in the Executive Departments. The Subcommittee's records and broad investigative jurisdiction over government operations and national security issues, however, actually antedate its creation, since it was given custody of the jurisdiction of the former Special Committee to Investigate the National Defense Program (the so-called "War Investigating Committee" or "Truman Committee"), chaired by Senator Harry S. Truman during the Second World War and charged with exposing waste, fraud, and abuse in the war effort and war profiteering. Today, the Subcommittee is part of the Committee on Homeland Security and Governmental Affairs.¹

The Subcommittee has had 10 chairmen: Senators Homer Ferguson of Michigan (1948), Clyde R. Hoey of North Carolina (1949–1952), Joseph R. McCarthy of Wisconsin (1953–1954), John L. McClellan of Arkansas (1955–1972), Henry M. Jackson of Washington (1973–1978), Sam Nunn of Georgia (1979–1980 and 1987–1994), William V. Roth of Delaware (1981–1986 and 1995–1996), Susan M. Collins of Maine (1997–2001); Norm Coleman of Minnesota (2003–2007); and Carl Levin of Michigan (2001–2002 and 2007–present).

Until 1957, the Subcommittee's jurisdiction focused principally on waste, inefficiency, impropriety, and illegality in government operations. Its jurisdiction then expanded over time, today encompassing investigations within the broad ambit of the parent committee's responsibility for matters relating to the efficiency and economy of operations of all branches of the government, including matters related to: (a) waste, fraud, abuse, malfeasance, and unethical practices in government contracting and operations; (b) organized criminal activities affecting interstate or international commerce; (c) criminal activity affecting the national health, welfare, or safety, including investment fraud, commodity and securities fraud, computer fraud, and offshore abuses; (d) criminality or improper practices in labor-management relations; (e) the effectiveness of present national security methods, staffing and procedures, and U.S. relationships with international organizations concerned with national security; (f) energy shortages, energy pricing, man-

¹In 1952, the parent committee's name was changed to the Committee on Government Operations. It was changed again in early 1977, to the Committee on Governmental Affairs, and again in 2005, to the Committee on Homeland Security and Governmental Affairs, its present title.

agement of government-owned or controlled energy supplies; and relationships with oil producing and consuming countries; and (g) the operations and management of Federal regulatory policies and programs. While retaining the status of a subcommittee of a standing committee, the Subcommittee has long exercised its authority on an independent basis, selecting its own staff, issuing its own subpoenas, and determining its own investigatory agenda.

The Subcommittee acquired its sweeping jurisdiction in several successive stages. In 1957—based on information developed by the Subcommittee—the Senate passed a Resolution establishing a Select Committee on Improper Activities in the Labor or Management Field. Chaired by Senator McClellan, who also chaired the Subcommittee at that time, the Select Committee was composed of eight Senators—four of whom were drawn from the Subcommittee on Investigations and four from the Committee on Labor and Public Welfare. The Select Committee operated for 3 years, sharing office space, personnel, and other facilities with the Permanent Subcommittee. Upon its expiration in early 1960, the Select Committee's jurisdiction and files were transferred to the Subcommittee on Investigations, greatly enlarging the latter body's investigative authority in the labor-management area.

The Subcommittee's jurisdiction expanded further during the 1960s and 1970s. In 1961, for example, it received authority to make inquiries into matters pertaining to organized crime and, in 1963, held the famous Valachi hearings examining the inner workings of the Italian Mafia. In 1967, following a summer of riots and other civil disturbances, the Senate approved a Resolution directing the Subcommittee to investigate the causes of this disorder and to recommend corrective action. In January 1973, the Subcommittee acquired its national security mandate when it merged with the National Security Subcommittee. With this merger, the Subcommittee's jurisdiction was broadened to include inquiries concerning the adequacy of national security staffing and procedures, relations with international organizations, technology transfer issues, and related matters. In 1974, in reaction to the gasoline shortages precipitated by the Arab-Israeli war of October 1973, the Subcommittee acquired jurisdiction to investigate the control and management of energy resources and supplies as well as energy pricing issues.

In 1997, the full Committee on Governmental Affairs was charged by the Senate to conduct a special examination into illegal or improper activities in connection with Federal election campaigns during the 1996 election cycle. The Permanent Subcommittee provided substantial resources and assistance to this investigation, contributing to a greater public understanding of what happened, to subsequent criminal and civil legal actions taken against wrongdoers, and to enactment of campaign finance reforms in 2001.

In 1998, the Subcommittee marked the 50th anniversary of the Truman Committee's conversion into a permanent subcommittee of the U.S. Senate.² Since then, the Subcommittee has developed par-

²This anniversary also marked the first date upon which internal Subcommittee records generally began to become available to the public. Unlike most standing committees of the Senate whose previously unpublished records open after a period of 20 years has elapsed, the Perma-

ticular expertise in complex financial matters, examining the key causes of the 2008 financial crisis, structured finance abuses, financial fraud, unfair credit practices, money laundering, commodity speculation, and a wide range of offshore and tax haven abuses. It has also focused on issues involving health care fraud, foreign corruption, and waste, fraud and abuse in government programs. In the half-century of its existence, the Subcommittee's many successes have made clear to the Senate the importance of retaining a standing investigatory body devoted to keeping government not only efficient and effective, but also honest and accountable.

B. SUBCOMMITTEE INVESTIGATIONS

Armed with its broad jurisdictional mandate, the Subcommittee has conducted investigations into a wide variety of topics of public concern, ranging from corporate misconduct, including the Senate's most in-depth investigation of the Enron Corporation, to unfair energy prices, predatory lending, and tax evasion. Over the years, the Subcommittee has also conducted investigations into criminal wrongdoing, including money laundering, the narcotics trade, child pornography, labor racketeering, and organized crime activities. In addition, the Subcommittee has investigated a wide range of allegations of waste, fraud, and abuse in government programs and consumer protection issues, addressing problems ranging from unfair credit card practices to health care fraud. Most recently, the Subcommittee conducted Congress' most in-depth examination of the 2008 financial crisis, holding four hearings and issuing a 750-page bipartisan report.

(1) Historical Highlights

The Subcommittee's investigatory record as a permanent Senate body began under the Chairmanship of Republican Senator Homer Ferguson and his Chief Counsel (and future Attorney General and Secretary of State) William P. Rogers, as the Subcommittee inherited the Truman Committee's role in investigating fraud and waste in U.S. Government operations. This investigative work became particularly colorful under the chairmanship of Senator Clyde Hoey, a North Carolina Democrat who took the chair from Senator Ferguson after the 1948 elections. The last U.S. Senator to wear a long frock coat and wing-tipped collar, Mr. Hoey was a distinguished Southern gentleman of the old school. Under his leadership, the Subcommittee won national attention for its investigation of the so-called "five percenters," notorious Washington lobbyists who charged their clients 5 percent of the profits from any Federal contracts they obtained on the client's behalf. Given the Subcommittee's jurisdictional inheritance from the Truman Committee, it is perhaps ironic that the "five percenters" investigation raised allegations of bribery and influence-peddling that reached right into the White House and implicated members of President Truman's staff. In any event, the fledgling Subcommittee was off to a rapid start.

ment Subcommittee on Investigations, as an investigatory body, may close its records for 50 years to protect personal privacy and the integrity of the investigatory process. With this 50th anniversary, the Subcommittee's earliest records, housed in the Center for Legislative Archives at the National Archives and Records Administration, began to open seriatim. The records of the predecessor committee—the Truman Committee—were opened by Senator Nunn in 1980.

What began as colorful soon became contentious. When Republicans returned to the Majority in the Senate in 1953, Wisconsin's junior Senator, Joseph R. McCarthy, became the Subcommittee's Chairman. Two years earlier, as Ranking Minority Member, Senator McCarthy had arranged for another Republican Senator, Margaret Chase Smith of Maine, to be removed from the Subcommittee. Senator Smith's offense, in Senator McCarthy's eyes, was her issuance of a "Declaration of Conscience" repudiating those who made unfounded charges and used character assassination against their political opponents. Although Senator Smith had carefully declined to name any specific offender, her remarks were universally recognized as criticism of Senator McCarthy's accusations that communists had infiltrated the State Department and other government agencies. Senator McCarthy retaliated by engineering Senator Smith's removal from the Subcommittee, replacing her with the newly-elected Senator from California, Richard M. Nixon.

Upon becoming Subcommittee Chairman, Senator McCarthy staged a series of highly publicized anti-communist investigations, culminating in an inquiry into communism within the U.S. Army, which became known as the Army-McCarthy hearings. During the latter portion of those hearings, in which the parent Committee examined the Wisconsin Senator's attacks on the Army, Senator McCarthy recused himself, leaving South Dakota Senator Karl Mundt to serve as Acting Chairman of the Subcommittee. Gavel-to-gavel television coverage of the hearings helped turn the tide against Senator McCarthy by raising public concern about his treatment of witnesses and cavalier use of evidence. In December 1954, in fact, the Senate censured Senator McCarthy for unbecoming conduct. In the following year, the Subcommittee adopted new rules of procedure that better protected the rights of witnesses. The Subcommittee also strengthened the rules ensuring the right of both parties on the Subcommittee to appoint staff, initiate and approve investigations, and review all information in the Subcommittee's possession.

In 1955, Senator John McClellan of Arkansas began 18 years of service as Chairman of the Permanent Subcommittee on Investigations. Senator McClellan appointed a young Robert F. Kennedy as the Subcommittee's Chief Counsel. That same year, Members of the Subcommittee were joined by Members of the Senate Labor and Public Welfare Committee on a special committee to investigate labor racketeering. Chaired by Senator McClellan and staffed by Robert Kennedy and other Subcommittee staff members, this special committee directed much of its attention to criminal influence over the Teamsters Union, most famously calling Teamsters' leaders Dave Beck and Jimmy Hoffa to testify. The televised hearings of the special committee also introduced Senators Barry Goldwater and John F. Kennedy to the nation, as well as leading to passage of the Landrum-Griffin Labor Act.

After the special committee completed its work, the Permanent Subcommittee on Investigations continued to investigate organized crime. In 1962, the Subcommittee held hearings during which Joseph Valachi outlined the activities of La Cosa Nostra, or the Mafia. Former Subcommittee staffer Robert Kennedy—who had by

then become Attorney General in his brother's Administration—used this information to prosecute prominent mob leaders and their accomplices. The Subcommittee's investigations also led to passage of major legislation against organized crime, most notably the Racketeer Influenced and Corrupt Organizations (RICO) provisions of the Crime Control Act of 1970. Under Chairman McClellan, the Subcommittee also investigated fraud in the purchase of military uniforms, corruption in the Department of Agriculture's grain storage program, securities fraud, and civil disorders and acts of terrorism. In addition, from 1962 to 1970, the Subcommittee conducted an extensive probe of political interference in the awarding of government contracts for the Pentagon's ill-fated TFX ("tactical fighter, experimental") aircraft. In 1968, the Subcommittee also examined charges of corruption in U.S. servicemen's clubs in Vietnam and elsewhere around the world.

In 1973, Senator Henry "Scoop" Jackson, a Democrat from Washington, replaced Senator McClellan as the Subcommittee's Chairman. During his tenure, recalled Chief Clerk Ruth Young Watt—who served in this position from the Subcommittee's founding until her retirement in 1979—Ranking Minority Member Charles Percy, an Illinois Republican, became more active on the Subcommittee than Chairman Jackson, who was often distracted by his Chairmanship of the Interior Committee and his active role on the Armed Services Committee.³ Senator Percy also worked closely with Georgia Democrat Sam Nunn, a Subcommittee member who subsequently succeeded Senator Jackson as Subcommittee Chairman in 1979. As Chairman, Senator Nunn continued the Subcommittee's investigations into the role of organized crime in labor-management relations and also investigated pension fraud.

Regular reversals of political fortunes in the Senate during the 1980s and 1990s saw Senator Nunn trade the chairmanship three times with Delaware Republican William Roth. Senator Nunn served from 1979 to 1980 and again from 1987 to 1995, while Senator Roth served from 1981 to 1986, and again from 1995 to 1996. These 15 years saw a strengthening of the Subcommittee's bipartisan tradition in which investigations were initiated by either the Majority or Minority and fully supported by the entire Subcommittee. For his part, Senator Roth led a wide range of investigations into commodity investment fraud, offshore banking schemes, money laundering, and child pornography. Senator Nunn led inquiries into Federal drug policy, the global spread of chemical and biological weapons, abuses in Federal student aid programs, computer security, airline safety, and health care fraud. Senator Nunn also appointed the Subcommittee's first female counsel, Eleanor Hill, who served as Chief Counsel to the Minority from 1982 to 1986 and then as Minority Chief Counsel from 1987 to 1995.

(2) More Recent Investigations

In January 1997, Republican Senator Susan Collins of Maine became the first woman to chair the Permanent Subcommittee on Investigations. Senator John Glenn of Ohio became the Ranking Mi-

³It had not been uncommon in the Subcommittee's history for the Chairman and Ranking Minority Member to work together closely despite partisan differences, but Senator Percy was unusually active while in the Minority—a role that included his chairing an investigation of the hearing aid industry.

minority Member. After Senator Glenn's retirement, Michigan Democrat Carl Levin succeeded him in January 1999, as the Ranking Minority Member. During Senator Collins' chairmanship, the Subcommittee conducted a number of investigations affecting Americans in their day-to-day lives, including investigations into mortgage fraud, deceptive mailings and sweepstakes promotions, phony credentials obtained through the Internet, day trading of securities, and securities fraud on the Internet. Senator Levin, while Ranking Minority Member, initiated an investigation into money laundering. At his request, the Subcommittee held hearings in 1999 on money laundering issues affecting private banking services provided to wealthy individuals, and in 2001, on how major U.S. banks providing correspondent accounts to offshore banks were being used to advance money laundering and other criminal schemes. Senator Collins chaired the Subcommittee until June 2001, when the Senate Majority party changed hands, and Senator Levin assumed the chairmanship. Senator Collins, in turn, became the Ranking Minority Member.

During the 107th Congress, both Senator Collins and Senator Levin chaired the Subcommittee. In her first 6 months chairing the Subcommittee at the start of the 107th Congress, Senator Collins held hearings examining issues related to cross border fraud, the improper operation of tissue banks, and Federal programs designed to fight diabetes. Senator Levin then assumed the chairmanship and, as his first major effort, led an 18-month bipartisan investigation into the Enron Corporation, which had recently collapsed into bankruptcy. As part of that investigation, the Subcommittee reviewed over 2 million pages of documents, conducted more than 100 interviews, held four hearings, and issued three bipartisan reports focusing on the role played by Enron's Board of Directors, Enron's use of tax shelters and structured financial instruments, and how major U.S. financial institutions contributed to Enron's accounting deceptions, corporate abuses, and ultimate collapse. The Subcommittee's investigative work contributed to passage of the Sarbanes-Oxley Act which enacted accounting and corporate reforms in July 2002. In addition, Senator Levin continued the money laundering investigation initiated while he was Ranking Minority Member, and the Subcommittee's work contributed to enactment of landmark reforms strengthening U.S. anti-money laundering laws in the 2001 PATRIOT Act. Also during the 107th Congress, the Subcommittee opened new investigations into offshore tax abuses, border security, and abusive practices related to the pricing of gasoline and other fuels.

In January 2003, at the start of the 108th Congress, after the Senate Majority party again changed hands, Senator Collins was elevated to Chairman of the full Committee on Governmental Affairs, and Republican Senator Norm Coleman of Minnesota became Subcommittee Chairman. Over the next 2 years, Senator Coleman held hearings on topics of national and global concern including illegal file sharing on peer-to-peer networks, abusive practices in the credit counseling industry, the dangers of purchasing pharmaceuticals over the Internet, Federal contractors with billions of dollars in unpaid taxes, SARS preparedness, border security, and how Saddam Hussein abused the United Nations Oil for Food Program.

At the request of Senator Levin, then Ranking Minority Member, the Subcommittee also examined how some U.S. accounting firms, banks, investment firms, and tax lawyers were designing, promoting, and implementing abusive tax shelters across the country; and how some U.S. financial institutions were failing to comply with anti-money laundering controls mandated by the PATRIOT Act, using as a case history Riggs Bank accounts involving Augusto Pinochet, the former President of Chile, and Equatorial Guinea, an oil-rich country in Africa.

During the 109th Congress, Senator Coleman held additional hearings on abuses associated with the United Nation's Oil for Food Program, and initiated a series of hearings on Federal contractors who were paid with taxpayer dollars but failed to pay their own taxes, resulting in billions of dollars in unpaid taxes. He also held hearings on border security issues, securing the global supply chain, Federal travel abuses, and consumers hurt by abusive tax refund loans or unfair energy pricing. At Senator Levin's request, the Subcommittee held hearings on offshore tax abuses responsible for \$100 billion in unpaid taxes each year, and on U.S. vulnerabilities caused by States forming 2 million companies each year with hidden owners.

During the 110th Congress, in January 2007, Senator Levin once again became Subcommittee Chairman. He focused on investigations into complex financial and tax topics, including unfair credit card practices, tax and accounting mismatches involving executive stock options, excessive speculation in the natural gas and crude oil markets, and offshore tax abuses involving tax haven banks and non-U.S. persons dodging payment of U.S. taxes on U.S. stock dividends. The Subcommittee's work contributed to enactment of two landmark bills, the Credit Card Accountability Responsibility and Disclosure Act (Credit CARD Act) which reformed credit card practices, and the Foreign Account Tax Compliance Act (FATCA) which tackled offshore tax issues. At the request of Senator Coleman, then Ranking Minority Member, the Subcommittee also conducted investigations into Medicare and Medicaid health care providers who cheat on their taxes, fraudulent Medicare claims involving deceased doctors or inappropriate diagnosis codes, U.S. dirty bomb vulnerabilities, Federal payroll tax abuses, abusive practices involving transit benefits, and problems involving the United Nations Development Program.

During the 111th Congress, Senator Levin continued as Chairman of the Subcommittee, while Senator Tom Coburn joined the Subcommittee as its Ranking Minority Member. During the 111th Congress, the Subcommittee dedicated much of its resources to a bipartisan investigation into key causes of the 2008 financial crisis, looking in particular at the role of high-risk home loans, regulatory failures, inflated credit ratings, and high-risk, conflicts-ridden financial products designed and sold by investment banks. The Subcommittee held four hearings, released thousands of documents, and produced bipartisan findings of fact and recommendations. In addition, the Subcommittee held hearings on excessive speculation in the wheat market, tax haven banks that helped U.S. clients evade U.S. taxes, keeping foreign corruption out of the United States, and social security disability fraud.

II. SUBCOMMITTEE HEARINGS DURING THE 111TH CONGRESS

A. *Tax Haven Banks and U.S. Tax Compliance—Obtaining the Names of U.S. Clients with Swiss Accounts (March 4, 2009)*

The Subcommittee's first hearing in the 111th Congress focused on the issue of tax haven banks that facilitate U.S. tax evasion. The Subcommittee has estimated that U.S. taxpayers using offshore tax schemes cost an estimated revenue loss of \$100 billion in unpaid taxes each year. Offshore tax abuses also undermine the integrity of the Federal tax system and shift the tax burden from high income taxpayers onto the middle class. In the previous Congress, in 2008, the Subcommittee held 2 days of hearings and released a bipartisan staff report demonstrating how two offshore banks, UBS of Switzerland and LGT Bank of Liechtenstein, had actively facilitated tax dodging by U.S. taxpayers and used offshore secrecy laws to hide the actions of both their clients and their own personnel.

In March 2009, the Subcommittee continued its tax haven bank investigation by holding a hearing on what the U.S. Government was doing to stop UBS from aiding and abetting U.S. tax evasion and to obtain the names of U.S. taxpayers with hidden UBS accounts in Switzerland. At the hearing, the Subcommittee released a number of UBS documents showing the extent of the bank's efforts to help U.S. clients evade U.S. taxes. One 2004 UBS internal report indicated that 32 UBS Swiss bankers had traveled to the United States and made 3,800 client visits in a single year, and that the bank then had a total of 52,000 Swiss account relationships with U.S. residents who had not disclosed their accounts to the Internal Revenue Service (IRS).

The hearing took testimony from two panels of witnesses. On the first panel, John A. DiCicco, Acting Assistant Attorney General for the Tax Division at the Department of Justice (DOJ), and Douglas H. Shulman, IRS Commissioner, described the criminal and civil legal actions taken by the U.S. Government with respect to UBS. They explained that criminal proceedings had led UBS, in February 2009, to enter into a deferred prosecution agreement with DOJ, admit to participation in a scheme to defraud the United States of tax revenue, pay a fine of \$780 million, and turn over the names of 250–300 U.S. clients who had participated in the fraud. Mr. DiCicco and IRS Commissioner Shulman also described ongoing civil proceedings in which the U.S. Government was attempting to enforce a court-approved John Doe summons to obtain from UBS the names and account documentation for all remaining U.S. clients with undisclosed Swiss accounts.

The second panel took testimony from the Chief Financial Officer of UBS Global Wealth Management and Swiss Bank, Mark Branson, who had traveled from Zurich, Switzerland to testify. Mr. Branson acknowledged and expressed regret for the bank's past conduct and repeated the pledge made by UBS at an earlier Subcommittee hearing that it would close the offending accounts and no longer open Swiss accounts for U.S. clients without notifying the IRS. This pledge represented the first time a major bank in a tax haven jurisdiction promised to no longer open accounts for U.S. clients without alerting the IRS. While UBS also promised to cooper-

ate with the U.S. investigation into its actions, Mr. Branson testified that, due to Swiss bank secrecy laws, it might not be able to disclose any additional U.S. client names to the United States. He explained that the Swiss government had intervened in the John Doe proceedings to prevent any additional disclosure of client information and had asserted that, instead of the John Doe summons, the United States ought to be using the procedures set up under the U.S.-Swiss tax treaty to obtain the information it wanted.

The witnesses agreed, however, that the U.S.-Swiss tax treaty, like other tax treaties and tax information exchange agreements around the world, was not designed to handle inquiries into taxpayers whose names were unknown. As the IRS explained in a court pleading, the Swiss have consistently applied the tax treaty “to provide the [IRS] assistance only in response to specific requests that name a particular taxpayer.” In the UBS case, for example, after the United States made a request under the treaty for the names of the 52,000 UBS Swiss account relationships with U.S. clients, the Swiss government determined that only 12 accountholders met the treaty standards and could be disclosed to the United States. In addition, the Swiss allowed those 12 to appeal its determination, leading to lengthy proceedings in Swiss courts. The IRS stated in a court pleading 7 months after making its request: “The Swiss Government has not provided any records sought under the Treaty Request, and it is not clear when, if ever, it will.” The Swiss government was invited to appear at the Subcommittee hearing to discuss the UBS matter and the pending U.S. treaty request, but it declined to send a representative.

Later in 2009, after the hearing, Switzerland and the United States reached agreement on a new tax treaty with slightly broader terms and, in August 2009, the Swiss agreed to turn over the names of an additional, estimated 4,400 UBS clients. In return, the United States agreed to forgo obtaining the names of the remaining tens of thousands of U.S. clients with undisclosed UBS accounts in Switzerland. Over the following 2 years, the 4,400 names were slowly provided by the Swiss to the United States.

The Subcommittee’s work on abusive practices by tax haven banks contributed to enactment by Congress, in 2010, of the Foreign Account Tax Compliance Act (FATCA) which, among other provisions, requires foreign banks to disclose all accounts opened by U.S. persons or pay a 30 percent tax on income generated by U.S. investments held by those banks. In addition, the Subcommittee’s work contributed to a world or wide effort to pressure tax havens to stop using secrecy laws to facilitate tax evasion. In response to this worldwide campaign, by 2010, virtually all offshore jurisdictions around the world, including Switzerland, stated publicly they would no longer use secrecy laws to facilitate tax evasion and committed to adopting international standards on tax information exchange. Implementation of those pledges continues.

B. Excessive Speculation in the Wheat Market (July 21, 2009)

Since 2001, the Subcommittee has investigated the pricing of energy commodities, such as crude oil, natural gas, and gasoline; allegations of price manipulation and excessive speculation; and actions taken by the Commodity Futures Trading Commission

(CFTC) and the commodity exchanges to police commodity markets. In 2009, the Subcommittee extended its investigation of commodity markets by releasing a 270-page bipartisan staff report and holding a hearing on pricing and speculation issues involving wheat.

As part of its investigation, the Subcommittee compiled and examined millions of trading records from the Chicago Mercantile Exchange, Kansas City Exchange, Minneapolis Grain Exchange, the CFTC, and others to track and analyze trends in wheat prices. The data showed that commodity index traders—traders who are not producers or consumers of wheat, but buy wheat futures to help offset their financial exposure from selling commodity index instruments to third parties—had injected billions of dollars, in the aggregate, into the wheat futures market over 6 years. The data also showed that commodity index traders had increased their holdings from a total of about 30,000 wheat contracts in 2004, up to 220,000 contracts in 2008, enlarging their market share so that, in each year since 2006, commodity index traders held between 35 percent and 50 percent of all outstanding wheat futures contracts on the Chicago Mercantile Exchange. The investigation concluded that, as a result, commodity index traders had, in the aggregate, pushed up futures prices, disrupted the normal relationship between futures prices and cash prices for wheat, and caused farmers, grain elevators, grain processors, consumers, and others to experience significant unwarranted costs and price risks. The excessive speculation engaged in by index traders had also made it more difficult to use the futures market to protect against price changes.

The report released by the Subcommittee on June 24, 2009, included bipartisan findings of fact and recommendations. One of the key findings was that significant and persuasive evidence indicated that one of the major reasons for the recent wheat market problems was the unusually high level of speculation in the Chicago wheat futures market due to purchases of futures contracts by index traders offsetting sales of commodity index instruments. To diminish and prevent this type of excessive speculation in the Chicago wheat futures market, the investigation recommended that the CFTC phase out exemptions and waivers that had allowed some index traders to operate outside of the trading limits designed to prevent excessive speculation. That action would then enable the CFTC to impose on index traders the same position limits for wheat contracts that apply to other speculators, and rein in the excessive speculation disrupting wheat prices. In addition, the investigation recommended that the CFTC analyze the impact of commodity index trading on other commodities, including crude oil, to determine if excessive speculation was distorting prices.

The hearing took testimony from three panels of witnesses who reacted to the Subcommittee's investigation and report, and described their own wheat market experiences and analysis of wheat prices. The first witness was CFTC Chairman Gary Gensler who described the CFTC's concern with preventing excessive speculation from distorting commodity prices and commercial hedging efforts. The second panel heard from four witnesses with expertise on commodity issues, including a wheat producer, wheat user, wheat trader, and consumer protection group. The panelists were

Thomas Coyle, Vice President and General Manager of Chicago and Illinois River Marketing LLC, Nidera, Inc., and Chairman of the National Grain and Feed Association; Hayden Wands, Director of Procurement for the Sara Lee Corporation and Chairman of the Commodity and Agricultural Policy of the American Bakers Association; Steven H. Strongin, head of the Global Investment Research Division for Goldman Sachs Group, Inc.; and Mark Cooper, Director of Research for the Consumer Federation of America. The third and final panel heard from Charles P. Carey, Vice Chairman of the CME Group, which manages the Chicago Mercantile Exchange, the largest wheat futures market in the world.

The witnesses generally agreed that commodity index traders had an increased presence in the wheat market, the wheat market was experiencing increased price volatility and hedging failures, and recent trends showed an ongoing disconnect between wheat futures and cash prices, but they often disagreed on the causes of those problems. The wheat producer, user and consumer witnesses saw commodity index traders as responsible for excessive speculation and price distortions, while the wheat trader and exchange operator did not. The CFTC chairman promised additional study.

In response to the Subcommittee's work, the CFTC intensified its review of wheat price convergence problems and revoked some position limit waivers and exemptions that had been granted to wheat index traders. The CME Group tried other remedies as well, but index traders continued to dominate the wheat markets and wheat pricing problems continued to plague its market. In 2010, Congress enacted the Dodd-Frank Wall Street Reform and Consumer Protection Act which, among other provisions, mandated stronger regulation of all commodity markets and related commodity derivatives, provided stronger tools to restrain excessive speculation, and mandated the imposition of position limits on commodity traders.

C. Keeping Foreign Corruption out of the United States: Four Case Histories (February 4, 2010)

Since 2003, the Subcommittee has conducted a series of investigations into U.S. practices that may contribute, wittingly or unwittingly, to corruption in foreign countries. In February 2010, the Subcommittee held a hearing and released a 330-page bipartisan staff report showing how politically powerful foreign officials, their relatives, and close associates—referred to as Politically Exposed Persons (PEPs) in international agreements—have funneled millions of dollars in illicit money into the United States using the services of U.S. lawyers, real estate and escrow agents, lobbyists, and other professionals. During the course of this investigation, the Subcommittee reviewed millions of pages of documents, conducted more than 100 interviews, and traced millions of dollars in suspect funds.

The investigation developed four case histories, involving PEPs from Equatorial Guinea, Gabon, Nigeria, and Angola, to expose some of the tactics being used to bring suspect funds into the United States. The case histories showed, for example, how PEPs used U.S. shell corporation, law office, trust, and family bank accounts to bring suspect funds into the United States; used U.S. real estate and escrow agents to purchase lavish residences and aircraft

with suspect funds; and used a U.S. lobbyist to distribute suspect funds across the country and around the globe. Another case history showed how U.S. banks allowed PEPs to wire transfer suspect funds into the United States, including funds from around the globe from a known arms dealer and felon; millions of dollars that the head of a central bank attempted to transfer from the central bank to a private account in the United States; and funds from a private bank that catered to PEPs in a country known for corruption.

The investigation also showed that many of the U.S. professionals assisting PEPs, including lawyers, real estate and escrow agents, and lobbyists, were exempt from anti-money laundering (AML) laws which would require them to know their customers, evaluate the source of funds transferred into the United States, and report suspicious activity to law enforcement. The investigation offered a number of recommendations to help keep foreign corruption out of the United States, including by revoking the AML exemptions granted to real estate and escrow agents, identifying the owners of U.S. shell corporations, and tightening controls on shell company and law office accounts.

The hearing took testimony from three panels of witnesses. The first panel called two lawyers and a lobbyist who assisted PEPs in Equatorial Guinea and Gabon to bring suspect funds into the United States. At the hearing, all three panelists asserted their Fifth Amendment rights under the Constitution and declined to testify.

The two lawyers, Michael Jay Berger and George I. Nagler, had each worked for Teodoro Obiang, the 40-year-old son of the President of Equatorial Guinea who was under investigation by the Justice Department for corruption and other misconduct. He was also an Equatorial Guinea Cabinet Minister and a PEP in his own right. Although they did not work together, the two attorneys formed five California shell corporations for Mr. Obiang's use, with names like Beautiful Vision, Unlimited Horizon, and Sweetwater. The lawyers then opened accounts for those shell corporations at multiple banks, and allowed Mr. Obiang to transfer funds into and out of them to advance his interests. In addition, each attorney allowed Mr. Obiang to wire millions of dollars into the attorney's law office or attorney-client bank accounts and forwarded the funds to other accounts controlled by Mr. Obiang, thereby disguising the origin of the funds as from Equatorial Guinea, a country many banks viewed as high risk.

The remaining panelist, Jeffrey C. Birrell, served as a registered lobbyist for the Republic of Gabon. From 2003 until at least 2007, he worked closely with Omar Bongo, the now deceased President of Gabon, to buy U.S.-made armored vehicles and obtain U.S. Government permission to buy six C-130 military cargo aircraft from Saudi Arabia to support the Bongo regime. In connection with those projects, more than \$18 million was wire transferred from Gabon into Mr. Birrell's U.S. corporate bank accounts. Part of that money came from President Bongo's personal account; most came from an entity in Gabon called "Ayira." At President Bongo's direction, Mr. Birrell spent millions of dollars of the Gabon money on the armored car and aircraft projects, including wiring more than

\$1 million to various “consultants” around the world and at least another \$4 million to a Bongo advisor with accounts in Brussels and Paris. When the aircraft deal fell through, Mr. Birrell wired over \$9 million of the Ayira money to an account in President Bongo’s name—not in Gabon—but in the country of Malta. Mr. Birrell’s corporate bank accounts became conduits for multi-million-dollar suspicious wire transfers directed by President Omar Bongo through the U.S. financial system.

The second panel of witnesses heard from a U.S. real estate agent, escrow agent, and two banks that facilitated suspect PEP transactions in the United States. The real estate agent, Neal Baddin, helped Teodoro Obiang purchase a \$30 million mansion in Malibu, in part by accepting multiple wire transfers from Equatorial Guinea into an escrow account at a U.S. bank. Mr. Baddin testified that he had no legal obligation to inquire into the source of those funds or evaluate whether they might be the proceeds of crime. Mr. Obiang also bought a \$38.5 million U.S.-built Gulfstream jet. After one U.S. escrow agent, as an AML precaution, refused to proceed with the aircraft purchase without more information about the source of the funds, another escrow agent, Insured Aircraft Title Services Inc. (IATS), stepped in and completed the transaction with no questions asked. The second panelist, Brenda K. Cobb, an IATS Vice President, explained that U.S. regulations currently exempted escrow agents from any AML obligations and so did not require the company to screen client funds. Both Mr. Baddin and Ms. Cobb testified that, if the law had required their firms to take AML precautions, their firms would have complied with the law.

The second panel also heard from two banks that facilitated PEP transactions in the United States. William J. Fox was Senior Vice-President and Global Anti-Money, Laundering and Economic Sanctions Executive of Bank of America; Wiecher H. Mandemaker was the Director of General Compliance, Personal Financial Services, Anti-Money Laundering Compliance, for HSBC Bank USA. Mr. Fox expressed regret that for a period of 18 years, from 1989 to 2007, a Bank of America branch in Scottsdale, Arizona provided more than 30 accounts to Pierre Falcone, a notorious arms dealer who supplied weapons during Angola’s civil war in violation of a U.N. arms embargo. Mr. Falcone had a long history of run-ins with the law, was incarcerated for a year in 2000, was a fugitive from a 2004 global arrest warrant, and at the time of the hearing was serving a 6-year prison term in France. Bank of America documents indicated that the bank knew who he was, yet never designated him a PEP despite his being an Angolan Ambassador, never designated his accounts as high-risk despite deposits of substantial sums of offshore money, and never closed his accounts until contacted by the Subcommittee. Mr. Mandemaker acknowledged that, for over a decade, HSBC provided U.S. banking services to Banco Africano de Investimentos (BAI), a \$7 billion Angolan private bank whose largest shareholder was Angola’s State-owned oil company and which catered to PEP clients. Despite PEPs in BAI’s management and clientele, and HSBC’s inability despite multiple requests to get clear information about BAI’s owners or a copy

of its AML procedures, HSBC continued to provide the BAI bank with ready access to the U.S. financial system.

The third and final panel heard from three Federal Government representatives: David T. Johnson, Assistant Secretary for International Narcotics and Law Enforcement Affairs at the U.S. Department of State; Janice Ayala, Assistant Director, Office of Investigations, Immigration and Customs Enforcement (ICE) at the U.S. Department of Homeland Security; and James H. Freis, Jr., Director of the Financial Crimes Enforcement Network (FinCEN) at the U.S. Department of Treasury. All three expressed concern about U.S. professionals facilitating foreign corruption through the United States and reacted to proposals to strengthen U.S. barriers to foreign corruption, including implementing stronger PEP controls at banks to identify and monitor PEP clients; requiring persons setting up U.S. shell companies to identify their beneficial owners; revoking AML exemptions for real estate and escrow agents; preventing misuse of law office and attorney-client bank accounts; and strengthening U.S. visa and immigration policies to make foreign corruption a legal basis for excluding or removing a foreign PEP from the United States.

D. Wall Street and the Financial Crisis: The Role of High-Risk Home Loans (April 13, 2010)

In November 2008, the Subcommittee initiated a bipartisan investigation into key causes of the 2008 financial crisis which cost millions of jobs, caused the loss of millions of homes, destroyed savings, shuttered good businesses, and put the United States into the worst economic tailspin since the Great Depression. The investigation's goals were threefold: To construct a public record of the facts to deepen public understanding of what happened; identify some of the root causes of the crisis; and provide a factual foundation for the ongoing effort to fortify the country against the recurrence of a similar crisis in the future. As part of its investigation, the Subcommittee conducted over 150 interviews and depositions, consulted with dozens of experts, and subpoenaed and reviewed millions of pages of documents.

In April 2010, the Subcommittee held four hearings examining how high-risk mortgage lending, regulatory failures, inflated credit ratings that misled investors, and high-risk, conflicts-ridden financial products designed and sold by investment banks contributed to the financial crisis, using case histories in each hearing to illustrate the problems.

The first hearing, on April 13, 2010, focused on the role of high-risk home loans and the mortgage backed securities that those loans produced, using as a case history the lending and securitization practices of Washington Mutual Bank. Washington Mutual Bank, the largest U.S. thrift with more than \$300 billion in assets, issued billions of dollars in high-risk mortgage loans, packaged them into securities that later experienced a high rate of delinquency or loss, and then collapsed in the largest bank failure in U.S. history. Washington Mutual securitized over \$77 billion in subprime home loans as well as billions of dollars of other high-risk home loans, including interest-only, home equity, and "Option Adjustable Rate Mortgages (ARM)" loans. Many of those loans used

initial low “teaser” interest rates that, unless the loan was refinanced, were later replaced with much steeper rates and higher monthly payments. The Option ARM loans also allowed borrowers, for a specified period, to pay less than the interest they owed each month, resulting in a larger rather than reduced mortgage debt, a feature called negative amortization. When home prices stopped increasing, many borrowers were unable to refinance their loans, defaulted on their mortgages, and lost their homes while the related mortgage securities plummeted in value.

At the hearing, the Subcommittee released thousands of pages of hearing exhibits documenting Washington Mutual’s role in the 2008 financial crisis. The hearing exhibits demonstrated, for example, that the reason that Washington Mutual executives embarked upon a high-risk lending strategy was because they had projected that high-risk home loans, which generally charged higher interest rates and produced higher sales prices on Wall Street, would be more profitable for the bank than lower risk home loans. The documents also showed that Washington Mutual and its affiliate, Long Beach Mortgage Company, used shoddy lending practices riddled with credit, compliance, and operational deficiencies. Those practices included issuing loans with erroneous or fraudulent borrower information, “stated income loans” in which borrowers stated their income with no supporting documentation, loans with inaccurate appraisals, and loans in which the borrowed amount equaled 90 percent or more of the value of the home. The hearing exhibits also showed that Washington Mutual and Long Beach steered many borrowers into loans they could not afford when the higher monthly payments built into those loans took effect. Those high-risk loans were nevertheless packaged into mortgage-backed securities sold to investors worldwide, saturating financial markets with mortgage-backed securities that later incurred high rates of delinquency and loss.

The hearing exhibits also showed that, at times, Washington Mutual securitized loans that it had identified as likely to go delinquent, without disclosing its analysis to investors who bought the securities, and securitized loans tainted by fraudulent information, without notifying purchasers of the fraud that had been discovered. In addition, the documents showed that Washington Mutual’s compensation system rewarded loan officers and loan processors for speed and volume in issuing loans, rather than for issuing high quality loans. The compensation system also paid extra to loan officers who overcharged borrowers or added stiff prepayment penalties, and awarded bank executives millions of dollars even when their high-risk lending strategy placed the bank in financial jeopardy.

The hearing took testimony from two panels of former bank personnel. The first panel consisted of two former Washington Mutual risk management officers and the chief auditor who were employed by the bank during the run up to its collapse in 2008. The witnesses were James Vanasek, former Chief Risk Officer from 2004 to 2005; Ronald Cathcart, former Chief Risk Officer from 2006 to 2008; and Randy Melby, former General Auditor from 2004 to 2008. All three witnesses acknowledged the bank’s high-risk lending practices, poorly performing loans and mortgage-backed securi-

ties, and weak oversight of loan personnel and the third party mortgage brokers that provided loans to the bank. All three described how they alerted bank management to the risks and other problems, but were ignored or marginalized by the bank's senior officers.

The second panel of witnesses heard from four senior Washington Mutual officers, the bank's Chief Executive Officer (CEO), President, Home Loans Division head, and head of the Capital Markets Division. The witnesses were Kerry Killinger, former President, CEO, and Chairman of the Board of Washington Mutual; Stephen Rotella, former President and Chief Operating Officer of the bank; David Schneider, former President of the Home Loans Division; and David Beck, Former Division Head of Capital Markets. These four bank officers also acknowledged the bank's dismal performance, but claimed they worked hard to reduce the bank's risk and address other problems. They portrayed the bank as a victim of, rather than a contributor to, the financial crisis and denied their practices contributed to the bank's downfall.

In April 2011, the Subcommittee issued a 750-page bipartisan staff report summarizing its investigation into high-risk lending practices discussed at the hearing and offering recommendations to prevent similar problems in the future. The Subcommittee's work contributed to the enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank Act"). Among other provisions, the Dodd-Frank Act prohibited stated income loans; imposed restrictions on loans using low teaser rates or negative amortization; and required banks to retain a portion of the credit risk of each mortgage-backed security they issued.

E. Wall Street and the Financial Crisis: The Role of Bank Regulators (April 16, 2010)

The second in the series of Subcommittee hearings on key causes of the 2008 financial crisis, on April 16, 2010, focused on the role of Federal bank regulators charged with ensuring the safety and soundness of the U.S. banking system. The Subcommittee used as a case study regulatory oversight of Washington Mutual, focusing on the Office of Thrift Supervision (OTS), which was the bank's primary regulator, and the Federal Deposit Insurance Corporation (FDIC), which was its backup regulator.

At the hearing, the Subcommittee released thousands of pages of hearing exhibits documenting actions taken by OTS and the FDIC, from 2004 to 2008, to ensure the safety and soundness of Washington Mutual, the sixth largest bank in the United States and OTS's largest institution. Together, the documents demonstrated that feeble oversight by the regulators, combined with weak regulatory standards and agency infighting, allowed Washington Mutual Bank to engage in high-risk and shoddy lending practices and the sale of poor quality and sometimes fraudulent mortgages that contributed to both the bank's demise and the 2008 financial crisis.

The hearing exhibits showed that over a 5-year period, from 2003 to 2008, OTS identified over 500 serious deficiencies in Washington Mutual's lending practices, risk management, and asset quality, but failed to force adequate corrective action to prevent the bank's failure. The documents demonstrated that OTS was aware of, yet

tolerated, Washington Mutual and its affiliate Long Beach Mortgage Company's engaging in year-after-year of shoddy lending and securitization practices, including the origination and sale of loans and mortgage-backed securities with notoriously high rates of delinquency and loss.

The hearing exhibits also demonstrated that OTS allowed Washington Mutual to originate hundreds of billions of dollars in high-risk loans, knowing that the bank used unsafe and unsound teaser rates, qualified borrowers using those teaser rates rather than the higher interest rates that would later take effect, permitted borrowers to make minimum payments resulting in negatively amortizing loans, relied on rising house prices and refinancing to avoid payment shock and loan defaults, had unsafe concentrations of loans in particular States, and had no realistic data to calculate loan losses in markets with flat or declining house prices. The documents show that, due in part to the short-term profits obtained by the bank from its lending activities, OTS repeatedly failed to take enforcement action to stop Washington Mutual's unsafe and unsound practices or strengthen its portfolio of high-risk, poor-quality loans and securities.

In addition, the hearing exhibits disclosed agency infighting in which OTS actively impeded FDIC oversight of Washington Mutual by blocking the FDIC's access to bank data, refusing to allow it to participate in bank examinations, and rejecting requests to review bank loan files. OTS also rejected FDIC recommendations for stronger enforcement action.

The documents also demonstrated that Federal bank regulators were hobbled in their efforts to end unsafe and unsound mortgage practices at U.S. banks by weak regulatory standards, use of guidance instead of enforceable regulations to limit bank practices, and the failure to set clear deadlines for bank compliance. The case history exposed an ineffective regulatory culture at OTS in which bank examiners were demoralized by their inability to stop unsafe practices, their supervisors' reluctance to take formal enforcement actions even after years of recorded bank deficiencies, and an agency culture that treated banks as "constituents" rather than regulated entities. In addition, the case history showed how OTS and the FDIC allowed Washington Mutual to reduce its risks by selling its high-risk assets, without concern that those assets might saturate the financial system, contribute to investor losses, and undermine investor confidence in the U.S. mortgage market.

The hearing heard from three panels of witnesses. The first panel consisted of two Federal Inspectors General who had prepared a joint report on the regulatory failures associated with Washington Mutual. The witnesses were Eric Thorson, Inspector General for the U.S. Treasury Department, and Jon T. Rymer, Inspector General for the FDIC. Both testified that the OTS had identified numerous serious deficiencies at the bank, but failed to take needed enforcement actions to change the bank's conduct. Both agreed that OTS allowed short-term profits to excuse high-risk practices and poor quality assets. Both also agreed that OTS and the FDIC failed to provide accurate ratings of the bank's management and financial condition; and OTS engaged in unacceptable tactics to impede FDIC oversight.

The second panel took testimony from five regulators who helped oversee Washington Mutual prior to its collapse, three from OTS and two from the FDIC. The witnesses were John Reich, former Director of OTS; Darrel Dochow, former OTS West Regional Director; Lawrence Carter, former OTS Examiner-in-Charge at Washington Mutual from 2004 to 2006; John Corston, Acting FDIC Deputy Director of the Large Institutions and Analysis Branch; and J. George Doerr, FDIC Deputy Regional Director for the Division of Supervision and Consumer Protection in San Francisco. The witnesses generally agreed that the bank's activities were high risk, but asserted they did not violate regulatory standards. The FDIC witnesses criticized the extent to which OTS allowed Washington Mutual's loan practices to layer risks and gave the bank more time to comply with bank guidance limiting high-risk activities.

The third panel took testimony from the heads of OTS and the FDIC, Sheila C. Bair, FDIC Chairman, and John E. Bowman, OTS Acting Director. Both acknowledged the regulatory failures underlying the collapse of Washington Mutual, testifying among other matters that regulators had been too tolerant of risk, and the regulatory standards should have banned stated income loans and limited other risky products and practices.

In April 2011, the Subcommittee issued a 750-page bipartisan staff report summarizing its investigation into the regulatory failures discussed at the hearing and offering a number of recommendations to prevent similar problems in the future. The Subcommittee's work contributed to the enactment of the Dodd-Frank Act which, among other provisions, abolished OTS and moved its regulatory responsibilities to another bank regulator; prohibited a number of high-risk lending practices; strengthened the FDIC's oversight role; and created a Financial Oversight Stability Council to detect and prevent systemic risks to the U.S. financial system.

F. Wall Street and the Financial Crisis: The Role of Credit Rating Agencies (April 23, 2010)

The third in the series of Subcommittee hearings examining key causes of the financial crisis, on April 23, 2010, focused on the role of the credit rating agencies that rated residential mortgage backed securities (RMBS) and collateral debt obligations (CDOs) from 2004 to 2008. The Subcommittee's investigation used as a case history the two largest U.S. credit rating agencies, Moody's and Standard & Poor's ("S&P"), which together rated tens of thousands of RMBS and CDO securities in the years prior to the financial crisis. Those ratings proved to be both inaccurate and inflated, as evidenced by studies showing that over 90 percent of the RMBS securities given AAA ratings in 2006 and 2007, were later downgraded to junk status, subjecting investors to unusually high rates of delinquency and loss.

At the hearing, the Subcommittee released thousands of pages of hearing exhibits documenting actions taken by Moody's and S&P during the period 2004 to 2007. Those documents showed how some investment bankers pressured the credit rating agencies to provide favorable ratings for the RMBS and CDO products they designed and planned to sell, and how Moody's and S&P—which were paid by those firms—repeatedly gave into that pressure. The hearing ex-

hibits also disclosed how competitive pressures, including the drive for market share and the need to accommodate investment bankers bringing in business, caused Moody's and S&P to weaken their standards for issuing favorable ratings. The documents also showed that Moody's and S&P made record profits rating structured finance products during this period, primarily from rating complex RMBS and CDO products.

The documents showed that Moody's and S&P issued AAA and other investment grade credit ratings for the vast majority of RMBS and CDO securities they rated, deeming them safe investments even though many relied on high-risk home loans. In late 2006, high-risk mortgages began incurring delinquencies and defaults at an alarming rate. Despite signs of a deteriorating mortgage market, Moody's and S&P continued for 6 months to issue investment grade ratings for numerous RMBS and CDO securities.

The hearing exhibits showed that Moody's and S&P were aware of the increasing risks associated with the subprime, interest-only, and adjustable rate mortgages being issued by lenders, including their increasing use of stated income loans that did not document a borrower's ability to repay debt, loans containing fraudulent borrower or appraisal information, and loans with initial teaser rates that relied on the borrower refinancing the debt before higher interest rates took effect. The documents also showed that Moody's and S&P were aware of housing prices leveling out, delinquency rates climbing, and related MBS and CDO securities incurring increased losses, despite their AAA ratings. One S&P analyst told a superior in early 2007, that he did not expect the ratings to "hold" through the year.

The documents also showed that in July 2007, within days of each other, Moody's and S&P suddenly announced mass downgrades of hundreds of RMBS and CDO securities. Those mass downgrades shocked the financial markets, triggered sales of assets that had lost their investment grade status, and contributed to the collapse of first the RMBS and then the CDO secondary markets. Financial firms and investors were left holding billions of dollars of suddenly unmarketable securities whose value began plummeting. The Subcommittee's investigation concluded that the 2007 mass downgrades, which were unique in U.S. financial history and which made it clear that RMBS and CDO securities were no longer safe investments, were the most immediate trigger of the financial crisis.

The hearing exhibits also showed that, from 2004 to 2007, Moody's and S&P used credit rating models with data that was inadequate to predict how high-risk home loans would perform. In addition, they showed that Moody's and S&P failed to factor into their models increased credit risks due to mortgage fraud, lax underwriting standards, and unsustainable housing price appreciation. By 2006, Moody's and S&P knew their RMBS and CDO ratings were inaccurate, revised their rating models to produce more accurate ratings, but then failed to use the revised models to re-evaluate their existing RMBS and CDO ratings, delaying thousands of rating downgrades and allowing those securities to carry inflated ratings that could mislead investors. In addition, despite record profits, Moody's and S&P failed to assign sufficient re-

sources to adequately rate new products and test the accuracy of their existing ratings.

At the hearing, three panels of witnesses reacted to the Subcommittee's investigation and hearing exhibits. The first panel took testimony from four former Moody's and S&P employees involved with rating RMBS and CDO securities. The witnesses were Frank Raiter, former Managing Director of Mortgage-Backed Securities at S&P; Richard Michalek, former Vice President and Senior Credit Officer in the Structured Derivative Products Group at Moody's; Eric Kolchinsky, former Team Managing Director in the Structured Derivative Products Group at Moody's; and Arturo Cifuentes, Ph.D., former Senior Vice-President at Moody's and currently Director of the Finance Center at the University of Chile. These former Moody's and S&P employees described multiple instances of competitive pressures, inadequate resources, and conflicts of interest that weakened the credit rating process and criticized their employers for issuing inaccurate ratings.

The second panel took testimony from three senior credit rating officials who oversaw RMBS and CDO ratings in the run up to the 2008 financial crisis. The witnesses were Susan Barnes, Managing Director of Mortgage-Backed Securities at S&P; Peter D'Erchia, Managing Director of U.S. Public Finance and former Global Practice Leader for Surveillance at S&P; and Yuri Yoshizawa, Group Managing Director for Structured Finance at Moody's Investors Service. These senior officers essentially defended their firms and denied that competitive pressures or conflicts of interest affected the ratings process.

The third and final panel took testimony from the heads of Moody's and S&P during the years proceeding the financial crisis. The witnesses were Raymond W. McDaniel, Jr., Chairman and Chief Executive Officer of Moody's Corporation; and Kathleen A. Corbet, President of S&P from 2004 to 2007. Both witnesses expressed dissatisfaction with their companies' ratings performance and acknowledged taking steps to strengthen their ratings process. Both also essentially denied any breakdown in their ratings process, and portrayed their firms as victims of an unexpected widespread decline in housing price appreciation which rendered their credit ratings inaccurate.

In April 2011, the Subcommittee issued a 750-page bipartisan staff report summarizing its investigation into the inaccurate and inflated credit ratings and mass rating downgrades discussed at the hearing. The report also provided bipartisan recommendations to prevent similar problems in the future. The Subcommittee's work contributed to the enactment of the Dodd-Frank Act which, among other provisions, strengthened SEC oversight of the credit rating agencies, instituted new controls to improve the credit rating process, banned Federal regulations requiring reliance on credit ratings, and initiated a study to determine how to address the conflicts of interest inherent when credit rating agencies are paid by the firms whose financial products are being rated.

G. Wall Street and the Financial Crisis: The Role of Investment Banks (April 27, 2010)

The fourth and final hearing in the Subcommittee series of hearings on key causes of the 2008 financial crisis took place on April 27, 2010. It focused on the role of investment banks, using as a case history Goldman Sachs, a Wall Street investment bank that was a leader in developing RMBS and CDO products and the secondary mortgage market, and then profited from the collapse of that same market during the crisis. In addition, the hearing examined actions taken by Goldman indicating that it had engaged in troubling and sometimes abusive practices raising multiple conflict of interest concerns.

At the hearing, the Subcommittee released thousands of pages of hearing exhibits documenting actions taken by Goldman during the run up to the financial crisis. These documents showed that, from 2004 to 2007, in exchange for lucrative fees, Goldman helped lenders notorious for issuing high-risk, poor quality loans securitize them, obtain favorable credit ratings for them, and sell the resulting RMBS securities to investors, injecting billions of dollars of risky loans into the financial system. The hearing exhibits also showed how Goldman Sachs magnified the risks associated with subprime mortgages by re-securitizing related RMBS securities in CDOs, referencing them in synthetic CDOs, and selling the CDO securities to investors worldwide. In addition, Goldman promoted standardized credit default swaps and other products to enable investors to bet on the failure as well as the success of RMBS and CDO securities.

The hearing exhibits also showed how, as high-risk home loans began to default, loan delinquency rates increased, and RMBS and CDO securities began to incur losses in late 2006, Goldman suddenly reversed course and began to bet against the mortgage market. The documents detailed how Goldman sold its mortgage investments, used a variety of tactics to build a very large net short position, and either locked in or cashed out its profits during 2007, generating billions of dollars in gain. One internal Goldman email characterized this 2007 effort as the “big short.” As a result, during the financial crisis, while other investment banks incurred large losses, Goldman showcased its mortgage profits, citing its net short position.

The hearing exhibits also provided detailed information about Goldman’s efforts during late 2006 and the first half of 2007, to originate and sell four mortgage-related CDOs known as Hudson, Anderson, Timberwolf, and Abacus. Goldman designed those CDOs, underwrote them, and recommended the CDO securities to clients. In three of the CDOs, Goldman also secretly bet against the securities, either in whole or in part. In the fourth, Goldman allowed a favored client to help select the assets and then bet against the CDO. Goldman did not inform the investors to whom it marketed and sold the CDO securities that it had a negative view of the mortgage market at the same time, that it was shorting the mortgage market, or that Goldman or a favored client had bet against the same CDO securities that Goldman was selling to them.

The hearing took testimony from three panels of witnesses, all of whom were former or current Goldman employees. The first panel

consisted of four former or current Goldman employees involved with trading mortgage products. The witnesses were Daniel L. Sparks, former head of Goldman's Mortgage Department; Michael J. Swenson, Managing Director with the Structured Products Group Trading Desk; Joshua S. Birnbaum, former Managing Director of Structured Products Group Trading Desk; and Fabrice P. Tourre, Executive Director of the Structured Products Group Trading Desk in London, England. The second panel consisted of two senior Goldman officers, David A. Viniar, Goldman's Chief Financial Officer; and Craig W. Broderick, Goldman's Chief Risk Officer. The third panel took testimony from Lloyd C. Blankfein, Goldman's Chairman and Chief Executive Officer.

The witnesses responded to questions about Goldman's actions during the financial crisis and information in the hearing exhibits. Goldman's senior officers essentially denied that Goldman had accumulated a large short position in the mortgage market or bet against the mortgage assets that it had marketed and sold to its clients. They also denied that Goldman had engaged in troubling conduct when it failed to tell clients that it held the short side of the CDO securities that Goldman was recommending they buy. When confronted with emails showing that Goldman personnel had sharply negative views of the CDOs the firm was selling to its clients, the witnesses contended that Goldman was acting as a market-maker rather than an underwriter of those securities, it had no legal obligation to disclose material adverse information to its clients, and its clients were sophisticated investors who would have been uninterested in Goldman's views. The witnesses also took the position that the firm had no fiduciary duty to the clients to whom Goldman recommended and sold the CDO securities. When asked whether the firm had been engaged in proprietary trading when shorting the mortgage market and selling the CDO securities, the witnesses avoided answering the question and testified that Goldman had put its clients' interests first.

In April 2011, the Subcommittee issued a 750-page bipartisan staff report summarizing its investigation into the Goldman case history discussed at the hearing. The report also offered bipartisan recommendations to address some of the issues raised. The Subcommittee's work contributed to the enactment of the Dodd-Frank Act which, among other provisions, bars banks and certain other financial firms from engaging in high-risk proprietary trading, prohibits them from engaging in proprietary trades involving conflicts of interest, and prohibits sponsors of asset-backed securities from engaging in conflicts of interest such as betting against the securities they sponsor.

H. Social Security Disability Fraud: Case Studies in Federal Employees and Commercial Drivers Licenses (August 4, 2010)

In 2010, the Subcommittee began examining waste, fraud, and abuse issues associated with Federal disability programs. In August 2010, the Subcommittee held a hearing and released a GAO report examining questionable disability payments made by the Social Security Disability Insurance (DI) program, which provides benefits to disabled individuals who can no longer work, and by the Supplemental Security Income (SSI) program, which in part sup-

ports disabled persons and their families based upon financial need. In 2009, these two programs provided disabled Americans with financial benefits totaling nearly \$160 billion. While the DI overpayment rate was about 1 percent in FY2008, the SSI overpayment rate reached 10 percent that year, followed by 8 percent in FY2009.

The hearing focused on a Federal program that allows disabled individuals to undertake a 9-month trial work period, without losing their benefits, to see if they can return to work. Disability recipients are required to notify the Social Security Administration when they begin employment and if they earn in excess of program limits. GAO used data matching and specific case studies to examine the extent to which disability recipients may be abusing that work program. A data match examining 4.5 million Federal employees identified about 24,500 who received disability payments while also earning Federal paychecks; 1,500 of whom were paid more than the program limit of about \$1,000 per month and together received disability benefits totaling \$1.7 million per month. Another data match examining 600,000 persons with a commercial drivers license as well as another database together found 62,000 individuals who received a commercial drivers license after their disability start date, raising questions about whether they were improperly receiving disability payments worth millions of dollars.

The hearing took testimony from two witnesses. Gregory D. Kutz, Managing Director of Forensic Audits and Special Investigations at the Government Accountability Office (GAO), described the GAO investigation, its findings, and recommendations. Michael J. Astrue, Commissioner of the Social Security Administration (SSA), described the disability programs, their complex requirements, and SSA's efforts to detect, prevent, and punish fraud. After the hearing, GAO and SSA discussed continued use of the data matches to detect and prevent Social Security disability fraud committed by employed persons.

I. Examining the Efficiency, Stability, and Integrity of the U.S. Capital Markets (Joint hearing with the Subcommittee on Securities, Insurance, and Investment of the Committee on Banking, Housing, and Urban Affairs) (December 8, 2010)

As part of its inquiry into the financial crisis and financial markets, in December 2010, the Subcommittee held a joint hearing with the Senate Banking Subcommittee on Securities, Insurance, and Investment to examine stock market dysfunctions and trading abuses that threaten market stability and investor confidence. The hearing examined challenges posed by modern trading practices in which U.S. stocks are now traded on 13 public exchanges and over 240 less transparent, off-exchange trading venues. In particular, the hearing examined how U.S. trading markets have been victims of, and remain vulnerable to, system-wide problems, and how Federal regulators do not have the necessary tools to police the markets for trading abuses.

At the hearing, the two Subcommittees released hearing exhibits documenting the issues. On May 6, 2010, U.S. capital markets suffered a systemic collapse when one futures order, placed at the wrong time and in the wrong way, set off a chain reaction that af-

fect the futures market, U.S. stock markets, and dragged the Dow Jones Industrial Average down nearly 700 points, wiping out billions of dollars of value in a few minutes for no apparent reason. Both the futures and stock markets recovered in about 20 minutes, but left investors and traders in shock. After 5 months of study, a joint CFTC-SEC report concluded that the crash was essentially triggered by one large sell order placed in a volatile futures market using an algorithm that set off a cascade of out-of-control computerized trading in futures, equities, and options. Using the events of May 6, 2010, as an example, the hearing examined risks to U.S. capital trading venues and potential tools for regulators to combat those risks.

In addition, the hearing examined issues related to trading abuses. Traders today buy and sell stock on and off exchange, simultaneously trading in multiple venues. Evidence indicates that orders in some stock venues are being used to affect prices in other stock venues; and that futures trades on CFTC-regulated markets are being used to affect prices on SEC-regulated options and stock markets. Some traders also use high-speed trading programs to execute their strategies, sometimes submitting and then cancelling thousands of phony orders to affect prices. The hearing discussed some of the tactics that sophisticated traders could use to manipulate prices, and potential tools for regulators to detect and stop those abuses.

The hearing took testimony from two panels. The first panel consisted of SEC Chairman Mary Schapiro and CFTC Chairman Gary Gensler. The second panel heard from stock traders, an academic expert, and the self-regulatory authority for stock exchanges. The panelists were Dr. James J. Angel, Ph.D., CFA, Associate Professor of Finance at Georgetown University McDonough School of Business; Thomas Peterffy, CEO of Interactive Brokers; Manoj Narang, CEO of Tradeworx; and Kevin Cronin, Global Head of Equity Trading at Invesco Ltd. The final panelist was Stephen Luparello, Vice Chairman of the Financial Industry Regulatory Authority (FINRA) which oversees multiple stock exchanges in the United States.

The witnesses generally agreed that the current market structure lacked transparency, and that a better system to identify orders, cancellations, and trading activity was needed. Mr. Peterffy testified about his concerns that U.S. financial markets may be susceptible to an intentional, malicious attack that could create a system-wide failure.

Regulatory coordination was identified as a critical priority, and implementing a comprehensive “consolidated audit trail” as soon as practically possible was suggested, although some concerns were raised about the timing and costs of those efforts. During the hearing, SEC Chairman Schapiro stated that the SEC’s expected time frame was shorter and costs lower for the consolidated audit trail than originally proposed. Regulators have also introduced “circuit breakers” to stop market trading in emergency conditions, including events similar to the May 6, 2010 market crash. Financial regulators, including the SEC and CFTC, have continued to work to enhance their abilities to detect and prevent market dysfunctions and trading abuses.

III. LEGISLATIVE ACTIVITIES DURING THE 111TH CONGRESS

The Permanent Subcommittee on Investigations does not have legislative authority, but because its investigations play an important role in bringing issues to the attention of Congress and the public, the Subcommittee's work frequently contributes to the development of legislative initiatives. The Subcommittee's activity during the 111th Congress was no exception, with Subcommittee hearings and Members playing prominent roles in the development of several legislative initiatives.

A. Credit Card Accountability Responsibility and Disclosure Act (Public Law 111-24)

On May 22, 2009, partly in response to Subcommittee hearings on abusive credit card practices, Congress enacted the Credit Card Accountability Responsibility and Disclosure Act (Credit CARD Act). This bill included provisions taken from a 2007 bill, S. 1395, the Stop Unfair Practices in Credit Cards Act, introduced by Senator Levin to put an end to the credit card abuses examined during the Subcommittee's 2007 hearings. It also included provisions from a 2009 bill, S. 414, introduced by Senator Chris Dodd, Chairman of the Committee on Banking, Housing, and Urban Affairs, and cosponsored by Senator Levin and others. The Dodd-Levin bill incorporated almost all of the provisions from the Levin bill, added provisions from an earlier Dodd bill, and produced the strongest consumer protections of any credit card reform bill then in Congress. The Dodd-Levin bill provided the foundation for the final bill enacted into law.

Among other provisions, the law prohibits interest charges on any portion of a credit card debt which the cardholder paid on time during a grace period; prohibits interest rate hikes for cardholders who pay on time and meet their credit card obligations; prohibits the charging of over-the-limit fees unless the cardholder selects a card allowing the credit limit to be exceeded; limits the number of over-the-limit fees that can be charged for a single instance of exceeding a credit card limit; prohibits charging a fee to allow a cardholder to make a payment on a credit card debt; strengthens protections related to gift cards; and strengthens protections for underage cardholders.

B. Foreign Account Tax Compliance Act (FATCA), included as Subtitle A of Title V of the Hiring Incentives to Restore Employment (HIRE) Act (Public Law 111-147)

On March 18, 2010, partly in response to Subcommittee hearings on actions taken by tax haven banks to facilitate U.S. tax evasion by providing U.S. taxpayers with hidden offshore bank accounts, Congress enacted the Foreign Account Tax Compliance Act (FATCA), included as Subtitle A of Title V of the Hiring Incentives to Restore Employment (HIRE) Act. FATCA was sponsored by Congressman Charles Rangel and Senator Max Baucus.

Among other provisions, the law requires foreign financial institutions to disclose all accounts opened by U.S. persons or pay a 30 percent tax on any investment income generated by an institution's U.S. investments. It covers a broad range of foreign accounts, U.S.

persons, and foreign financial institutions. The law also includes several provisions addressing offshore tax abuses identified in earlier Subcommittee hearings, including provisions to prevent misuse of foreign trusts by tax dodgers, and to stop non-U.S. persons from using complex financial transactions to dodge payment of U.S. taxes on U.S. stock dividends.

C. Dodd-Frank Wall Street Reform and Consumer Protection Act (Public Law 111-203)

On July 21, 2010, partly in response to Subcommittee hearings on key causes of the financial crisis, Congress enacted the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). Prior to the bill's approval by the Senate, Banking Committee Chairman Chris Dodd stated that the Subcommittee's final hearing on the financial crisis, featuring Goldman Sachs, was "a critical hearing just days before we brought this bill to the floor which highlighted many of the problems that have persisted in the financial services sector."

The law addresses many of the problems identified in the Subcommittee investigation into the financial crisis. Among other provisions, it bars mortgage lenders from issuing stated income loans that fail to document the borrower's ability to repay the debt; restricts the use of loans with low teaser rates and negative amortization; and requires banks to retain a portion of the credit risk of each mortgage-backed security they issue. It also dissolves the Office of Thrift Supervision; and creates a Financial Oversight Stability Council to detect and prevent systemic risks to the U.S. financial system. In addition, it strengthens SEC oversight of credit rating agencies; imposes new restrictions on the credit rating process; and bans Federal regulations requiring reliance on credit ratings. The law also sharply limits high-risk proprietary trading by banks and other systemically significant firms; and bars them from engaging in conflicts of interest. In addition, the law addresses a number of problems identified in earlier Subcommittee hearings on commodity speculation and financial engineering. Among other provisions, the law mandates stronger regulation of all commodity markets and related commodity derivatives, provides stronger tools to restrain excessive speculation, and mandates the imposition of position limits in both futures and commodity swaps markets. It also repeals the statutory ban on regulating swaps and, for the first time, imposes a set of safeguards and oversight requirements for regulating all swaps and swap dealers. It also establishes the Consumer Financial Protection Bureau.

D. Hedge Fund Transparency Act (S. 344)

On January 29, 2009, to address issues related to hedge funds, some of which control billions of dollars and were active in mortgage markets during the financial crisis, Senators Grassley and Levin introduced the Hedge Fund Transparency Act. This bill sought to clarify the authority of the SEC to require hedge funds to register with the agency, disclose basic information about their ownership and operations, and comply with SEC information requests.

The bill also sought to require hedge funds to comply with the same anti-money laundering (AML) obligations as other financial institutions, including by establishing an AML program and reporting suspicious activity. Prior Subcommittee hearings had disclosed how some hedge funds bring millions of offshore dollars into the United States without any AML screening of the funds. Although the Grassley-Levin bill was not enacted into law, a year later, Title IV of the Dodd-Frank Wall Street Reform and Consumer Protection Act mandated hedge fund registration with the SEC, established an extensive system of hedge fund requirements, and gave the SEC broad authority to oversee and regulate these financial institutions. It did not, however, address the hedge fund AML exemption.

E. Authorizing the Regulation of Swaps Act (S. 961)

On May 4, 2009, to address issues related to the inability of the SEC and CFTC to regulate swap transactions, including credit default swaps that played a major role in the financial crisis, Senators Levin and Collins introduced the Authorizing the Regulation of Swaps Act. This bill sought to repeal statutory prohibitions that barred Federal regulators from overseeing or imposing capital, liquidity, disclosure, or other safeguards on swap transactions, including credit default swaps. The bill also sought to give Federal financial regulators immediate, clear authority to regulate the trillions of dollars in swap transactions taking place in the United States. Although this bill was not enacted into law, a year later, the Dodd-Frank Wall Street Reform and Consumer Protection Act included a similar repeal and provided broad authority for Federal financial regulators to oversee swap transactions, swap dealers, and swap markets.

F. Protect Our Recovery Through Oversight of Proprietary Trading Act (S. 3098)

On March 10, 2010, to address issues raised in the Subcommittee's hearing on the role of investment banks in the financial crisis, Senators Jeff Merkley and Levin, together with other cosponsors, introduced the Protect Our Recovery Through Oversight of Proprietary Trading Act (PROP Trading Act). Among other provisions, this bill sought to prohibit banks from engaging in proprietary trading; holding certain interests in, engaging in certain relationships with, or bailing out hedge funds or other private funds; and engaging in high-risk activities or material conflicts of interest. It also sought to restrict systemically significant financial firms from engaging in similar conduct without adequate capital and liquidity safeguards. These provisions sought to codify the "Volcker Rule," named after former Federal Reserve Chairman Paul Volcker who was the original proponent of these types of prohibitions and restrictions. In addition, the bill sought to ban conflicts of interest in asset-backed securitizations, such as when the sponsor of asset-backed securities bets against the securities it has sponsored. Provisions based upon the Merkley-Levin bill were included in Sections 619 and 620 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, which has since been enacted into law.

G. Prevent Excessive Speculation Act (S. 447)

On Feb. 13, 2009, to address issues related to commodity speculation examined in past Subcommittee hearings, Senator Levin introduced the Prevent Excessive Speculation Act. This bill was similar to a bill with the same name introduced in the prior Congress by Senators Levin, Harkin, and Bingaman. Its objectives were to close loopholes in the U.S. commodities laws that impeded U.S. oversight of U.S. commodity trades on foreign exchanges and in the over-the-counter (OTC) markets and ensure that large commodity traders could not use those markets to avoid CFTC oversight or trading limits. Among other provisions, the bill sought to require the CFTC, rather than individual exchanges, to set position limits on the amount of futures contracts any trader could hold on regulated exchanges to prevent excessive speculation and price manipulation; close the so-called "London loophole" by giving the CFTC the same authority to police traders in the United States who trade U.S. futures contracts on a foreign exchange as it has to police trades on U.S. exchanges; and require foreign exchanges that want to install trading terminals in the United States to impose comparable position limits as the CFTC imposes on domestic exchanges to prevent excessive speculation and price manipulation. The bill also sought to strengthen disclosure, market oversight, and enforcement authority to protect U.S. consumers, businesses, and the economy from further energy and other pricing shocks. Although the Levin bill was not enacted into law, a year later, Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act provided the CFTC with similar authority, while also extending its authority over all commodity swaps.

H. Stop Tax Haven Abuse Act (S. 506)

On March 2, 2009, to address a myriad of tax abuses examined in past Subcommittee hearings, Senators Levin, Sheldon Whitehouse, McCaskill, and Bill Nelson from Florida introduced the Stop Tax Haven Abuse Act. This legislation was based upon 6 years of Subcommittee investigations into offshore tax havens, abusive tax shelters, and the professionals who design, market, and implement tax dodges. The Subcommittee has estimated that the loss to the Treasury from offshore tax abuses alone approaches \$100 billion per year.

Among other measures, the bill would establish rebuttable presumptions in tax enforcement cases that offshore companies and trusts are controlled by the U.S. persons who send or receive assets from them; authorize Treasury to take special measures against foreign jurisdictions and financial institutions that impede U.S. tax enforcement; and strengthen penalties on tax shelter promoters. It would also close offshore trust loopholes; require U.S. financial institutions to report certain offshore activities to the IRS; and require hedge funds and company formation agents to understand the identity of their offshore clients and report suspicious activity to U.S. law enforcement. In addition, it would prevent companies that are managed and controlled from the United States from claiming foreign status for tax purposes; close a loophole that enables non-U.S. persons to dodge payments of U.S. taxes on U.S. stock dividends; and ban tax patents. A companion bill was intro-

duced in the House (H.R. 1265). While the bills were not enacted into law, a year later, the Foreign Account Tax Compliance Act (FATCA) established an extensive new system to require foreign financial institutions to disclose all offshore accounts opened by U.S. persons. In addition, FATCA enacted into law provisions similar to those in the Stop Tax Havens Abuse Act to prevent misuse of foreign trusts by tax dodgers, and to stop non-U.S. persons from using complex financial transactions to dodge payment of U.S. taxes on U.S. stock dividends.

I. Ending Excessive Corporate Deductions for Stock Options Act (S. 1491)

On July 22, 2009, to close a tax loophole examined in a 2007 Subcommittee hearing showing that, each year, corporations claim tens of billions of dollars in stock option tax deductions in excess of the stock option expenses shown on their books, Senators Levin and McCain introduced S. 1491, the Ending Excessive Corporate Deductions for Stock Options Act.

IRS data shows that, each year from 2005 to 2009, corporations as a whole took U.S. tax deductions for stock options that were billions of dollars greater than the expenses shown on their financial statements. The total amount of excess tax deductions ranged from \$12 billion to \$61 billion per year. The IRS data also showed that a relatively small number of corporations took the majority of those excess deductions: 250 out of the millions of corporations that filed corporate tax returns each year.

The bill would amend the tax code to require that corporate tax deductions for stock option compensation not exceed the stock option expenses shown on the corporate books. It would also allow corporations to deduct stock option compensation in the same year it is recorded on the company books, without waiting for the options to be exercised; and ensure research tax credits use the same stock option deduction. The bill would also subject stock option pay for top corporate executives to the existing \$1 million cap on the tax deductions that publicly traded corporations can claim for executive pay, in order to prevent taxpayer subsidies of outsized executive compensation. The bill was referred to the Finance Committee which took no further action.

J. Incorporation Transparency and Law Enforcement Assistance Act (S. 569)

On March 11, 2009, Senators Levin, Grassley, and McCaskill introduced S. 569, the Incorporation Transparency and Law Enforcement Assistance Act, to protect the United States from U.S. corporations with hidden owners being misused to commit crimes, including terrorism, drug trafficking, money laundering, tax evasion, financial fraud, and corruption. The bill is based upon past Subcommittee investigations which found that the 50 States establish nearly two million U.S. companies each year without knowing who is behind them, the lack of ownership information requirements invite wrongdoers to incorporate in the United States, and that same lack of ownership information impedes U.S. law enforcement efforts.

Among other provisions, the bill would require the States to obtain beneficial ownership information for the corporations or limited liability companies formed within their borders; require States to provide that information to law enforcement in response to a subpoena or summons; and impose civil and criminal penalties for persons who knowingly submit false ownership information. The bill would also exempt all publicly traded corporations, since they already provide ownership information to the SEC. The bill was referred to the Committee on Homeland Security and Governmental Affairs which took no further action.

IV. REPORTS

In connection with its investigations, the Subcommittee frequently issues lengthy and detailed reports. During the 111th Congress, the Subcommittee released two such reports, listed below, both of which have been partly described in connection with Subcommittee hearings.

A. *Excessive Speculation in the Wheat Market, July 21, 2009 (Report prepared by the Majority and Minority staffs, and printed in the record of the related Subcommittee hearing on July 21, 2009.)*

On June 24, 2009, Subcommittee Chairman Levin and then Acting Ranking Minority Member Coburn released a 261-page bipartisan staff report entitled, “Excessive Speculation in the Wheat Market.” This report, the result of a year-long Subcommittee investigation, examined how commodity index traders, in the aggregate, made such large purchases on the Chicago wheat futures market that they pushed up futures prices, disrupted the normal relationship between futures prices and cash prices for wheat, and caused farmers, grain elevators, grain processors, consumers, and others to experience significant unwarranted costs and price risks.

The report’s conclusions were based upon a review of millions of trading records from the Chicago Mercantile Exchange (CME), Kansas City Exchange, Minneapolis Grain Exchange, the Commodity Futures Trading Commission (CFTC), and others, which the Subcommittee used to track and analyze wheat prices. The data showed that commodity index traders—traders who are not producers or consumers of wheat, but buy wheat futures to help offset their financial exposure from selling commodity index instruments to third parties—injected billions of dollars, in the aggregate, into the wheat futures market over the last 6 years. Commodity index traders increased their holdings from a total of about 30,000 wheat contracts in 2004, up to 220,000 contracts in 2008. That sevenfold increase dramatically enlarged the market share of commodity index trading so that, in each year since 2006, commodity index traders held between 35 percent and 50 percent of all outstanding wheat futures contracts on the Chicago exchange.

The report determined that there was substantial and persuasive evidence that, by purchasing so many futures contracts, commodity index traders, in the aggregate, pushed up futures prices, created an unprecedented, large, and persistent gap between futures and cash wheat prices in the Chicago market, and impeded the two prices from converging at contract expiration. The report presented

evidence, for example, that the average gap between futures and cash prices on the expiration of futures contracts on the Chicago exchange, called the “basis,” grew from about 13 cents per bushel in 2005, to 34 cents in 2006, to 60 cents in 2007, to \$1.53 in 2008, a tenfold increase in 4 years. The Levin-Coburn report found that the large number of wheat futures contracts purchased by index traders on the Chicago exchange created additional demand for those contracts and was a major contributing factor in the increasing difference between wheat futures prices and cash prices from 2006 to 2008.

The report also determined that these unwarranted price changes imposed an undue burden on wheat farmers, grain elevators, grain merchants, grain processors, consumers, and others by making it difficult to use the futures market to protect against price changes and by generating significant unanticipated costs. Those costs included higher margin calls due to higher futures prices; failed hedges; and disruption of normal pricing patterns and relationships. The Levin-Coburn report concluded that the large number of wheat futures contracts purchased and held by commodity index traders on the Chicago futures exchange over the last 5 years constituted excessive speculation.

The Commodity Exchange Act requires the key Federal commodities regulator, the CFTC, to prevent excessive speculation by imposing position limits on commodity traders. But the report found that, in the wheat market, instead of restricting traders to no more than 6,500 wheat contracts at a time, its standard position limit for wheat, the CFTC had allowed some commodity index traders to hold up to 10,000, 26,000, or even 53,000 contracts at a time. The report also disclosed that, at the time of the inquiry, six commodity index traders were authorized to hold a total of up to 130,000 wheat contracts at a time, instead of up to 39,000 contracts, or one-third less if the standard position limits had been applied. The Levin-Coburn report concluded that the CFTC actions to waive position limits for commodity index traders facilitated excessive speculation in the Chicago wheat futures market, and that waiving position limits for those index traders was inconsistent with the CFTC’s statutory mandate to maintain position limits to prevent excessive speculation.

The report also examined the impact of inflated futures prices on Federal crop insurance, which is backed with taxpayer dollars. The report explained that the Federal crop insurance program uses settlement prices from certain futures contracts to determine how much money should be paid to a farmer who has purchased coverage and to set insurance premiums. Futures prices that are higher than justified by supply and demand fundamentals in the cash market increase the cost of purchasing crop insurance for farmers as well as for Federal taxpayers who share in the cost. The report explained that the increasing lack of predictability as to the difference between the futures price and the cash price for wheat—the “basis”—also undermines the reliability and effectiveness of the formulas used to calculate insurance payouts. The report concluded that, because Federal crop insurance uses futures prices in its calculations, inflated futures prices can inflate insurance premiums, whose cost is shared by farmers and taxpayers, and impair the ac-

curacy of the formulas used to determine the payouts to farmers, resulting in either overpayments or underpayments.

To stop excessive speculation in the wheat market, the Levin-Coburn report recommended that the CFTC phase out existing waivers that permitted commodity index traders to exceed the standard limit of 6,500 wheat contracts per trader at any one time, and apply the standard position limit to all commodity index traders in the wheat market. If pricing problems persisted on the Chicago exchange, the report recommended lowering the position limit further, such as to the 5,000 contract limit that applied to wheat traders until 2005. In addition, the report recommended that the CFTC undertake an analysis of the impact of commodity index trading on other commodities, including crude oil, to determine if excessive speculation was distorting prices, and whether position limit waivers for index traders should be phased out to eliminate excessive speculation. The report also urged the CFTC to develop reliable data on the extent to which commodity index traders purchase non-agricultural commodity futures contracts, especially for crude oil and other energy commodities, so that data could be analyzed to detect and prevent excessive speculation.

This report was the fifth in a series released by the Subcommittee on commodity pricing issues since 2003. The first four focused on energy prices, including for gasoline, crude oil, and natural gas. This report was the first by the Subcommittee to examine agricultural prices.

B. Keeping Foreign Corruption Out of the United States: Four Case Histories, February 4, 2010 (Report prepared by the Majority and Minority staffs, and released in conjunction with and reprinted in the record of a related Subcommittee hearing on February 4, 2010.)

On February 4, 2010, Subcommittee Chairman Levin and Ranking Minority Member Coburn released a 386-page bipartisan staff report entitled, “Keeping Foreign Corruption Out of the United States: Four Case Histories.” The report examined how politically powerful foreign officials, their relatives, and close associates—referred to in international agreements as “Politically Exposed Persons” (PEPs)—used the services of U.S. professionals and financial institutions to bring large amounts of suspect funds into the United States to advance their interests. It is the latest in a series of Subcommittee hearings and reports examining how foreign corruption affects the United States.

During the course of its investigation, the Subcommittee staff conducted over 100 interviews, issued over 50 subpoenas, and reviewed millions of pages of documents. Using four case histories, the report exposed how some PEPs used U.S. lawyers, real estate and escrow agents, lobbyists, bankers, and even university officials, to circumvent U.S. anti-money laundering (AML) and anti-corruption safeguards. It also identified some of the legal gaps, poor due diligence practices, and inadequate PEP controls that, at times, made these tactics possible.

Obiang Case History. The first case history focused on Teodoro Obiang, son of the President of Equatorial Guinea (EG) and an EG cabinet minister who, from 2004 to 2008, used U.S. professionals

and financial institutions to move over \$110 million in suspect funds into the United States. At the time of the report, Mr. Obiang was the subject of an ongoing U.S. criminal investigation, had been identified in corruption complaints filed in France, and was a focus of a 2004 Subcommittee hearing showing how Riggs Bank facilitated EG officials in opening accounts and engaging in suspect transactions.

The report detailed how two U.S. lawyers, Michael Berger and George Nagler, helped Mr. Obiang circumvent U.S. AML and PEP controls at U.S. financial institutions by allowing him to use attorney-client, law office, and shell company accounts as conduits for his funds and without alerting the bank to his use of those accounts. If a bank later uncovered Mr. Obiang's use of an account and closed it, the lawyers helped him open another. The lawyers also formed five U.S. shell companies for Mr. Obiang, with names that included Beautiful Vision, Unlimited Horizon, and Sweetwater Malibu. In addition, two U.S. real estate agents, Neal Baddin and John Kerrigan, helped Mr. Obiang buy and sell high-end real estate in California including the purchase of a \$30 million Malibu residence with funds wire transferred from Equatorial Guinea. Mr. Obiang also used a U.S. escrow agent to purchase a \$38.5 million U.S.-built Gulfstream jet. When one escrow agent, McAfee and Taft, as a voluntary AML precaution, refused to proceed without information about the source of the funds for the purchase, another escrow agent, International Airline Title Services Inc., stepped in and completed the transaction with no questions asked. U.S. law currently exempts attorneys, real estate agents, and escrow agents from the PATRIOT Act's requirement to establish AML programs. Mr. Obiang also brought large amounts of suspect funds into the United States by taking advantage of U.S. wire transfer systems that were not programmed to block wire transfers bearing his name.

Bongo Case History. The second case history focused on Omar Bongo, President of Gabon for 41 years until his death in June 2009. President Omar Bongo was a focus of a 1999 Subcommittee hearing showing how he used offshore shell companies to move over \$100 million in suspect funds through accounts at Citibank Private Bank. He was also mentioned in connection with the ELF oil scandal and recent corruption complaints filed in France. The case history focused on several examples of how President Bongo used lobbyists and bank accounts belonging to family members to bring suspect funds into the United States.

The report detailed how, from 2003 through at least 2007, Mr. Bongo employed a U.S. lobbyist, Jeffrey Birrell, to purchase six U.S.-built armored vehicles and obtain U.S. Government permission to buy six U.S.-built C-130 military cargo aircraft from Saudi Arabia to support the Bongo regime. As part of the armored car and C-130 transactions, over \$18 million was wire transferred from Gabon into U.S. corporate bank accounts controlled by Mr. Birrell. Mr. Birrell received the funds primarily from President Omar Bongo and an entity called Ayira. He later transferred \$9.2 million of the funds provided by Ayira to a foreign account held in the name of President Omar Bongo in Malta. He also wire transferred over \$4.2 million to foreign bank accounts opened in the name of

a senior Bongo adviser, and over \$1 million in payments to foreign bank accounts held in the name of various “consultants.” Mr. Birrell’s corporate accounts served as a conduit for those Bongo funds.

In addition, President Bongo provided large amounts of cash to his daughter, Yamilee Bongo-Astier, who deposited the cash into bank accounts and safe deposit boxes at U.S. financial institutions in New York from 2000 to 2007. Ms. Bongo-Astier made multiple large dollar deposits into her accounts at banks that were unaware of her PEP status, but knew she was an unemployed student. One bank closed her account after receiving an \$183,500 wire transfer from Gabon; another did so after discovering she had \$1 million in \$100 bills in her safe deposit box, which she said her father had brought into the United States using his diplomatic status and without declaring the cash to U.S. authorities. Another member of the Bongo family, Inge Lynn Collins Bongo, was the wife of Ali Bongo, the current President of Gabon and its former Minister of Defense. In 2000, she formed a U.S. trust, the Collins Revocable Trust, and opened accounts in the name of that Trust at banks in California. For 3 years, from 2000 to 2003, Mrs. Bongo accepted multiple large offshore wire transfers into the Trust accounts and used the funds to support a lavish lifestyle and move money among a network of bank and securities accounts benefitting her and her husband. Due to inadequate PEP lists prepared by third party vendors, the financial institutions administering the Bongo accounts were, more often than not, unaware of their clients’ PEP status and did not subject their accounts to enhanced monitoring.

Douglas-Abubakar Case History. The third case history focused on Jennifer Douglas, a U.S. citizen and fourth wife of Atiku Abubakar, former Vice President and former candidate for President of Nigeria. The report detailed how, from 2000 to 2008, Ms. Douglas helped her husband bring over \$40 million in suspect funds into the United States through wire transfers sent by offshore corporations to U.S. bank accounts. In a 2008 civil complaint, the SEC alleged that Ms. Douglas received over \$2 million in bribe payments in 2001 and 2002, from Siemens AG, a major German corporation. While Ms. Douglas denied wrongdoing, Siemens had already pled guilty to U.S. criminal charges, settled civil charges related to bribery, and told the Subcommittee that it had sent the payments to one of her U.S. accounts. In 2007, Mr. Abubakar was the subject of corruption allegations in Nigeria related to the Petroleum Technology Development Fund.

Of the \$40 million in suspect funds, \$25 million was wire transferred by offshore corporations into more than 30 U.S. bank accounts opened by Ms. Douglas, primarily by Guernsey Trust Company Nigeria Ltd., LetsGo Ltd. Inc., and Sima Holding Ltd. The U.S. banks maintaining those accounts were, at times, unaware of her PEP status, and they allowed multiple, large offshore wire transfers into her accounts. As each bank began to question the offshore wire transfers, Ms. Douglas indicated that all of the funds came from her husband and professed little familiarity with the offshore corporations actually sending her money. When one bank closed her account due to the offshore wire transfers, her lawyer helped convince other banks to provide new accounts. In addition,

two of the offshore corporations wire transferred about \$14 million over 5 years to American University in Washington, DC, to pay for consulting services related to the development of a Nigerian university founded by Mr. Abubakar. American University accepted the wire transfers without asking about the identity of the offshore corporations or the source of their funds, because under current law, the University had no legal obligation to inquire.

Angola Case History. The fourth and final case history examined three Angolan PEP accounts, involving an Angolan arms dealer, an Angolan government official, and a small Angolan private bank that catered to PEP clients, to show how the account holders gained access to the U.S. financial system and attempted to exploit weak U.S. AML and PEP safeguards.

First, the report examined Pierre Falcone, a notorious arms dealer who supplied weapons during the Angolan civil war in violation of a U.S. arms embargo, was a close associate of Angolan President Jose Eduardo Dos Santos, and was the target of criminal investigations resulting in his imprisonment in France. The report detailed how he used personal, family, and U.S. shell company accounts at Bank of America in Arizona to bring millions of dollars in suspect funds into the United States and move those funds among a worldwide network of accounts. Bank of America maintained nearly 30 accounts for the Falcone family from 1989 to 2007, did not treat Mr. Falcone as a PEP, and did not consider his accounts to be high risk, even after learning in 2005 that he was an arms dealer and had been imprisoned in the past. In 2007, after receiving a Subcommittee inquiry about the Falcone accounts, the bank conducted a new due diligence review, closed the accounts, and expressed regret at providing Mr. Falcone with banking services for years.

Next, the report examined Dr. Aginaldo Jaime, a senior Angolan government official, who was head of Banco Nacional de Angola (BNA), the Angolan Central Bank, when he attempted, on two occasions in 2002, to transfer \$50 million in government funds to a private account in the United States, only to have the transfers reversed by the U.S. financial institutions involved. Dr. Jaime invoked his authority as BNA Governor to wire transfer the funds to a private bank account in California during the first attempt and, during the second attempt, to purchase \$50 million in U.S. Treasury bills for transfer to a private securities account in California. Both transfers were initially allowed, then reversed by bank or securities firm personnel who became suspicious of the transactions. Partly as a result of those transfers and the corruption concerns they raised, in 2003, Citibank closed not only the accounts it had maintained for BNA, but all other Citibank accounts for Angolan government entities, and closed its office in Angola. The report observed that, in contrast, HSBC continued to provide banking services to BNA in the United States and elsewhere, and may be providing the Central Bank with offshore accounts in the Bahamas.

Finally, the report examined Banco Africano de Investimentos (BAI), a \$7 billion private Angolan bank whose largest shareholder was Sonangol, the Angolan State-owned oil company. The report detailed how BAI offered banking services to Sonangol, Angolans in the oil and diamond industries, and Angolan government officials. It noted that, over the last 10 years, BAI gained entry to the U.S.

financial system through accounts at HSBC in New York, using HSBC wire transfer services, foreign currency exchange, and U.S. dollar credit cards for BAI clients, despite providing troubling answers about its ownership and failing to provide a copy of its AML procedures to HSBC after repeated requests. Despite the presence of PEPs in BAI's management and clientele, HSBC decided against designating BAI as a "Special Category of Client" requiring additional oversight until November 2008, years after the account was first opened.

The Levin-Coburn report contained a number of recommendations to stop PEPs from misusing U.S. professionals and financial institutions to bring illicit funds into the United States. Among other measures, the report urged Congress to enact a law and the U.S. Treasury Department to issue rules implementing the PEP controls identified in a World Bank study, including by requiring banks to use reliable PEP databases to screen clients, use account beneficial ownership forms that ask for PEP information, obtain financial declaration forms filed by PEP clients with their governments, and conduct annual reviews of PEP account activity to detect and stop suspicious transactions. The report also recommended that Treasury repeal all of the exemptions it granted in 2002, from the PATRIOT Act requirement to establish AML programs, including for real estate and escrow agents. The report also recommended that Treasury require U.S. financial institutions to institute stronger controls on attorney-client and law office accounts to prevent circumvention of U.S. AML and PEP controls. In addition, the Levin-Coburn report recommended that Congress enact legislation requiring persons forming U.S. corporations to disclose the names of the beneficial owners of those U.S. corporations. Finally, the report recommended strengthening U.S. immigration and visa provisions to stop foreign corruption out of the United States.

V. GAO REQUESTED AND SPONSORED REPORTS

In connection with its investigations, the Subcommittee makes extensive use of the resources and expertise of the Government Accountability Office (GAO), the Offices of Inspectors General (OIGs) at various Federal agencies, and other entities. During the 111th Congress, the Subcommittee requested a number of reports and studies on issues of importance to Congress and to U.S. consumers. Most of these reports have already been described in connection with Subcommittee hearings. Several additional reports that were of particular interest, and that were not covered by Subcommittee hearings, are the following:

A. Bank Secrecy Act: Federal Agencies Should Take Action to Further Improve Coordination and Information-Sharing Efforts (GAO-09-227), February 12, 2009

Since 1999, the Subcommittee has conducted multiple investigations into money laundering vulnerabilities affecting the United States and worked to strengthen U.S. anti-money laundering (AML) laws. In 2009, in response to a bipartisan request from Subcommittee Chairman Levin and Ranking Minority Member Coleman, later replaced by Senator Coburn, GAO issued a report providing an overview of Federal AML programs designed to protect

the United States from terrorists, criminals, and other wrongdoers. The GAO report disclosed that, while AML programs at U.S. banks are well developed, AML programs at securities firms, commodity traders, and money service businesses are only partially in place, while AML programs at hedge funds, private equity funds, and other covered businesses have yet to be mandated or implemented.

The Federal legal framework for combating money laundering began with the Bank Secrecy Act of 1970, has been repeatedly amended over the years, and was substantially strengthened by the USA PATRIOT Act of 2001 (Patriot Act). The PATRIOT Act, for the first time, required AML safeguards to be required for business sectors other than banking. The lead Federal agency charged with administering AML requirements is the Financial Crimes Enforcement Network (FinCEN), a bureau of the U.S. Department of the Treasury. FinCEN works with and relies on multiple Federal and State agencies to develop AML regulations, oversee AML compliance, and take AML enforcement actions. GAO was asked to describe how AML responsibilities were distributed; describe how FinCEN and other agencies were implementing their AML responsibilities; and evaluate their coordination efforts. GAO concluded that, while Federal agencies had enhanced their AML compliance programs over the years, more work was needed to strengthen coordination and information-sharing efforts.

The GAO report explained that FinCEN, with a staff of about 300 and an annual budget of about \$73 million, provided general oversight of U.S. AML programs and was charged by Treasury with issuing AML regulations and enforcing compliance. The report also explained that FinCEN had delegated primary AML regulatory, examination, and enforcement authority to other Federal agencies. For example, FinCEN had delegated AML oversight of the banking sector to the five Federal banking agencies, the Federal Reserve System, Federal Deposit Insurance Corporation (FDIC), Office of the Comptroller of the Currency (OCC), Office of Thrift Supervision (OTS), and National Credit Union Administration (NCUA). FinCEN delegated AML oversight of securities firms to the Securities and Exchange Commission (SEC) and of commodity firms to the Commodity Futures Trading Commission (CFTC), both which, in turn, delegated day-to-day oversight to certain self-regulatory organizations (SROs), such as the Financial Industry Regulatory Agency (FINRA), National Futures Association, and Chicago Mercantile Exchange. FinCEN had delegated AML oversight of all other types of covered financial institutions, including money service businesses, casinos, and insurance companies—sometimes referred to as nonbank financial institutions or NBFIs—to the Internal Revenue Service (IRS). Many of these agencies also had independent statutory authority to impose AML requirements.

GAO determined that FinCEN worked with each of the agencies to develop appropriate regulations, examination standards, and enforcement actions to ensure compliance with Federal AML laws. Key AML obligations include implementing written AML policies and procedures, appointing an AML compliance officer, providing AML training to personnel, and auditing AML compliance. Most covered institutions are also required to file suspicious activity reports with FinCEN. GAO determined that FinCEN also retained

enforcement authority for AML violations, and could take enforcement actions independently or concurrently with the functional regulators.

The GAO report identified significant discrepancies among the agencies in the number of examiners with AML expertise and the frequency of AML examinations. The report showed that banking institutions underwent a higher rate of AML examinations compared to other covered firms, including broker-dealers, mutual funds, and commodity firms. The report also showed that the number of AML examinations performed by Federal agencies had declined in recent years, with a corresponding decrease in the number of AML violations identified and in the number of enforcement actions taken. With respect to the IRS, the GAO report explained that the IRS has no independent AML enforcement authority and referred its cases to FinCEN for enforcement actions. The GAO report found that, from 2006 to 2008, the IRS had referred about 50 cases to FinCEN which took an average of 485 days—more than 1 year—to review the referrals. The GAO report did not specify how any enforcement actions were actually taken by FinCEN on the IRS-referred cases. GAO reported that FinCEN and the IRS had accepted a GAO recommendation to strengthen FinCEN procedures for handling enforcement referrals.

The GAO report also stated that, while banking and IRS examiners used AML examination materials available to the public, securities and commodity examiners use examination materials which were not publicly available and could not be discussed in a public setting. The GAO report did not provide any rationale for keeping the manuals secret and pointed out the benefits of Federal regulators developing and applying consistent AML examination standards across business sectors. GAO also noted that while FinCEN and the IRS had issued an examination manual for money services businesses, no such manual existed for other types of NBFIs with AML obligations. GAO also found that the IRS had not fully coordinated its examinations of money service businesses with the States, potentially missing opportunities to reduce duplication and leverage resources.

The GAO report contained a number of criticisms of FinCEN. GAO noted, for example, that FinCEN took years to conclude AML memorandums of understanding with the key Federal agencies charged with AML oversight. It also took over a year to review cases referred by the IRS for enforcement actions. The report noted that FinCEN took until 2006, to replace a paper-based system for tracking case referrals with an electronic case management system. GAO also noted that, despite a 2001 PATRIOT Act requirement for all covered businesses to institute AML programs to prevent terrorist financing and money laundering, FinCEN had yet to issue regulations requiring several of these firms to set up AML programs, including hedge funds and private equity funds that funnel billions of dollars in offshore funds into the United States. In 2002, FinCEN proposed a rule to cover those investment firms, but never finalized it. The GAO report also highlighted and recommended reversing an ongoing FinCEN policy that denied direct access to its database of suspicious activity and currency reports for SEC and CFTC self-regulatory organizations and some State regulators.

GAO also recommended that all of the Federal and State agencies involved with AML oversight establish a nonpublic forum in which they could discuss and strengthen coordination of regulatory, examination, and enforcement issues.

B. Securities and Exchange Commission: Oversight of U.S. Equities Market Clearing Agencies (GAO-09-318R), February 26, 2009

In response to a joint request by Subcommittee Chairman Levin and Finance Committee Ranking Minority Member Grassley, GAO released a report analyzing the clearing and settlement process for U.S. equities markets, with a particular focus on transactions in which one party fails to deliver the security promised. Failures to deliver (FTDs) had become a focus of market participants complaining of manipulative short selling.

The report observed that the prompt, accurate, and efficient settlement of trades is essential to the smooth functioning of any equities market. When investors agree to trade an equity security, the purchaser promises to deliver cash to the seller, and the seller promises to deliver the security to the purchaser. The process by which the seller receives payment and the buyer receives the security is known as the clearance and settlement process and is carried out by a clearing agency. The report noted that, in U.S. equities markets, a centralized clearance and settlement system had been established to reduce risks and increase market efficiencies. Trades were typically cleared and settled through self-regulatory organizations (SRO) that register with and are subject to oversight by the Securities and Exchange Commission (SEC). GAO reported that, in the United States, virtually all equity securities trades were cleared and settled through the National Securities Clearing Corporation (NSCC) or the Depository Trust Company (DTC), both of which were clearing agency subsidiaries of the Depository Trust and Clearing Corporation (DTCC).

The GAO report provided a detailed description of the NSCC and DTC processes for clearing and settling equities trades, as well as the SEC's oversight efforts through its examination program for clearing agencies. The report included an explanation of how the NSCC and DTC systems handled FTDs.

GAO explained that the U.S. clearance and settlement process for equity securities operated on a standard 3-day settlement cycle. The GAO report stated that, according to DTCC, 99.9 percent of daily equities transactions by dollar value cleared and settled within the standard 3-day settlement period. In the remaining transactions, the seller failed to deliver the securities on time, resulting in an FTD. GAO reported that, as of December 31, 2007, the value of aggregated FTDs was \$7.5 billion.

GAO reported that, due to the volume and value of trading in U.S. equity markets, NSCC netted trades and payments among its participants using a Continuous Net Settlement System. GAO explained that this system was a book entry accounting system, whereby each NSCC participant's daily purchases and sales of securities, based on trade date, were automatically netted into one long position (right to receive) or one short position (obligation to deliver) for each security purchased or sold. The participant's cor-

responding payment obligations were, similarly, netted into one obligation to pay or one obligation to receive money.

GAO explained that, for each participant with a short position on settlement date, NSCC instructed the securities depository designated by the participant, typically DTC, to deliver securities from the participant's account at the depository to the NSCC's account. NSCC then instructed the depository to deliver those securities from NSCC's account to participants with net long positions in the security. If a participant failed to deliver the total number of securities that they owed NSCC on a particular settlement date, NSCC might be unable to meet its delivery obligations, resulting in FTDs for participants with net long positions.

GAO reported that, according to the SEC, many FTDs were caused by processing delays or mechanical errors, and were typically resolved within a few days. GAO observed that FTDs could also result from naked short selling. While not defined in the Federal securities laws, GAO explained that, according to the SEC, "naked" short selling generally referred to selling a security without having purchased or borrowed it to make delivery, potentially resulting in a FTD. The GAO report explained that FTDs may deprive shareholders of the benefits of ownership, such as voting and lending. In addition, GAO reported that, in recent years, investors, publicly traded companies, and others had expressed concerns that FTDs may be indicative of an illegal trading strategy known as manipulative naked short selling, in which short sellers attempt to profit by inundating the market with sales of a security to artificially drive down its stock price. GAO reported that, to facilitate and monitor industry compliance with rules and emergency orders to curb FTDs and potential manipulative naked short selling, NSCC electronically submitted FTD data on a daily basis to the SEC and U.S. stock exchanges.

The GAO report also explained that, to minimize FTDs, if a participant's account did not have the required amount of securities to be delivered, NSCC used an automated Stock Borrow Program to borrow the shares to meet as many of the participant's delivery obligations as possible. Under this program, NSCC participants could instruct NSCC on the specific securities from their DTC account that were available for borrowing to cover NSCC's Continuous Net Settlement System delivery shortfalls. Any shares that NSCC borrowed were debited from the lending participant's DTC account, delivered to NSCC, and, subsequently, delivered to a NSCC participant with a net short position. NSCC created a right to receive a (net long) position for the lender in the Continuous Net Settlement System to show that it was owed securities. Until the securities were returned, the lending participant no longer had ownership rights in them and, therefore, could not re-lend them. The GAO report also explained that any delivery made using the Stock Borrow Program did not relieve the NSCC participant that failed to deliver of its obligation to deliver the relevant securities to the NSCC.

In addition to describing the clearance and settlement process in U.S. stock markets, the GAO report reviewed the examination program constructed by the SEC for clearing agencies. GAO explained that the SEC Office of Compliance Inspections and Examinations (OCIE) administered the SEC's nationwide examination and in-

spection program, including for clearing agencies. GAO determined that the OCIE conducted both regular cycle and special examinations for clearing agencies. GAO reported that the largest clearing agencies, including NSCC and DTC, were examined every other year, while smaller clearing agencies were examined on a 2- or 3-year cycle, depending on OCIE resources. GAO explained that these examinations included reviewing the clearing agency's process for handling FTDs.

C. Regulation SHO: Recent Actions Appear to Have Initially Reduced Failures to Deliver, but More Industry Guidance Is Needed (GAO-09-483), May 12, 2009

In response to a joint request by Subcommittee Chairman Levin, Finance Committee Ranking Minority Member Grassley, and Judiciary Subcommittee on Crime and Drugs Chairman Specter, GAO released a report analyzing recent actions taken by the Securities and Exchange Commission (SEC) to curb failures to deliver securities and manipulative naked short selling.

A "short sale" occurs when a person sells a borrowed stock. A "naked" short sale refers to selling short without having actually borrowed the securities needed to make delivery. After making the sale, the seller then "covers" the position by actually buying the stock and returning it to the lender. If the stock price falls in value in the interim, then the short seller profits by selling the stock for more than it cost to repurchase the shares, in other words by selling high and then buying low. The GAO report explained, "In general, short selling is used to profit from an expected downward price movement, provide liquidity in response to unanticipated demand, or hedge the risk of a long position . . . in the same or related security."

Because short sellers may profit on the decline in a company's stock price, they may seek ways to drive down the stock prices of the companies in which they invest. In addition, while most short selling is legal, some is not. The GAO report observed that "short selling also may be used to illegally manipulate the prices of securities," by depressing the price of a security to induce others to buy or sell it. Naked short selling is of particular concern since it may be used to create an artificial downward pressure on a stock price by flooding the market with sales.

Failures to deliver (FTD) occur when the seller of a stock does not deliver the stock to the purchaser within the required settlement period, which is typically 3 days. Although FTDs can be caused by mechanical errors and processing delays, they also result from naked short selling. The GAO report observed that FTDs "may undermine the confidence of investors, making them reluctant to commit capital to an issuer that they believe to be subject to such manipulative conduct."

In 2004, the SEC issued Regulation SHO to, among other things, address large and persistent FTDs and curb the potential for manipulative naked short selling in equity securities. In July 2008, in the midst of the financial crisis, the SEC issued an emergency order that restricted short sales in the publicly traded securities of 19 large financial institutions, unless the seller had borrowed, or arranged to borrow, the security prior to the sale, and required de-

livery of the security on the settlement date. Almost immediately, the order was amended to exempt market makers engaged in market making transactions and the sales of restricted securities. This “pre-borrow” requirement expired in August 2008. In September 2008, the SEC issued another emergency order that, among other measures, temporarily increased delivery requirements on all short sales, implemented an anti-fraud rule regarding short sales, and temporarily banned all short sales involving approximately 800 financial institutions. The enhanced delivery requirement in this temporary order was scheduled to expire on July 31, 2009.

GAO was asked to provide an overview of Regulation SHO and related SEC actions; regulators’ and market participants’ views on the effectiveness of the rule; and regulators’ efforts to enforce the rule. As part of its inquiry, GAO analyzed FTD data from January 2005 through December 2008. The GAO report found that the SEC’s actions in September 2008, had resulted in a significant decrease in the number of securities with large FTDs. GAO also found that the staff of the SEC and Financial Industry Regulatory Authority (FINRA) agreed that, in connection with short selling, market manipulation “is difficult to detect and successfully prosecute, and the potential damage to an individual company could be severe.” The SEC and FINRA staff also agreed that the potential for market manipulation continued even under the temporary rule.

Some of the market participants interviewed by GAO recommended that the SEC issue a final rule requiring all short sellers to borrow securities before any short sale. The SEC staff said the Commission was considering imposing a pre-borrow requirement to curb FTDs and market manipulation related to naked short selling. The SEC staff said that the Commission was also considering, however, whether the costs of a pre-borrow requirement might outweigh the benefits because, among other factors, FTDs represented only 0.01 percent of the dollar value of trades. The GAO report also recommended that the SEC improve industry guidance regarding the steps that should be taken to implement a pre-borrow requirement.

D. Credit Cards: Fair Debt Collection Practices Act Could Better Reflect the Evolving Debt Collection Marketplace and Use of Technology (GAO-09-748), September 21, 2009

To advance the Subcommittee’s longstanding concerns about credit card and debt collection abuses, four Subcommittee members, Chairman Levin, Ranking Minority Member Coleman, later replaced by Senator Coburn, and Senator McCaskill, asked GAO to conduct an investigation into credit card debt collection practices. The resulting GAO report provided a detailed description of the credit card debt collection industry and abusive debt collection practices; found that the key Federal law, the Fair Debt Collection Practices Act (FDCPA), was outdated and ineffective; reported Federal enforcement cases to stop abusive practices were infrequent; and demonstrated that consumer protections against abusive debt collection practices needed to be modernized and strengthened.

To conduct its inquiry, GAO analyzed documents and interviewed representatives from six large credit card issuers, six third-party debt collection agencies, six debt buyers, two law firms, Federal

and State agencies, and attorneys and organizations representing consumers and collectors.

GAO presented evidence indicating that credit card delinquency rates had spiked since 2007, with more than \$23 billion in nonsecuritized debt 30 to 180 days late in 2008. According to Federal Reserve data cited in the report, about 6.6 percent of credit cards were 30 or more days past due in the first quarter of 2009, the highest rate in 18 years.

To collect this debt, GAO determined that credit card issuers typically used their own personnel, in internal collection departments, to collect on credit card debt that is less than 6 months old, but often hired third-party collection agencies or law firms to collect older debt. GAO noted that contracts between the credit card issuers and debt collectors often specified the collection policies and practices that should be used. In addition, credit card issuers sometimes sold portfolios of delinquent credit card debt to third party debt-buyers, trading potential long-term cash flows for the short-term proceeds of a sale.

GAO reported that, according to the U.S. Census Bureau, in 2006, more than 4,400 debt collection companies in the United States employed approximately 143,000 people. Many of those companies were very small, while a few debt collection firms were extremely large: 43 percent employed 4 or fewer people, while about 3 percent employed 500 or more. GAO also reported that the debt buying industry had grown, by one industry estimate, from \$57 billion of purchased debt in 2003, to \$100 billion in 2006.

The GAO report described how different types of credit card debt were categorized and sold. GAO observed that credit card accounts could be resold multiple times, and that several factors influenced the price of these accounts, including their age, location, and number of times previously placed for collection. The report also presented evidence that the price of delinquent debt had declined in recent years. According to one industry source, “fresh” debt—debt that is 6 to 9 months past due and never placed with a collection agency—sold for about 15 cents on the dollar in March 2007; in January 2009, it sold for about 6 cents on the dollar. “Tertiary” debt—debt that is more than 2 years past due or previously placed with two collection agencies—sold for about 4 cents on the dollar in March 2007; in January 2009, it sold for between 1 and 2 cents.

GAO also reported on how credit card issuers and third-party debt collectors attempted to collect debt, citing evidence of a rising volume of debt collection court cases placing increasing burdens on State courts. GAO noted that the Federal Trade Commission has reported that the majority of cases on many State court dockets on any given day are debt collection cases. GAO also reported that a study by the Urban Justice Center estimated, for example, that in 2006, 320,000 debt collection cases were filed just in New York City’s Civil Court. That study also estimated that, in Chicago’s Cook County Circuit Court, more than 119,000 civil debt collection lawsuits were pending as of June 2008, and that municipal court judges in Ohio handle as many as 1,000 debt collection cases per week. GAO also cited a review by the Boston Globe which found that at least 60 percent of small claims cases filed in Massachusetts in 2005, were filed by debt collectors. GAO reported that con-

sumer groups, attorneys, and the FTC all agree that the number of debt collection State court cases had increased in recent years and was putting a strain on State court systems.

The GAO report explained that the primary Federal law governing third-party debt collection, FDCPA, prohibited debt collectors from using abusive, deceptive, and unfair collection practices. GAO also explained that the Federal Trade Commission (FTC), the lead Federal agency for detecting and taking enforcement actions involving FDCPA violations, received more complaints about the debt collection industry than any other industry, logging about 79,000 complaints on third-party debt collectors in 2008 alone, which was almost 19 percent of all of the complaints the FTC received.

The GAO report explained that the FTC was not the only agency charged with stopping debt collection abuses. Since most large credit card issuers are nationally-chartered banks, Federal banking regulators were also responsible for overseeing their debt collection practices and protecting consumers from unfair practices. In addition, States enforced State fair debt collection laws, some of which provided protections additional to those of FDCPA.

The GAO report described a variety of abusive practices engaged in by some debt collectors. They included trying to collect debt that is not owed or is beyond the statute of limitations, making harassing telephone calls prohibited by law, threatening to make arrests that the debt collector had no authority to make, and collecting debt that had been discharged in bankruptcy. GAO observed that the extent of abusive practices could not be determined due to the lack of data. GAO also noted that debt buyers and collection agencies often may not have adequate information about the accounts they have purchased or access to the billing statements or other documentation needed to verify the debt, sometimes leading a debt collector to try to collect from the wrong consumer or for the wrong amount. In addition, GAO noted that, as credit card debts were sold and resold, verification of the facts became more difficult as the owner of the debt became farther removed from the original creditor.

The GAO report determined that, despite receiving tens of thousands of complaints, Federal agencies took only 32 formal enforcement actions over the last decade related to abusive debt collection activities. Those formal enforcement actions included 24 enforcement actions by the FTC against debt collectors, at least 13 of which involved credit card debt; and three formal enforcement actions by the FDIC against banks involved in collecting credit card debt. These infrequent enforcement actions were dwarfed by the number of complaints of abusive practices and the volume of debt collection activity documented in the report.

The GAO report also found that the law had not kept up with new technologies and evolving debt collection practices. GAO noted that communication technologies that have become common involving mobile telephones, email, caller identification, answering machines, and fax machines were not prevalent when FDCPA was enacted in 1977. In addition, GAO noted that the FTC was not given rulemaking authority to implement the FDCPA, which limited the FTC's ability to address such basic issues as how debt collectors

should use email, cell telephone numbers, and answering machines in their debt collection efforts and what efforts they should undertake to verify account and debt information. GAO indicated that most stakeholders involved in the process of debt collection with whom GAO spoke, including consumer protection groups, State and Federal agencies, credit card issuers, debt collectors, and debt buyers, expressed support for updating the FDCPA. GAO explicitly recommended that Congress amend the law to update its provisions.