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113-115

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 TWELFTH CONGRESS



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III

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PERMANENT SUBCOMMITTEE ON INVESTIGATIONS

CHAIRMAN: CARL LEVIN

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The following is the Activities Report of the Permanent Subcommittee on Investigations during the 112th 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 nine 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 collapse of Enron Corp. in 2001, 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 financial misconduct, 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. In the last Congress, among other matters, the Subcommittee conducted Congress' most in-depth examination of the 2008 financial crisis, holding four hearings and issuing a 750-page bipartisan report on key causes of the crisis. In this Congress, the Subcommittee has focused on money laundering problems at a major global bank, offshore tax abuses by major U.S. multinational corporations, excessive commodity speculation by mutual funds and others, and deficiencies in Social Security disability programs and Department of Homeland Security (DHS) fusion centers intended to combat terrorism.

(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 Sub-

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.

committee'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.

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, replacing her with the newly elected Senator from California, Richard 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, 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, Elea-

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.

nore Hill, who served as Chief Counsel to the Minority from 1982 to 1986 and then as Chief Counsel from 1987 to 1995.

(2) More Recent Investigations

At the beginning of the 105th Congress, 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 Minority Member, while also serving as Ranking Minority Member of the full Committee. Two years later, in the 106th Congress, after Senator Glenn's retirement, Michigan Democrat Carl Levin succeeded him as the Subcommittee's Ranking Minority Member. During Senator Collins' chairmanship, the Subcommittee conducted investigations into issues affecting Americans in their day-to-day lives, including 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 initiated an investigation into money laundering. At his request, in 1999, the Subcommittee held hearings 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.

During the 107th Congress, both Senator Collins and Senator Levin chaired the Subcommittee. Senator Collins was chairman until June 2001, when the Senate Majority party changed hands; at that point, Senator Levin assumed the chairmanship and Senator Collins, in turn, became the Ranking Minority Member. 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. When Senator Levin assumed the chairmanship, as his first major effort, the Subcommittee initiated 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 the Ranking Minority Member, and the Subcommittee's work contributed to enactment of major 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 Af-

fairs, and Republican Senator Norm Coleman of Minnesota became Chairman of the Subcommittee. 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, 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 meet their own tax obligations, resulting in billions of dollars in unpaid taxes. He also held hearings on border security issues, securing the global supply chain, Federal travel abuses, abusive tax refund loans, and 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, after the Senate majority shifted, Senator Levin once again became Subcommittee Chairman, while Senator Coleman became the Ranking Minority Member. Senator Levin focused the Subcommittee on investigations into complex financial and tax matters, including unfair credit card practices, executive stock option abuses, 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 the problem of hidden offshore bank accounts used by U.S. persons to dodge U.S. taxes. At the request of Senator Coleman, the Subcommittee also conducted bipartisan 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 and released thousands of documents. The Subcommittee's work contributed to passage of another landmark financial reform bill, the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010. 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, how to keep foreign corruption out of the United States, and social security disability fraud.

During the 112th Congress, Senator Levin and Senator Coburn continued in their respective roles as Chairman and Ranking Minority Member of the Subcommittee. In a series of bipartisan investigations, the Subcommittee examined how a global banking giant, HSBC, exposed the U.S. financial system to an array of money laundering, drug trafficking, and terrorist financing risks due to poor anti-money laundering controls; how two U.S. multinational corporations engaged in offshore tax abuses, including how Microsoft shifted profits offshore to dodge U.S. taxes, and Hewlett Packard secretly brought offshore funds back home without paying taxes by utilizing abusive short term loan schemes; and how excessive commodity speculation by mutual funds and others were taking place without Dodd-Frank safeguards such as position limits being put into effect. At the request of Senator Coburn, the Subcommittee also conducted bipartisan investigations into problems with Social Security disability determinations that, due to poor procedures, perfunctory hearings, and poor quality decisions, resulted in over 1 in 5 disability cases containing errors or inadequate justifications; how DHS, State, and local intelligence fusion centers failed to yield significant, useful information to support Federal counterterrorism efforts; and how certain Federal contractors that received taxpayer dollars through stimulus funding nevertheless failed to pay their Federal taxes.

II. SUBCOMMITTEE HEARINGS DURING THE 112TH CONGRESS

A. *Stimulus Contractors Who Cheat on Their Taxes: What Happened? (May 24, 2011)*

The Subcommittee's first hearing in the 112th Congress, held at the request of Senator Coburn, focused on a report by the Government Accountability Office (GAO) entitled, "Thousands of Recovery Act Contract and Grant Recipients Owe Hundreds of Millions in Federal Taxes." The report was the latest in a series of GAO reports stretching back to 2004, each prepared at the request of the Subcommittee, which collectively exposed tens of thousands of Federal contractors and service providers that had failed to pay their taxes, even while being paid with taxpayer dollars. Those prior GAO reports focused on tax-delinquent defense contractors, General Service Administration contractors, and Medicare and Medicaid health care service providers, among others, and examined ways to better identify contractors with outstanding tax debt and to recover a portion of their unpaid taxes through imposing levies

on their contract payments under the Federal Payment Levy Program.

On May 24, 2011, the Subcommittee held its hearing focusing on the latest GAO report and took testimony from two witnesses: Gregory D. Kutz, Director of Forensic Audits and Investigative Service at GAO, and Daniel L. Gordon, Administrator of the Office of Federal Procurement Policy (OFPP) at the U.S. Office of Management and Budget.

GAO testified that the American Recovery and Reinvestment Act (ARRA), enacted on February 17, 2009, appropriated \$275 billion to be distributed for Federal contracts, grants, and loans, and, as of March 25, 2011, \$191 billion of that \$275 billion had been paid out. GAO also testified that, while the vast majority—well over 90 percent—of the contractors that received stimulus payments under ARRA were in compliance with Federal requirements and had paid their taxes, a small portion, about 5 percent, had taken taxpayer dollars, while failing to meet their tax obligations. According to GAO, that 5 percent translated into about 3,700 ARRA contractors and grant recipients out of a total of about 63,000, and resulted in total unpaid Federal taxes exceeding \$750 million.

GAO also examined 15 of the ARRA recipients in more detail. GAO testified that those 15 were collectively responsible for \$40 million in unpaid taxes and had engaged in abusive or potentially criminal activities, including failing to remit payroll taxes that had been taken out of employee paychecks but never sent to the IRS. Failing to remit payroll taxes is both a civil and criminal violation of law. In one instance, GAO identified a security company that had received \$100,000 in Federal funds, yet owed over \$9 million in primarily payroll taxes from 5 years earlier that the company had never forwarded to the IRS. The company had also been cited by the Department of Labor for violating Federal labor laws. In another instance, GAO identified a social services company that owed over \$2 million in taxes, yet received more than \$1 million in Federal funds. That company had defaulted on several installment agreements with the IRS which finally imposed a penalty on one of its executives. GAO found that the executive had numerous transactions with casinos totaling hundreds of thousands of dollars a year, indicating he had substantial funds to reduce the company's tax debt, yet had failed to do so. GAO indicated that the IRS had taken collection or enforcement action against all 15 recipients.

GAO also found that, while some of the ARRA recipients were subjected to the tax levy program, about \$315 million of the tax debt was not, because the ARRA funds had not been paid directly by the Federal Government to the tax delinquent. Instead, in those cases, the Federal Government had paid the funds to a State, prime contractor, or grant recipient which, in turn, had made payments to the ultimate recipients. The businesses that received their money from a State, prime contractor, or grant recipient were never screened by the Federal tax levy program and so escaped having any portion of their funds withheld for payment of their tax debt. The hearing highlighted that gap in the tax levy program.

OFPP testified about the progress that had taken place in the tax levy program to increase the number of Federal payments screened for unpaid taxes, including completion of measures to

screen all payments to Medicare health care service providers beginning in 2011. OFPP also discussed policy steps that had been taken to deny Federal contract awards to contractors and subcontractors with serious tax delinquencies. Those steps included establishing a policy against awarding Federal contracts to tax delinquents, and amending the Federal Acquisition Regulation (FAR) to require businesses bidding on Federal contracts to certify in writing if they have a tax debt of \$3,000 or more, so that Federal agencies would know about their tax debt prior to awarding a contract. The FAR also made nonpayment of tax grounds for debarring a business from bidding on any Federal contract. Still another step was conducting an evaluation of whether Federal contracting officers and debarment officials were fully utilizing tax debt information and encouraging them to debar contractors with flagrant disregard for their tax obligations.

*B. Excessive Speculation and Compliance with the Dodd-Frank Act
(November 3, 2011)*

The Subcommittee's second hearing focused on speculation in the commodities markets and implementation of provisions in the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) to impose position limits on speculators trading commodity futures, options, and swap contracts. It was the latest in a series of Subcommittee hearings, beginning in 2001, focusing attention on how excessive speculation affects commodity prices, including in the crude oil, natural gas, and wheat markets, and what actions have been or should be taken by the Commodity Futures Trading Commission (CFTC) and the exchanges to detect, prevent, and punish trading abuses.

Commodity markets are designed, not to attract investors, but to enable producers and users of physical commodities to arrive at market-driven prices and hedge their price risks over time. Speculators who, by definition, do not intend to use or deliver the commodities they trade, seek instead to profit from the price changes. The key problem examined by the Subcommittee has been an explosion of speculators over the past decade who, instead of facilitating commodity trading, have come to dominate U.S. commodity markets, overriding normal supply and demand factors, distorting prices, and increasing price volatility. The result has been commodity prices which are more reflective of trading by speculators than fundamental forces of supply and demand by end users. The hearing examined evidence of, not only the increasing role of commodity speculation in U.S. markets, but also efforts to apply the new Dodd-Frank position limits rule to protect consumers, businesses, and the commodity markets themselves from the price distortions, price volatility, and hedging failures attributable to excessive speculation.

The hearing presented evidence on primarily three groups of speculators, commodity index funds, commodity related exchange traded products (ETPs), and commodity related mutual funds. The hearing showed how swap dealers were offering investors bilateral swaps linked to commodity index values and hedging their swap positions by buying the commodity futures on which the indexes were based. These practices have led to commodity index traders

contributing billions of dollars to commodity speculation. The hearing also showed how ETPs were marketing securities that track the value of designated commodities, but trade like stocks on an exchange, enabling investors to profit off commodity price changes without actually buying any futures. Like swap dealers, many ETP managers were shown to support the value or offset the risks of their funds by purchasing commodity futures, in 2011 alone pouring over \$120 billion of speculative money into U.S. commodity markets. In addition, the hearing showed that, over the past 3 years, the mutual fund industry had established at least 40 commodity related mutual funds that, by 2011, had accumulated assets of over \$50 billion. Their sales materials showed that they were marketing themselves to average investors as commodity funds and engaging in many types of commodity speculation.

At the November hearing, the first panel of witnesses presented testimony from three individuals on the negative consequences of increasing commodity speculation in U.S. markets. Wallace C. Turbeville, a Derivatives Specialist with Better Markets, Inc., explained how swap dealers, hedge funds, high frequency traders, and other speculators made commodity trades that pushed up energy prices. Paul N. Cicio, President of the Industrial Energy Consumers of America, described how U.S. manufacturers and other businesses faced rapidly changing energy prices that had little relationship to the supply and demand factors affecting end users. Tyson T. Slocum, Director of the Energy Program at Public Citizen, described how American families paid inflated energy prices due to excessive speculation, citing a study showing that, in 2011, excessive speculation added \$600 to the average family's gasoline expenditures. The three witnesses also discussed positive and negative aspects of the final rule issued by the CFTC during the prior month to implement the Dodd-Frank position limit requirements.

The final witness was Gary Gensler, CFTC Chairman. He confirmed the growing dominance of speculators in U.S. commodity markets, noting, for example, that in 2011, 80 percent of the outstanding futures contracts for crude oil were held by speculators. He also explained that, in an effort to address excessive commodity speculation, Congress had enacted as part of the Dodd-Frank Act new statutory requirements for the CFTC to impose position limits on speculators. Position limits prohibit individual traders from holding more than a specified number of futures contracts at a specified time, such as during the close of the so-called "spot month" when a futures contract expires, and buyers and sellers have to settle up financially or through the physical delivery of commodities. Position limits help ensure commodity traders cannot exercise undue market power over prices during those times, such as by cornering the market. Mr. Gensler observed that the new Dodd-Frank requirements were intended, not only to protect consumers and businesses from excessive speculation and price manipulation, but also to prevent U.S. commodity markets from losing the confidence of commodity producers and end users in the markets' pricing and hedging capabilities. He also discussed the CFTC's final rule on position limits and his expectation that the rule would be challenged in court by commodity speculators.

C. Compliance with Tax Limits on Mutual Fund Commodity Speculation (January 26, 2012)

The Subcommittee held a followup hearing on commodity speculation in January 2012, focusing on the expanding role of commodity related mutual funds, a relatively new development in U.S. commodity markets. In particular, the Subcommittee hearing examined actions taken by the Internal Revenue Service (IRS) in issuing over 70 private letter rulings that enabled mutual funds to make unlimited indirect investments in commodities through offshore shell corporations or financial instruments known as commodity-linked notes, despite longstanding statutory restrictions on mutual fund investments in commodities.

By law, mutual funds are supposed to derive 90 percent of their income from investments in securities and not more than 10 percent from alternatives like commodities. That statutory requirement in the tax code has, in the past, caused mutual funds to spend the lion's share of their money on stocks, bonds, and other securities, becoming an engine of investment in U.S. capital markets. In addition, due to the statutory restriction, mutual funds were not significant participants in U.S. commodity markets. But in 2006, the mutual fund industry began pressing the IRS to permit it to use complex financial transactions that would, in essence, enable mutual funds to get around the 90 percent rule and engage in commodity investments beyond the 10 percent limit.

In response to petitions filed by individual mutual funds, the IRS issued a series of private letter rulings, from 2006 to 2010, that explicitly allowed the mutual funds to whom the letters were addressed to use either wholly owned offshore corporations or commodity linked notes to make unrestricted commodity investments, notwithstanding the 10 percent limit. The private letter rulings stated that the mutual funds could treat the resulting income—not as income from a commodities investment—but as income from a “securities” investment, referring to the stock of the company they had formed or the note they had issued to avoid the tax code restrictions.

The hearing presented evidence that, in response to the letter rulings, by 2011, U.S. mutual funds had established at least 40 wholly owned controlled foreign corporations (CFCs), with accumulated assets of over \$50 billion, whose sole function was to trade commodities. Those CFCs were organized as offshore shell corporations, typically in the Cayman Islands, with no offices or employees of their own and with a commodities portfolio run by employees located in the mutual fund's U.S. offices. One mutual fund disclosed, for example, that all of the commodity investment decisions for its offshore shell corporation were made by the mutual fund's employees in Rockville, Maryland. Another revealed that all commodity trading decisions were made by its traders in New York. Still another mutual fund stated that its offshore commodity fund had no “Cayman presence,” describing it as “smoke and mirrors” to obtain the tax benefit. Sales materials showed that the offshore corporations were marketing themselves to average investors as commodity funds and participating in many types of commodity speculation, directly contributing to increased speculation in the markets.

The January hearing took testimony from two witnesses: IRS Commissioner Douglas Shulman and Department of the Treasury Acting Assistant Secretary for Tax Policy Emily McMahon. The witnesses were asked why the IRS had not barred the mutual funds from doing indirectly what they were prohibited from doing directly, and whether the private letter rulings were undermining IRS efforts to combat sham corporations and financially engineered transactions used to circumvent the tax code. The witnesses were also advised that the actions of the mutual fund industry had unleashed a new flood of speculative commodity investments in U.S. markets affecting energy and other prices. Both witnesses defended the IRS' actions, but also testified that the IRS had recently imposed a moratorium on issuing new private letter rulings in this area, while reviewing the policy issues. In addition, the Commodity Futures Trading Commission (CFTC) indicated that it was considering issuing a new rule requiring such offshore shells to register with the CFTC as commodity pools.

The hearing also presented evidence that, in 2010, Congress had rejected an attempt by the mutual fund industry to change the tax code to explicitly allow mutual funds to make unrestricted commodity investments. As introduced in 2009, and passed by the House in 2010, the Regulatory Investment Company Modernization Act would have changed the law to permit mutual funds to utilize income from "commodities" under Section 851 of the tax code. The Senate, however, removed that provision from the bill before approving it. Removal of the commodities provision was, in fact, the only change made to the House-passed bill. The Senate-passed bill was returned to the House which then enacted the bill into law as amended. The end result was that Congress had rejected an attempt to add commodities to the list of acceptable income for mutual funds under the 90 percent rule. When asked about these developments, the IRS and Treasury witnesses indicated that they were aware of the legislative history, but did not view it as dispositive on the issue of whether mutual funds could continue to make indirect commodity investments in ways that could be treated as securities investments.

D. U.S. Vulnerabilities to Money Laundering, Drugs, And Terrorist Financing: HSBC Case History (July 17, 2012)

The Subcommittee's next hearing examined money laundering, drug trafficking, and terrorist financing vulnerabilities created in the United States when a global bank, HSBC, used its U.S. affiliate, HSBC Bank USA (HBUS), to provide U.S. dollars and access to the U.S. financial system to a worldwide network of high risk affiliates, high risk correspondent banks, and high risk clients. This hearing was the latest in a series of Subcommittee hearings, dating back to 1999, on anti-money laundering (AML) deficiencies at U.S. financial institutions.

The key focus of the hearing was how HSBC had abused its U.S. access. HSBC is one of the largest banks in the world, with headquarters in London, over 7,200 offices in more than 80 countries, 300,000 employees, and 2011 profits of nearly \$22 billion. Its U.S. affiliate, HBUS, had more than 470 U.S. branches and 4 U.S. million customers, and served as the U.S. nexus for the entire HSBC

worldwide network. In 2008, for example, HBUS processed 600,000 wire transfers per week; in 2009, two-thirds of the U.S. dollar payments HBUS processed came from HSBC affiliates in other countries. One HSBC executive told the Subcommittee that a major reason why HSBC opened its U.S. bank was to provide its overseas clients with a gateway into the U.S. financial system. At the same time, HBUS had a history of weak anti-money laundering controls.

Most international banks want access to U.S. dollars, because U.S. dollars are accepted internationally, are the leading international trade currency, and hold their value better than other currencies. Banks also want access to U.S. wire transfer systems which move money across international lines quickly and securely. In addition, they want to be able to clear U.S. dollar monetary instruments like travelers cheques, bank cheques, and money orders. Global banks also want the safety, efficiency, and reliability that are the hallmarks of U.S. banking.

When an international bank abuses its U.S. access, it may allow affiliates operating in countries with severe money laundering, drug trafficking, or terrorist financing threats to open up U.S. dollar accounts without establishing safeguards at their U.S. affiliate. Some of those affiliates may operate in secrecy jurisdictions. Some may allow poorly managed or corrupt foreign banks to make use of the affiliate's U.S. dollar account. Other affiliates may allow high risk clients to use their U.S. accounts without taking adequate anti-money laundering steps. The global parent may even allow its affiliates to pressure their U.S. counterpart to ease up on U.S. anti-money laundering restrictions or look the other way in the presence of suspicious activity. The end result is that the U.S. affiliate can become a focus of risk for an entire network of bank affiliates, including their correspondents and clients around the world, and end up aiding and abetting transactions that fund terrorists, drug cartels, tax cheats, or other wrongdoers.

In the case of HSBC, the Subcommittee's hearing and an accompanying bipartisan staff report identified five key areas of concern. The first involved HBUS' providing U.S. dollar accounts to high risk HSBC affiliates without performing due diligence, including a Mexican affiliate with unreliable AML controls. The second involved HSBC's failing to stop deceptive conduct by HSBC affiliates to circumvent an HBUS screening filter designed to block transactions by terrorists, drug kingpins and rogue nations like Iran. The third involved HBUS' providing bank accounts to overseas banks with links to terrorist financing. The fourth involved HBUS clearing hundreds of millions of dollars in bulk U.S. dollar travelers cheques, despite suspicious circumstances. The fifth involved HBUS offering bearer-share accounts, a high risk account that invites wrongdoing by facilitating hidden corporate ownership.

In addition to those problems, the hearing presented evidence that the bank's primary regulator, the Office of the Comptroller of the Currency (OCC), was aware of the mounting AML problems at HBUS, yet tolerated them for 5 years, without taking any formal or informal enforcement action. When the OCC finally decided the problems required a regulatory response, it lowered HBUS' consumer compliance rating instead of its safety and soundness rating. Every other Federal banking agency treats AML deficiencies as a

matter of safety and soundness; only the OCC treated AML deficiencies as if they were a matter of consumer protection law.

At the hearing, the Subcommittee took testimony from four panels of witnesses. The first panel consisted of David S. Cohen, Under Secretary for Terrorism and Financial Intelligence at the U.S. Department of the Treasury; and Leigh H. Winchell, Assistant Director of Investigative Programs, U.S. Immigration & Customs Enforcement at the Department of Homeland Security. Both witnesses explained how U.S. AML safeguards protected the country from money laundering, drug trafficking, and terrorist financing, among other wrongdoing.

The second panel of witnesses consisted of officials from HSBC and HBUS who were asked about AML deficiencies at the bank. They included Stuart A. Levey, HSBC's Chief Legal Officer; David Bagley, Head of HSBC Compliance; Paul Thurston, Chief Executive of HSBC's Retail Banking and Wealth Management; and Irene Dorner, HBUS President and Chief Executive Officer. In addition, two former bank officials testified, Michael Gallagher, former HBUS Executive Vice President; and Christopher Lok, former Head of the bank's Global Banknotes division. The HSBC officials admitted and expressed regret for the bank's AML deficiencies and described actions taken by the bank to strengthen its AML controls. They included increasing the HBUS AML staff from about 130 to nearly 1,000 employees; closing the accounts of over 325 high risk banks and 25 embassies; revamping its country and client risk assessment methodologies; strengthening its transaction monitoring and wire transfer reviews; and establishing AML due diligence and information sharing requirements for all HSBC affiliates. HBUS also increased its annual compliance budget ninefold to about \$250 million. In addition, HSBC strengthened its global compliance department by giving it hiring and management authority over all 3,500 compliance officers worldwide and authorizing it to set and enforce global AML and other compliance standards, including by ordering the closing of accounts. Mr. Bagley, longtime head of HSBC Compliance, after expressing regret for the bank's past performance, announced his resignation at the hearing.

The third panel consisted of current and former officials from the U.S. Office of Comptroller of the Currency (OCC). They included Thomas J. Curry, Comptroller of the Currency; Daniel P. Stipano, OCC Deputy Chief Counsel; and Grace E. Dailey, former OCC Deputy Comptroller for Large Banks Supervision. The OCC officials admitted that the OCC had taken too long to confront HSBC about its AML deficiencies and announced actions taken to compel the bank to take corrective action. The OCC also agreed with the report's recommendations about its own failings, and announced that it would revamp its AML oversight procedures. Among other changes, the OCC announced that it would treat AML deficiencies as a safety and soundness and management issue, and would enable examiners to cite banks for violating any of the four components of an effective AML program, which consist of establishing effective internal controls, a capable compliance officer, an independent audit function, and AML training. The OCC also announced that it would put into place a program to identify banks

with AML deficiencies that exceeded a specified threshold and take appropriate, timely enforcement action.

The Department of Justice later filed a deferred prosecution agreement against HSBC in connection with its AML misconduct. In response, among other actions, the bank agreed to pay a criminal fine of \$1.9 billion.

E. Social Security Disability Programs: Improving the Quality of Benefit Award Decisions (September 13, 2012)

The Subcommittee's next hearing examined issues related to the quality of disability benefit awards, using as a case history 300 actual case files of claimants under the Social Security Disability Insurance (SSDI) and Supplement Security Income (SSI) programs. This bipartisan investigation, undertaken at the request of Senator Coburn, resulted in a September hearing and the release of a Coburn report.

The Social Security SSDI and SSI programs provide financial support to Americans who, due to a disability, are incapable of working at a full-time job. In recent years, the number of individuals receiving disability insurance aid has dramatically increased. In the 5-years prior to the hearing, SSDI recipients increased by 22 percent, from 7.1 million in 2007 to 8.7 million individuals in April 2012. Over the same period, the percentage of the country's population between the ages of 25 and 64 receiving SSDI benefits rose from 4.5 percent in 2007, to a record-high of 5.3 percent in March 2012. The 2008 financial crisis contributed to the problem when millions of workers lost their jobs and employer-sponsored health insurance. Without health insurance and the health care it paid for, in some instances chronic conditions held in check by treatment worsened and became disabling, requiring workers to turn to Federal disability insurance. Increased disability insurance payments, in turn, increased the stress on the Social Security Disability Trust Fund, which some estimates predict may be unable to pay full benefits by 2016. In addition to solvency problems, the disability programs have experienced long application backlogs.

The Subcommittee investigation focused on the decisionmaking process resulting in an award of benefits to applicants. To evaluate the award process, the Subcommittee reviewed 300 actual electronic case files, with all identifying personal information removed. The cases were taken from three counties in three States, Virginia, Alabama, and Oklahoma, reflecting different levels of per capita enrollment in the SSDI and SSI programs. The cases provided a cross-section of applicants who were awarded disability benefits at different stages of review within the Social Security Administration (SSA): at the stage of the initial application, upon reconsideration, upon appeal before an administrative law judge (ALJ), or upon appeal before the Social Security Appeals Council. The review examined only cases in which benefits were awarded, and not any cases in which benefits were denied. The Coburn report summarized the information obtained, providing case-specific information normally unavailable to the public, since disability hearings examine individuals' personal medical records.

The report and hearing disclosed evidence of troubling practices in many cases on how awards were made. The evidence showed, for

example, that one judge who decided over 1,500 disability cases per year took inappropriate shortcuts in his opinions, cutting and pasting medical evidence from the case file into his opinions without explaining or analyzing what it meant, and writing the phrase "etc., etc., etc." rather than describing the relevant evidence. Despite being confronted by his chief judge in person and by letter, for years he continued to produce the same poor quality decisions. In other cases, evidence indicated that some judges held perfunctory hearings that lasted less than 10 minutes, failed to elicit any testimony from the person applying for benefits, and failed to examine medical evidence raising questions about whether that person was entitled to disability benefits. In still other cases, poorly written opinions awarding benefits failed to identify the medical evidence showing how the requirements for establishing a disability were met, did not acknowledge or address evidence that impairments were not disabling or evidence that the claimant had been working, and at times even misrepresented medical findings or hearing testimony.

The report found that the 300 cases contained a large number of low quality decisions, a finding consistent with the Social Security Administration's own internal research. An SSA quality review process whose findings had not previously been made widely available found that, in 2011, 22 percent or over 1 in 5 disability cases decided by an SSA Administrative Law Judge contained errors or were inadequately justified. Those errors went in both directions, resulting in either the award or denial of benefits. Those errors and inadequacies did not mean that the 1 in 5 disability decisions were all wrongly decided; they meant that the opinions being produced in those cases did not contain the type of analysis needed to be confident that the cases were correctly decided and disability benefits went to the truly disabled.

The hearing took testimony from two panels of witness. The first panel consisted of two senior SSA administrative law judges, based in Washington, who oversaw aspects of the disability award program. Judge Patricia A. Jonas was Executive Director of SSA Appellate Operations, and Deputy Chair of the Appeals Council in the SSA Office of Disability Adjudication and Review (ODAR). Judge Debra Bice was Chief Administrative Law Judge in the SSA ODAR. Both witnesses testified about the problems they had observed in the disability award process as well as efforts undertaken to address them. Judge Jonas discussed the agency's 2009 creation of a quality review process which, for the first time, developed criteria and procedures for reviewing ALJ disability decisions, identified statistically significant problem areas nationwide, and supported new policy guidance to increase decisionmaking efficiency and accuracy. Judge Bice described SSA's counseling and disciplinary process for judges that decide too few cases or issue poor quality decisions.

The second panel consisted of senior Administrative Law Judges from the counties reviewed during the course of the Subcommittee investigation. Judge Douglas S. Stults was a Hearing Office Chief Administrative Law Judge for the SSA ODAR in Oklahoma City. Judge Thomas W. Erwin was the Hearing Office Chief Administrative Law Judge for the SSA ODAR in Roanoke, Virginia. Judge

Ollie L. Garmon, III, was the Regional Chief Administrative Law Judge for Region IV of the SSA ODAR, based in Atlanta, Georgia. All three admitted that poor quality decisionmaking was a problem and described their efforts to improve the decisionmaking process, while protecting the independence of the ALJs under their supervision.

F. Offshore Profit Shifting and the U.S. Tax Code—Part 1 (Microsoft & Hewlett-Packard) (September 20, 2012)

The Subcommittee's final hearing during the 112th Congress presented two case studies, involving Microsoft Corporation and Hewlett-Packard Corporation, showing how some profitable U.S. multinationals exploit U.S. tax and accounting loopholes to avoid the payment of U.S. taxes. The Microsoft case history focused on the shifting of profits offshore to controlled foreign corporations to avoid U.S. taxes; the Hewlett-Packard case history focused on the use of an abusive short term loan scheme to return offshore funds to the United States without paying any U.S. tax.

The hearing was the latest in a decade of Subcommittee investigations into how multinational corporations and wealthy individuals use offshore tax schemes to dodge U.S. taxes, leaving other taxpayers to make up the difference. According to the Congressional Research Service, the share of corporate income taxes in the United States has fallen from a high of 32 percent of Federal tax revenue in 1952, to 9 percent in 2009. Meanwhile, payroll taxes—which almost every working American must pay—have increased from 10 percent of Federal revenue to 40 percent.

The hearing presented evidence that Microsoft had developed software products in the United States using U.S. research and development tax credits, and then used aggressive transfer pricing transactions to shift the rights to market its intellectual property to controlled foreign corporations in Puerto Rico, Ireland, and Singapore, each of which was a low or no tax jurisdiction, thereby shielding the bulk of its worldwide sales profits from U.S. taxation. The hearing also presented evidence that from 2009 to 2011, by transferring certain rights to its intellectual property to a Puerto Rican subsidiary, Microsoft shifted nearly \$21 billion offshore, or almost half of its U.S. retail sales net revenue, dodging up to \$4.5 billion in taxes on goods sold in the United States. In 2011 alone, the evidence indicated that Microsoft avoided paying U.S. tax on 47 percent of its U.S. sales revenue. Evidence indicated that Microsoft excluded an additional \$2 billion in U.S. taxes on passive income attributed to its offshore subsidiaries, using the so-called “check-the-box” and “look-through” rules to circumvent Subpart F taxation of passive foreign profits.

In addition to showing how some U.S. taxable income was shifted offshore, the hearing showed how some offshore revenue was later returned to the United States untaxed. The evidence examined Hewlett-Packard's use of a tax loophole in Section 956 of the tax code to avoid paying U.S. taxes on billions of dollars in offshore income that it had returned to the United States to run its U.S. operations. Hewlett-Packard obtained the offshore cash by directing two of its controlled foreign corporations in Belgium and the Cayman Islands to provide serial, alternating loans to its U.S. operations.

From March 2008 to September 2012, Hewlett-Packard used those intercompany loans to provide an average of about \$3.6 billion per day for use in its U.S. operations, claiming they were tax-free, short term loans of less than 30 days duration under Section 956. The evidence indicated that its auditor, Ernst & Young, knew that the company was using a structured loan program to obtain billions of dollars in continual offshore loans each year, yet supported Hewlett-Packard's view that the offshore funds had not been repatriated to the United States, but qualified as occasional short-term loans exempt from U.S. taxation.

An accompanying, bipartisan memorandum found that weaknesses in the U.S. tax code's transfer pricing regulations, Subpart F, and Section 956, and in accounting rules issued by the Financial Accounting Standards Board regarding indefinitely invested foreign earnings, had encouraged and facilitated the multinationals' tax avoidance.

The hearing heard from three panels of witnesses. The first panel consisted of three international tax and accounting experts. Stephen E. Shay, former head of international tax policy at the U.S. Department of the Treasury, was a professor at Harvard Law School. Reuven S. Avi-Yonah was the Irwin I. Cohn Professor of Law at the University of Michigan School of Law. Jack T. Ciesielski was a Certified Public Accountant and President of R.G. Associates, Inc., of Baltimore, Maryland. All three criticized the abusive conduct and tax and accounting deficiencies exposed by the two case histories.

The second panel consisted of representatives from Microsoft, Microsoft's auditor Ernst & Young, and Hewlett Packard. Microsoft was represented by Bill Sample, Corporate Vice President for Worldwide Tax, who defended Microsoft's tax strategies as permitted by law. Hewlett-Packard was represented by Lester Ezrati, Senior Vice President and Tax Director, who was accompanied by John N. McMullen, Senior Vice President and Treasurer. Hewlett-Packard's auditor, Ernst & Young, was represented by Beth Carr, a partner in the International Tax Services division and senior manager of the Hewlett-Packard account. They testified that the Hewlett-Packard offshore loan arrangements were permitted by law.

The third and final panel consisted of representatives from the IRS and Financial Accounting Standards Board (FASB). William J. Wilkins, IRS Chief Counsel, was accompanied by Michael Danilack, IRS Deputy Commissioner (International) in the Large Business and International Division. Susan M. Cosper was FASB's Technical Director. The witnesses testified about the tax and accounting measures at issue in the case histories, while declining to express any opinion on the specifics of the two companies.

III. LEGISLATIVE ACTIVITIES DURING THE 112TH 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 112th Congress was no exception, with Subcommittee

hearings and Members playing prominent roles in the development of several legislative initiatives.

A. Stop Tax Haven Abuse Act (S. 1346)

On July 12, 2011, to address multiple tax abuses examined in Subcommittee hearings, Senators Levin, Conrad, Whitehouse, Shaheen, Bill Nelson, Sanders, Durbin, and Begich introduced the Stop Tax Haven Abuse Act. This legislation was based upon 8 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 is at least \$100 billion per year.

Among other measures, the bill would authorize Treasury to take special measures against foreign jurisdictions and financial institutions that impede U.S. tax enforcement; 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; and strengthen penalties on tax shelter promoters. It would also prevent companies that are managed and controlled from the United States from claiming foreign status for tax purposes; and close a tax loophole allowing credit default swap payments to be treated as non-U.S. source income when sent from the United States to persons offshore. Other provisions would require multinational corporations to report the taxes they pay on a country-by-country basis in public SEC filings; and treat any deposits they make through a controlled foreign corporation to a U.S. financial account as taxable, repatriated income. In addition, the bill would require U.S. financial institutions to report certain offshore activities to the IRS; and require U.S. hedge funds and company formation agents to establish anti-money laundering programs. A companion bill containing the same provisions was introduced in the House (H.R. 2669). The Senate bill was referred to the Finance Committee which took no further action.

One of the bill provisions, authorizing special measures to combat foreign jurisdictions or institutions that significantly impede U.S. tax enforcement, was later included in a Senate transportation bill to help provide funding for that legislation. It passed the Senate, but was not adopted in the House or enacted into law.

B. Ending Excessive Corporate Deductions for Stock Options Act (S. 1375)

On July 7, 2011, to close a tax loophole examined in a 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, Sherrod Brown, McCaskill, and Whitehouse introduced S. 1375, the Ending Excessive Corporate Deductions for Stock Options Act.

IRS data has shown 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 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. A blatant example of the problem came to light in connection with Facebook's initial stock offering in May 2012, when it disclosed in its public registration statement that it planned to claim a \$16 billion stock option tax deduction, which was enough to eliminate its taxable income for years, while at the same time showing a fraction of that amount on its books as an expense and promoting the company to investors as highly profitable.

To put an end to such excessive stock option tax deductions, the bill would amend the tax code to require that corporate tax deductions for stock option compensation not exceed the stock option expenses actually shown on the corporate books. It would also allow corporations to deduct stock option compensation in the same year the compensation 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. In addition, the bill would subject stock option pay for top executives to the existing \$1 million cap on the tax deductions that publicly traded corporations can claim for executive pay, in order to eliminate taxpayer subsidies of outsized executive compensation. The bill was referred to the Finance Committee which took no further action.

C. Tax Lien Simplification Act (S. 1390)

On July 20, 2011, Senators Levin and Begich introduced S. 1390, the Tax Lien Simplification Act, to modernize the Federal tax lien system by replacing the current local, paper-based filing system with an electronic Federal registry system on the Internet that would be available to the public at no cost. The IRS has estimated that, over 10 years, the new system would save taxpayers \$150 million.

Tax liens are a principal tool used by the IRS to collect funds from tax delinquents. Currently, public notices of tax liens are filed on paper in one or more of 4,100 local recording offices, each with its own formatting and legal styling requirements. The IRS maintains a service center dedicated to monitoring local lien requirements; preparing liens in the proper format; requesting local officials to file the liens; paying lien filing fees; tracing and replacing lost filings; correcting errors; and, once resolved, releasing the liens. To streamline the current system, among other provisions, the bill would establish an electronic registry in which all Federal tax liens would use a common format, operate under common security and privacy requirements, and permit direct filing by IRS personnel. When resolved, the IRS would have 20 days instead of the current 30 days to release a tax lien. The public would be able to search the online registry for free. The bill was referred to the Finance Committee which took no further action.

D. Incorporation Transparency and Law Enforcement Assistance Act (S. 1483)

On August 2, 2011, Senators Levin, Grassley, Feinstein and Harkin introduced S. 1483, 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, that 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 exempt all publicly traded and regulated corporations, as well as certain other corporations whose ownership information was already available. The bill was referred to the Committee on Homeland Security and Governmental Affairs which took no further action.

E. Closing the Derivatives Blended Rate Loophole Act (S. 2033)

On January 23, 2012, Senator Levin introduced S. 2033, the Closing the Derivatives Blended Rate Loophole Act, to close a loophole that effectively allows taxpayers who make short-term investments in certain derivatives to treat much of their earnings as long-term capital gains. Closing this loophole would eliminate a tax code provision that favors short-term speculation over long-term investment, and provides an unjustified tax break to a small group of financial speculators. The bill is based upon past Subcommittee investigations into derivatives, financial speculation, and the tax code.

Under current law, taxpayers generally can claim the lower capital gains tax rate on earnings only if those earnings come from the sale of assets held for more than a year. The lower tax rate is restricted to those assets in order to encourage long-term investment in the U.S. economy. But under Section 1256, traders in covered derivatives can claim 60 percent of their income as long-term capital gains, no matter how briefly they have held the asset. Eliminating the resulting blended tax rate for earnings from covered derivatives has been estimated to produce, over 10 years, a tax savings of \$3 billion. The bill was referred to the Finance Committee which took no further action.

F. Cut Unjustified Tax (CUT) Loopholes Act (S. 2075)

On February 17, 2012, Senators Levin, Conrad, Begich, and Whitehouse introduced S. 2075, the Cut Unjustified Tax Loopholes or CUT Loopholes Act, to close a series of tax loopholes, not only to increase the fairness of the tax code, but also to produce significant revenues for deficit reduction.

The bill combined in a single package two of the tax reform bills discussed earlier, the Stop Tax Haven Abuse Act and the Ending Excessive Corporate Deductions for Stock Options Act. In addition, it included provisions to restrict corporations from deducting expenses for moving operations offshore and put an end to certain abuses involving foreign tax credits, intellectual property moved offshore, and the shifting of corporate profits to tax havens. Closing

the loopholes was estimated to produce, over 10 years, at least \$155 billion in deficit reduction. The bill was referred to the Finance Committee which took no further action.

IV. REPORTS, PRINTS, AND STUDIES

In connection with its investigations, the Subcommittee often issues lengthy and detailed reports. During the 112th Congress, the Subcommittee released five such reports, listed below, some of which have already been partly described in connection with Subcommittee hearings.

A. *Wall Street and the Financial Crisis: Anatomy of a Financial Collapse, April 13, 2011 (Report prepared by the Majority and Minority staffs of the Permanent Subcommittee on Investigations and released in connection with four Subcommittee hearings held in 2010)*

In November 2008, the Subcommittee initiated a bipartisan investigation into key causes of the 2008 financial crisis which contributed to the loss of millions of jobs and homes, destroyed savings, shuttered good businesses, and produced the worst U.S. economic decline since the Great Depression. In April 2010, the Subcommittee held four hearings focusing on how high risk mortgage lending, regulatory failures, inflated credit ratings, and high risk, conflicts-ridden financial products designed and sold by investment banks helped cause the financial crisis, using case histories to illustrate the problems. One year later, in April 2011, the Subcommittee released a 750-page bipartisan staff report, the longest in its history, further detailing its investigation, releasing additional documents, and providing specific factual findings and policy recommendations. It was the only bipartisan report produced by Congress on the financial crisis.

High Risk Home Loans. The first section of the Levin-Coburn report focused on high risk home loans and their inclusion in mortgage backed securities, 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, could not afford the higher monthly payments that took effect, defaulted on their mortgages, and lost their homes while the related mortgage securities plummeted in value.

The report presented evidence showing 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 report also presented evidence showing 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 report also showed that Washington Mutual and Long Beach steered many borrowers into loans they could not afford when 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.

In addition, the report 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. The report also 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 that were likely to be repaid. The compensation system also provided extra compensation 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 report offered a number of recommendations to prevent similar problems with high risk home loans and mortgage backed securities in the future. Those recommendations included ensuring future residential mortgages have a low risk of delinquency or default; requiring financial institutions issuing mortgage related securities to retain not less than 5 percent of the credit risk with no hedging offset for a reasonable but limited period of time; safeguarding taxpayer dollars by requiring banks with high risk structured finance products or negatively amortizing loans to meet conservative loss reserve, liquidity, and capital requirements; and using the required bank activities study under Section 620 of the Dodd-Frank Act to identify high risk structured finance products and impose a reasonable limit on the amount of such products that can be included in a bank's investment portfolio.

Regulatory Failures. The second section of the report focused on the regulatory failures of Federal bank regulators charged with ensuring the safety and soundness of the U.S. banking system. The case study examined regulatory oversight of Washington Mutual, focusing on the Office of Thrift Supervision (OTS), which was the bank's the primary regulator, and the Federal Deposit Insurance Corporation (FDIC), which was its backup regulator.

The report examined 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' largest institution. The report found that feeble oversight by the regulators, combined with weak regulatory standards and agency infighting, enabled Washington Mutual Bank to engage in high-risk and shoddy lending practices and sell poor quality and sometimes fraudulent mortgages that contributed to both the bank's demise and the financial crisis.

The report presented evidence 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 report showed 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 report 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. In addition, the report showed 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 report documented 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 report showed 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 report offered a number of recommendations to prevent similar regulatory failures in the future. Those recommendations included dismantling OTS as a bank regulator; urging Federal bank regulators to review major financial institutions to identify those with ongoing, serious lending deficiencies; and eliminating any regulatory policy providing deference to bank management, inflated CAMELS ratings, or use of short term profits to excuse high risk activities. The report also recommended strengthening the CAMELS ratings system, and undertaking a study of the U.S. financial system to identify high risk lending practices at financial institutions and evaluate any systemic impacts.

Inflated Credit Ratings. The third section of the report focused on the credit rating agencies that assigned creditworthiness ratings to residential mortgage backed securities (RMBS) and collateral debt obligations (CDOs) from 2004 to 2008. The report used as case histories 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.

The report 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, those high risk mortgages began incurring delinquencies and defaults at an alarming rate, leading to losses in the RMBS and CDO securities referencing those mortgages. Despite those and other signs of a deteriorating mortgage market, Moody's and S&P continued for another 6 months in 2007, to issue investment grade ratings for numerous RMBS and CDO securities.

The report presented evidence that some investment bankers had pressured the credit rating agencies to provide favorable ratings for the RMBS and CDO products they planned to sell, and that Moody's and S&P—which were paid by those firms—repeatedly gave into that pressure. The report also documented 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. In addition, the report showed that Moody's and S&P made record profits from rating structured finance products in the years running up to the financial crisis.

The report demonstrated 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 report 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 report also presented evidence 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 mortgage related securities 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 report concluded that the 2007 mass downgrades, which were unique in U.S. financial history and made it clear that RMBS and CDO securities were no longer safe investments, were the most immediate trigger of the financial crisis.

The report 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, it 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 resources to adequately rate new products and test the accuracy of their existing ratings.

The report offered a number of recommendations to prevent similar credit rating problems in the future. Those recommendations included urging the SEC to rank existing credit rating agencies in terms of their performance, including the accuracy of their ratings; and facilitating the ability of investors to hold credit rating agencies accountable in civil lawsuits for inflated credit ratings. The report also recommended strengthening the SEC's inspection, examination, and regulatory authority to ensure credit rating agencies instituted internal controls, methodologies, and employee conflict of interest safeguards to increase ratings' accuracy, and assigned higher risks to financial instruments whose performance could not be reliably predicted due to their novelty or complexity, or because they relied on assets from parties with poor track records. In addition, the report recommended that the SEC ensure prompt use by the credit rating agencies of new forms providing comprehensible, consistent, and useful ratings information to investors; and that Federal agencies take steps to reduce the Federal Government's reliance on privately issued credit ratings.

Investment Bank High Risk Products and Conflicts of Interest. The fourth and final section of the report focused on the role of investment banks in the financial crisis, using two case histories. The first involved 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. The report detailed numerous troubling and sometimes abusive practices by Goldman raising multiple conflict of interest concerns. The second case history involved Deutsche Bank which constructed and sold CDOs that it knew to contain poor quality assets.

In the first case history, the report presented evidence that, from 2004 to 2007, in exchange for lucrative fees, Goldman helped lenders notorious for issuing high risk, poor quality loans to 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. It 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 report 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 report 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, even though it knew all four contained poor quality assets likely to fail. 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 to bet against the resulting CDO, without informing other investors in the CDO about the favored client's actions. In the case of all four CDOs, 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, 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.

In the second case history, the report presented evidence on actions taken by Deutsche Bank, from late 2006 through 2007, in exchange for lucrative fees, to issue 15 CDOs securitizing about \$11 billion in assets, despite a deteriorating U.S. mortgage market. In 2006, Deutsche Bank's Global head of CDO trading, Gregg Lippmann, referred to the bank's CDO business as a "cdo machine" and "ponzi scheme," and at one point wrote: "[W]e are looking for ways

to get out of this risk, but for now the view has been, we like the fees and the league table credit (and dammit we have a budget to make)." The report provided details about one \$1.1 billion CDO called Gemstone 7, which Deutsche Bank had constructed with a hedge fund, HBK, and which included RMBS securities that Mr. Lippmann had described as "crap" and "pigs." It showed how Mr. Lippmann had approved moving one of the RMBS securities from the bank's inventory to Gemstone 7, even after asking, "DOESN'T THIS DEAL BLOW," and being told by a trader, "yes it blows I am seeing 20-40 percent writedowns." To motivate its sales force to sell Gemstone securities despite poor quality assets, Deutsche Bank offered special financial incentives and directed the sales force to seek buyers in Europe and Asia. While Deutsche Bank was unable to sell all of the Gemstone securities, it did remove \$700 million in risk from its books, at the same time contaminating the U.S. market with shoddy securities that quickly lost value.

The report showed that Deutsche Bank traded in the U.S. mortgage market, not only on behalf of clients, but also on a proprietary basis. The evidence indicated that the bank mostly purchased long mortgage related assets, but also allowed Mr. Lippmann to buildup a \$5 billion short position, betting against the mortgage market. That position eventually produced bank profits of \$1.5 billion. Despite that profitable short position, through its mortgage department and an affiliated hedge fund, Winchester Capital based in London, Deutsche Bank accumulated more than \$25 billion in long mortgage positions. In 2007, its mortgage department reported an overall loss of \$4.5 billion, demonstrating the massive losses that proprietary trading can produce.

The report offered a number of recommendations to prevent investment banks from producing and selling high risk products tainted by conflicts of interest. Those recommendations included urging Federal bank regulators to design strong conflict of interest prohibitions for investment banks and conduct a review of banks' structured finance transactions, including RMBS, CDO, CDS, and ABX activities, to identify legal violations and stop abusive practices. The report also recommended allowing only narrow exceptions to the new Dodd-Frank statutory ban on proprietary trading by banks, permitting only activities that serve clients or reduce risk. In addition, the report recommended using the Section 620 banking activities study to evaluate the appropriateness of allowing federally insured banks to design, market, and invest in naked credit default swaps, synthetic financial instruments, and structured finance products with risks that cannot be reliably measured.

B. Repatriating Offshore Funds: 2004 Tax Windfall for Select Multinationals, October 11, 2011, with Addendum issued on December 14, 2011 (Report Prepared by the Majority Staff of the Permanent Subcommittee on Investigations)

In October 2011, the Subcommittee released a majority staff report showing how a 2004 tax break allowing U.S. multinationals to get a substantial tax discount for bringing offshore funds back home did not produce new jobs or increased research expenditures to spur economic growth, but was followed instead by increased stock buybacks and executive pay and more investments offshore.

In December 2011, an addendum to that report showed how claims by some multinationals that their offshore funds were “trapped” abroad by high tax rates were untrue, since those corporations were already using an existing tax loophole to place nearly \$250 billion in offshore funds in U.S. banks, U.S. Treasury bonds, and U.S. stocks without triggering any tax liability. The report recommended against enactment of a new repatriation tax break that would benefit only a small percentage of U.S. corporations at the expense of the many domestic companies that do not send funds offshore.

The Levin report showed that the 2004 repatriation tax break enabled U.S. companies to bring \$312 billion in offshore earnings back to the United States at the low tax rate of 5.25 percent. Though the law specified allowable uses of those repatriated funds, and expressly prohibited using repatriated money for stock repurchases or executive pay, it did not require corporations to track their use of repatriated funds and so provided no mechanism to monitor compliance with the law. To determine how the corporations actually used their repatriated funds, the Subcommittee surveyed the 15 corporations that repatriated the most money through qualifying dividends, and an additional four firms that repatriated significant amounts. The top 15 corporations together brought back a total of \$155 billion in offshore earnings, while the additional firms increased that total to \$163 billion, together representing more than half of all funds repatriated as qualifying dividends.

The report contained a number of factual findings with respect to those repatriated funds. First, the report found that the repatriation tax break had failed in its express purpose to increase U.S. jobs. After repatriating \$155 billion, the top 15 repatriating firms reduced their overall U.S. workforce by nearly 21,000 jobs. Second, the report found that the repatriation tax break did not accelerate investments in research and development. Instead, among the top 15 repatriating corporations, the pace of R&D spending slightly decreased after the tax break. Third, the report found that, despite a prohibition on using repatriated funds for stock repurchases, the top 15 repatriating corporations accelerated their spending on stock buybacks after repatriation, increasing them by 16 percent from 2004 to 2005, and 38 percent from 2005 to 2006. Overall, the surveyed corporations more than doubled the amount of their average stock repurchases, from about \$2.2 billion in 2004 to \$5.3 billion in 2007. Moreover, despite a prohibition on using repatriated funds for executive compensation, the report determined that the pay of the top five executives at the top 15 repatriating corporations jumped 27 percent from 2004 to 2005, and another 30 percent from 2005 to 2006. In comparison, average worker pay in the same years increased 3 percent and 11 percent.

The report also presented evidence that the repatriation tax break benefited only a narrow slice of the U.S. economy, primarily pharmaceutical and technology corporations, while providing no benefit to domestic firms that chose not to engage in offshore operations or investments. The report observed that the 5.25 percent tax rate created a competitive disadvantage for domestic businesses that chose not to do business offshore, and provided a windfall for multinationals in a few industries without benefiting the U.S. econ-

omy as a whole. The report also determined that multinationals had significantly increased their offshore cash holdings since the 2004 tax break, indicating that the tax break itself encouraged the offshoring of funds. Finally, the report determined that a substantial share of the repatriated funds came from tax haven jurisdictions such as Bermuda, the British Virgin Islands, the Cayman Islands, and Switzerland, with seven of the surveyed corporations repatriating between 90 and 100 percent of their funds from tax havens. The report concluded that a repeat repatriation tax break would similarly fail to boost jobs or research expenditures, and would instead encourage firms to keep more cash overseas in hopes of future tax breaks.

The report addendum provided new data showing that large multinational U.S. corporations with substantial offshore funds had already placed nearly half of those funds in U.S. bank accounts and U.S. investments without paying any U.S. tax on those foreign earnings. Corporations are able to invest their foreign earnings in the United States without treating them as “repatriated” and subject to taxation, because Section 956(c)(2) of the Federal tax code already allows U.S. corporations to use foreign funds to make a wide range of U.S. investments without incurring tax liability. If those U.S. investments then produce income, that additional income may be subject to taxation.

The addendum’s data derived from a Subcommittee survey of 27 U.S. multinational corporations. The survey disclosed that, collectively, the 27 multinationals held a total of \$538 billion, or more than half a trillion dollars, in tax-deferred foreign earnings at the end of Fiscal Year 2010. By comparison, in mid-2011, all U.S. corporations held tax-deferred foreign earnings totaling an estimated \$1.4 trillion.

The survey determined that 46 percent of that \$538 billion in foreign earnings—almost \$250 billion—was maintained in U.S. bank accounts or invested in U.S. assets such as U.S. Treasuries, U.S. stocks other than their own, U.S. bonds, or U.S. mutual funds. The survey also found that nine of the 27 companies, or one-third, including Apple, Cisco, Google, and Microsoft, held between 75 and 100 percent of their tax-deferred foreign earnings in U.S. assets. The Subcommittee’s survey information was the first to provide specific data on the amount of tax-deferred offshore corporate earnings that are maintained in the United States.

The \$250 billion of foreign funds invested in U.S. assets demonstrated that U.S. corporations were already well aware of the tax code provision allowing them to return foreign earnings to the United States on a tax-free basis. Those tax-deferred foreign earnings were in addition to overall domestic cash holdings of U.S. corporations, which at the time of the report was estimated by the Federal Reserve at \$2 trillion. As a result of the survey data, the addendum concluded that U.S. corporations were already taking advantage of the security and stability of the U.S. financial system without paying U.S. taxes on their offshore funds, and that a new repatriation tax break would raise additional tax fairness issues.

C. U.S. Vulnerabilities to Money Laundering, Drugs, and Terrorist Financing: HSBC Case History, July 17, 2012 (Report Prepared by the Majority and Minority Staffs of the Permanent Subcommittee on Investigations and released in conjunction with the Subcommittee's hearing on July 17, 2012)

In July 2012, the Subcommittee held a hearing, described earlier, examining how a large global bank, HSBC, through its U.S. affiliate, HSBC Bank USA (HBUS), exposed the United States to a wide array of money laundering, drug trafficking, and terrorist financing risks due to poor anti-money laundering (AML) controls. The hearing also examined the failure of the bank's primary regulator, the Office of the Comptroller of the Currency (OCC), to compel HBUS to take corrective action, despite ongoing evidence of the bank's AML deficiencies over a 6-year period. In connection with that hearing, the Subcommittee released a 330-page bipartisan staff report that detailed the investigation, provided factual findings, and offered recommendations to address the problems identified.

The Levin-Coburn report described HBUS' operations and explained how HBUS opened U.S. accounts for HSBC's 80 affiliates around the world. The report also explained that HBUS had a history of poor AML controls, having first been cited, in 2003, with severe AML deficiencies by the Federal Reserve and New York State Banking Department which required the bank to overhaul its AML program. That same year, HBUS converted from a State to a national bank charter, changing its primary regulator to the OCC. The report noted that, in 2010, the OCC also cited HBUS for severe AML deficiencies, identifying, among other issues, the bank's failure to monitor \$60 trillion in wire transfer and account activity; a backlog of 17,000 unreviewed account alerts regarding potentially suspicious activity; and its failure to conduct AML due diligence before opening accounts for HSBC affiliates. The report also noted that, prior to 2010, the OCC had failed to take a single enforcement action against the bank, despite ample evidence of AML problems.

The report focused on five types of AML deficiencies at HBUS which exposed the United States to money laundering, drug trafficking and terrorist financing risks. The first involved HBUS' servicing of high risk HSBC affiliates, using as a case history the U.S. account opened for HSBC Bank Mexico (HBMX). The report detailed evidence indicating that HBUS treated HBMX as a low risk account, despite HBMX's location in a country facing substantial money laundering and drug trafficking challenges; HBMX's high risk clientele which included casas de cambio suspected of involvement with the drug trade; HBMX's high risk products which included offering U.S. dollar accounts in the Cayman Islands, a secrecy jurisdiction, to circumvent a Mexican prohibition on U.S. dollar accounts; and HBMX's long history of weak know-your-customer and other AML controls. The report also described how HBMX transported \$7 billion in physical U.S. dollars to HBUS from 2007 to 2008, outstripping other Mexican banks, even one twice its size, leading regulators to express concern to HBMX that the volume of dollars suggested the presence of illegal drug proceeds. The report showed that, because HBMX was an HSBC affil-

iate, as a policy matter, HBUS had performed no initial due diligence to evaluate its AML risks and conducted no ongoing monitoring of the HBMX account, leaving it in the dark about the account's suspicious activity.

Second, the report presented evidence that some HSBC affiliates had taken actions to circumvent a transaction filter required by the U.S. Office of Foreign Asset Control (OFAC) to identify and block transactions involving known terrorists, persons involved with weapons of mass destruction, drug lords, or rogue jurisdictions such as Iran or North Korea. Because the OFAC filter can delay transactions permitted by law, some HSBC affiliates had developed tactics to bypass it, including by stripping information from wire transfer documents. The report detailed evidence showing that, from at least 2001 to 2007, two HSBC affiliates sent nearly 25,000 transactions involving \$19 billion through their HBUS accounts without disclosing the transactions' links to Iran. In addition, from 2002 to 2007, some HSBC affiliates sent potentially prohibited transactions through HBUS involving Burma, Cuba, North Korea, Sudan, and other prohibited countries or persons. The report indicated that HSBC Group compliance personnel were aware of actions taken by some HSBC affiliates to circumvent the OFAC filter, but failed to stop it or inform HBUS about its extent. The report also described internal HBUS documents which showed that key senior HBUS officials were informed as early as 2001, that the bank was processing undisclosed Iranian transactions from HSBC affiliates.

In the third area of concern, the report presented evidence that HBUS provided U.S. dollars and banking services to some banks in Saudi Arabia and Bangladesh, despite evidence suggesting that the banks had links to terrorist financing. The report detailed, for example, that due to terrorist financing concerns, in 2005, HBUS closed correspondent banking and banknotes accounts it had provided to Al Rajhi Bank, Saudi Arabia's largest private financial institution whose key founder was identified as an early financial benefactor of al Qaeda. For nearly 2 years, HBUS compliance personnel resisted pressure from HSBC personnel in the Middle East and United States to resume business with the bank. In December 2006, however, after Al Rajhi Bank threatened to pull all of its business from HSBC unless it regained access to HBUS' banknotes program, HBUS agreed to resume supplying Al Rajhi Bank with physical U.S. dollars. Despite ongoing troubling information, HBUS provided nearly \$1 billion in U.S. dollars to Al Rajhi Bank until 2010, when HSBC decided, on a global basis, to exit the U.S. banknotes business.

Fourth, the report presented evidence that HBUS was routinely clearing suspicious bulk travelers checks. The report showed that, from at least 2005 to 2008, HSBC cleared \$290 million in U.S. travelers cheques for a Japanese regional bank, Hokuriku Bank, despite evidence of suspicious activity benefiting Russians who claimed to be in the used car business. HBUS cleared the Hokuriku travelers cheques on a daily basis, at times clearing \$500,000 or more in a single day. The cheques were in denominations of \$500 or \$1,000, submitted in large blocks of sequentially numbered cheques, and signed and countersigned with the same illegible sig-

nature. HBUS stopped clearing the cheques only after an OCC examination uncovered stacks of them being processed with inadequate AML controls.

The fifth and final area of concern examined in the report presented evidence of HBUS opening accounts for bearer share corporations, a notorious type of corporation that invites secrecy and wrongdoing by assigning ownership to whomever has physical possession of the shares. The report indicated that, over the course of a decade, HBUS had opened over 2,000 bearer share accounts. At its peak, HBUS' Miami office had over 1,670 bearer share accounts; the New York office had over 850; and the Los Angeles office had over 30. The Miami bearer share accounts alone held assets totaling an estimated \$2.6 billion, generating annual bank revenues of \$26 million. The report noted that multiple internal audits and regulatory examinations had criticized the accounts as high risk and advocated that HBUS either take physical custody of the shares or require the corporations to register the shares in the names of the shareholders, but HBUS bankers initially resisted. The report noted that, by 2011, HBUS had reduced its bearer share accounts to 26, while maintained a policy allowing new accounts.

In addition to describing HBUS' poor AML controls, the report detailed the OCC's failure for many years to compel better performance. The report noted that OCC examiners repeatedly identified key AML deficiencies at the bank, but during the 6-year period from 2004 to 2010, OCC officials did not respond with any formal or informal enforcement actions, essentially allowing the bank's AML problems to fester. The report identified key weaknesses in the OCC's AML oversight efforts that contributed to the agency's tolerating the bank's AML problems, including treating AML deficiencies as a consumer compliance concern instead of a matter of safety and soundness; deeming AML problems to be Matters Requiring Attention by bank management rather than casting them as statutory violations; conducting narrowly focused AML examinations; and ignoring AML examinations that found AML problems year after year. In 2009, after learning of law enforcement investigations raising AML issues at HBUS, the OCC suddenly expanded and intensified an ongoing AML examination at the bank. That examination culminated in a September 2010 OCC supervisory letter identifying severe AML problems and an October 2010 Cease and Desist Order requiring HBUS to revamp its program.

The report recommended that HBUS take a number of steps to strengthen its AML controls, including conducting due diligence reviews of HSBC affiliates to identify AML risks; implementing stronger controls to ensure the bank did not process transactions with prohibited persons such as terrorists, drug lords, and rogue regimes; closing accounts of banks linked to terrorist financing; overhauling its AML controls on travelers cheques; and banning bearer share accounts. HBUS subsequently implemented all but the last of these recommendations, while taking additional steps to strengthen its AML controls, as described earlier.

The report also recommended that the OCC strengthen its AML oversight efforts. One recommendation was that the OCC follow the lead of other Federal regulators in treating AML deficiencies as a threat to a bank's safety and soundness, and lower a bank's man-

agement ratings if AML problems were not resolved. Another was that the OCC cite banks for statutory violations if they failed to meet any one of the four minimum statutory requirements for an effective AML program. In addition, the report recommended that the OCC take stronger action when a bank hit a threshold number of AML statutory violations or Matters Requiring Attention. The OCC subsequently implemented all of those recommendations.

D. Social Security Disability Programs: Improving the Quality of Benefit Award Decisions, September 12, 2012 (Report Prepared by the Minority Staff of the Permanent Subcommittee on Investigations and released in conjunction with the Subcommittee's hearing on September 13, 2012)

In September 2012, the Subcommittee held a hearing, described earlier, examining the quality of decisions by the Social Security Administration (SSA) to award benefits under its disability programs. The hearing was based upon a bipartisan investigation. In connection with the hearing, the Subcommittee released a 132-page minority staff report that detailed the investigation, provided factual findings, and offered recommendations to address the problems identified.

The Coburn report described how the Subcommittee obtained actual case files, with personal information removed, for SSA beneficiaries accepted into the Social Security Disability Insurance (SSDI) or Supplemental Security Income (SSI) program from three specific counties in Virginia, Alabama, and, Oklahoma, reflecting different levels of per capita enrollment in the programs. After the Subcommittee provided selection criteria, SSA randomly selected 300 electronic case files that met the criteria, 100 from each specified county. The cases provided a cross-section of applicants who were awarded disability benefits at different stages of SSA review, including at the initial application stage, the reconsideration stage, upon appeal before an administrative law judge (ALJ), and upon appeal before the Social Security Appeals Council. The report explained that the Subcommittee investigation carefully reviewed each case file to evaluate the decisions reached, the rationale used, the testimony and information provided by the claimant, the objective medical evidence in the file, any expert or physician opinions rendered, and other relevant evidence contained in the case files provided by SSA. The report noted that, by limiting its review to 300 case files from three counties, the Subcommittee was able to drill down into the specifics of each case and provide a detailed case study of how disability approval decisions were made, their weaknesses, and how they could be improved.

The report indicated that the investigation's review of the 300 disability case files found that more than a quarter of agency decisions failed to properly address insufficient, contradictory or incomplete evidence. The report noted that this finding corroborated a new 2011 internal quality review conducted by SSA itself, which found that, on average nationwide, disability decisions made at the ALJ level had errors or were insufficient 22 percent of the time. The three counties examined by the Subcommittee were in regions with even higher individual error rates, according to SSA, of between 23–26 percent.

Citing specific information from the 300 case files, the report presented evidence regarding procedural problems in how some of the cases were handled by the SSA ALJs. The report presented evidence, for example, that some SSA ALJs held perfunctory hearings lasting less than 10 minutes, misused testimony provided by vocational or medical experts, or failed to elicit hearing testimony needed to resolve conflicting information in a claimant's case file. In other cases, disability applicants, usually through their representatives, submitted medical evidence immediately before or on the day of an ALJ hearing or after the hearing's conclusion, a practice leading to confusion about the supporting evidence as well as inefficiencies in case analysis. Still another problem was that, in many cases before the ALJs, consultative examinations (CEs) submitted on behalf of either SSA or a claimant consisted of little more than conclusory statements with insufficient reference to objective medical evidence or how the CE's findings related to other evidence in the case file. In addition, in written decisions, the report found that the consultative examinations were either summarily dismissed or heavily relied upon, with little to no explanation.

The report identified other problems with the quality of the written decisions awarding disability benefits. Again citing information from specific case files, the report presented evidence that, in many cases, at both the initial and appellate levels of review, the State-based Disability Determination Services (DDS) examiners and SSA ALJs issued decisions approving disability benefits without citing adequate, objective medical evidence to support the finding; without explaining the medical basis for the decision; without showing how the claimant met basic listing elements; or at times without taking into account or explaining contradictory evidence. The report described, in particular, cases in which the ALJ opinion failed to demonstrate how the claimant met each of the required criteria in the SSA's Medical Listing of Impairments to qualify under "Step Three" in the application process. Awards at Step Three are reserved for those with medical conditions SSA has determined to be severe enough to qualify an applicant for benefits.

The report also found that the majority of disability awards reviewed by the Subcommittee at the ALJ level utilized SSA medical-vocational grid rules. The report observed that a recent SSA analysis had found that benefit awards were made under these grid rules at a rate of 4 to 1, compared to awards made due to a claimant's meeting a medical listing. The report presented evidence that, at times, those decisions were the result of a claimant's representative and the ALJ negotiating an award of benefits by changing the disability onset date to the claimant's 50th or 55th birthday. Still another problem was that some case files showed DDS examiners and ALJs reached their decisions after relying on the Department of Labor's outdated Dictionary of Occupational Titles (DOT), which SSA was in the process of replacing with a new Occupational Information System, to identify jobs open to claimants with limited disabilities. The report noted that the last major revision to the DOT had occurred in 1977, yet the new database was not expected to be ready until 2016. The report noted that, in the meantime, SSA disability decisionmakers would continue to rely on the DOT which did not reflect current labor market trends or jobs available in the

national economy. Finally, the report noted that ALJ decisions had failed in some cases to adequately analyze the effect of factors such as obesity and drug and alcohol abuse on a claimant's impairment.

The report provided a number of recommendations to strengthen the decisionmaking process used to award disability benefits. First, it recommended requiring a government representative at all ALJ hearings to ensure key evidence and issues were properly presented, to reduce instances in which SSA ALJs overlooked evidence indicating a claimant was not disabled, and to increase consistency and accountability in ALJ decisionmaking. The report also recommended strengthening the new ALJ quality review process by conducting more reviews of ALJ decisions during the year and developing metrics to measure the quality of disability decisions. To eliminate confusion, inefficiencies, and abuses associated with the SSA practice of allowing medical evidence to be submitted at any point in a disability case, the report recommended closing the evidentiary record 1 week prior to an ALJ hearing, with exceptions only for significant new evidence for which exclusion would be contrary to the public interest. The report also recommended additional training for ALJs on the use of SSA Medical Listings, and on how to analyze and address issues involving drug and alcohol abuse. Another recommendation was for SSA to move more quickly in replacing the outdated Dictionary of Occupational Titles with a usable Occupational Information System to ensure decisionmakers had accurate information about available jobs. The report also recommended that the SSA consult with ALJs to improve the usefulness of agency-funded consultative examinations (CEs), including by requiring an explanation of any significant disparity between a CE's analysis and other evidence in the case file. Finally, the report advocated reviewing the SSA's medical-vocational guidelines to determine if reforms are needed.

E. Federal Support For and Involvement In State and Local Fusion Centers, October 3, 2012 (Report Prepared by the Majority and Minority Staffs of the Permanent Subcommittee on Investigations)

In October 2012, following a 2-year investigation at the request of Senator Coburn, the Subcommittee released a 107-page bipartisan staff report finding that Federal funding provided by the Department of Homeland Security (DHS) to State and local intelligence "fusion centers" had not yielded significant useful information to support Federal counterterrorism efforts. Among other problems, the Coburn-Levin report showed that the fusion centers produced intelligence that was of uneven quality, was often untimely, and sometimes endangered civil liberties, and showed that DHS did not effectively monitor the use of Federal funds provided to State and local fusion centers, which sometimes made questionable expenditures. In addition, the report determined that senior DHS officials were aware of the problems hampering effective counterterrorism work with the fusion centers, but did not always inform Congress of the issues, nor ensure the problems were fixed in a timely manner.

The report noted that, since 2003, over 70 State and local fusion centers, supported in part with Federal funds, had been created or

expanded in part to strengthen U.S. intelligence capabilities, particularly to detect, disrupt, and respond to domestic terrorist activities. The report also observed that DHS' support for State and local fusion centers had, from the beginning, centered on their professed ability to strengthen Federal counterterrorism efforts. In addition, the report noted that, while fusion centers may provide valuable services in fields other than terrorism, such as contributing to traditional criminal investigations, public safety, or disaster response and recovery efforts, the Subcommittee investigation had focused on the Federal return from investing in State and local fusion centers using the counterterrorism objectives established by law and DHS.

The report described the Subcommittee's investigative efforts, which included interviewing dozens of current and former Federal, State and local officials, reviewing more than a year's worth of intelligence reporting from fusions centers, conducting a nationwide survey of fusion centers, and examining thousands of pages of financial records and grant documentation.

The report presented evidence, using examples taken from DHS intelligence reports based upon fusion center information, that DHS intelligence officers assigned to State and local fusion centers produced intelligence of uneven quality—oftentimes shoddy, rarely timely, sometimes endangering civil liberties, occasionally taken from already-published public sources, and more often than not unrelated to terrorism. The report explained that, despite reviewing 610 intelligence reports from April 1, 2009 to April 30, 2010, the Subcommittee investigation could identify no fusion center reporting which uncovered a terrorist threat or contributed to the disruption of an active terrorist plot. Moreover, the report disclosed that nearly a third of the reports—188 out of 610—were never published for use within the intelligence community, often because they lacked useful information or potentially violated DHS guidelines to safeguard Americans' civil liberties or Privacy Act protections.

The report further noted that DHS officials' public claims about fusion centers were not always accurate. It observed, for example, that DHS officials had asserted that some fusion centers existed when they did not, and had, at times, overstated fusion center successes. The report also revealed that DHS officials had initially failed to disclose an extensive, non-public evaluation of the State and local fusion centers, conducted in 2010, which had identified problems at both the centers and DHS. The report noted that, even when asked about that 2010 evaluation, DHS had avoided acknowledging it, initially withheld documents, and repeatedly resisted information requests, unnecessarily prolonging the Subcommittee investigation.

Finally, the report presented evidence of problems related to Federal spending on State and local fusion centers. The report disclosed that DHS was unable to provide an accurate tally of how much it had granted to States and cities to support fusion centers over time, and instead produced estimates indicating that it had spent somewhere between \$289 million and \$1.4 billion since 2003, broad estimates that differed by over \$1 billion. The report showed that DHS was also unable to specify the amount of Federal funds provided to individual fusion centers. In addition, the report de-

tailed evidence showing that DHS did not effectively monitor how Federal funds were used to strengthen fusion center counterterrorism efforts and often did not even track how the funds were ultimately spent. A review of the expenditures at five fusion centers found that Federal funds were used to purchase dozens of flat screen TVs, two sport utility vehicles, cell phone tracking devices, and other surveillance equipment unrelated to the analytical mission of fusion centers, which are not charged with collecting intelligence. The report noted that, at the same time, according to DHS assessments, the fusion centers making the questionable expenditures lacked basic intelligence capabilities.

The report provided a number of recommendations to address the problems uncovered in connection with State and local fusion centers. They included urging Congress to revisit the stated purpose of providing Federal support to DHS fusion centers, and requiring DHS either to conform its fusion center efforts to match its counterterrorism statutory purpose, or redefine its fusion center mission. The report also recommended that DHS reform its intelligence reporting efforts at State and local fusion centers to eliminate duplication and improve training of DHS intelligence reporters. In the area of funding, the report recommended that DHS track how much money it gave to each fusion center, strictly align grant funding to meet Federal needs and reflect a fusion center's value and performance, and not allow Federal funds to be spent on items that did not directly contribute to the Federal counterterrorism mission. The report also recommended that the Program Manager for the Information Sharing Environment in the office of the Director of National Intelligence conduct regular evaluations of fusion center capabilities and performance. Finally, the report recommended that DHS strengthen its practices and guidelines to protect civil liberties, prevent DHS personnel from improperly collecting and retaining intelligence on Constitutionally protected activity, prohibit the retention of inappropriate and illegal reporting, and promptly bar poorly performing personnel from issuing domestic intelligence reports involving Americans.

V. 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 112th Congress, the Subcommittee requested a number of reports and studies on issues of importance. Several 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. *Tax Administration: IRS's Information Exchanges with Other Countries Could Be Improved through Better Performance Information (GAO-11-730), September 9, 2011*

For over a decade, the Subcommittee has conducted investigations into various aspects of offshore tax abuses which are estimated to cost the U.S. treasury at least \$100 billion in unpaid taxes each year. Subcommittee investigations have included exam-

ining the difficulties often encountered by the IRS in obtaining information from offshore tax havens with secrecy laws. In September 2011, in response to a bipartisan request from Subcommittee Chairman Levin and Ranking Minority Member Coburn, GAO prepared a report examining the current status of U.S. tax information exchange arrangements with other countries, including the number and types of tax treaties and agreements in effect, the volume of information exchange activity, and the amount of time taken to process information requests. The GAO report disclosed that the IRS had a mixed record on using international tax agreements to combat offshore tax abuse. On the positive side, the GAO report disclosed for the first time that the IRS had established automatic information exchange arrangements with 25 countries and, in 2010, used those arrangements to obtain over 2 million data items on U.S. taxpayers with offshore income. Aside from that automatic information exchange, however, the GAO report also disclosed that the IRS initiated only a couple hundred specific requests for taxpayer information per year from other countries.

The GAO report explained that, in response to the trillions of dollars in cross-border financial activity, U.S. and other tax authorities around the world had established mechanisms to exchange information with each other to administer and enforce compliance with their respective tax laws. To study those arrangements, GAO collected information on existing U.S. tax information exchange agreements, analyzed IRS data on information exchanges, and interviewed program officials and the users of exchanged information.

The GAO report determined that, as of April 30, 2011, the United States had in force 143 tax treaties, tax information exchange agreements, or mutual legal assistance treaties including tax provisions with 90 foreign jurisdictions. The report provided a list and the key features of each of those agreements. GAO determined that, while the agreements had many similar features, the specifics of each information exchange were unique to the legal and administrative arrangements agreed to by the United States and each signatory jurisdiction.

To analyze the information exchanges under the agreements, GAO reviewed 5 years of data supplied by the IRS division of Exchange of Information and Overseas Operations on tax information requests initiated and completed between 2006 and 2010. GAO explained that tax information exchange partners may choose to provide information to each other on a regular basis, through what is referred to as an automatic exchange of information. The GAO report found that in 2010 alone, as a result of automatic data exchange arrangements with 25 foreign jurisdictions, the IRS received about 2.1 million data items from those countries, while providing about 2.5 million data items to them. GAO reported that the automatic information exchanges typically provided data on wages, interest, dividends, or other forms of income paid to persons from a specified country.

GAO also reviewed one-time only tax information requests made by either the IRS to another country, referred to as outgoing requests, or by a foreign country to the IRS, referred to as incoming requests. The number of those outgoing and incoming requests was

relatively small compared to the number of data exchanges taking place on an automated basis. Over the 5-year period from 2006 to 2010, GAO found that the IRS initiated a total of about 900 tax information requests to other countries, ranging from a low of 165 to a high of 236 requests made in a single year. GAO noted that each request could have referred to one or multiple taxpayers. GAO's figures indicated that, on average over the 5-years, the IRS sent less than one specific request for taxpayer information per day to a foreign country.

During the same 5-year period, GAO found that, outside of the automated process, foreign jurisdictions made a total of about 4,200 specific tax information requests to the IRS, resulting in more than four times as many incoming as outgoing requests. GAO's figures indicated that, on average over the 5-year period, the 90 jurisdictions collectively made about 840 requests per year, or less than 3 requests per day to the United States.

GAO also reported that, of the 900 outgoing requests and 4,200 incoming requests, 711 involved a single foreign jurisdiction, which was not named in the report due to IRS confidentiality rules. GAO also noted that the request activity was concentrated among a small group of countries, with the ten most active countries making roughly 68 percent of the outgoing and incoming requests. Those ten countries were also not named due to IRS confidentiality rules.

The GAO report determined that, over the 5-year period, foreign jurisdictions made about 300 spontaneous disclosures of taxpayer information to the IRS per year, meaning the information was provided outside of any automatic or specific request process. GAO reported that the IRS made about 10 spontaneous disclosures of taxpayer information per year to other countries. GAO stated those numbers fluctuated widely by year.

In addition to analyzing the number of requests, GAO examined how long it took to complete work on the requests. Overall, GAO found that most requests took between 50 and 200 days to complete, although some took much less time and others much longer. GAO also found that, on average, the IRS was 17 percent faster than other countries in completing requests. GAO also analyzed the types of information requested, finding that corporate records, tax return data, bank records, public records, and third-party interviews were the most frequently requested.

One key issue that the Subcommittee asked GAO to examine was the extent to which international requests for tax information were required to include the names of specific taxpayers. GAO reported that, as a general rule, the IRS and its tax information exchange partners did not make or respond to information requests lacking specific taxpayer names or other specific taxpayer identifiers, such as account numbers. GAO also reported that the United States had made a recent policy change to support information requests that identify a specific group of persons under investigation. GAO reported that, in January 2011, the United States changed its standard tax information exchange agreement to provide that an information request was adequate if it contained "the identity of the person or [an] ascertainable group or category of persons under examination or investigation." GAO noted that the United States was working with other nations to adopt a similar approach in the

internationally accepted model tax information exchange agreement.

The GAO report also commented on the IRS data collection efforts with respect to its tax information exchanges with foreign jurisdictions. GAO observed that the IRS did not consistently collect or analyze performance data, such as the type of information requested, whether the information was collected successfully, or the views of staff about the usefulness of the information received or the effectiveness of the process for obtaining it. GAO noted that collecting this information could help program managers assess how well the IRS is managing the information exchange process, and how to strengthen it.

To improve IRS tax information exchange arrangements, GAO recommended that the IRS identify, assemble, and analyze key performance data to improve the information exchange program. GAO recommended that the IRS collect on a routine basis consistent and accurate data on specific tax information exchange cases, as well as feedback from program users. The report indicated that the IRS concurred with GAO's recommendations.

B. Crop Insurance: Savings Would Result from Program Changes and Greater Use of Data Mining (GAO-12-256), March 13, 2012

In the 111th Congress, the Subcommittee conducted an investigation into excessive speculation in U.S. wheat markets, which touched in part on the functioning of the Federal crop insurance program. In March 2012, in response to a request from Subcommittee Ranking Member Coburn, GAO issued a report examining ways to reduce Federal crop insurance costs. Program costs include subsidies that pay for part of farmers' insurance premiums. According to the Congressional Budget Office, for fiscal years 2013 through 2022, Federal crop insurance program costs—primarily premium subsidies—will average \$8.9 billion annually. The GAO report determined that, if a limit of \$40,000 had been applied to individual farmers' crop insurance premium subsidies, as it is for other farm programs, the Federal Government would have saved up to \$1 billion in crop insurance program costs in 2011. GAO also determined that, if premium subsidies had been reduced by 10 percentage points for all farmers participating in the program, as recent studies had proposed, the Federal Government would have saved about \$1.2 billion in 2011. In addition, GAO determined that additional cost savings could be achieved through greater use of data mining efforts to prevent and detect waste, fraud and abuse in the program.

The U.S. Department of Agriculture (USDA) administers the Federal crop insurance program with private insurance companies. In 2011, the program provided about \$113 billion in Federal crop insurance coverage for over 1 million policies. To conduct its study, GAO analyzed USDA data, reviewed economic studies, and interviewed USDA officials.

The GAO report explained that, to analyze possible cost savings from limiting premium subsidies, it selected \$40,000 as an example of a potential subsidy limit on individual farmer crop insurance premium subsidies, because it is the limit for direct payments,

which provide fixed annual payments to farmers based on a farm's crop production history. GAO determined that if such a limit had been applied in 2011, it would have affected up to 3.9 percent of all participating farmers, who accounted for about one-third of all premium subsidies and were primarily associated with large farms. For example, one of those farmers insured crops in eight counties and received about \$1.3 million in premium subsidies. In addition, GAO determined that if premium subsidies been reduced by 10 percentage points for all farmers participating in the program, as recent studies proposed, the Federal Government would have saved about \$1.2 billion in 2011. GAO also cautioned that a decision to limit or reduce premium subsidies would raise other considerations, such as the potential effect on the financial condition of large farms and on program participation.

On the issue of whether cost savings could be achieved through greater use of data mining tools, the GAO report noted that USDA had already been using data mining tools to prevent and detect fraud, waste, and abuse in the crop insurance program, whether perpetrated by farmers, insurance agents, or adjusters, since 2001. GAO explained, for example, that past cases had revealed that some farmers were found to have harvested a high-yielding crop, hid its sale, and then reported a loss to receive an insurance payment. To prevent and detect those and other frauds, GAO explained that USDA's Risk Management Agency (RMA), which is responsible for overseeing the integrity of the crop insurance program, used data mining to identify farmers who had received claim payments that were higher or more frequent than others in the same area. USDA then informed the identified farmers that at least one of their fields would be inspected during the coming growing season to evaluate the crop. RMA officials told GAO that this action had substantially reduced total claims.

GAO opined that the USDA had not maximized its use of the data mining tools, however, largely because of competing compliance review priorities. GAO determined, for example, that the value of RMA's identifying suspect farmers may have been reduced by the fact that USDA's Farm Service Agency (FSA)—which conducts field inspections for RMA—did not complete all such inspections, and neither FSA nor RMA had a process to ensure that the results of all inspections were accurately reported. GAO noted, for example, that RMA did not obtain field inspection results for about 20 percent of identified farmers in 2009, and 28 percent in 2010. As a result, not all of the farmers RMA identified were subject to a review, increasing the likelihood that fraud, waste, or abuse occurred without detection.

GAO determined that not all field inspections were completed, in part because FSA State offices were not required to monitor the completion of such inspections. In addition, RMA generally did not provide insurance companies with FSA inspection results when crops were found to be in good condition, although USDA's Inspector General had reported this information might be important for followup. Furthermore, RMA had not directed insurance companies to review the results of all completed FSA field inspections before paying claims filed after inspections showed a crop was in good condition. As a result, GAO found that insurance companies might

not have information that could help identify claims that should be denied.

To reduce crop insurance program costs, GAO recommended that Congress consider limiting premium subsidies for individual farmers, reducing subsidies for all farmers, or both. GAO also recommended that USDA encourage the completion of field inspections to reduce instances of waste, fraud and abuse in the crop insurance program. GAO indicated in the report that USDA agreed with encouraging the completion of field inspections, but not with placing limits on premium subsidies. GAO indicated in response that, when farm income was approaching record high levels at the same time the Nation faced severe fiscal problems, limiting premium subsidies was an appropriate area for consideration.

C. Medicaid: Providers in Three States with Unpaid Federal Taxes Received Over \$6 Billion in Medicaid Reimbursements (GAO-12-857), July 27, 2012

Since 2004, the Subcommittee has conducted an ongoing investigation and series of hearings examining Federal contractors that receive taxpayer funds in payment for their work, but nevertheless fail to pay their taxes. In 2007, a Subcommittee hearing focused on the problem with respect to tax delinquent Medicaid providers who are paid in part with Federal funds. The 2007 hearing featured a GAO report which disclosed, in a review of just seven States, that nearly 30,000 Medicaid providers, including doctors, nursing homes, and other medical providers, owed unpaid taxes collectively totaling more than \$1 billion. In July 2012, in response to a bipartisan request from Subcommittee Chairman Levin and Ranking Minority Member Coburn, Finance Committee Chairman Max Baucus and Ranking Minority Member Orrin Hatch, and Judiciary Committee Ranking Minority Member Charles Grassley, GAO again examined Medicaid providers with unpaid taxes, this time in the context of the American Recovery and Reinvestment Act of 2009 (ARRA) which had increased the Federal share of Medicaid funding provided to the States. The GAO report disclosed that about 7,000 Medicaid providers in three States, Florida, New York, and Texas, received a total of about \$6.6 billion in Medicaid reimbursements in 2009, while owing over \$790 million in unpaid Federal taxes.

Federal law does not currently prohibit health care providers with tax debt from enrolling in Medicaid. To determine the magnitude of unpaid taxes owed by Medicaid providers who received ARRA funding, GAO compared Medicaid reimbursement information from the three States to known IRS tax debts as of September 30, 2009. The three States were among those that received the largest portion of ARRA's increased Federal funding of Medicaid.

The GAO report determined that about 7,000 Medicaid providers in the three selected States owed approximately \$791 million in unpaid Federal taxes from calendar year 2009 or earlier. GAO also determined that those tax delinquents represented about 5.6 percent of all Medicaid providers reimbursed by the selected States during 2009. In addition, GAO calculated that the 7,000 Medicaid providers with unpaid taxes received a total of about \$6.6 billion in Medicaid reimbursements during 2009, including both ARRA

and other sources of Medicaid funds. GAO cautioned that the amount of unpaid Federal taxes GAO identified was likely understated because Internal Revenue Service (IRS) taxpayer data reflected only the amount of unpaid taxes either reported on a tax return or assessed by IRS through enforcement; it did not include entities that did not file tax returns or underreported their income.

The GAO report provided additional detail about 40 individual Medicaid providers from the three selected States, each of whom had at least \$100,000 in Federal tax debt. GAO determined that those 40 Medicaid providers received a total of about \$235 million in Medicaid reimbursements (including ARRA funds) in 2009, while owing unpaid Federal taxes of about \$26 million through 2010. The amount of unpaid taxes ranged from about \$100,000 to over \$6 million per provider. GAO also disclosed that IRS records indicated that two of the providers were or had previously been under criminal investigation, and that one provider had been caught participating in a medical billing fraud.

The GAO report explained that in the case of most Federal contractors with unpaid taxes, the IRS had the authority to seize or "levy" all or a portion of any Federal payment made to them, to satisfy their tax debt and, in some instances, was authorized to use an automated process to continuously levy any Federal payments made to those delinquent taxpayers. GAO also explained that Medicaid reimbursements had never actually been subject to a continuous levy, because the IRS had determined that Medicaid reimbursements did not qualify as Federal payments, since they also included State funds. If the Federal levy process could be used, the GAO report estimated that the IRS could have collected between \$22 million and \$330 million in the selected States in 2009, from the tax delinquent Medicaid providers. States contacted by GAO, however, expressed concerns about using continuous levies, given the challenges they already encounter with processing one-time IRS levies. The States described, for example, problems with reaching IRS revenue officers and with the IRS sending levy notices to the wrong address.

To recover funds from Medicaid providers with unpaid taxes, GAO recommended that the IRS explore opportunities to enhance collection efforts, including through the use of continuous levies. The report indicated that the IRS agreed with GAO's recommendation.

D. Income Security: Overlapping Disability and Unemployment Benefits Should be Evaluated for Potential Savings (GAO-12-764), July 31, 2012

Since 2009, the Subcommittee has conducted an ongoing investigation into waste, fraud, and abuse in Federal disability programs. In July 2012, in response to a bipartisan request from Subcommittee Chairman Levin and Ranking Minority Member Coburn, as well as from Chairman Tom Carper and Ranking Minority Member Scott Brown of the Subcommittee on Federal Financial Management, Government Information, Federal Services and International Security, GAO examined the interaction of Federal Disability Insurance (DI) payments which are intended to support disabled persons incapable of working at a full-time job, and State-op-

erated Unemployment Insurance (UI) payments, which are intended to support persons who are ready and willing to work. The GAO report disclosed that, in Fiscal Year 2010, 117,000 individuals received concurrent DI and UI payments totaling more than \$850 million, and that, under existing program authority, such concurrent payment were allowable in certain circumstances.

Both the disability and unemployment insurance programs are paid for by money deducted from worker paychecks and sent to DI and UI trust funds. The GAO report explained that DI payments were made available to workers who were unable to engage in "substantial gainful activity," due to disabling physical or mental impairments. In contrast, UI payments were designed to provide temporary cash benefits to eligible workers able to work but involuntarily unemployed. The GAO report explained that both the DI and UI trust funds faced serious fiscal sustainability challenges, which could be relieved in part if overlapping DI and UI payments were reduced.

GAO was asked to determine the extent to which individuals across the country received DI and UI benefits concurrently. To do so, GAO matched State unemployment files with Social Security Administration (SSA) disability files for Fiscal Year 2010. GAO determined that only a small fraction of the program beneficiaries received dual benefits from both programs. In Fiscal Year 2010, 10 million individuals received disability benefits totaling \$122 billion, while 11 million individuals received unemployment benefits totaling \$156 billion. GAO found that individuals receiving benefits from both programs accounted for one-third of 1-percent of the benefits paid, creating an overlap of substantially less than 1 percent, but even that small overlap involved payments totaling \$281 million from the disability program and \$575 million from the unemployment insurance program, for a total of \$850 million. GAO also identified one individual who had received over \$62,000 in overlapping benefits in a year.

GAO cautioned that, under certain circumstances, individuals may be eligible for concurrent benefit payments due to differences in DI and UI eligibility requirements. Disability insurance is available to workers who are unable to perform "substantial gainful activity" due to physical or mental impairments expected to last at least 12 months or result in death. Regulations have generally defined "substantial gainful activity" to mean an individual with the ability to earn an average of over \$1,000 a month for a calendar year. Put another way, a person whose disability prevents them from earning over \$1,000 a month is still eligible to receive disability benefits even if they perform some part-time work. If a disabled person has a part-time job, loses that job, and collects unemployment insurance, no Federal law currently requires a reduction of their disability payments due to their receipt of unemployment benefits.

State-run unemployment insurance programs temporarily and partially replace lost earnings for workers who have lost their job through no fault of their own. To collect benefits, an individual must be able to perform suitable work when offered. While all unemployment insurance programs must conform to broad Federal guidelines, specific program eligibility is set on a State by State

basis and varies widely. The GAO report did not identify any State that prohibited the payment of unemployment benefits to a person already receiving disability insurance, and reported that at least 10 States had enacted laws providing that no worker may be considered ineligible for UI benefits due to illness or disability occurring after the worker filed a UI claim. The result was that States generally allowed a disabled person who lost a part-time job to collect unemployment benefits, provided that UI deductions had been taken from their paychecks. GAO also explained that, while SSA must reduce DI benefits for individuals receiving certain other government disability benefits, such as worker's compensation, no Federal law required or authorized an automatic elimination of overlapping DI and UI benefits. The GAO report noted that, as a result, neither SSA nor DOL had any procedures to identify overlapping payments.

GAO indicated that reducing or eliminating overlapping payments could offer substantial savings to DI and UI programs, but noted that actual savings were difficult to estimate since the potential costs of establishing mechanisms to do so were not readily available. GAO recommended that DOL and SSA work together to evaluate overlapping DI and UI cash benefit payments and take appropriate action to stop any improper payments. GAO also recommended that the agencies evaluate the fiscal sustainability of the DI and UI trust funds. GAO indicated that DOL and SSA agreed with both recommendations.

E. Border Security: Additional Actions Needed to Strengthen CBP Efforts to Mitigate Risk of Employee Corruption and Misconduct (GAO-13-59), December 4, 2012

Over the years, the Subcommittee has conducted investigations into border security issues and corruption issues. In December 2012, in response to a request from Subcommittee Ranking Minority Member Coburn as well as Congressman Michael McCaul, Chairman of the Subcommittee on Oversight, Investigations, and Management of the House Committee on Homeland Security, GAO prepared a report examining efforts by the U.S. Customs and Border Protection (CBP), a component of the Department of Homeland Security, to combat corruption and ensure the integrity of the CBP workforce.

CBP is responsible for securing U.S. borders and facilitating legal travel and trade. CBP employees have been targeted by drug-trafficking and other transnational criminal organizations offering bribes to facilitate the illicit transport of drugs, aliens, and other contraband across U.S. borders, particularly in the southwest. CBP's Office of Internal Affairs (IA) is responsible for promoting the integrity of CBP's workforce, programs, and operations. Other CBP components are responsible for implementing IA integrity initiatives. GAO was asked to examine data on arrests of and allegations against CBP employees for corruption or misconduct; CBP's implementation of integrity-related controls; and CBP's strategy to combat corruption. To conduct its study, GAO analyzed arrest and allegation data, reviewed integrity-related policies and procedures, and interviewed CBP officials in headquarters and at four locations along the southwest border.

The GAO report determined that CBP data indicated that arrests of CBP employees for corruption-related activities since Fiscal Year 2005 accounted for less than 1 percent of CBP's entire workforce per fiscal year. GAO determined that the majority of arrests of CBP employees, from Fiscal Year 2005 through Fiscal Year 2012, were related to misconduct, identifying 2,170 reported incidents of arrests for such misconduct as domestic violence or driving under the influence. GAO also determined that a total of 144 current or former CBP employees had been arrested or indicted for corruption-related activities, such as the smuggling of aliens and drugs, of whom 125 had been convicted as of October 2012. In addition, GAO determined that the majority of allegations against CBP employees since Fiscal Year 2006 occurred at locations along the southwest border. GAO reported that CBP officials indicated they were concerned about the negative impact that those cases had on agency-wide integrity.

The GAO report also described CBP's integrity-related controls. GAO explained that CBP employed screening tools to mitigate the risk of employee corruption and misconduct for both applicants—using such tools as background investigations and polygraph examinations—and incumbent CBP officers and Border Patrol agents—using such tools as random drug tests and periodic re-investigations. GAO reported, however, that CBP's Office of Internal Affairs (IA) did not have a mechanism to maintain and track data on which of its screening tools provided information used to determine which applicants were not suitable for hire. GAO indicated that maintaining and tracking such data was consistent with internal control standards and could better position CBP IA to gauge the relative effectiveness of its screening tools.

GAO also reported that CBP IA was considering requiring periodic polygraphs for incumbent officers and agents; however, it had not yet fully assessed the feasibility of expanding the program. GAO explained that CBP had not yet fully assessed, for example, the costs of implementing polygraph examinations on incumbent officers and agents, including the costs for additional supervisors and adjudicators, or assessed the tradeoffs among periodic tests at various frequencies. GAO indicated that a feasibility assessment of program expansion could better position CBP to determine whether and how to best achieve its goal of strengthening integrity-related controls for officers and agents. GAO noted further that CBP IA had not consistently conducted monthly quality assurance reviews of its adjudications since 2008, as required by internal policies, to help ensure that adjudicators are following procedures in evaluating the results of the preemployment and periodic background investigations. GAO reported that CBP IA officials indicated they had performed some of the required checks since 2008, but could not provide data on how many checks were conducted. GAO reported that, without these quality assurance checks, it was difficult for CBP IA to determine the extent to which deficiencies, if any, existed in the adjudication process.

The GAO report determined that CBP did not have in place an integrity strategy, as called for in its Fiscal Year 2009–2014 Strategic Plan. GAO reported that, during the course of the review, CBP IA began drafting a strategy, but CBP IA's Assistant Commis-

sioner indicated that the agency had not yet set target timelines for completing or implementing the strategy. GAO reported that the Assistant Commissioner also stated that there had been significant cultural resistance among some CBP components to acknowledging CBP IA's authority to oversee all integrity-related activities. GAO indicated that setting target timelines would be consistent with program management standards and could help CBP monitor progress made toward the development and implementation of an agency-wide integrity strategy.

The GAO report recommended, among other measures, that CBP track and maintain data on sources of information used to determine which applicants were unsuitable for hire, assess the feasibility of expanding the polygraph program to incumbent officers and agents, consistently conduct quality assurance reviews, and set timelines for completing and implementing a comprehensive integrity strategy. The report indicated that DHS concurred with the recommendations and reported taking steps to address them.