FINANCIAL SERVICES AND GENERAL GOVERNMENT APPROPRIATIONS FOR 2010

HEARINGS

BEFORE A

SUBCOMMITTEE OF THE

COMMITTEE ON APPROPRIATIONS

HOUSE OF REPRESENTATIVES

ONE HUNDRED ELEVENTH CONGRESS

FIRST SESSION

SUBCOMMITTEE ON FINANCIAL SERVICES AND GENERAL GOVERNMENT APPROPRIATIONS

JOSÉ E. SERRANO, New York, *Chairman*

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NOTE: Under Committee Rules, Mr. Obey, as Chairman of the Full Committee, and Mr. Lewis, as Ranking Minority Member of the Full Committee, are authorized to sit as Members of all Subcommittees.

DAVID REICH, BOB BONNER, LEE PRICE,
KARYN KENDALL, and ANDRIA OLIVER,
Subcommittee Staff

PART 5

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Federal Communications Commission	**125**

Printed for the use of the Committee on Appropriations

Part 5

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FINANCIAL SERVICES AND GENERAL GOVERNMENT APPROPRIATIONS FOR 2010

WEDNESDAY, MARCH 11, 2008.

SEC ACTIONS RELATING TO THE FINANCIAL CRISIS

WITNESS

MARY L. SCHAPIRO, CHAIRMAN, U.S. SECURITIES AND EXCHANGE COMMISSION

SUBCOMMITTEE INTRODUCTION

Mr. SERRANO. What we are going to do is upset the camera view only by taking a little time to welcome the members of the subcommittee.

This is our first official hearing of the subcommittee for the year, and I am very pleased to welcome Mrs. Emerson as our Ranking Member to the subcommittee. She and I have worked on many issues before, and if I had to choose a Ranking Member this session, she would have been the one. So the Republican leadership listened to me.

We also want to just say that on our side, I believe there is one returning member, and all the others chose to go to the Defense subcommittee. I cannot blame them—or maybe they knew that any subcommittee that has the name "Financial Services" in it is one that you either have a lot of fun with or that you stay far away from during this time.

Debbie Wasserman Schultz, from the State of Florida, is with us. We have Rosa DeLauro from Connecticut, Mr. Chet Edwards from the great State of Texas, Allen Boyd from Florida, Chaka Fattah from Pennsylvania, Barbara Lee from California, and Adam Schiff from California.

So, on this side, there is one New Yorker, two from Florida, two from California. I am outnumbered, but as you well know, I have the gavel.

Would you like to speak to the subcommittee?

Mrs. EMERSON. Thank you, Mr. Chairman. We have one returning member, Mr. Kirk, Mark Kirk, from Illinois. John Culberson from Texas is also on the subcommittee, and we have Ander Crenshaw from Florida. So we actually have three Floridians who outnumber us, I suppose.

I also would like to introduce my staff: John Martens, who is our Minority Staff Director, and Justin Rone from my office who handles all of our work on financial services issues and who is our counsel.

Mr. SERRANO. They are all on Facebook.

Mrs. EMERSON. I do not know. I do not belong to Facebook, so I have not ever gone and looked.

Mr. SERRANO. You should try. I just told them I am on TV at 10 o'clock, and they are all watching.

We have our committee clerk, David Reich, who is sitting over to my right. Bob Bonner and Karyn Kendall also work on the subcommittee, and Ed O'Kane is right here behind me. Lee Price is over to my right. Everybody is to my right. There is Andria Oliver, who is to my left.

We want to take this opportunity to welcome all of you. This is, unfortunately, an exciting time to be chairing this committee, and I say "unfortunately" because we wish it were during wonderful times. What we will be doing during the next 2 years will be very difficult, and the role that I see for this committee, Mrs. Emerson and members, I think was best said by Barney Frank, the Chairman of the Financial Services Committee, when he said, "I authorize it and Serrano has to pay for it."

It is more than pay for it. We also have to supervise it and we have to oversee it, and it is our oversight role in the Appropriations Committee that, I think, will play a major role in what we do this year. These will be exciting times, and I look forward to working with all of you to do the right thing for our country.

CHAIRMAN SERRANO'S OPENING STATEMENT

I welcome you to this hearing of the Financial Services and General Government Subcommittee. Today, the subcommittee will hear testimony from the Chairman of the Securities and Exchange Commission, the Honorable Mary Schapiro. Chairman Schapiro was nominated by President Obama, was unanimously confirmed by the Senate and was sworn into office on January 27, 2009. Chairman Schapiro, I congratulate you on your appointment, and I welcome you to this hearing.

The SEC plays an essential role in our economy by protecting the public through the enforcement of our securities laws. Given this important mission, I am troubled by reports that an environment of lax oversight and enforcement at the Commission was a contributing factor in the financial crisis now facing the country today. For example, investment banks were allowed to become overextended, which led to the eventual collapse of three of Wall Street's largest banks. A major Ponzi scheme went undetected, causing $50 billion in investor losses. The SEC started, then stopped, an investigation into fraud allegations of a financial services company in Texas. Investor losses in that case are now believed to exceed $8 billion. Which brings us to today's hearing.

The purpose of today's hearing is two-fold. First, I am interested in hearing more about the lessons the SEC has learned from the experience leading up to and during this financial crisis. We are in the midst of the worst economic downturn since the Great Depression 80 years ago, and it is important to fully understand how we got here and how to avoid repeating past mistakes.

Second, looking forward, I would like to hear more about your ideas regarding government-wide regulatory reform and what principles you believe should govern that reform.

I would like to hear more about your priorities at the Commission, particularly your plans to rebuild the Commission's oversight, inspection and enforcement capabilities. I know you have an ambitious agenda of changes you are working to implement, and I look forward to hearing more about them in your testimony.

The subcommittee stands ready to assist the Commission as it moves forward under your leadership. I would note that in the just completed 2009 omnibus bill, which I believe the President will sign today, the subcommittee provided the Commission with an additional $30 million above the requested level to enhance oversight, inspection and enforcement activities and for management initiatives.

Chairman Schapiro, for the upcoming fiscal year 2010 budget cycle, I ask that you work closely with the subcommittee to advise us of your resource needs.

If I may depart from my prepared statement, you know I have been in public office for 35, going on 36 years. I have never heard an agency say, "We do not want money." Traditionally, every agency, whether in the State assembly where I was for 16 years, or here, where I have been for 20 years, tells us that they need money. I have to say that the last administration at the SEC was the only agency I ever ran into where we would sit here and say, "How much do you need?" and they would say, "We have enough."

"We are willing to give you some more."

"Okay. We do not need any more."

"Do you have need to hire some more people to do the oversight?"

"No. We are fine."

When you look at everything that has happened, you know that something was up that we did not understand, but they were the first agency I have ever met that just did not want any more resources.

Now, I am not suggesting that you should ask us for everything in the Treasury, because you know that we have financial difficulties, too, in terms of what we can allocate, but it is our intent to make sure you have the resources necessary to do the work you have to do.

We live in difficult economic times. Commercial banks are failing every week, unemployment is up sharply, and home foreclosures are mounting. Confidence in our credit rating agencies is sinking, and evidence of major securities fraud is growing. We need to restore the health of our financial system to put us on a path to economic recovery. To accomplish this, we need an SEC that is equipped to handle the regulatory challenges of the 21st century.

Mr. SERRANO. With that, I would like to recognize our Ranking Member, Mrs. Emerson.

RANKING MEMBER EMERSON'S OPENING STATEMENT

Mrs. EMERSON. Thank you, Mr. Chairman.

Since this is our first hearing, I do want to say for the record that it is an honor to be the Ranking Member of the subcommittee. I thank you for having said those kind words about me, and it is going to be especially challenging during this very trying economic time.

The subcommittee has jurisdiction over a diverse group of agencies, many of which that do have a profound impact on Americans' lives and on the financial stability of our economy. I really do look forward to working cooperatively with you, Chairman Serrano, to improve the operations of the Federal Government and the workings of our economy as well as to help all Americans through this economic crisis.

Chairman Schapiro, welcome and congratulations on your confirmation. As Chairman Serrano has described, our current economic crisis has left markets in turmoil, losing trillions of dollars in value, hurting every segment of our economy, including family savings, small business, and retirement and pension funds. So I know that you are quite well aware of the challenging task that you have in front of you to improve the transparency in the securities markets, to uncover fraud and deception, while not at the same time overregulating markets and hindering economic recovery.

So I look forward to working with you and with Chairman Serrano to make sure that you have all the tools and resources necessary to ensure investors are protected and that markets are functioning properly.

However, I do want to point out that, since the failure of companies such as Enron, Global Crossing and Arthur Andersen, the Congress has provided the SEC with additional regulatory tools with the enactment of the Sarbanes-Oxley legislation and has more than doubled the SEC's annual appropriations. So under those circumstances, it is a bit difficult to see how the SEC was not better positioned to deal with our current economic turmoil and how the SEC allowed the Madoff scandal to continue for so many years. Yet I do want to be helpful to you and provide the SEC with the tools and the resources that you believe are needed, and at the same time, I want some assurances that the resources we give you and any additional help that you need, even beyond that, will be effectively utilized.

So welcome once again. I look forward to your testimony.

Thank you, Mr. Chairman.

Mr. SERRANO. Thank you.

Before we begin, just a little housekeeping.

I will be pretty strict to the 5-minute rule only because we usually get a good turnout. We have two Chairmen of subcommittees here—Ms. DeLauro and Mr. Edwards—so you know that the Chairman and the Ranking Member get a little leeway; but after that, the gavel gets pretty strict. We will recognize members, after the Ranking Member and the Chairman speak, for questions based on when you arrived at the hearing, alternating between both sides of the dais. So once again, we thank you for listening to our opening statements and for putting up with a little housekeeping.

Before we go on, I would like to recognize two people from my personal staff who will be working with us all year long. They are Nadine Berg, who is sitting quietly in the audience, listening to what you guys are saying about me, and Philip Schmidt, who is also a member of my staff.

We thank you for being with us today. We thank you for taking on this major responsibility. We stand ready to assist you.

If you would summarize your testimony, your full statement will go in the record. We would like you to keep your summary down to 5 minutes.

CHAIRMAN SCHAPIRO'S OPENING STATEMENT

Ms. SCHAPIRO. Thank you, Mr. Chairman, Ranking Member Emerson and members of the subcommittee. I very much appreciate the opportunity to be here today to testify. This is the first time I am testifying on behalf of the Securities and Exchange Commission.

I just want to add, Mr. Chairman, that I greatly appreciate your remarks. I am fairly confident you will never hear me say that this agency cannot use more resources and more tools to do a better job.

Mr. SERRANO. I was afraid of that.

Ms. SCHAPIRO. As we all know, these past 12 months have been a wrenching time for all Americans. Trillions of dollars of wealth have been lost, and millions have seen their retirement funds, savings and college tuition funds shrink. This crisis has challenged our citizens' faith in our market system.

As the new Chair of the Securities and Exchange Commission, whose primary responsibility is protecting investors, I know that we must act promptly and decisively to re-earn investors' confidence. To that end, since taking office just a few weeks ago, I and my colleagues on the Commission have already taken action to begin to help restore confidence in the markets.

First, we ended the 2-year penalty project which had weighed down our enforcement staff and had acted as a disincentive to bringing crucial enforcement actions.

Second, we instituted a new process that enables us to much more rapidly initiate investigations.

Third, I have hired a seasoned and well-respected Federal prosecutor to head our enforcement division, and he begins in 2 weeks.

Fourth, we launched a review that will ultimately revamp the way we sort through and handle the more than 700,000 tips and complaints and referrals that this agency receives each year.

Fifth, we are working to incorporate a more sophisticated risk-based methodology into our inspections and examination programs that oversee broker-dealers and investment advisers.

Sixth, we are vigorously pursuing our responsibilities to oversee credit rating agencies, as provided in the Credit Agency Reform Act. In the next month, we will hold a roundtable to examine what additional steps may be necessary in the oversight of ratings agencies.

Important questions have been raised both by Members of Congress and by the citizens whom we all serve about the job that the SEC has been doing. The Commission and our staff are committed to restoring the SEC's reputation as the investors' advocate—facilitating capital formation and maintaining fair, orderly and efficient markets.

As we move forward to restore investor confidence, however, we find ourselves digging out of a deep hole. Between 2005 and 2007, when the SEC should have been growing and changing to meet increasingly complex markets, the agency's budget was flat, and even declining. This necessitated significant staffing cuts implemented

through a hiring freeze as well as a two-thirds reduction in investments in information technology over a 4–year period. I am very grateful for both the support of this committee over the past 2 years and for the President's request of 1.026 billion dollars for fiscal year 2010.

With these additional funds, we plan to add both enforcement and examination staff, focusing on detecting and on deterring fraud. We will also invest in our risk assessment programs, adding staff and incorporating risk assessment into all aspects of our operations.

Finally, we will continue to build the technology that will enable us to better mine the data that is filed with the SEC and to evaluate the tips and complaints that we receive.

To be the investors' advocate, we must regain our position as a tough cop on the beat. Your support for the 2009 appropriation of $943 million is a very, very important step in that direction, and I very much appreciate the subcommittee's leadership in this regard. These funds will be enormously helpful as we work to reinvigorate and strengthen the SEC.

Unfortunately, I have learned during my short tenure that this funding level will still require the agency to make some cuts in its current operations. Because I do not believe it would be wise for the SEC to retrench during these perilous times, I have submitted to you a reprogramming request to use $17 million in fiscal year 2009 from the SEC's unspent prior year funds.

Let me please be clear. I am not asking for new funds. Rather, we are seeking authority to spend money that was approved but unspent in prior years. This investment could pay substantial dividends in the years the come. With these funds, we will not have to wait until 2010 to build out our technology and further strengthen our risk-based surveillance tools. We can early-hire enforcement and examination staff, significantly increasing our presence within the investment adviser, broker-dealer, and mutual fund communities.

When I served on the SEC 15 years ago, the organization was considered one of the gems of the Federal Government. Since returning a few short weeks ago, I have found an organization that, while admittedly harmed by missteps of the past, is committed to restoring its reputation. We will work hard to re-earn your faith and the confidence of the investing public.

Again, I thank you for your continued strong support of the SEC and of its critical mission. I welcome your questions. Thank you.

Mr. SERRANO. Thank you so much.

[The information follows:]

Testimony

Before the Subcommittee on Financial Services and General Government

Committee on Appropriations

U.S House of Representatives

March 11, 2009

By

Mary Schapiro

Chairman

U.S. Securities and Exchange Commission

Chairman Serrano, Ranking Member Emerson, Members of the Subcommittee, thank you for the opportunity to testify today on behalf of the Securities and Exchange Commission.

I am pleased to have the opportunity to discuss the Commission's role in the financial crisis and to discuss possible reforms to improve investor protection and confidence in our markets.

The last year has been a wrenching time for the investors whom the SEC is charged with protecting. Trillions of dollars in wealth have been destroyed during the economic downturn, and millions of Americans have seen their retirement nest eggs and college tuition funds shrink as a result. The economic crisis has challenged faith in our system of capital formation and allocation, a system that has proved over the long term to be the greatest for creating wealth the world has seen.

For an agency charged with protecting investors, maintaining fair, orderly and efficient markets, and facilitating capital formation, the events of the last year need to be understood, and the lessons learned so that we can restore investors' confidence in our markets. This means that the SEC needs to act promptly, decisively, and with resolve. This also means we must have a renewed commitment to protecting investors who provide the capital used to fund the productive enterprises that create jobs and wealth. While we have a tripartite mission at the SEC, investor protection is the essential piece from which the ability to promote capital formation and to maintain fair, orderly and efficient markets flows.

To that end, I've already announced several changes at the agency to restore confidence to investors and reiterate our commitment to investor protection.

One of my very first actions as Chairman has been to end the two-year "penalty pilot" program, which had required the Enforcement staff to obtain a special set of approvals from the Commission in cases involving civil monetary penalties against public companies as punishment for securities fraud. Enforcement staff had complained that the procedures unnecessarily delayed the prosecution of cases and discouraged the staff from either seeking a penalty or seeking an appropriately high penalty. At a time when the SEC needs to be sending a message that corporate wrongdoing will not be tolerated, and that the penalty for wrongdoing will be meaningful, the penalty pilot program sent the wrong message to the staff and to the public.

Another change I have implemented to bolster the SEC's Enforcement program is to provide for more rapid approval of formal orders of investigation that allow SEC staff to use the power of subpoenas to compel witness testimony and the production of documents. In investigations that require use of subpoena power, time is of the essence, and delay can be quite costly to the investigation. To ensure that subpoena power is available to the staff when needed, the agency has returned to a policy of timely consideration of formal orders by the seriatim process or, where appropriate, by a single Commissioner acting as duty officer.

In addition, I have recently hired Robert Khuzami, a longtime federal prosecutor who served as Chief of the Southern District of New York's Securities and Commodities Fraud Task Force, as the new Director of the Division of Enforcement. I will work with him on management reforms, including harnessing technology, improving risk assessment, and improving training and supervision for our line law enforcement personnel, so that we can maximize our resources to combat fraud and wrongdoing in our markets.As committed as we are to vigorous enforcement of the securities laws, we are also mindful that the complexity of 21st century markets and the varied nature of frauds and scams require that the sophistication and tools available to our Enforcement and Examination programs keep pace. Important questions have been raised concerning the agency's handling of tip or whistleblower information related to the activities of Beranrd Madoff. Former Chairman Cox asked the SEC Inspector General to look into what happened and report back to the Commission.

It is clear that, regardless of the ultimate findings of the Inspector General, the agency needs to improve its ability to process and pursue appropriately the more than 700,000 tips and referrals it receives annually. We have retained the Center for Enterprise Modernization to begin work immediately on a comprehensive review of internal procedures to evaluate tips, complaints, and referrals, with a goal of establishing a process that will more effectively identify valuable leads for potential enforcement action. In addition to these changes, it is essential that we work to improve our risk-based oversight of broker-dealers and investment advisers. Our Office of Compliance Inspections and Examinations, together with other agency staff, are presently working on an initiative to identify the key data points that would facilitate a risk-based oversight methodology and better allow the staff to identify and focus on firms presenting risk. OCIE is also continuing to focus on the training and expertise of examination staff -- and has formulated a plan to recruit additional individuals with experience in different facets

of the industry -- to further build the knowledge base of our inspections program to conduct oversight of complex trading strategies and products that exist in our markets today. As well, the examination staffs of the SEC and FINRA are working together to identify ways that incipient frauds might be detected at an early stage.

I also plan to focus on the critical role played by rating agencies, and to improve the current ratings process. The SEC recently approved additional rules under our authority in the Credit Rating Agency Reform Act to address certain weaknesses in the ratings process. These rules were a first step in our continuing efforts to bring transparency and accountability to the ratings process, which plays a critical role in the market's pricing and allocation of capital. We are convening a roundtable next month of rating agencies, users of ratings, academics, and others to focus on what the commission can do to address the existing conflicts of interest in the rating agency model.

In other areas, the agency has worked hard in the last year in the current market crisis. In the area of accounting standards, the SEC staff completed a congressionally-mandated study of fair value accounting. The staff issued guidance to financial institutions so that they can give fuller disclosure to investors, particularly with respect to hard-to-value assets. We have also continued to work closely with the Financial Accounting Standards Board to deal with such issues as consolidation of off-balance sheet liabilities, the application of fair value standards to inactive markets, and the accounting treatment of bank support for money market funds.

In the area of combating false rumors and manipulative activity in the marketplace, the agency initiated examinations of the effectiveness of broker-dealers' and investment advisers' controls to prevent the spreading of false information. The SEC adopted a package of measures designed to strengthen investor protections against naked short selling, including rules requiring that fails from short sales be closed out in a significantly shorter time, eliminating the options market maker exception of Regulation SHO and expressly targeting fraud in short-selling transactions. As we move forward, the Commission will consider other steps necessary to eliminate manipulative and illegal activity in our markets, and limit market volatility.

In an effort towards bringing the unregulated world of credit default swaps into the sunlight, the agency has worked with private parties and its regulatory counterparts at the Commodity Futures Trading Commission and the Federal Reserve to facilitate the development and regulatory approval of central counterparties, clearance and settlement systems, and trading platforms for these products. I look forward to working with the Congress to ensure that these central clearinghouses, which are designed to mitigate systemic risk posed by the credit default swap market, are appropriately regulated.

Over the coming year, we will have an agenda that also focuses on issues of corporate governance, including proxy access, risk disclosure and the linkage between executive compensation and risk taking, money market fund regulation, retail investor protection and international cooperation.

SEC Resources

Few of the initiatives I have identified can be implemented with the SEC's existing resources. Most of this agenda will require additional funding, particularly to rebuild the agency's workforce and invest in new technologies.

With respect to the SEC's workforce, the agency suffered a significant decline in staffing levels a few years ago, due to several years of flat or declining budgets. Between 2005 and 2007, the agency lost 10 percent of its employees, a decline that inevitably affected all of the SEC's major programs. The agency's Division of Corporation Finance was reduced by 13 percent, its Examination staff fell by 7 percent, and the Enforcement workforce fell by 10 percent.

Yet as the SEC staff has declined, the securities markets grew dramatically. For example, since 2005 the number of investment advisers registered with the Commission has increased by 32 percent and their assets under management have jumped by over 70 percent to more than $40 trillion. The size, complexity, and geographical diversity of broker-dealer operations have expanded significantly, as exemplified by the 67 percent rise in the number of broker-dealer branch offices. There has been dramatic growth and complexity in structured financial products and credit derivatives in recent years. The amount of outstanding asset-backed securities more than doubled over the course of this decade to almost $2.5 trillion in 2007, and the issuance of collateralized debt obligations globally reached $521 billion in 2006, up from $157 billion just two years earlier. The SEC oversees more than 30,000 registrants including 12,000 public companies, 4,600 mutual funds, 11,300 investment advisers, 600 transfer agencies, and 5,500 broker dealers with a total staff of 3600 people.

In the context of such rapidly expanding markets, I believe the reductions in the SEC's staff seriously undermined the agency's ability to effectively oversee the markets and effectively pursue violations of the securities laws.

With support from this subcommittee, during the last two fiscal years the SEC was able to lift its hiring freeze and begin rebuilding its workforce. I also want to thank this subcommittee for providing additional funds to the SEC in the proposed appropriation for this fiscal year. As you know, the previous Administration's request for FY 2009 gave the SEC an increase of less than 1 percent over last year. But, the SEC will require a 5 percent increase just to sustain current staffing levels and provide cost-of-living and merit adjustments for staff. As a result, the previous Administration's request would have resulted in a cut of nearly 100 staff. The subcommittee's support for a 2009 appropriation of $943 million for the SEC will be enormously helpful as we work to reinvigorate and strengthen the agency in the wake of the last few difficult months. I am very grateful for that support. However, I have learned since coming to the agency several weeks ago that this funding level would still require the agency to make significant cuts in its current operations. I do not believe it would be wise for the SEC to retrench during such perilous times in our markets for investors.

For this reason, I have just submitted a reprogramming request to the subcommittee to use $17 million in the SEC's unspent prior year funds in fiscal year 2009. These are monies appropriated to the agency and obligated in past years, so this is not a request for the subcommittee to find new funds for the agency. Rather, the use of these prior year funds in 2009 would make a very big difference in allowing our important work of rebuilding investor confidence in the markets to continue unimpeded.

Then, I believe we must go further, if we hope to restore the SEC as a vigorous and effective regulator. The President is requesting a total of $1.026 billion for the agency in FY 2010, a 9 percent increase over the FY 2009 appropriation. This proposal demonstrates the Administration's firm resolve to strengthen oversight over our financial markets. It will fund an additional 50 staff for the SEC and enhance our ability to uncover and prosecute fraud and begin to build desperately needed technology.

Specifically, we plan to add staff to the SEC's Enforcement program to focus on pursuing tips, complaints, and other leads, increasing the resources the SEC can dedicate to frauds that citizens bring to our attention. The Examination program would also receive new positions to expand its inspections of credit rating agencies and to strengthen risk-based surveillance and examination oversight of investment advisers. Finally, I plan to increase the number of staff in our Office of Risk Assessment specifically dedicated to deepening our understanding of risk and incorporating risk assessment into all aspects of operations. The reprogramming request I mentioned earlier also would allow us to accelerate the hiring process for these staff, so we can bring them on board this fiscal year.

Although I believe expanding our workforce is a critically important step, I believe the agency must work smarter as well. That is why the President's request for FY 2010 also contains funds for additional investments in our information systems. These investments have dropped by two-thirds over the last four years, and as a result the SEC has a growing list of technology needs that have gone unfunded. With the additional IT funds provided under the President's Budget for FY 2010, I plan to focus on several key projects:

- First and foremost, we will use additional funds to enhance our systems for handling tips, complaints, and referrals. The SEC has a number of different processes to track this kind of information, but there is no central repository or system through which this information comes together to ensure it is handled consistently or appropriately. We are launching a comprehensive review of our current processes and investing over the next couple of years in new systems as needed. This is what the citizens who take the trouble to send in tips, as well as the investing public, demand and deserve.

- The SEC also plans to use additional technology funding to improve our ability to identify emerging risks to investors. We have many internal data repositories that have resulted from filings, examinations, investigations, economic research, and other ongoing activities. But we need better tools to mine this data, link it

together, and combine it with data sources from outside the Commission to determine which firms or practices deserve a closer look.

- Finally, we would aim to complete the multi-year efforts to improve the case and exam management tools available to our enforcement and examination programs. These systems will give our senior managers better information on the mix of cases, investigations, and examinations, so they can apply resources swiftly to the continually evolving set of issues and problems in the markets. In addition, these tools will provide better support for line staff in these programs, so they can be more productive and better able to match the sophisticated systems used by the financial industry.

I want to thank you for your continued strong support for the SEC and its critical mission. By taking the steps I have outlined here—empowering enforcement to better respond to tips and other leads, enhancing our risk-based oversight of the markets, and leveraging technology—I believe we can successfully restore investor's confidence in both the SEC and in our nation's securities markets.

I would be happy to answer any questions you may have.

U.S. Securities and Exchange Commission

SEC Biography: Chairman Mary L. Schapiro

Mary L. Schapiro is the 29th Chairman of the U.S. Securities and Exchange Commission. Chairman Schapiro was appointed by President Barack Obama on January 20, 2009, unanimously confirmed by the U.S. Senate, and sworn in on January 27, 2009. She is the first woman to serve as the agency's permanent Chairman.

Chairman Schapiro's priorities at the SEC include reinvigorating a financial regulatory system that must protect investors and vigorously enforce the rules; and working to deepen the SEC's commitment to transparency, accountability, and disclosure while always keeping the needs and concerns of investors front and center.

Prior to becoming SEC Chairman, she was CEO of the Financial Industry Regulatory Authority (FINRA) — the largest non-governmental regulator for all securities firms doing business with the U.S. public. Chairman Schapiro joined the organization in 1996 as President of NASD Regulation, and was named Vice Chairman in 2002. In 2006, she was named NASD's Chairman and CEO. The following year, she led the organization's consolidation with NYSE Member Regulation to form FINRA.

Chairman Schapiro previously served as a Commissioner of the SEC from December 1988 to October 1994. She was appointed by President Ronald Reagan, reappointed by President George H.W. Bush in 1989, and named Acting Chairman by President Bill Clinton in 1993. She left the SEC when President Clinton appointed her Chairman of the Commodity Futures Trading Commission, where she served until 1996.

Chairman Schapiro is an active member of the International Organization of Securities Commissions (IOSCO). She was Chairman of the IOSCO SRO Consultative Committee from 2002 to 2006.

A 1977 graduate of Franklin and Marshall College in Lancaster, Pa., Chairman Schapiro earned a Juris Doctor degree (with honors) from George Washington University in 1980. Chairman Schapiro was named the Financial Women's Association Public Sector Woman of the Year in 2000. She received a Visionary Award from the National Council on Economic Education (NCEE) in 2008, honoring her as a "champion of economic empowerment."

http://www.sec.gov/about/commissioner/schapiro.htm

SEC REGULATORY FAILURES

Mr. SERRANO. As I said before, we are excited at your approach to making changes. With that in mind, my first question would be a general question.

The global financial crisis had its roots in the general regulatory failures of the last decade or more. The lack of Federal regulations of financial derivatives and of other complex investment vehicles, the willingness of rating agencies to assign investment-grade status to high-risk securities, and an SEC oversight program that allowed investment banks to become overleveraged all contributed to the crisis we find today.

So, in your opinion, how did we allow the regulatory failures to occur? Was it just general policy or was it people not being on top of things or was there something where people were inventing new schemes and new ways of investing, if you will, and government or regulatory agencies could not keep up with it?

Secondly, how would you then turn the Commission around to make sure that we are on top of these issues as we face new challenges—if I may say, new schemes? Because I assure you—and you know this well—as we are sitting here today, there are a bunch of guys, and maybe ladies too, trying to figure out how to beat the system again. In fact, as we know, there are people trying to beat the system with the monies that we just allocated to help the system recover. That as long as we are alive in this world, as long as there is a world, somebody is going to try to figure out how to try to beat the system.

So what happened? How do you turn this around?

Ms. SCHAPIRO. It is such a great question, and we could probably spend the whole day talking about it. I think there are so many causes to the financial crisis that we are now trying to resolve. I guess I would chalk it up to a few things.

One is the very rapid growth of the size and complexity of the markets and regulators who did not either fully appreciate the complexity or the connectedness of financial institutions as they engaged in all kinds of new and highly leveraged financial activities. I do not think regulators fully understood the financial impact of all of that.

As you might recall, just a year ago, we were all talking about competitiveness and the U.S. position in the world as the leader in financial markets and what could we do to even further reduce regulation in order to ensure that listings came to the New York Stock Exchange and not to London, or that businesses were started in the United States and not in other countries, and that new financial products would be invented in the U.S. and not in other places. Our focus as a society and as a regulatory community very much was on how do we maintain competitiveness, which is very important, but to the exclusion of a tight and rigorous regulatory regime. So I think that also contributed.

We also have a regulatory system that has gaps. We have vast parts of the financial system that are unregulated, as with hedge funds. We have enormously popular products, like credit default swaps, which currently have $25 trillion in notional value that are

virtually unregulated. So we had gaps in the system as a third contributing factor, I think.

Fourth, I would say—and this is very much my personal view—that regulators lost their skepticism and thought that market discipline was what was really necessary, that nobody would ever bet the ranch, that nobody would take a foolish economic risk that might put the franchise in danger. I think what we have learned is that people either did not understand the risks or assumed that, at the end of the day, everything would work out all right. So we as regulators lost our skepticism about the real effect of market discipline in corralling risky behavior.

I think there are so many causes, and those are just very few. We could also talk about lax underwriting standards in the mortgage industry. We can talk about investment banks that securitized away mortgages and other products in order to spread the risk, thinking that spreading the risk would save their institutions. But in fact, of course, as we know, that is not at all what happened.

How we turn it around is really the challenge we at the SEC and throughout the Federal Government and you as Members of Congress are really grappling with right now.

For the Securities and Exchange Commission, it very much means a real and genuine recommitment to serving investors. That is what we are there for. We are the only agency in the Federal Government solely charged with the protection of investors and with maintaining the integrity of the capital markets, the public disclosure system that allows investors to allocate their capital based on informed consent and the understanding about the financial situation of companies. It is about writing rules that govern the interaction between brokers and advisers and their customers. It is about ensuring that we have adequate resources to make sure that people are, in fact, playing by the rules.

So we have to recommit. We have to get back to basics. We have to build our enforcement capability. We have to have a sense of urgency in dealing with these problems. We have to be smarter and more efficient. We have to look at risks and focus our examination program and our enforcement program on the risks, not just on what the calendar tells us about it is time to walk back into this firm and look at their operations. So we need new skillsets. We need new tools. We need additional resources, and we need a recommitment and a refocus on what these markets exist for. It is to raise capital, to create jobs to build businesses, and to allow investors to share in that wealth creation. These markets at the end of the day exist for the investor.

Mr. SERRANO. I have really one more question before I turn it over to Mrs. Emerson, but I want to ask you, on a personal level, sort of your personal opinion.

You do not have to name names. We know of a couple of people who will or who have been indicted for Ponzi schemes and so on. The mood in Washington seems to be let's move forward; let's not look back. But when you do not look back, some people get away with things they did which caused the problem.

Without naming names, do you think some folks on Wall Street and at other places are going to get away with what otherwise would have been a crime?

Ms. SCHAPIRO. I would certainly hope not. I said in my confirmation hearing—and I believe this deeply—that there can be no sacred cows. We have to look at the failures at every level of our system, whether it is on Wall Street within the firms, or at the mortgage companies, or at the rating agencies throughout the financial system to understand what went wrong, because we will repeat the mistakes of the past if we don't understand them. And we have to hold those accountable who are responsible for putting us in the situation we are in right now. We are highly committed to doing that.

Mr. SERRANO. Okay. So when we hear people say let's move ahead, let's look forward, you are saying that as you look to see what went wrong and you stumble onto people who made it go wrong, if there is criminal damage there, you will deal with that?

Ms. SCHAPIRO. We will never be effective at deterring fraudulent conduct if we do not prosecute it when we find it, so we have to look back, but we have to plan to move ahead as well. I think we are capable of doing both of those things.

REGULATORY REFORM

Mr. SERRANO. Let me ask my last question for this round.

The Emergency Economic Stabilization Act requires the White House to make recommendations to Congress by April 30 for improving the United States' financial regulatory system.

From the perspective of the SEC, what are the principles that you believe should govern regulatory reform? In your view, how would the type of regulatory reform that you would like to see impact the funding and staffing needs at the Commission?

Ms. SCHAPIRO. I think it is really important that we have the focus we do right now on the creation of a systemic regulator, and that there is some entity within the Federal Government that is monitoring and keeping a check on the risks that exist in our system with the largest financial institutions. I think it is equally important that we have a focus on investor protection and on the protection of the capital markets, through which I mean increased transparency and disclosure.

So while I think the focus on systemic risk is important right now, I would be very concerned if we lost our focus on ensuring that there is an investors' advocate in the Federal Government who will bring the big enforcement cases, who will pursue the Ponzi schemes, who will go into the investment advisers, the brokerage firms, the mutual funds and ensure that they are playing by the rules and that the hard-earned assets and earnings of American citizens are being protected with all of those different entities. I think that is an equally important pillar of financial regulation. I know it is not the focus at the moment, but we absolutely cannot lose sight of that.

Mr. SERRANO. Thank you. Thank you so much.

Mrs. Emerson.

Mrs. EMERSON. Thank you, Mr. Chairman.

Chairman Schapiro, I want to ask you a few questions about the Madoff scheme, but really as it applies to how you want to move forward, if you will, because obviously we all know that you were not at the helm of the SEC during such time that this occurred. And I do appreciate the fact that you are trying to rework the mix of skills among the staff people to try to better uncover complex securities fraud.

But let me just ask you these three questions—or four, perhaps—and then you can answer them all at one time.

First of all, have now your enforcement supervisors begun conducting regular reviews of all pending cases so that we can ensure that a case like the Madoff one will not languish on a lower level staff person's desk who really does not understand that there might have been potential fraud committed?

Have you been working closely with the inspector general to understand what went wrong?

Lastly, what incentives do people have to come forward with information regarding potential securities fraud? Hopefully you all will be protecting whistleblowers' identities, but I assume you all are working on that. I know that most people really want to do the right thing, to identify wrongdoing, but they are nervous about getting their names in the paper or they are going to be sued or some such thing. So just share with us how you plan to work through all of this, if you will.

Ms. SCHAPIRO. Sure. I am happy to do that.

As you can imagine, it is unfortunate that the SEC is currently being defined more by what it has missed than by what it has done, and certainly Madoff is an enormous component of that.

As I mentioned, we have hired a new enforcement director who has spent 11 years as a Federal prosecutor, running the Securities and Commodities Fraud Task Force in the Southern District of New York. He is tremendously experienced in securities fraud prosecutions, and he will begin in a couple of weeks.

As I have talked with him since we convinced him to join the team, we have talked a lot about getting through the cases, understanding those thousand or so outstanding cases and making sure we are moving to the front of the line as quickly as possible those that are likely to really impact investors in a meaningful way.

I will say that 2 weeks ago, we filed three TROs in one day for Ponzi schemes, and there is no doubt but that the enforcement division is a bit on fire with respect to Ponzi schemes, and we could talk more about that.

As you also know, we have an inspector general investigation ongoing about what went wrong with Madoff, and we look forward very much to his report and to his findings. I do talk with him on a fairly regular basis. His report will not be done for months, and I feel I have to run the agency in the meantime, and we do not have the luxury of waiting months to start to make some of the structural changes that I think are really critical to addressing what went wrong with Madoff.

As you point out, we received a tip, information that was quite creditable and fairly complete, outlining why the returns that were promised by Madoff were highly unlikely to be legitimate. We get, as I said, 700,000 to 1.5 million complaints a year and tips a year. We have to figure out a way to deal with that volume of information. So I contracted in the last week with the Center for Enterprise Modernization, who has worked with other Federal agencies to do just this sort of process review for the handling of data coming into the agency, and then to make some short-term and longer-term recommendations to us on how we might better mine that data, understand what is important in it, and then jump on those matters as a priority to try to head off Ponzi schemes and problems like that much earlier.

We are also working on a package of proposed regulatory reforms that would deal with issues like the custody of customer assets, potentially an independent audit by an accounting firm of investment advisers—such a requirement does not exist—and so there is also a regulatory reform package that we are working on, and our examination program is refocused on a number of these kinds of issues.

Your final question: What incentives exist?

At the SEC, the only financial incentive for whistleblowing is actually limited to the insider trading area where the agency can, in fact, pay a bounty for insider trading tips. We are actively discussing within the agency whether we should propose to Congress that we have a broader whistleblower statute for the Securities and Exchange Commission. Our thinking is very early at this point, but we will certainly be back to talk about that in more detail.

SEC STAFFING

Mrs. EMERSON. I appreciate that. Thanks.

When you are talking about attracting new people and competent staff, I mean most people, I think, do not realize that you all are able to pay your staff significantly more than many government agencies. I am curious, though. Do you all lose staff to the private sector? I should say the private sector now probably has plenty of staff from whom you could call.

I mean, obviously, number 1: Do you lose staff to the private sector? Number 2: Are there more Wall Street veterans, for example, looking for employment with you all? Third: Has the Special Inspector General for TARP asked for your assistance in conducting his investigations? Have you been able to detail staff to him?

Ms. SCHAPIRO. Let me start with the last first.

I have met with the Special Inspector General for TARP, SIG TARP, I think they shorthand themselves. I personally met with him. He has met with our enforcement people. We expect a very close working relationship. I think they need to rely on us because we have the bodies and the capability to bring civil actions for the misuse of the TARP funds by financial institutions, so we are forging a very strong and positive relationship, and we are looking forward to working together.

We have traditionally lost people significantly to the private sector. While the SEC can pay better than many other Federal agencies, we do not compete with Wall Street, for sure. Pay parity has

made an enormous difference. We have reduced our attrition rate from about 12 percent, on average, between 1994 and 2000 to somewhere between 5.5 and 8.5 percent. I would guess that in recent months, it has been a good bit lower than that because Wall Street is not really hiring. That makes this a wonderful opportunity for us to attract people who both need jobs, but also who are kind of ready to sit on the other side of the table, maybe who have been a little bit unhappy with their Wall Street experience and who therefore can bring skillsets to us that we might not otherwise ever be able to attract: financial analysis, trading, forensic accounting kinds of experiences. It would be my hope that we can bring in exactly those kinds of people.

Mrs. EMERSON. Thank you so much, Mr. Chairman.

Mr. SERRANO. Thank you.

Mr. Edwards.

GRAMM-LEACH-BLILEY ACT

Mr. EDWARDS. Chairman Schapiro, obviously our financial markets and private enterprise system depend on trust, and that trust has been lost. I want to thank you for taking on the tremendously important responsibility of trying to restore that trust, and I hope we on a bipartisan basis will be partners with you in that effort.

I would like to ask about your opinion in regard to the impact of the Gramm-Leach-Bliley law passed in 1999.

To what extent, in your opinion, did that have an impact on the meltdown in our financial services markets and among financial services firms? Do you think we should revisit that law? If so, could you mention one or two specific items in that law that we ought to reconsider?

Ms. SCHAPIRO. That is a terrific question, and it is a hard one to answer. I guess I would love to think about it and perhaps come back to you with some more careful thoughts.

I mean, clearly, we have a situation that has evolved in part because of Gramm-Leach-Bliley, where the size of financial institutions has grown to extraordinary dimensions, and that may be one of the issues here as we think about systemic risk. But if you will indulge me, I would love to come back to you in a more thoughtful way on that question.

[The information follows:]

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

THE CHAIRMAN

April 15, 2009

The Honorable Chet Edwards
U.S. House of Representatives
2369 Rayburn Building
Washington, D.C. 20515-4311

Dear Representative Edwards:

I am writing in response to questions you raised during my March 11 testimony before the Financial Services Subcommittee of the House Appropriations Committee regarding the Gramm-Leach-Bliley Act. I appreciated the opportunity to testify as well as your thoughtful questions on this issue.

You asked in particular if I thought that Congress should revisit Gramm-Leach-Bliley. My answer is "yes." While it is difficult for me to say with certainty what role Gramm-Leach-Bliley played in the financial meltdown, I do believe Congress should revisit the Act as a part of its overall consideration of financial regulatory reform.

One important area for consideration concerns the differences in the protections available to investors who purchase securities from a broker and investors who purchase securities from a bank, and the potential for regulatory arbitrage and investor confusion associated with those differences. For example, broker-dealers are subject to a number of enforceable requirements that do not apply to banks, including requirements to:

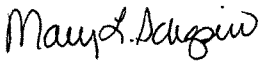
- Recommend only suitable investments;
- Arbitrate disputes with customers;
- Ensure that only fully licensed and qualified personnel sell securities to customers;
- Disclose to investors, through FINRA, the disciplinary history of employees; and
- Adequately supervise all employees.

Moreover, I also believe that Congress should consider amendments to grant the Commission the authority to access information from broker-dealer affiliates, including banks, as necessary to help understand and mitigate the significant operational risks that these affiliates can pose to broker-dealers. The Commission at times has been hindered in its ability to obtain information related to these broker-dealer risks. This would parallel the authority that bank regulators already have under Gramm-Leach-Bliley.

I appreciate your raising this important policy issue, and I look forward to working with you and other Members of Congress as you take up legislation to improve our financial

regulatory structure. Please do not hesitate to contact me at 202-551-2000, or Julie Davis, Deputy Director of the SEC's Office of Legislative and Intergovernmental Affairs, at 202-551-2010 if you have further questions or if we can be of any assistance.

Sincerely,



Mary L. Schapiro

CREATING AN EFFECTIVE WHISTLEBLOWER PROGRAM

Mr. EDWARDS. Okay. Could I ask you then about whistleblowers? You referenced that in your review of that.

I would have to believe instinctively that without an effective whistleblower system, we just could never provide you enough resources to effectively regulate such a massive number and size of firms throughout the country.

Can you tell me how the present whistleblower laws work? What kind of a reward is offered? How is the system working? It looks like there are nearly 2,000 tips a day that you get.

How do you ferret out the good from the bad there?

Ms. SCHAPIRO. Right now, the main reward for being a whistleblower is the good feeling you get of having done something important, because we do not have the authority to pay except where the whistleblowing relates to insider trading. So that is one reason we are considering whether we should ask Congress to expand our capability in that area.

I have talked with other agencies, including the IRS, which has a very well-defined whistleblower function. I think that we might benefit enormously from that. Whistleblowers tend to do a lot of the work for you—hand you something that is pretty fully baked. Then it would enable us to run with that kind of information and to pursue cases in a much more aggressive way.

We have to leverage third parties to do our job. There are 3,600 employees at the SEC. We are responsible for over 30,000 regulated entities, and those are the 12,000 public companies. But even if we take them out of the mix, there are 11,000 investment advisers, there are 8,000 mutual funds. Think of the impact on American citizens from the conduct of those people. There are 5,000 brokerage firms. You can give us all the money and all the people in the world, and we are still going to need to rely on citizens, on the private sector, on accounting firms and others to be able to do our job effectively, given the number of registrants that we have responsibility for. So we are trying to be very creative and think about how we can both, through whistleblower authority potentially but also through other mechanisms, leverage others' efforts to do our jobs.

Mr. EDWARDS. I will finish, as my 5 minutes are about up, by just saying that I hope you will also look at the judicial system as also a tool that we can use as part of the system of checks and balances. I know we voted for litigation reform in financial services a number of years ago. Like most laws, I am sure it was not perfect, and perhaps we need to leverage the private sector. We hear a lot of talk about frivolous lawsuits, but in this particular arena, it might be that we need some serious lawsuits that again bolster the resources you have within your agency to keep these firms honest and to restore trust.

Thank you, Mr. Chairman.

Mr. SERRANO. Thank you.

As I said before, California has two members on the committee. Texas has two members. New York has only one. Florida has three. So we recognize Mr. Crenshaw.

MORE EFFECTIVE REGULATION NEEDED

Mr. CRENSHAW. Thank you, Mr. Chairman.

Thank you for being here today.

We are talking a lot about confidence and credibility, and you are part of that in your new role. I guess, in the big picture, the lack of credibility comes right now on account of the Department of Treasury. They are there, and have got the big job to kind of figure out how to restore confidence. You know, there seems to be a lack of direction, but underneath all that, you have got your own problems in how we deal with just the regulatory aspect. So I want to ask you a couple of questions about that.

One of the things—when they talk about restoring confidence, they look at the SEC, and they say, "Well, gee, the investors really have not been protected. So do we need more regulation or do we not need more regulation?"

I want to ask you about that, because some would argue that right now it is not so much whether we need more regulation but, rather, more effective regulation. I hear stories of smaller firms, that they have got regulators just swarming like fire ants, looking at all of the records, seeing if everybody passed their tests and filed their forms and signed their documents.

Then on the other hand, you see in the big picture these things like Madoff and these huge violations that occurred that do not seem to get the focus. Then on the other hand, I read an article just not long ago that kind of, I think, tracks this. I think it was a Harvard study that looked at some of the regulation, and it found out that the big firms that are headquartered in money center areas tend to have lower levels of sanctions once an investigation takes place than do some of the smaller firms that are in outlying areas. It talked about the fact that sometimes the way that happens is, instead of having a judicial proceeding if it is a big firm that is kind of in a money center, then they will go to administrative hearings, number 1, as opposed to judicial hearings. Then number 2, the sanctions that are actually levied tend to be lower. I guess the inference there is if you are an enforcer and someday you want to go to work for a big Wall Street firm, you may tend to be lax in terms of your regulation.

So, if you could, comment on both of those: number 1, if you think that is true, if you have seen those studies, and if it is true, what are you going to do to make sure that does not happen? Then the bigger picture in regulation, some would say right now, is that we have got to put the fire out, that we need more regulation, that it is okay to have regulators doing all kinds of things, maybe overdoing regulation in one area. It is probably okay to do that, but if we are not regulating in other areas, we ought to do more than that. But some would argue we have got to get the financial crisis solved before we kind of get too involved in some of the technical aspects of additional regulations.

So could you comment on those two? Number 1, do you think we are getting the kind of oversight fairness that we ought to get? If not, are you going to kind of work on that?

Number 2, where do the priorities fit in terms of making sure that we expand the regulation or we do not expand the regulation, but make sure that we kind of solve the crisis first?

Ms. SCHAPIRO. Well, let me take the last part first.

I think it is a great question. Do we need more regulation or not? The tendency is to assume, since things went wrong, we must.

I think there are gaps we need to fill that are fairly targeted. They relate in the narrow world of the SEC to things like the custody of assets and the certification that assets exist and so forth. And we are looking at a fairly targeted package of regulatory reforms. What I think we really need is more boots on the ground.

If I can give one example, there are 11,300 investment advisers, of which Madoff was one. The riskiest 100 of those will be examined once every 3 years. The risk is 1,000 of those will be examined once every 3 years. The other 10,000 will be examined on a random sampling basis, which means it may be 10 years before we show up. There is a real deterrent effect to knowing that there is a high likelihood that a regulator is going to show up and look at the books and records and understand whether your people are properly licensed and whether the assets exist and whether the account statements are truthful.

So I think it is not that we need a lot more rules, but that we need a lot more people or capability through technology at the SEC to understand whether the rules that exist are being followed, and then the capability to enforce them when they are not.

You know, I have a lot of sympathy for the point with respect to whether sanctions against small firms are disproportionate to those against large firms. In my prior position, I worked very closely with something called a small firm advisory board, which was made up of brokerage firms from around the country that had fewer than 150 employees, and many had as few as 5 or 6 or a dozen employees. We had to get a lot of feedback from them about what the impact of regulation was on them and what their views were with respect to whether sanctions were disproportionate. From that learning, I know that there is absolutely that perception, and it may, in fact, be a reality in some instances. And we need at the SEC to be highly sensitive to that.

If our goal is to put somebody out of business, then we should put somebody out of business. But if our goal is to create a deterrent effect through our conduct, then we have to do that in a measured way. We are working on the concept of a small business advisory committee to work with us on some of those issues going forward. We have one now that works with us on Sarbanes-Oxley-related issues, and we are looking at expanding that so we can be sure we get that input.

Mr. CRENSHAW. Thank you.

Mr. Chairman, where is the clock?

Mr. SERRANO. How is that?

Mr. CRENSHAW. Is there a clock somewhere that is turning yellow and red?

Mr. SERRANO. I have the clock.

Mr. CRENSHAW. Okay.

Mr. SERRANO. I have the gavel. I have the title.

Mr. CRENSHAW. Do your eyes start blinking after 4 minutes?

Mr. SERRANO. In fact, it is interesting that Mr. Crenshaw brings that up, because you got 6 minutes.

Mr. CRENSHAW. You know, if I had an extra minute—

Mr. SERRANO. No. Seriously, we do keep a clock back here. Here is the the clock. Costco, I think.

They are unionized, right?

Mrs. EMERSON. Yes, they are unionized.

Mr. SERRANO. Really, we would not cheat you out of any time.

Mr. CRENSHAW. Just for the witness as well, I didn't know was I missing something.

Mr. SERRANO. No. That is fine. That is fine. I like oranges, by the way.

Mr. CRENSHAW. Thank you. Grapefruit.

Ms. WASSERMAN SCHULTZ. We will have to get together on that in the next meeting.

Mr. SERRANO. Mr. Schiff.

Mr. SCHIFF. Thank you, Mr. Chairman, and please let me know when my 15 minutes are up.

ENFORCEMENT AND DETERRENCE

Mr. SERRANO. Mr. Schiff, you get 5.

Mr. SCHIFF. Madam Chair, I wanted to ask you about a couple of things.

One is you point out that a big part of what you need are more resources for enforcement. You need simply more eyes on those who are practicing in this area to make sure we uncover when there are frauds before they get to the level of the Madoffs. I wonder, too, whether there is adequate deterrence, because no matter how many people you hire, you are never going to be able to keep an eye on everyone. When you consider that Mr. Madoff was involved in defrauding more money than probably every bank robber in the history of the country has ever stolen put together, he has probably defrauded more than that, and you wonder whether it is possible that the penalties are proportionate to the level of the harm that he has done.

We talked a little bit earlier this week at a meeting of the New Democrats where I shared my—and I think it is widely felt throughout the country—anger over the fact that he is still free in his penthouse apartment when he should be in a cell somewhere. He may be there very shortly. But the magnitude of this harm was so great that it makes me wonder whether we need to—and I say this as a former prosecutor—rewrite the rules regarding detention, to take into consideration not just flight risk but the gravity of the harm that has been caused; because I think to the rest of the country, it looks horribly inequitable that someone who has committed this kind of crime is confined to a multi-multimillion dollar penthouse apartment while people who commit garden-variety burglaries go to jail without bail.

So in any event, I would be interested to know whether you are giving any thought to whether the penalties provide a sufficient deterrent or whether this is simply an enforcement and not a deterrence issue.

MARK-TO-MARKET

Then on a very unrelated topic, I would like to ask your thoughts on mark-to-market. Many of us have been concerned. I know there is a Financial Services authorization hearing on this tomorrow. But with the role that it played in the downward spiral of the markets, I understand that the SEC completed a study earlier this year on mark-to-market accounting and suggested that the existing fair value of mark-to-market requirements should not be suspended since they would potentially erode confidence in what these balance sheets were really worth.

How do you balance the present pitfall against what we have seen in terms of the recent history?

So, if you could address those two issues.

Ms. SCHAPIRO. Sure. There could not be two more different issues.

Let me say on the first—and this is a purely personal view—I would agree very much with you that we ought to look at the question of detention. I do not know the thinking with respect to why he was permitted to remain free or as a prisoner in his penthouse during this period. SEC penalties, as you know, are limited. We can fine. We can get an injunction against one's continuing to violate the law. We can expel somebody from the securities industry. We can get a bar that prohibits one from being an officer or a director of a public corporation. We cannot send people to jail, although we work actively and aggressively with the criminal authorities to support their prosecution of securities fraud, as is happening in the Madoff case. And we will be at the beck and call, frankly, of the criminal authorities whenever and wherever they need our support, whether it is expertise or companion civil cases to go with their criminal cases, because the deterrent effect of a prison sentence is undoubtedly greater than the deterrent effect of a civil injunction.

So I agree with you. And our new enforcement director, I am confident, with his 11 years as an assistant U.S. Attorney, will have very much the same approach to cooperative efforts with criminal authorities at the State level and at the Federal level as well.

On fair value accounting, you take this question up really so perfectly. Investors have told us that fair value is important to them because it gives them transparency and a real insight into the financial statements, and that is information they need to make decisions about how to allocate capital. That said, there is undoubtedly—and I have a lot of sympathy for this, and the agency does as well—a lot of difficulty in determining the value of illiquid assets in the kinds of markets we are experiencing right now. I want to say unequivocally it is not our intention that these assets be written down to zero just because the markets are illiquid, or to fire-sale prices, let alone zero.

We have asked FASB, through our recent study on fair value accounting and through virtually daily contact, to get on with providing guidance to businesses about how to apply fair value accounting, particularly in distressed and illiquid markets, so that we can have a bit more of a rational approach going forward. FASB has committed to us that this guidance will be out in the second quarter, and we are continuing to push them very hard, but we

think it will be very helpful in valuing these Tier 3 or illiquid or, as Chairman Bernanke said yesterday, idiosyncratic assets that are hard to value right now.

Mr. SCHIFF. So your recommendation, rather than doing away with the mark-to-marketing rule, would be to have a better definition of what the market value is?

Ms. SCHAPIRO. I think that is right. A better application and more judgment in the application, so that assets are not being written down to fire-sale prices.

Mr. SCHIFF. Thank you, Mr. Chairman.

Mr. SERRANO. I apologize for the sound of the gavel. We usually do not gavel while the witness is speaking. It is just that I thought Schiff was going to get in another question.

While you were making your opening comments, I could not help but think that at yesterday's Commerce, Justice, Science hearing, we learned what we knew ahead of time, but we reaffirmed that the Latino population in the Federal prison has grown dramatically because 48 percent of all Latinos in Federal prison are there on immigration violations while this gentleman is sitting in a penthouse.

Mr. Kirk.

WORK OF THE FINANCIAL SERVICES SUBCOMMITTEE

Mr. KIRK. Thank you, Mr. Chairman.

Mary, you have a lot of fans in Chicago, so we are thrilled at your appointment.

I want to thank the Chair for this hearing. Except for cable television, the last major hearing of this committee was April 10, almost a year ago. I think we should operate very independently from the authorizing committee. I know authorizers would like us just to go away and that they would like this subcommittee to be in a state of blissful inaction, so I am thrilled that we are actually now having a hearing. We have seen TARP I and TARP II let over $1 trillion in money go without any hearings by this subcommittee, and I think it is really good that you are getting back in the game here. I hope we are going to be extremely active.

Mr. SERRANO. If the gentleman would yield on my time.

Mr. KIRK. On your time. Great.

Mr. SERRANO. Most of what you saw with TARP and all that happened after the season ended. It is our intent to be very much involved. If you will see a statement that I made just this morning regarding the Treasury Department, you will see that this Chairman and this committee will not play ball with anyone who does not want to do the right thing.

Secondly, the Financial Services Committee does not really want us to go away. In fact, this subcommittee was homeless, and we are using one of their rooms, so it is a good relationship. I understand what the gentleman is saying, and I am sure at the end of the season you will realize that we will be involved to the point that we are supposed to be involved. I thank you for your concern.

REINSTATING THE UPTICK RULE

Mr. KIRK. Well, I would just say that the jurisdiction of the subcommittee should never have a season. It is 365, 24/7.

We have seen problems with the Geithner plan, or just in general the direction of the stock market, the stock market's dropping 5 percent from year end to the inauguration. It dropped 12 percent after the Geithner plan. It dropped another 11 percent after the budget. The Wall Street Journal reports we have now under this Congress experienced the fastest drop of the stock market of any Congress ever, including the Congresses under Hoover and Roosevelt. John Prestbo of Dow Jones, I guess, reports that he is now considering delisting GM and Citi from the Dow. So this is a pretty big issue.

Barney told us that you were considering reimposing the uptick rule, which your great, great, great, great predecessor, the legendary Joe Kennedy when he first created this job, imposed in 1938. So let me put it to you directly:

Did you tell Barney you are going to reimpose the uptick rule? Because I am thrilled that you did.

Ms. SCHAPIRO. What I told the Chairman—and I said this in my confirmation hearing—is that I was interested in reexamining the entire area of short selling. I think that while the agency engaged in somewhat of a model rulemaking when they eliminated the uptick rule—they did a pilot program; they took 3 years to study it; they did all of those things—that the world has changed rather dramatically in the past year.

We have our scheduling for early next month, assuming that I have the votes on the Commission—I cannot do it on my own—to propose reinstating the uptick rule and to potentially look at some other alternatives as well with respect to short selling, and hopefully, we will get that proposal out in April. That is exactly what I told the Chairman, but the Commission, obviously, needs to concur in that. It is a rulemaking process, but my view is that the world did change and we need to relook at that.

I hear from thousands of investors a week on this issue, but I hear from sophisticated investors, retail investors, institutions. There are some people who are strongly opposed as well, but there is clearly interest in our reexploring this.

Mr. KIRK. Right. Thank you.

The last thing: We are worried about not-as-tough enforcement as we should have on the ban on naked short selling, and I think this committee would be very interested in what resources you need to enhance enforcement there.

Ms. SCHAPIRO. I would love to come back to you specifically on resources. But prior to my coming to the agency in 2008, two rules were enacted to try to restrict the damage from naked short selling, including a specific antifraud rule that would have dealt with deceiving brokers or dealers or others with your ability or your intent to deliver on a short sale when you, in fact, were not capable of doing that.

We have made it a very big focus in our examination program. In fact, we have just concluded an examination sweep solely focused on naked short selling. I have not seen the results of that yet, but I can assure you it is an area we are looking at carefully and are taking very seriously.

Mr. KIRK. Thank you, Mr. Chairman.

Mr. SERRANO. Thank you.

Ms. DeLauro.

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

Congratulations to you, Madam Chairman.

I am a new member to this committee, and am delighted to serve, Mr. Chairman, with you and with my other colleagues.

I would not have opened my remarks with this comment, but I guess I can't help but not let this go by to my colleague, Mr. Kirk: President Obama has been in office for 52 days. It is the prior administration that brought us to our knees financially over a period of 8 years. If someone had been minding the store at that particular time, we would not be in this financial mess that we are today.

Given that, Madam Chairman, let me ask my questions, and I will try to move quickly.

Mr. KIRK. I actually agree with you.

CREATION OF A SUPER-REGULATOR

Ms. DELAURO. I have 5 minutes. I have 5 minutes, and I was not intending to take that time because of my questions.

The Chairman of the Federal Reserve, Mr. Bernanke, talked about the creation of a U.S. super-regulator. What he says is, "The international multibusiness scope of today's financial firms leaves open too many loopholes that the regulators can cover. Lack of regulation left government regulators with little ability to control what has become known as a too-big-to-fail institution—Citigroup, AIG."

He also says that the Federal Reserve has a central role, given its broad expertise, and that expertise is needed to create such a regulator. He believes that the Fed should play an important role in the creation of such a position.

I do not know what your views are on that. Where do you see the SEC fitting into this structure? What role would the SEC play if a super-regulator were established?

Ms. SCHAPIRO. I have sort of a preliminary concern about the creation of a single monolithic regulator. They exist in some countries. The U.K., notably, with the Financial Services Authority has a single regulator who has both systemic, prudential, and investor protection considerations. I think our markets, though, are very, very different here. We have enormous retail participation.

Ms. DELAURO. Has it worked in the U.K?

Ms. SCHAPIRO. Well, they are talking about dismantling it and revisiting that entire idea, so I think the jury is probably out there as well.

My concern about a single monolithic regulator is that, while I do believe we need a systemic regulator, we need an entity with the ultimate responsibility for the protection of the financial system, for the monitoring of it and for checking the excesses in it.

A systemic regulator will always trump an investor-protection regulator's concerns, I fear. And I do not think that that would be good in our market, given the level of retail participation that we have. I much more favor an approach where there is an SEC, perhaps combined with some other agencies that are there to ensure disclosure by public companies, high standards of corporate governance, transparency in stock market transactions, the credibility and the fiscal soundness of clearing agencies and exchanges, writ-

ing the rules that govern the conduct of brokerage firms, mutual funds, investment advisers, and enforcing those rules. I think that in a massive regulator, those functions get pushed to the side while we worry about the integrity of the entire system.

So I feel quite strongly that we need an SEC, or something that looks very much like it, whether it is combined with other agencies or not, that is on the front line of capital markets regulation and investor protection.

Ms. DELAURO. The resources and the enforcement tools.

Ms. SCHAPIRO. Absolutely.

RESTORING INVESTOR CONFIDENCE

Ms. DELAURO. I will ask you a very, very basic question, which has to do with my constituency.

It has been hard enough for folks to understand the bailout of Wall Street, and you know what this has meant to their own economic prospects. You know they see hundreds of billions of dollars in taxpayers' money which is looking as if—to them—that we have not improved the quality of the equity markets or have eased the credit crunch.

When it comes to the SEC and to regulation reform, it becomes more difficult to communicate what we are doing here. Short selling, mark-to-market accounting, an uptick rule, credit default swaps, short selling, these are not words that people talk about around their kitchen tables. So I am asking in simple English—and I do not know if I ask this for myself or for my other colleagues—how do we explain what happened and what we are trying to do in order to help us restore this confidence in the financial sector so that people get some idea of what track we are on, how we are trying to do this and that we are actually trying to do a job out here that is going to alleviate the problem?

Ms. SCHAPIRO. That is a very hard question.

I think we talked in the very beginning of the hearing about the causes, in response to the Chairman's question, of the situation we are in now. You start with the lax underwriting of mortgages, and you carry that all the way through the securitization process, the excessive leverage on Wall Street, the fact that we have vast parts of the financial system that are completely unregulated, as in hedge funds or as in credit default swaps.

The glue that helped hold all of these things together and made them such a massive problem is really the interconnectedness of all of the financial institutions that are engaged in this activity, so that when problems begin in one, they radiate immediately into multiple other financial institutions. Our banking system, our financial system, cannot afford for all of those institutions to fail, and so TARP and TALF and all the other programs are really geared towards stabilizing the financial system so that we can then go and get back to a more rational place with less leverage, with less complexity, with less interconnectedness, and with potentially less size so that "too big to fail" can maybe someday pass back out of our lexicon the way it has passed in so easily in the last several years.

Ms. DELAURO. Thank you, Mr. Chairman.

Mr. SERRANO. Thank you.

Before some of the members came in, I had welcomed Mr. Edwards. I want to welcome Ms. DeLauro, who is a new member of the committee and who is Chairwoman of the Agriculture Subcommittee of Appropriations; Ms. Debbie Wasserman Schultz who is Chairwoman of the Legislative Branch Appropriations. In fact, there are more cardinals at this hearing today than at the Archdiocese of New York right now.

Ms. DELAURO. Or of Connecticut.

Ms. WASSERMAN SCHULTZ. Or a Jewish one.

Mr. SERRANO. You are the first Jewish cardinal, right?

Ms. WASSERMAN SCHULTZ. No. No.

Mr. SERRANO. With that in mind, we do welcome a new member, our friend from California, where the World Baseball Classic will finally end. Notwithstanding how we New Yorkers feel about you guys taking the Giants and the Dodgers both—we have forgiven you since 1957, I think—Ms. Barbara Lee, it is an honor to have you on the committee.

Ms. LEE. Thank you very much. Is it my turn, Mr. Chairman?

Mr. SERRANO. Yes, it is. Do you think I was just saying that to be nice? That was the intro.

Ms. LEE. I see how you run this committee, and I love it. Thank you, Mr. Chairman.

First, this is my first committee hearing, and I really do look forward to working with you, Mr. Chair, and with the Ranking Member, Congresswoman Emerson, as we tackle these very challenging financial issues.

I served on the Financial Services Committee for 8 years and saw this coming, and there were a few of us who raised these issues for many, many years with regard to the deregulation of the financial services industry and as to what was going on with regard to the SEC with its lack of resources for enforcement and as to many of the difficulties now, unfortunately, that our country is faced with, and you, Madam Chair. But I am very delighted that you are there, and congratulations. I look forward to working with you.

Ms. SCHAPIRO. Thank you.

TROUBLED ASSET RELIEF PROGRAM (TARP)

Ms. LEE. I wanted to ask you again about TARP, just how the SEC and TARP kind of work together if at all.

I mean what is the relationship there? I ask you this because I know in TARP we do not see a lot of enforcement mechanisms, and I am wondering what the SEC's role is with regard to any enforcement of TARP funds.

Then specifically my staff has met with many of our community banks that have been recipients of TARP funding. They are considering now giving back that money because of the onerous restrictions that the smaller community banks are subjected to; the reporting requirements and all of the issues that the larger banks have had to deal with. They are sort of painted with a bad brush.

So, if you were weighing in on this, how do you see that relationship? What do you think we could do to help the community banks ensure that they are not painted with the same brush as the bad actors were?

Ms. SCHAPIRO. I have tremendous sympathy, and I have heard concerns expressed articulately and broadly about community banks, that have kind of stuck to their knitting and who knew their customers and who did not create a lot of issues, that are being sort of embroiled in the same controversy and issues as the larger money center banks.

I will say the SEC has two main interactions with TARP. One is that because we write the rules that require disclosure by public companies—and many banks are in fact public companies whose shares are traded—we have disclosure rules that are impacting what they are reporting in their quarterly and annual filings that are then made public.

So just as a specific example, when the executive compensation limitations were put in the bill that require a sale and pay, the ability of shareholders to provide an advisory vote on compensation for recipients of TARP funds, the SEC will in fact review that disclosure. We will ultimately pass rules. We could not do it on the weekend between when the bill was passed and when it was effective, but we will ultimately write rules that will govern the disclosure about executive compensation and the ability of shareholders to have an advisory vote on executive pay.

The other main way we interact is really through working with what is called SIG TARP, the Special Inspector General for TARP funds. I have met with him and with some of his team. He has met with our enforcement team. We are working together, and we will work together very closely to ensure that to the extent there is any misuse of TARP funds or fraud in the use of TARP funds, that we are able to support them rapidly with both expertise and the capability to go to court and get redress. We have, actually, already done one case where somebody was lying about his receipt of TARP funds in order to attract other investment, and that case was brought several weeks ago. But we expect that we will have plenty of work to do in this area.

VICTIMS OF MADOFF PONZI SCHEME

Ms. LEE. Thank you. One more quick question.

In terms of the victims of Bernard Madoff, what is going on and how are they going to be compensated?

Ms. SCHAPIRO. That is a very good question and one that is on many people's minds.

SIPC, the Securities Investor Protection Corporation, which is responsible for taking over a financial firm in bankruptcy, is now corralling all of the assets of Mr. Madoff's, locating assets and securing those assets. It has begun a process where they have mailed out, to all of the customers that they can identify, claim forms. It has asked that those claim forms be submitted to them; and they have, in fact, begun to make payments on claims under the SIPC insurance fund to some of the victims of Bernard Madoff.

As you can imagine, because all of the recordkeeping appears to have been false, it is an enormously complex task to dissect and then to put back together a clear picture of all of the activity and of all of the potential victims. But SIPC has indeed, I believe this week, started to pay out on the very first of those claims, which

are limited to $500,000 per customer. So certainly for many people, it is nowhere near the money they may have lost.

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

Mr. SERRANO. There will be, by the way, a second round of questions.

We now go to Ms. Wasserman Schultz, the young woman from Florida. I like oranges, and I like grapefruit and stone crabs—and key lime pie.

Ms. DELAURO. Sounds good.

CREDIT RATING AGENCIES

Ms. WASSERMAN SCHULTZ. Thank you, and welcome, Madam Chair. It is good to be with you.

One of the things that has not been focused on is the role of credit rating agencies. I want to get a better understanding of your plan to—I mean much of the problem was caused by the credit rating agencies' running amuck, essentially, and not doing their jobs appropriately, and their ratings essentially becoming meaningless.

Does the SEC currently have sufficient statutory authority? Are they regulated enough? Are there any steps that you can take? What are the basic principles that you are going to use to guide the discussion about that?

Ms. SCHAPIRO. Until 2006 when the Credit Rating Reform Act was passed, the SEC had virtually no authority. It designated rating agencies as nationally recognized statistical rating organizations, but it was a pretty meaningless designation, and there was very little competition.

Congress passed that law, and in 2008 the SEC actually—and this, again, is before my time—engaged in fairly extensive rulemaking for rating agencies. But again, this was in 2008, so we were well into the crisis at that point. It was really requiring record retention, explanations of when they deviated from their model in giving a rating, lots of disclosure about the performance of ratings over time. They prohibited rating agencies from rating a product that they had helped to structure, and tried to deal with that conflict.

So there was pretty extensive rulemaking done by the agency, and there were actually a couple of more pending rule proposals that were in the pipeline when I arrived.

I am not sure if it is enough, to be perfectly honest. We are holding a roundtable on April 15. We have invited all of the rating agencies to come and talk about what went wrong and shed some light on the issues there. We are asking them what have they done on their own to try to improve the situation. We are inviting a lot of the people who have had some very interesting ideas about what would be a better model than the issuer pays for the rating, which is conflicted in lots of obvious ways. There have been some very thoughtful proposals put out there, and we have invited those people to come and speak about them.

We have a panel to talk about how to inject more competition into this space so that perhaps we could have higher-quality ratings and a less captive industry, and we have invited investors, users of ratings pension funds.

Ms. WASSERMAN SCHULTZ. So from all this information gathering, you plan to——

Ms. SCHAPIRO. We hope to come back and say we think we need to do rulemaking in this area, or come back to Congress and say we would like authority to move forward in the following way.

SEC STAFFING RATIOS

Ms. WASSERMAN SCHULTZ. Just very quickly, Mr. Chairman, before my time expires:

I wanted to talk to you. Since this is the Financial Services Appropriations Committee, at the New Dems' meeting that we had with you the other day—which thank you very much for being there—you talked about your employee-to-regulated-entity ratio. I just wanted to tell you that was really informative, and I think it would be helpful to hear from you on that.

My understanding is that in the last fiscal year, the SEC had only around 400 FTEs tasked with managing 11,300 investment advisers. Do you have the resources? I mean you used the FDIC as a comparison where they actually have one to one.

Ms. SCHAPIRO. I did. On a full staff basis, the FDIC has about 5,000 employees and about 5,100 banks. We have in total about 3,600 employees and about 30,000 regulated entities. But when you get down into the examination program, there are 11,000 investment advisers, of which Madoff was one, and we have about 400 examiners in that space. So we examine about 14 percent of advisers every year. That is a long time before they may have a visit from the SEC.

The numbers for mutual funds are equally scary, in some ways more scary, given the extent to which we all rely on mutual funds for our investments. There are a couple hundred inspectors for 8,000 mutual funds holding many trillions of dollars.

Ms. WASSERMAN SCHULTZ. Therein lies the problem.

So, Mr. Chairman, I know that the Chairwoman is hopeful that we will be able to assist her with that ratio and so are the many millions of investors who have been wronged or who may be being wronged who we might not be aware of.

Thank you. I yield back.

Mr. SERRANO. Thank you. We certainly will be very vigilant in trying to be helpful.

If you are from the Bronx, as I am, you are very sad about the fact that the Yankees have not won the World Series in a while, but if you are from Pennsylvania or anywhere near Philadelphia, you are very, very happy. Notwithstanding that, we welcome a great member, a great American, a great Pennsylvanian, Mr. Fattah, to the committee. He is recognized for 5 minutes.

Ms. DELAURO. Connecticut is unhappy as well.

Mr. FATTAH. Mr. Chairman, we did not win the Super Bowl yet, but we did win the World Series. We are coming after the Super Bowl.

Mr. SERRANO. You want to win both?

Mr. FATTAH. Yes.

Mr. SERRANO. You know, we are here because greed got us in trouble. That is why we are holding this hearing. You know that.

Mr. FATTAH. Madam Chairman, welcome back to the Commission. You were first appointed by President Ronald Reagan. Then you were appointed Chair by President Obama. So you are someone who should give everyone across the political spectrum a great deal of confidence.

INVESTING ABROAD

The markets have not given a lot of people confidence in many respects because of some of the issues that have been raised, but I am interested—as people have sought to make investments, a lot of people are now looking offshore to make investments, and I note your investment in terms of the international association.

If you would, give the committee any thoughts about what can be done at the SEC to help Americans think through any of the challenges that they face in looking to make investments in markets abroad.

RELIEF FOR MADOFF FRAUD VICTIMS

Secondly, on the Madoff matter in particular, one of the things that happened is a lot of people lost money. The government actually gained some money since their taxes were paid on these supposed profits. As we try to figure out how victims are going to be made whole, it would seem that perhaps, given the government's failure to properly regulate this matter, that there may be some role in terms of putting into this fund the taxes that were paid that were obviously part and parcel to the scheme that was afoot.

So I would be interested in your thoughts on those.

Ms. SCHAPIRO. That is actually a very interesting idea. I had not thought about it, and we obviously are not involved in the tax issues. I have read many articles debating whether people should be seeking to file amended tax returns now, or whether they should wait, and what they should do about taxes that may have been paid on fraudulent or on nonexistent profits. I think it is an interesting idea to think about whether some of that tax money should be set aside, but I would leave that to all of you.

I think we have a lot of issues internationally, and we have a very active international office. It started out, really, as a mechanism to cooperate on enforcement matters across borders. There are a number of jurisdictions where Americans invest actively, and there are a number of jurisdictions where the foreign residents invest actively in U.S. markets. So it is very important for us to work cooperatively with other regulators to share information, particularly when we think there may be illegal conduct emanating from their country into our markets. That is a big area of emphasis for us.

We also want to make it easy for Americans to invest safely in foreign markets at the lowest possible cost, but not at the risk of their being taken advantage of, or of not having adequate protection and regulation in those markets.

So we work extensively with foreign regulators towards a goal of trying to have the highest possible regulatory standards, enforcement programs, and levels of protection around the world so that U.S. Citizens can have some sense of comfort that if they are in-

vesting in a foreign market, they have somewhat similar protections that they would have here when they are investing.

Mr. FATTAH. Thank you.

Thank you, Mr. Chairman.

DECLINING STAFFING LEVELS IN SEC'S ENFORCEMENT DIVISION

Mr. SERRANO. Thank you.

As I stated earlier, there was this whole issue with the SEC in the past where it really was difficult for the committee to assist the Commission because it was the only Federal agency, or agency anywhere, that I have met in my 35 years in public office that did not want any more resources. They actually thought that they had enough. So the subcommittee is concerned regarding staffing levels at the Commission.

In recent congressional testimony, senior SEC officials stated that the Commission's enforcement division currently has 1,150 employees, 80 fewer than at its peak in 2005, and that the Office of Compliance, Inspections and Examinations has 790 employees, 90 fewer positions than it had at its peak in 2006.

What impact, in your opinion, has this staffing decline had on the SEC's mission?

Ms. SCHAPIRO. Well, you are absolutely right. Enforcement is down about 4.5 percent from its peak, and the Inspections group is down about 7.5 percent. But that actually only tells part of the story because the industry for which we have responsibility has also grown enormously during that period, so it is a bit of a double hit when we look at the decline in our resources.

I would never sit here and tell you that I think, had we had more resources, the agency would have caught the Madoff fraud earlier on. I cannot say that. I do not know the answer to that. I do know—and this is an eternal question for enforcement programs—that more people will allow us to make a bigger dent in the fraud and will allow us to have a greater deterrent effect. That does not mean we need unending numbers of resources—we can't probably train and manage those—but I do know it means that if we could have more people inspecting firms and on site and prosecuting cases much more quickly, we can be a more effective agency. We could get money back to investors faster. We could stop ongoing frauds faster. We could catch problems before they become the $50 billion Ponzi scheme.

IMPROVING STAFF TRAINING AND RECRUITING NEW STAFF

Mr. SERRANO. You know, I told you when we met in my office that I met a young man on the train coming from New York this week who told me his concern.

He said, "I cannot believe I am actually going to tell you that this is a concern of mine because it works in everybody's favor and the industry's."

He is in the financial services industry. He said when the people came to audit on many occasions, he would have to tell them—fill them in—on what they were supposed to be looking for. It is like my telling a reporter what to ask me, which I have tried and it does not work. They usually ask what they want to ask.

So is this a general situation at the Commission or is it, with the lack of staff numbers where they are supposed to be and the levels at which they are supposed to be, that there are not enough people to go around; and when people go out, they are not as well-versed or as experienced as others?

Ms. SCHAPIRO. I think it is probably a combination of things. I think our training has been inadequate. These markets have evolved so rapidly. Keeping people up to speed and capable of what is happening in brokerage firms really requires a very robust training program. That takes people out of the field and in the office, which means they are effectively reducing their presence and their deterrent effect within the firm. So I think we need to improve our training.

I think we need—and we have a phenomenal opportunity right now—to bring in much more current and useful skillsets with people who have lost jobs on Wall Street and who are anxious to do something and to do something very constructive. So financial analysts, people with trading backgrounds, and people with forensic accounting backgrounds, I think would also be very helpful here. We have historically had high turnover. Although as I said earlier, pay parity has helped us enormously in the last several years in dealing with that problem.

We are also looking at something, and we have launched this week the opportunity for our examiners to become certified fraud examiners and take a course that will get them that certification, and that will hopefully build the skillsets of some of the younger people who are already on the staff and who are very committed to doing a good job, but we have not always given them the tools that they need to do that job.

So we need to bolster our training, bring in some additional skills and give people the time to let their intellectual curiosity take them where an investigation ought to go. Because sometimes you are busy checking the boxes to get done what you have to get done, you do not take a step back and think about they might have violated a rule; but is this firm doing something that, at the end of the day, because it is leveraged 30 to 1, for example, is going to have a profound impact on the firm and on its customers? They might not have violated a rule, being leveraged 30 to 1, but that is the kind of thing you want your examiners to stop and think about, not just the rule set. And we need to help our people get there. They are capable, they are hardworking, but we have not always given them the tools.

Mr. SERRANO. So it is a situation where, in many cases, it is not that they are not prepared to look for something. It is that the people there, auditing, have the advantage of being involved in a new, innovative way of investing, if you will, and of running markets and institutions and that they still are not up to date?

Ms. SCHAPIRO. It has got to be a continuous learning process to keep up with Wall Street.

Mr. SERRANO. It reminds me of the time that I got stuck in my car. I left my keys inside the car on the Grand Concourse in the Bronx. The cops were there with me, the police department, and a guy who was with me. An hour and a half later, we could not

get in my car, and some guy rode by on a bicycle and said, "If I don't get in trouble, can I help you?"

I said, "No, you won't get in trouble," and the police said, "Yeah, you won't get in trouble." He did it in 30 seconds, you know. He opened the car for me. It was wonderful. I will bet you—maybe it is a blessing in disguise—that some of these guys are not employed, that they can come and show us what to look for.

Ms. SCHAPIRO. That is exactly right.

BLAME PLACED ON CAREER STAFF IN MADOFF FRAUD

Mr. SERRANO. Your predecessor, Chairman Christopher Cox—and I realize that you cannot comment on an ongoing inspector general investigation—placed the blame for the Madoff fraud's going undetected squarely on SEC career staff.

What is your reaction to such a charge? Isn't it unfair to put the entire blame on the career staff?

Ms. SCHAPIRO. I think it is unfair. The career staff of the SEC are hardworking. They are smart, and they are as committed to the protection of the public interest as any group of people I have ever worked with anywhere in government or in the private sector. So I think it is a very unfair rap.

Clearly, the SEC missed Madoff and potentially had multiple opportunities to put an end to the fraud. I would characterize our issues as being more about having a bit of a stovepipe organization where there is not enough communication from region to region or from department to department. I would characterize it as a problem of needing the right skills, so that when data or information is handed to people they understand what they are looking at, or they know where to go to get help, and understand whether they have been given something that is really meaningful and needs to be pursued. I would chalk it up to a pretty extraordinary amount of data that we have talked about, this 700,000 to 1.5 million tips and complaints, that come in every year and not having any rational process for really figuring out what to do with those and how to handle them and track them.

So I think it is a grossly unfair rap against the career staff. Clearly, there were some mistakes, and we have to learn from those mistakes. And we have to be willing to look very, very clear-eyed at what went wrong so we can fix it. But I think it is unfair to blame career staff or any staff.

Mr. SERRANO. I have one last question, though. Maybe you spoke about this already. If you did, I apologize.

Did Mr. Madoff have any legal—or association with the SEC? Did he have any relationship? Did he have to be registered with you in any way?

Ms. SCHAPIRO. His brokerage firm, which was largely a proprietary trading operation, was registered as a broker-dealer. The money management business, which was off to the side, not conducted through the brokerage firm, was not registered until 2006 when, I understand, the agency required it to register as an investment adviser. But prior to 2006 it was unregistered.

Mr. SERRANO. Thank you.

Mrs. Emerson.

Mrs. EMERSON. Thank you, Mr. Chairman. I forgot to mention to you that I am a rabid St. Louis Cardinals fan, so I think we will have a lot of fun going back and forth on your team versus others.

Mr. SERRANO. You have my deepest sympathies.

Mrs. EMERSON. You know, I am a National leaguer, so you are the American Leaguer. What can I say?

Mr. SERRANO. I am a good American.

TECHNOLOGY UPGRADES AT THE SEC

Mrs. EMERSON. Anyway, I just needed to tell you that before I forgot.

Chairwoman, when we talked in my office, you started talking a little bit about how you wanted to modernize your information technology systems, particularly the EDGAR system, which allows companies to file information with the SEC electronically and provides access to investors and to the general public on the filings.

Can you talk a little bit about the long-term plan you might have, an estimate of how much funding will be required to implement the technology upgrades that will provide greater access and search capabilities to investors? Do you believe that the SEC has the program and contract management and technical expertise to successfully implement such a major IT project?

Ms. SCHAPIRO. Well, a lot of our technology program management is outsourced. I appreciate, having presided over about a $150 million a year technology budget at my former employer's, the importance of terrific program management and the responsible stewardship of technology dollars, because projects have a way of growing and growing and growing and of getting away from you. They need tremendous management.

The priorities that I have set for our technology budget right now would include—and of which we have taken the first step—trying to deal with these tips and referrals and this data coming in so that we can modernize our business processes and can utilize technology to find the more profitable or useful bits of information to follow up on from an examination enforcement perspective.

We also have multiple internal repositories of data that come from the exams we have performed and from the investigations we have done. It is information that is filed with us by public companies, by accounting firms and others, and by our own economic analysis team. We have no capability to link that data and to mine it effectively, to look for trends or patterns or interesting issues that we ought to be following up on. So risk analysis and risk surveillance capability would be my second priority.

The third is that our enforcement program goes up against the best Wall Street law firms and the best law firms around the country. Yet we have very rudimentary case management technology and very rudimentary technology for e-discovery and to manage all of the millions of pages of documents that come in in the course of litigation.

Finally, the last technology focus that I think we need to have is on our core financial systems within the agency so that we are sure that our systems are well integrated and that we are performing the way we would expect a public company to perform in the control of its financial management systems.

Mrs. EMERSON. So is it possible that you have this ongoing upgrade, if you will? Is it being built or will it be built side by side to the system that you already have? Because I am just curious how, at the end of the period of which you think you have gotten all of the pieces together, you integrate it with the system you have now; or are you building something new, side by side, that might then not necessarily replace but integrate what you have got and add new things?

Ms. SCHAPIRO. I think it is a combination of integrating existing systems and putting systems in place where we still have many manual processes in the financial management area. But if you took an area like the tips and complaints, as I said, they come into virtually every office. Some are phone. Some are e-mail. Some are FedEx. Some are carrier pigeon. Some do not go into systems. Some are paper records that are kept.

So there is no single system, and there is certainly no integration of any existing system. So that is an area where we really need to build from scratch. I do not know that that means we need a customized system. I am a big fan of off-the-shelf technology solutions with minimal customization. If you can make that work for you, it is a far cheaper way to go, and there is support out there for that product, but those are things we will have to work through.

You know, of our $103 million or so technology budget last year—I think I mentioned this to you—87 percent of that was for the steady-state maintenance of our technology, which left us with about $13 million or $14 million for enhancements, new development. For an agency as focused on financial systems, trading systems and clearinghouses as the SEC is, so dependent upon an industry that is highly technical, for us to not have any more capability than $13 million or $14 million a year just does not make any sense.

Mrs. EMERSON. Well, it doesn't, but it seems awfully expensive just to keep things going as they are, too. But I hope that you will feel free to really just give us the bottom line.

Ms. SCHAPIRO. I will do that.

Mrs. EMERSON. That is not something on which I think you should shortchange yourself, if you will, just because we might think it sounds like too much money; because it seems that if you did have a better integrated system, certainly it would allow you not only to be more efficient in your jobs but also perhaps to find more bad guys at the same time.

Ms. SCHAPIRO. Absolutely.

REGISTRATION OF HEDGE FUNDS

Mrs. EMERSON. So I thank you for that. I have got one quick other question, and then I will hand it back to the Chairman.

Back in 2004, the SEC implemented a regulation requiring hedge funds to register investment advisers and to follow some basic disclosure requirements. Obviously, you said that there is no regulation, truly, of hedge funds because this was struck down in the courts. So does the SEC oversee hedge funds at all? If you do, do you think that the extent to which you do is enough to protect investors?

Ms. SCHAPIRO. Well, there are some hedge funds that, even though the rule was struck down, remain voluntarily registered with the SEC, but I think we have learned a lot about the value of voluntary regulation over the last year.

Our authority for unregistered hedge funds relates to being able to prosecute them essentially for fraud, as we can any citizen or entity that engages in fraud in the purchase or sale of securities. So we have a very, very limited scope there. I have supported for a long time the Federal registration of hedge funds, and then the authority for the SEC to determine what kinds of rulemaking might be appropriate to sort of fill out that registration requirement, whether it is reporting or qualifications for people running hedge funds or whatever.

Mrs. EMERSON. Thank you very much.

Mr. SERRANO. Thank you.

With the committee's permission, I am going to go a little out of order and recognize the gentleman from Florida, Mr. Boyd, due to the fact that in about 10 minutes we are going to start a series of votes, and we would like to wrap up as soon as we can.

Mr. Boyd, I have been telling all the Florida members that you have more members on the committee than any other State. I like oranges, stone crabs and grapefruit.

Mr. BOYD. Thank you, Mr. Chairman.

Mrs. EMERSON. He has got cotton up there, too.

Mr. SERRANO. That takes care of me.

Mr. BOYD. Mr. Chairman, I am delighted to be a new member on your committee. I want to apologize to you, to the committee, and to Chairman Schapiro for being late. I had a role in chairing the Budget Committee hearings which are going on now. So I hope you will indulge me for being late.

Mr. Chairman, I do not want to tread into water that has already been treaded on and take the committee's time if you have already answered this question. I can check the record and check the answers. But I did want to get into the mark-to-market and ask the Chairman if that subject has not been explored too deeply.

Mr. SERRANO. Go ahead.

MARK-TO-MARKET ACCOUNTING RULES

Mr. BOYD. Chairman Schapiro, the mark-to-market accounting rules have been somewhat controversial since the September crash.

Could you enlighten the committee on your feelings about mark-to-market accounting rules and what you think their role may or may not be relative to the current situation?

Ms. SCHAPIRO. I would be happy to do that.

The SEC, shortly before I arrived in January, did a study on fair value accounting that was transmitted to Congress. The study said, and I believe this to be true, that investors who have to make decisions about how to allocate their capital and where to invest, support fair-value accounting and mark-to-market accounting because they believe it does give them the best view into the financial condition of the company, and it gives them the kind of transparency they really want to make informed decisions.

That said, there is absolutely, particularly right now, a lot of difficulty in valuing illiquid assets and there is a real concern in how

fair-value accounting has been applied. Does it force people to write illiquid assets down to fire-sale prices? Is it creating more volatility than is really appropriate?

Our study requested that FASB, which is the accounting standard setter, get to work on providing guidance that will help people understand how to value illiquid assets in distressed markets.

I said earlier that Chairman Bernanke called them idiosyncratic assets, which is, perhaps, every asset right now, but to provide much greater guidance in how to value illiquid assets in this kind of market so that we can get the disclosure that we need, but without creating a situation of really dire consequences.

FASB has made a commitment to provide this guidance on how to measure in these markets and how to apply judgment, because accountants need to be applying judgment here, not just taking the simple way. And they have committed to give us guidance in the second quarter, and we are pushing them very, very hard to do that.

Mr. BOYD. The problem continues to be, I know in many of the instances, a requirement on the part of the regulator to the lender that additional reserve be set aside even for those loans that are performing.

Is there some way to solve the mark-to-market disclosure transparency problem without creating a problem for the lender and borrower?

Ms. SCHAPIRO. I think it is the interplay of the accounting rules and the capital requirements that I think are really an important issue here, that we need to be taking a look at, and whether they are encouraging what has come to be known as a word I never thought would come out of my mouth, "procyclicality," which is the tendency to ease up and to make credit readily available in boom times and then restrict it dramatically in times like we are experiencing, but restrict it more than perhaps changes in the borrower's credit would really argue for.

So I think it is an area where we need to look at the interaction of those two things because I think that is a contributing factor to the current situation.

Mr. BOYD. Thank you, Mr. Chairman.

Is my time up?

Mr. SERRANO. Just about.

Mr. BOYD. Okay, Mr. Chairman. I yield back.

Mr. SERRANO. Thank you so much.

Mr. Edwards.

NEW WHISTLEBLOWER LEGISLATION

Mr. EDWARDS. Chairman Schapiro, let me go back to the whistleblower issue.

You said you are in the process of reviewing ideas regarding whistleblower legislation or rules. Can you tell me what the timing of that review is and when you will be at a point where you could make specific recommendations?

Ms. SCHAPIRO. I have not thought about the timing. I would hope that we could be prepared to come back up here within the month and have a conversation about that.

Mr. EDWARDS. Okay.

Ms. SCHAPIRO. My chief of staff actually starts on Monday, and my legislative staff is still being built out, but I would love to be able to come back within a relatively short time period and understand, you know, what the implications are.

It is important to have a program that has contour and definition to it so that we do not go from 1.5 million tips and referrals a year to 2.5 million that we cannot handle. So we want to have some structure to it that, really, in order for there to be any kind of a payment associated with being a whistleblower, requires that you bring us something that is quite meaningful and leaves the agency with some discretion in this process. So we are looking at what other agencies are doing.

Mr. EDWARDS. In your opinion, could effectively written and implemented whistleblower legislation actually save taxpayers money? Could one employee's providing documents showing fraud perhaps be a lot more of an efficient use of taxpayers' dollars by rewarding him for that versus having dozens of investigators out, combing the books of complicated businesses?

Ms. SCHAPIRO. It certainly seems as a theoretical matter that it ought to be able to be an efficient way to get to the meaningful cases quickly.

Mr. EDWARDS. I would hope we could look at this fairly quickly.

Excuse me for the analogy, but as a father of two young boys, I notice that they clean their rooms a lot better when they know Mom or Dad is going to come look at them. I would think just the passage of whistleblower legislation, if legislation in fact is needed—if you do not have the regulatory authority to do it on your own, just the fact that we would have whistleblower laws on the books, with significant compensation for those who could provide documents to the SEC, proof of fraud, would immediately begin to impact behavior and would cause those who might otherwise carry out fraudulent actions to think twice about doing so.

So I would just thank you for looking at that, and I would welcome the opportunity, along with the Chairman and the Ranking Member, to hear your recommendations when you are comfortable.

Ms. SCHAPIRO. Thank you. We will look at it very, very carefully. We really just began this process of thinking about it. I do not even know what my fellow commissioners think about the issue, but we will look at it very seriously and will come back.

Mr. EDWARDS. Thank you.

Thank you, Mr. Chairman.

FACEBOOK

Mr. SERRANO. Thank you.

You were saying before how part of what has to happen is is that you have to be able to be prepared to deal with new ways of people doing business, to find out who is doing something at risk or creating a problem.

Just to give you an example, the world has changed a lot. On Facebook, a message comes in. "Congressman, as you continue this work, please do not forget the role of the rating agency, Standard & Poor's as an example, who allowed credit default swap transactions to be valued as AAA investments as opposed to below junk bond status. This is a key reason there was so much money that

flowed into a financial house of cards built on a sandcastle foundation."

So not only is the public watching on C-SPAN, but they are watching. They are paying attention, and they want results from us.

Mr. Crenshaw.

USING SEC RESOURCES MORE EFFECTIVELY AND EFFICIENTLY

Mr. CRENSHAW. Thank you, Mr. Chairman.

I think, Mr. Chairman, you are right. I think people want results. Our job is to provide the funds for you to provide the enforcement and regulation. And it is obvious that either the SEC was ill-equipped or it was misguided in monitoring these firms that it is supposed to monitor. That is kind of elucidating the obvious. And I guess when I listen to you and your testimony, you would say certainly, in part, ill-equipped; more boots on the ground; more people to help do the things.

On the misguided part, I want to press you a little bit because it seems like the easy answer to all of these problems is just pass another law or spend some more money, and everything will be fine.

Are there things that you are doing—when you come in and you see this and you ask yourself what is wrong here and part of it is not enough money, but part of it may be—and this is my question—is it kind of the way the resources are allocated? You know, if we spend a lot of time and energy—and I read reports where the SEC will investigate someone for 3 years and will spend lots of time and energy and whatever, and there is a $5,000 fine at the end.

On the other hand, you have got Bernie Madoff—and not to beat a dead horse, but if you have got somebody who is registered with you and they are making 12 percent returns for an extended period of time, they have got a three-man accounting firm, you know, doing their accounting, they have not made a trade in a decade, it seems like in today's technological world, you could have a computer program that just went through and said everybody making a 12 percent return for 10 straight years gets popped up or people who have three-man accounting firms.

But I guess the question is: Have you looked enough to see—and I am sure you have and maybe you can share with us—to do the things that you need to do more efficiently, more effectively you know, allocating those resources you have in the most efficient way before you come in? What are some examples or maybe some things you have seen that maybe were misguided as part of the problem?

Ms. SCHAPIRO. It is a great question.

You know, there is always a desire for a law enforcement agency to try to have a presence across a broad spectrum of potential misconduct so that people don't think that we are not watching insider trading right now, so that is an opportunity to do that while we are focused on Ponzi schemes.

So you try to have a presence across the full range, but the fact is we do not have enough resources to always have a presence across the full range, and we have to select our cases based on the risk the potential conduct creates for the investing public.

I know that the new enforcement director who is coming in is really very committed to this process of taking apart the pipeline and of looking at what is old and is of minimal deterrent or punitive value, and pushing those things either out or shutting them down, knowing that somebody might have done something wrong. We are just not going to deal with that right now.

We are converting our resources to what I would describe as a higher and better use, the higher impact, better investor-protection kinds of cases. I think we will never have enough resources, any of us, to do all of the things we would like to do. We must be risk-based in our approach to enforcement.

Mr. CRENSHAW. Thank you.

Thank you, Mr. Chairman.

Mr. SERRANO. Thank you, sir.

Ms. DeLauro.

MERGING THE SEC AND CFTC

Ms. DELAURO. Thank you, Mr. Chairman.

I have a quick question, Madam Chair, and that is about—since I chair the Appropriations Subcommittee on Agriculture, where we have jurisdiction over the CFTC, I wanted to get your view on whether or not you think that a merger between the SEC and the CFTC is appropriate. We had Secretary Paulson suggesting such a move, and my understanding—I have not spoken to him recently—is that Chairman Frank of Financial Services is saying that is not being discussed.

Do you think combining the activities of these two efforts would make sense in terms of a merger?

Ms. SCHAPIRO. You know, I chaired the CFTC at some time in my life, and I have watched the debate, particularly in Congress, over this issue over many, many years, and I recognize that it is a very difficult issue.

Ms. DELAURO. Its jurisdiction is very interesting as well as to how it is spread out.

Ms. SCHAPIRO. It is as the futures markets have evolved and have become highly financial markets.

Frankly, I have tremendous admiration for the way those markets have developed with a genuine entrepreneurship and creativity, and they are among the most successful markets in the world, equity or derivative.

I think there is logic to bringing the two agencies together. I think there are some gaps between us. I think there are some overlaps. I think there is some frustration on the part of the industry that we can have identical products trading under a securities regime and under a commodities regime with slightly different rules. I think that there are sometimes real delays in getting products to market because both regulators have to agree.

At the same time, I also think that we can work very well with the CFTC as a separate and independent agency, and we can have a partnership that is more effective going forward than perhaps it has been historically, and that should not stop us from doing what is right to protect investors. I know the new CFTC Chair nominee is very much committed to that as well.

So I guess I am going to dodge your question a little bit and say it could be done, and it would make a lot of sense. But if it is not done, I think there is a lot we can do to work together and be more effective as co-regulators.

Ms. DELAURO. If you were thinking about its being done, would you separate it out, agricultural commodities?

Ms. SCHAPIRO. You know, I think that is a harder question because I think traditionally the way it has been thought about is that it is the mechanism of the futures markets that matters, not the underlying commodity that is being traded. I would have to think about that a lot more carefully, whether you would want to create a little agricultural sort of trading oversight agency versus financial. I am not sure that makes sense.

Ms. DELAURO. Thank you very much.

Thank you, Mr. Chairman.

Mr. SERRANO. Thank you.

Now we recognize my compadre, Mr. Kirk.

ENFORCEMENT OF NAKED SHORT SELLING

Mr. KIRK. Thank you.

I wanted to go back to, obviously, the point that resources are only part of the picture. Aggressiveness in corporate culture at the Commission is key. Of course, AIG had oversight by the Office of Thrift Supervision, which actually has a higher staffed entity ratio than the Commission, and they still missed it.

Back to my point on the better enforcement on naked short selling. My understanding is that the Commission is not really taking an aggressive position on enforcing the rule on new exchange-traded funds. We have on Wall Street some very leveraged, uber short funds.

For example, one that I noticed was called SKF, whose mission is ultrashort financial positions. Their mission statement is, "Our fund seeks daily investment results that correspond to twice the inverse of daily performance on the Dow Jones financial."

So it is a heavy, short position on the short term, but it appears they are using credit default swaps as their short position, so they are not actually in a traditional shorting of the market. They may be doing this through London.

The way I would explain it to Congressmen is that you are taking out life insurance on everybody in the neighborhood, and then suddenly there are a lot of deaths in the neighborhood, and you are collecting on all of these, so this is a de facto short.

I am wondering if you could look into this, because you mentioned $25 trillion in the CDS market, and you are actually a language leader. There may be a point where we do not call them "CDS's" and we call them "bond insurance" so we can then begin to think of them for what they actually are. Then a life insurance concept is that I cannot take out a life insurance policy on someone I am not related to. Yet these CDS positions are taken out, creating an enormous interest in destroying the assets so you can collect on the policy. By the way, that collection has been courtesy of the U.S. taxpayer lately.

Can you talk about using CDS's and shorts and enforcing naked short selling on this tactic?

Ms. SCHAPIRO. This is an issue, actually, that has only really come to my attention in the last couple of weeks, this idea of having a short position and then utilizing the CDS in this way.

I do not have any answer for you to the extent to which it is actively being pursued in the agency. I would like to get back to you on that. I know that I have passed the information that I have received in the last 2 weeks from a couple of different people on to our trading and markets division to take a look at it and see if we can understand the extent to which it is happening. I would be happy to come back to you with that.

[The information follows:]

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

THE CHAIRMAN

April 15, 2009

The Honorable Mark Kirk
U.S. House of Representatives
1030 Longworth House Office Building
Washington, D.C. 20515

Dear Representative Kirk:

I am writing in response to questions you raised during my March 11 testimony before the Financial Services and General Government Subcommittee of the House Appropriations Committee. I appreciated the opportunity to testify as well as your constructive questions.

During the hearing, you inquired about the SEC's enforcement with respect to abusive "naked" short selling. You also asked about a trading strategy in which credit default swaps ("CDS") are used in conjunction with short sales. The SEC is looking very closely at the area of short selling. On April 8, 2009, the Commission held an Open Meeting at which it approved for public comment several rule proposals that would restrict short selling. The release was recently published at http://www.sec.gov/rules/proposed/2009/34-59748.pdf. In addition, the Commission takes very seriously the concerns held by many in Congress and the investing public about abusive "naked" short selling.

Abusive "Naked" Short Selling

The Commission has been focused on the issue of abusive "naked" short selling since before my arrival in January, and I believe the agency's actions have led to a significant decline in failures to deliver.[1] In October 2008, the Commission adopted Temporary Rule 204T of Regulation SHO, which requires participants of a registered clearing agency to immediately close-out fails to deliver in all equity securities. Specifically, fails resulting from short sales must be closed out no later than the beginning of trading on the day after the fail first occurs, and fails resulting from long sales or market making activity must be closed out by no later than the beginning of trading on the third day after the fail occurs.

[1] In understanding the Commission's actions, it is important to note that "naked" short selling, or selling short without having borrowed the securities to make delivery, resulting in a "failure to deliver," commonly called a "fail," can occur for legitimate reasons, without any sort of manipulative intent. The mere fact that a transaction experiences a fail does not imply a violation of the federal securities laws. Indeed, a fail may occur as a result of a long sale (i.e., a sale of owned securities) as well as a short sale, and can be due to a processing error or the time it takes to obtain a needed legal opinion. Further, the practice of "naked" short selling can provide needed market liquidity in certain circumstances. For instance, market makers sometimes engage in legitimate "naked" short selling when they cannot immediately locate shares to borrow because there is high buying demand in a security.

Since the adoption of Rule 204T, fails have declined significantly. For example, the number of securities appearing on the list of securities that have high persistent fails relative to total shares outstanding, known as the "Threshold Securities" list, has dropped from approximately 500 securities in July 2008 to approximately 70 securities by the end of February 2009. The vast majority of the 70 securities are ETFs or other structured products, which generally fail for reasons unrelated to abusive short selling.

At the same time that it adopted Rule 204T, the Commission also adopted Rule 10b-21, a "naked" short selling antifraud rule, which prohibits deceiving certain persons, such as brokers and dealers, about the seller's intention or ability to deliver securities in time for settlement, and then failing to deliver those securities by the settlement date. When it adopted this rule, the Commission noted that the activity prohibited by Rule 10b-21 was (and continues to be) already illegal under the general antifraud provisions of the federal securities laws, but the Commission believed that the new rule would focus the attention of market participants on such activities and thereby increase compliance with Regulation SHO.

The goal of both Commission actions was to reduce the potential for use of abusive "naked" short selling tactics, including tactics used to facilitate market manipulation. To the extent that market manipulation through short sales may still occur, these new rules also provide the Commission with additional weapons in its arsenal to prosecute such illegal activity. Compliance with both of these anti-abusive "naked" short selling rules is a continuing focus of Commission examinations and is one of the risk areas identified in a new tool that our Office of Compliance Inspections and Examinations recently deployed (the "Risk Assessment Database for Analysis & Reporting," or RADAR) to help target examinations based on risk. Enforcement staff takes seriously all credible complaints regarding manipulative "naked" short selling.

When the SEC receives credible evidence of manipulative behavior involving "naked" short selling, the SEC is vigilant in following up on the information and pursuing wrongdoers. One of the first major projects the agency undertook upon my arrival in January was to launch a comprehensive review of how all tips, complaints and referrals are received, tracked, and pursued. That project is well underway, and I expect significant improvements to our processes this year.

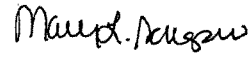
Short Selling and Credit Default Swaps

At the hearing, you expressed specific concerns about a trading strategy involving credit default swaps and short sales. The Division of Enforcement has numerous investigations open and active to examine this very scenario. In September, the Commission announced a wide ranging investigation focusing on this very topic. Overall, we have over 50 current investigations involving CDS issues. Selling short and buying CDS protection is a legal strategy. It is only with the added element of manipulative intent that it violates the federal securities laws.

In this context, it is worth noting that, although the SEC has anti-fraud jurisdiction over CDS, presently the agency does not have authority to promulgate rules related to reporting or record-keeping in this area, which would provide the type of information we typically would use to identify suspicious trading patterns. This information gap substantially inhibits our enforcement efforts in this area. Also, the efforts to provide central clearing for CDS will bring to this market much-needed transparency that will enable the Commission to better police transactions effected through the use of a central counterparty for manipulative activity, including any strategies that involve manipulative CDS trading coupled with short selling. However, additional recordkeeping, reporting, anti-fraud and anti-manipulation authority in this area is likely needed to fully address this issue.

I appreciate your interest in these important issues, and look forward to working with you and others in Congress to ensure that the SEC has the tools and resources to continue to vigorously enforce the securities laws and restore investors' confidence in our markets.

Sincerely,



Mary L. Schapiro
Chairman

Mr. KIRK. I appreciate that.

APPLICATIONS FOR CDS CLEARINGHOUSE

Also, I know we have the CDS clearinghouse, or I would call it the bond insurance clearinghouse program.

Can you give us a timeline on how you are doing in approving applications?

Ms. SCHAPIRO. Yes.

Mr. KIRK. Because making sure that positions are exactly defined, knowing who the parties are and the prices exchanged, give the kind of transparency and reassurance the market needs in this; and then rapidly approving this so we can bring all this out in the open, I think.

Ms. SCHAPIRO. I completely agree with you. I think it is critically important that we get this sort of central clearinghouse, central counterparty system up and operating. As you may know, the Commission approved, as the Fed did, the ICE Trust about a week ago. There is an application from the CME, and I expect a decision on that imminently.

Mr. KIRK. I am totally in favor of good financial investment in the city of New York, so I congratulate ICE. I would just say that having full competition getting CME on line so these two can go at it is what we would like.

Ms. SCHAPIRO. Absolutely. We have resolved, I think, all of the decisions and we will have a decision very soon, I expect, but I think competition in this space will be a very healthy thing.

Mr. KIRK. Absolutely. Thank you.

Thank you, Mr. Chairman.

Mr. SERRANO. Thank you.

Ms. Lee.

SUDAN INVESTMENT AND ACCOUNTABILITY ACT

Ms. LEE. Thank you, Mr. Chairman.

Madam Chair, let me first just say, in listening to you and given the fact that you have not fully staffed up, this may be a question for which we can wait to get the response back, but I was just going to put it out there.

Many of us have been involved for many years now in trying to end the horrific genocide that is taking place in Darfur. I authored legislation that would allow cities, States and universities to divest assets from companies doing business in the Sudan. It passed, and it was signed into law by President Bush. The Sudan Accountability and Investment Act was signed into law at the end of 2007 and, quite frankly, reluctantly by President Bush because he did issue a signing statement when he signed this bill. It was bipartisan. It is a good bill.

It does allow for safe harbors. There is a safe harbor provision that allows for investment companies making divestment decisions to not be faced with potential lawsuits. The SEC was charged with developing the regulations to allow these companies to divest so that they could take advantage of the safe harbor provisions. The SEC followed through, issued the regulation, and, to my knowledge, no company has taken advantage of this regulation.

So I am not sure if you are aware of this regulation and if there are any roadblocks. If we could get the status of that, it would be very useful because this was an important tool for us to use to help once again make our declaration of genocide in our statement and in our policy very clear to the Government of Sudan.

Ms. SCHAPIRO. I would be happy to get back to you on that. I have no idea what the status of it is, but I would be more than happy to provide that.

[The information follows:]

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

THE CHAIRMAN

March 20, 2009

The Honorable Barbara Lee
U.S. House of Representatives
2444 Rayburn House Office Building
Washington, D.C. 20515

Dear Representative Lee:

At the March 11, 2009 hearing of the House Subcommittee on Financial Services and General Government, you inquired whether any investment companies had utilized the "safe harbor" provision under the Sudan Accountability and Divestment Act of 2007 (the "Act"). This letter responds to your inquiry.

The Act, which was signed into law on December 31, 2007, provides, among other things, that no person may bring a civil, criminal, or administrative action against any registered investment company based solely upon the company divesting from securities issued by persons that the company determines conduct or have direct investments in certain business operations in Sudan. This safe harbor is available only if the investment company makes disclosures about the divestments in accordance with SEC regulations. The SEC disclosure regulations that implemented the safe harbor provided by the Act went into effect on April 30, 2008, and require disclosures under the Act to be included in SEC filings on Forms N-CSR and N-SAR.

My staff has reviewed filings on Forms N-CSR and N-SAR and has not located any instances of a registered investment company having made the disclosures required to rely on the Act's safe harbor. The reasons for this could vary from company to company. Some investment companies, for example, may have divested, but determined not to rely on the safe harbor. Other investment companies may have had no relevant holdings or may not have divested their relevant holdings. In any event, the SEC staff is not aware of any regulatory roadblocks preventing investment companies from utilizing the safe harbor should they choose to do so.

Please feel free to contact me with any further questions regarding this matter.

Sincerely,

Mary L. Schapiro
Chairman

Ms. LEE. Thank you very much.
Thank you, Mr. Chairman.
Mr. SERRANO. Thank you.
Ms. Wasserman Schultz.

REGULATION OF HEDGE FUNDS

Ms. WASSERMAN SCHULTZ. Thank you.

I know we touched on hedge funds a little bit this morning, but what is your view on the regulation of hedge funds and how we would go about making them more transparent?

Ms. SCHAPIRO. They are enormous players in the capital markets. I think one of the lessons again from the last year is that great swaths of unregulated institutions and products can create problems as much because we don't know what they are doing as because they might be doing something that is problematic.

So I think it is really important for hedge funds to be registered, certainly, at least systemically important ones. They ought to be subject to inspection and examination by the SEC, and the SEC probably needs sort of plenary authority to enact whatever other rules seem appropriate. Certainly, at a minimum, disclosure to the regulators about the trading practices, activities and holdings would be valuable. Whether there is a public disclosure component to that or not, I guess I don't know the right answer to that question, but I think we have got to develop a regulatory regime that is meaningful for hedge funds at this point.

IMPROVING INVESTOR LITERACY

Ms. WASSERMAN SCHULTZ. The other question I had was, although it is not really something that you are directly responsible for, what can the SEC do about improving investor literacy? I mean most people are completely in the dark about the investments that they are making. They do not understand them. It is very hard to get their minds around what decisions are being made on their behalf or the ones that they should make.

Ms. SCHAPIRO. We see every day, at a time like this, the sort of tragedy play out at the lack of investor literacy in our population generally. This is way beyond the SEC's purview.

My personal view is that we should have a mandatory requirement for graduation from high school that you achieve a certain level of financial literacy. But that is way beyond my either expertise or authority.

Ms. WASSERMAN SCHULTZ. Is there anything that the SEC can specifically do?

Ms. SCHAPIRO. We do have a very small investor education office. It does provide materials on a Web site. We reach about 8 million to 9 million investors a year who either visit the Web site, who call our office for information, or who we meet through investor forums that we hold around the country on a relatively small scale.

We are also partners with other Federal agencies, and that has been, you know, somewhat successful. We could do much more, I think, again with resources. I am sorry to say that. We could be partnering more with the States which I think have a great capability to deliver financial education. We could be partnering with AARP and groups like that. There is a tremendous need among

senior citizens who are disproportionately taken advantage of by fraud centers. We could partner with other organizations, I think, more effectively than we have been able to; but, in part, because we just have not had the resources to dedicate to it. It is absolutely essential, I think, to the economic future of the country.

Ms. WASSERMAN SCHULTZ. It really is.

Mr. Chairman, it is such a dice roll when people have their entire life savings tied up in the decision-making of a person whose decisions they just completely do not understand. I think even though it is not something they have been able to do, we should try when we craft our budget to make it more possible for them to reach more people so that they can keep track of their own investments.

Thank you. I yield back.

Mr. SERRANO. Thank you.

I would agree that what changes now is that when we craft this bill, we do it with the full understanding that everyone is hurting and that we have to find ways to prevent the past from taking place again, and look to the future with vigor and with strength, but with the ability to catch these things before they become a problem.

Mr. Boyd, you will be our last to ask questions.

CONSOLIDATION OF FINANCIAL REGULATORS

Mr. BOYD. Thank you, Mr. Chairman.

Chairman Schapiro, on the super-regulator issue or the fact that the industry is regulated by six or seven different regulators?

Ms. SCHAPIRO. Well, there are 50 State insurance regulators.

Mr. BOYD. But at a Federal level.

Ms. SCHAPIRO. Yes. At the Federal level, there are a dozen or so.

Mr. BOYD. Is that part of our problem? Would it be good for this Congress to consider some consolidation?

Ms. SCHAPIRO. I think it is part of our problem on a couple of different levels.

One is when you have multiple regulators, you undoubtedly have gaps between them and are not clear as to who is responsible. Sometimes you have the ability of regulated entities to select their regulator, which creates a whole set of issues as well. Then we have areas where multiple regulators are doing the same thing, vis-a-vis the same institutions, so now you are wasting your resources.

So I think we have to take a look at how rational is the structure that built up, in a way, logically over 70 years of economic history. You know, most of the agencies were created in the early part of the last century, and they built up around the type of institution or the type of product that was being sold. But it is time to take a fresh look at that because the lines between products don't make sense anymore, and institutions are in multiple lines of business.

Mr. BOYD. Of course you are not suggesting that people in the industry would learn how to game that system?

Ms. SCHAPIRO. No. No. No. Of course they would not.

Mr. BOYD. Thank you. Thank you, Madam Chairman.

QUESTIONS FOR THE HEARING RECORD

Mr. SERRANO. Thank you, Mr. Boyd.

I want to let the committee members know that we have the ability to insert questions for the record. I have five that I will insert for the record, Chairman Schapiro.

CONCLUDING REMARKS

Mr. SERRANO. Look at that timing. There goes the bell.

I have to tell you something. Your testimony today was frank, was strong, and it gives us a lot of hope. I have to tell you that the young woman to my left—I do not mean my political left, although she is—anyway, I am not going to ruin her Republican career here. She leaned over to me and said, "Isn't it nice to have someone who answers the question you ask?"

Ms. SCHAPIRO. Although, I tend to go on a little too long.

Mrs. EMERSON. Actually, not on this subject.

Mr. SERRANO. Not on this subject. We cannot go long enough.

So I really feel good about today's hearing, and I feel good about having you in this position, and I feel good about the fact that everything you told us today indicates that you know there is a huge problem, that major mistakes were made in the past, that some criminal acts were committed in the past, and that you want to get to the bottom of it all.

I know you have the support of this subcommittee. You have the support of the full committee. You have the support of even people who in the past, I believe, did not want certain oversight and who now know that their constituents have told them we have got to have oversight, that we have got to have controls. I know you have the President's support.

So I congratulate you on your testimony today. We will stay close as this process goes on. We will try to get you the resources for you to do the job you have to. We in all honesty cannot promise you anything because, as the economy hurts, so does the ability of Congress to come up with money. Not lately, but wait. When we ask, they will tell us, oh, we gave it all out to some other people, to the banks, months ago.

But I really congratulate you, and I thank you for your testimony today. I thank you for your service to our country.

Ms. SCHAPIRO. Thank you very much.

Financial Services and General Government Subcommittee
Hearing on the Securities and Exchange Commission
March 11, 2009

Questions for the Hearing Record from José E. Serrano

1. Stanford Group Fraud

Last month the SEC accused Robert Allen Stanford and three of his companies with perpetuating an $8 billion fraud against investors. I understand that in 2006, suspicions about the Stanford Group were raised within the SEC and that an investigation was opened in October 2006 but, in the words of an SEC official in Texas, the Commission "stood down" on its investigation at the request of another federal agency. The investigation resumed again in December 2008 which led to the current criminal charges.

Is it correct that an investigation was begun but was then stopped at the request of another agency? If so, can you tell the Subcommittee what agency made such a request and what was the basis for the request?

Response: I understand from the staff that the decision to have the Department of Justice (DOJ) take the lead on the Stanford investigation from June 2008 through December was not unusual and was made so that nothing was done to compromise the criminal investigation. In this respect, we deferred to the criminal authorities, who have many more investigative tools at their disposal. The criminal authorities also have the power, unlike the SEC, to seek jail time. Although we deferred to the criminal authorities during that six month period of time, our investigation and our collaboration with DOJ continued.

Is it customary for the SEC to halt an investigation at the request of another federal agency?

Response: The SEC is an independent civil agency. Although we work – often closely – with other federal and state criminal and regulatory authorities, our decisions and actions are separate and independent. Nevertheless, our relationship, particularly with federal criminal authorities, is cooperative. The nature and extent of the cooperation varies from case to case. Although we each work independently, I believe a cooperative relationship only serves to advance the interest and protection of investors. Again, although we deferred to the criminal authorities during that six month period of time, our investigation and our collaboration with DOJ continued.

Did resource constraints play a role in the decision to start, stop, then resume an investigation?

Response: I do not believe that resource constraints played a role in our decisions with regard to this investigation. There were, however, numerous impediments to our investigation throughout.

What prompted the SEC to restart the investigation again in December 2008?

Response: After receiving additional information, in coordination with DOJ, we moved forward in late December 2008 toward the emergency actions we filed in February. The request for a TRO and complaint were then filed by the Commission on February 16 and 17, 2009.

2. GAO Report

Earlier this year [January 9], the Government Accountability Office issued a report entitled "A Framework for Crafting and Assessing Proposals to Modernize the Outdated U.S. Financial Regulatory System." GAO prepared the report in order to help policymakers better understand existing problems with the financial regulatory system and craft and evaluate reform proposals.

Is the Administration incorporating the framework outlined by GAO into its proposals for regulatory reform?

Response: I understand that the Administration has been preparing a proposal on regulatory reform and has reached out to the Securities and Exchange Commission and others for input. I believe that in crafting its proposal the Administration has reviewed a number of proposals and reports, including the GAO's. In light of this question, however, I have asked staff to provide an additional copy of the GAO report to the Administration staff working on the proposal and have informed them of your interest.

3. U.S. Chamber of Commerce Recommendations

In February 2009, the U.S. Chamber of Commerce issued a report entitled "Examining the Efficiency and Effectiveness of the U.S. Securities and Exchange Commission." The report was prepared by a former senior official at the SEC, Jonathan G. Katz, who served as Secretary to the Commission for nearly 20 years. The report makes 23 recommendations, all of which could be implemented within the SEC's current jurisdiction, that is, no legislative changes would be required. Please provide the Subcommittee with SEC's views on the report's 23 recommendations.

Response: The Chamber's 23 recommendations fall within four broad categories: SEC Structure and Management, the Exemptive Order Process, the SRO Rule Filing Process, and the No Action Letter Process. While I believe that all of these recommendations deserve deliberate consideration, I have placed highest priority on considering those recommendations affecting the SEC's ability to act quickly to resolve the current problems facing our country and markets. In this vein, I have announced that we will be creating a Chief Operating Officer

position (see recommendation 4 under SEC Structure and Management), and that we are expanding the breadth of our staff expertise, primarily in the areas of risk assessment and fraud detection (see recommendation 6 under SEC Structure and Management). We have also expedited several exemptive order requests, in an effort to strengthen investor protections in the area of credit default swaps (see recommendations 1 and 4 under Exemptive Order Process). The remaining recommendations will be evaluated in the course of the next 12 months, as the Commission moves to restore investor confidence by diligently protecting investor interests and the integrity of the capital markets.

4. Qualifications of Accredited Investors in Hedge Funds

In 2007 the SEC proposed rule a rule that would increase the wealth threshold an individual would need to have in order to invest in a hedge fund. As incomes and net worth increase, the standards for qualifying as an accredited investor are becoming increasingly easy to meet. This means more people are participating in hedge funds and raises serious questions about individual investors' understanding of the potential risks and rewards presented by hedge funds and their capacity to absorb the potential losses. Adoption of such a rule could significantly reduce the number of U.S. households that are eligible to invest in hedge funds. What is the status of this proposed rule?

Response: Under current law, a hedge fund may not make, or propose to make, a public offering of its securities.[1] To comply with this requirement, most hedge funds rely on the safe harbor to Section 4(2) of the Securities Act of 1933 that is provided by Rule 506 of Regulation D. Consistent with this safe harbor, these hedge funds offer and sell their securities almost exclusively to accredited investors, as that term is defined under Rule 501(a) of Regulation D. The accredited investor qualification standards applicable to natural persons generally were established in 1982.

On December 27, 2006, the Commission proposed to amend Regulation D to add a new category of accredited investor, the "accredited natural person," under Regulation D that would apply to natural persons investing in hedge funds and other private investment pools, such as private equity funds. The new category was designed to address the rise in investor wealth and income from 1982 to the time of the proposal in 2006 and the non-public and increasingly complex nature of hedge funds.

As proposed:

"Accredited natural person" would be defined as any natural person who:

[1] Private investment pools, such as hedge funds, generally rely on one of two exclusions from the definition of investment company provided by the Investment Company Act of 1940, each of which state that any fund relying on the provision cannot make a public offering of its securites. *See* Section 3(c)(1) of the Investment Company Act and Section 3(c)(7) of the Investment Company Act.

- is an "accredited investor" (net worth exceeds $1 million, or whose individual income exceeds $200,000 (or joint income with the person's spouse exceeds $300,000) in each of the two most recent years and who has a reasonable expectation of reaching the same income level in the year of investment); *and*

- has at least $2.5 million in investments.

The $2.5 million investment standard was based on inflation-adjusted value of $1 million net worth in 1982 plus an additional amount to reflect risk and complexity of hedge fund investments. As proposed, the standard would be adjusted for inflation every five years. In addition, the accredited natural person standard would not apply to certain venture capital companies out of the concern that the proposal could impede capital formation.

On August 3, 2007, the Commission issued a separate proposal to amend other provisions of Regulation D and, at that time, requested additional comment on the accredited natural person proposal.

The Commission received over 600 comment letters in response to the requests for comment on the accredited natural person proposal. The vast majority of comments were negative. Among the concerns expressed were:

- The proposal would add another category of eligible investor (in addition to accredited investor, qualified purchaser and qualified client standards) creating additional regulatory complexity, confusion and increased compliance costs.

- The new standard could impede formation of domestic hedge funds, start-ups and smaller funds, and could cause issuers to move offshore.

- Hedge funds should not be singled out while there are arguably equally risky and riskier investments that can be sold to investors without enhanced requirements.

- The Commission does not have the authority to impose an investment test on investors in hedge funds.

- The requirement that an investor have $2.5 million in investments is arbitrary.

The Commission is continuing to assess the appropriate course of action with respect to the accredited natural person proposal, particularly as we examine more broadly how best to address the relative lack of regulation of hedge funds and their investment advisers. We expect to work very closely with Congress on these issues. In addition, as a result of the current financial crisis and the downturn in

the housing market, the questions about individual investors' understanding of the potential risks and rewards presented by hedge funds and their capacity to absorb the potential losses are all the more acute. We are hopeful that, working with Congress, we can address these issues in a way that best serves the interests of America's investors.

5. Insider Trading Allegation at Lehman Brothers

In April 2008, a former analyst on the semiconductor industry at Lehman Brothers provided documentation to the SEC's Enforcement Division claiming that employees at Lehman Brothers may have tipped off clients and traders about the content of research reports prior to the reports being made public, a clear violation of insider-trading regulations. Can you tell the Subcommittee if the SEC ever launched an investigation into this insider trading claim?

Response: While is it our policy to neither confirm nor deny the existence of an investigation, we can assure you that the information received in April 2008 regarding possible misconduct by employees at Lehman Brothers is receiving careful review in accordance with the Commission's responsibilities under the federal securities laws.

TUESDAY, MARCH 31, 2009.

FEDERAL TRADE COMMISSION (FTC)

WITNESS

JON LEIBOWITZ, CHAIRMAN, FEDERAL TRADE COMMISSION

CHAIRMAN SERRANO'S OPENING STATEMENT

Mr. SERRANO. The subcommittee will please come to order. Today we will be hearing from Jon Leibowitz, and I hope he is hearing us, the new Chairman of the Federal Trade Commission. The FTC has all sorts of interesting and important responsibilities, ranging from reviewing mergers and enforcing antitrust laws, to operating the National Do Not Call Registry that shields us from telemarketers to preventing deceptive practices in advertising, to name just a few.

Today, though, we have asked Chairman Leibowitz to focus on a particular set of FTC responsibilities, protecting consumers of financial services, a group that includes just about all of us. Unfortunately, consumer protection and financial services is a very timely topic.

We are in the midst of a financial crisis, a crisis that can be traced in part to an explosion of questionable mortgage lending practices. The end result is that our financial system is facing piles of toxic mortgage-related securities while millions of homeowners are facing the prospect of foreclosure and loss of their homes.

The Federal Trade Commission has regulatory responsibility for part of the mortgage industry, the part not run by banks or other depository institutions. Thus, the commission has jurisdiction over mortgage brokers and other nonbank lenders and servicers of mortgages, and these have been a growing and problematic force in mortgage lending.

The commission has taken enforcement action against some mortgage lenders engaged in unfair or deceptive practices. It has also done valuable public education work. But the problem of reckless and predatory lending seems to have pretty much continued unabated until the whole thing finally came crashing down last year.

Now that hard times are spreading, other aspects of the FTC's consumer protection role are becoming critically important. The Commission has the job of helping to protect the public from schemes that feed off financial misery, from foreclosure rescue scams that leave the homeowner in an even worse position than before; or debt settlement and credit repair services that take badly needed cash and deliver little or nothing in return; or abusive and illegal debt collection tactics.

At today's hearing, we would like to hear about the Commission's role in dealing with these sorts of problems, what has worked well

in the past, what hasn't worked so well, and what are your plans and priorities going forward?

I should also note that this subcommittee, working with our Senate counterparts, has recently taken action to strengthen the FTC's enforcement powers. Our part of the Omnibus Appropriations Act, which was just signed into law, provides the Commission with some new authorities in the area of mortgage lending, including new rulemaking authorities and expanded powers to seek monetary penalties against wrongdoers. The legislation also confers new powers on State Attorneys General to bring suit to enforce mortgage lending standards set by the FTC and other Federal agencies. We would be interested in hearing about how the FTC plans to make use of these new authorities.

Our witness, Jon Leibowitz, has been a member of the Federal Trade Commission since 2004. He was elevated to the chairmanship by President Obama on March 2nd. He has previously served in a number of staff positions with the United States Senate, including as staff director of the Subcommittee on Antitrust and chief counsel to Senator Herb Cole. He is a graduate of the University of Wisconsin and, of course, I have to mention, New York University School of Law.

Welcome to our subcommittee, and congratulations to your appointment as Chairman of the FTC. We look forward to your testimony today and look forward to closely working with you as time goes on.

With that, I would like to have our charming, debonair——

Mrs. EMERSON. I was just going to show you where to turn your microphone on.

Mr. SERRANO. Before I finish introducing you?

Mrs. EMERSON. No, after. Of course I want to hear all the nice things you are going to say about me.

Mr. SERRANO. Our ranking member, Mrs. Emerson.

MRS. EMERSON'S OPENING STATEMENT

Mrs. EMERSON. Thank you very much, Chairman, for those very nice words.

And Chairman Leibowitz, a warm welcome and many congratulations on your appointment to Chair the Federal Trade Commission.

I like the mission of the FTC because of its diversity and its importance in promoting competition by enforcing our Nation's antitrust laws and protecting consumers from fraud and deception.

As the Chairman noted, our current economic crisis has resulted in growing unemployment, the loss of trillions of dollars in the stock market, including the savings of so many Americans for retirement and for college, and also a 6.2 percent decline in GDP last quarter.

As we have learned over the past several months, this crisis was caused by greed that led to risky practices on Wall Street and in some banks and financial institutions across the country. Of course, I realize that some Americans could be to blame for buying houses they knew they couldn't afford, but so many more were victims of predatory and deceptive lenders.

I appreciate, too, Chairman Serrano, that you have been scheduling the oversight hearings on the financial crisis while we wait for the administration's formal budget request. We had a very informative session with the SEC earlier this month on our securities markets. So I look forward today to hearing what the FTC is doing to improve the practices of nonbank lending institutions and what you all are doing to educate Americans to be more responsible consumers.

Mr. Chairman, I must just add, too, I will look forward to rounding out our financial services with the appearance of Secretary Geithner. Hopefully the next time you schedule that won't get canceled.

Thank you so much for being here today.

Mr. SERRANO. We will keep scheduling until we get it right.

Please, if you could limit your testimony to 5 minutes and the whole thing will go in the record. This way we can grill you with some hard questions.

TESTIMONY OF CHAIRMAN LEIBOWITZ

Mr. LEIBOWITZ. I will wait for you to bring down the 800 watt klieg lights. I may ask for an additional 45 seconds, but I will go through it.

Chairman Serrano, Ranking Member Emerson, Mr. Edwards, I am Jon Leibowitz. I am Chairman of the Federal Trade Commission. I do appreciate the opportunity to testify today to talk to you about the FTC's role in protecting consumers from predatory mortgages and also to discuss our antitrust agenda and our resources.

The Commission's views are set forth in the written testimony, which you put in the record, but my answers to your questions are my own.

The FTC, as you know, is a small agency with a vast mission. We have about 1,100 FTEs working on both consumer protection and competition matters. We are heavily engaged in a wide range of areas, as both of you noted, from merger enforcement to privacy, from Do Not Call, which, by the way, Dave Barry referred to as the most successful government program since the Elvis stamp, to spam and spyware, from health care competition to deceptive calling cards, which, as you know, Mr. Chairman, are often marketed to low-income Hispanic consumers and recent immigrants.

If I can just give an aside, that is a poster for some of the calling cards that we brought an action against. And I left, between the two of you, a copy of some of the calling cards that were deceptive. And if you look at the back of that one, on the one you are holding, Congresswoman Emerson, in about a 1 point font, and I underlined it on the card over here, it says, "prices and terms subject to change without notice." Of course, these consumers were getting half of the time they bargained for, and there were a bunch of fees as well.

Mr. SERRANO. I apologize for interrupting you, but this is very courageous. We have discussed this in past hearings. There are a couple of issues in my community which are very touchy, and unless you know how to deal with them, you could run into trouble. One of them is the calling cards, which we know are ripping people off, but everybody in my district uses it to call mom back home.

Number two, which is a very touchy one, and you are hearing it from a Catholic, is all these crosses and rosaries that are advertised as curing everything that is happening in the world. I know that is a very touchy one. But if you watch Spanish TV, for $49.99, all your troubles go away.

Mr. LEIBOWITZ. I would convert from Judaism if that were true.

Mr. SERRANO. In the Argentine community, they also have them. But that one is a real touchy subject, because, you know, faith is something where the cross to us is a symbol of faith, but not at $49.99 and guaranteeing a new house and whatever else.

Anyway, thank you.

Mr. LEIBOWITZ. In those cases, by the way, we have partnered with Attorneys General, which is very, very important for us in leveraging our fairly limited resources.

Mr. SERRANO. Are these charged? Are they full?

Mr. LEIBOWITZ. They may be. I wouldn't call them full. I would call them half full, actually.

Mr. Chairman, the title of your hearing is, "How does the FTC leverage its resources?" And let me assure you that during these very difficult times for so many Americans, the FTC will make protecting consumers from predatory lending and deceptive financial practices a critical priority.

In the past 10 years, we have provided $465 million in redress to American consumers in connection with financial services cases. In the past 5 years, the FTC has brought more than 70 financial services enforcement actions. In the past 2 years, we have increased by more than 50 percent the number of FTEs that are working on financial services matters.

Just last week, our agency announced two more cases against so-called mortgage rescue operations that allegedly charged thousands of dollars in up front fees but failed to provide any assistance in saving people's homes. Even worse, these scurrilous companies impersonated a HUD-endorsed, nonprofit Hope Now Alliance which helps borrowers by offering free debt management and credit counseling services. I am pleased to report to the subcommittee that the courts issued temporary restraining orders stopping these fraudulent claims and freezing the company's assets.

This morning, we are announcing the launch of the FTC's new financial services education campaign "Money Matters" to give people useful information and resources about dealing with today's pressing financial issues, that is using credit, managing debt, paying the mortgage, and, of course, avoiding getting fleeced.

Do we have a copy? I think you guys have copies of the brochure on your desks.

We will be promoting this site through the media, both online and off, and through partner organizations that deal with folks face-to-face. You have all received paper copies today, as I just mentioned. The home page is on the poster over there. We hope you will link to it on your own Web sites so that your constituents can more easily benefit from it. It is at FTC.gov/moneymatters.

Moreover, as you mentioned, Mr. Chairman, the 2009 Omnibus Appropriations Act gave us new authority to issue regulations that will protect consumers from other predatory mortgage practices of nonbanks. We are very grateful for your efforts.

To start, we are looking at clearer rules on mortgage servicing which we recognized as a major and significant problem when we brought an action late last year against EMC, which is a subsidiary of Bear Sterns. In that case, the FTC got $28 million and distributed 86,000 redress checks to American consumers. It is something we are very, very proud of at the agency.

Beyond our consumer protection mission, we actively enforce the antitrust laws in a range of industries of critical importance to American consumers, including health care, energy, technology, real estate and retail goods, and the past 12 months have been particularly active for the Bureau of Competition, with more than 30 new enforcement actions.

More important, the agency has ramped up our attack on collusive pay-for-delay settlements in the pharmaceutical industry. Under these agreements, brand-name drug companies literally pay their generic competitors to stay out of the market. It is win-win for the companies, but it is lose-lose for consumers because it costs billions of dollars for them and also the Federal Government, which buys about 40 percent of all pharmaceuticals. In fact, my colleague, Tom Rosch, who is a Republican, is testifying today before the Energy and Commerce Committee about this issue. Every commissioner, Democrat, Republican and independent, over the last 10 years, has opposed these anticompetitive deals—every commissioner on the FTC.

Mr. Chairman, since 1990, as you know, a significant portion of our budget has been derived from fees collected for pre-merger notification filings under the Hart-Scott-Rodino Act, as well as a smaller amount of fees from the National Do Not Call Registry. HSR fees offset the Commission's annual appropriations, and they are used to fund both our consumer protection and our competition missions.

In about half of all the years, the fees are under the estimate, and in other years, they are over. The agency's fiscal year 2009 appropriations assumes an offset in collection of $168 million through the first 5 months of fiscal year 2009. Not surprisingly, the credit crisis has had an effect, and we have collected only about $16 million in HSR fees. But when the economy improves, we do expect the merger volume to surge. This year's likely shortfall, though, will clearly result in more funds having to be drawn from the Treasury's General Fund.

One final point, at our peak in the late 1970s, the Commission had nearly 1,800 FTEs, but during the 1980s, the FTE level was decreased by nearly half. Today, the Commission has only about 1,100 FTEs. To this committee's credit, you have recognized the demands placed on the agency and the way we have honored our commitment to American consumers, and you have responded by providing additional resources. This will greatly help us to fulfill our mission which is, of course, to help consumers.

Thank you for the opportunity to speak today. We look forward to speaking with the committee. I would be pleased to answer any questions you have.

[The information follows:]

PREPARED STATEMENT OF

THE FEDERAL TRADE COMMISSION

on

"Leveraging FTC Resources

to Protect Consumers of Financial Services and Promote Competition"

Before the

HOUSE COMMITTEE ON APPROPRIATIONS
SUBCOMMITTEE ON FINANCIAL SERVICES AND GENERAL GOVERNMENT
UNITED STATES HOUSE OF REPRESENTATIVES

Washington, D.C.
March 31, 2009

I. Introduction

Chairman Serrano, Ranking Member Emerson, and members of the Subcommittee, I am Jon Leibowitz, Chairman of the Federal Trade Commission (FTC or Commission).[1] I appreciate the opportunity to appear before you today to discuss the Commission's efforts to protect consumers of financial services. In the last five years, the FTC has brought more than 70 financial services consumer protection cases.

The FTC is the only federal agency with both consumer protection and competition jurisdiction in broad sectors of the economy. The agency enforces laws that prohibit practices that are harmful to consumers because they are anticompetitive, deceptive, or unfair, and it promotes informed consumer choice.

The current economic crisis has demonstrated the need for federal agencies to more effectively police the financial services industry. The crisis has had devastating effects on consumers' ability to obtain credit, make their credit payments, and maintain their credit ratings. Although the Commission believes that it has provided important protections to consumers of financial services, it must do more.

This testimony provides an overview of the FTC's consumer protection authority related to financial services, describes the Commission's recent law enforcement efforts and outreach on behalf of consumers of financial services, and recommends changes in the law and resources to enhance the FTC's ability to protect consumers. This testimony also discusses the Commission's recent competition agenda and current resource allocations.

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[1] The views expressed in this statement represent the views of the Commission. My oral presentation and responses to any questions are my own, however, and do not necessarily reflect the views of the Commission or any other Commissioner.

II. Overview of FTC Authority in the Financial Services Arena

Although many federal agencies have authority over financial services, the FTC is the only federal agency whose sole objective with respect to financial services is to protect consumers. The Commission enforces the Federal Trade Commission Act (FTC Act), which prohibits unfair or deceptive acts or practices in or affecting commerce. 15 U.S.C. § 45(a). The Commission also enforces many other consumer protection statutes that govern financial services providers, including the Truth in Lending Act (TILA), the Home Ownership and Equity Protection Act (HOEPA), the Consumer Leasing Act (CLA), the Fair Debt Collection Practices Act (FDCPA), the Fair Credit Reporting Act (FCRA), the Equal Credit Opportunity Act (ECOA), the Credit Repair Organizations Act (CROA), the Electronic Funds Transfer Act (EFTA), and the privacy provisions of the Gramm-Leach-Bliley Act (GLB Act).

Although the Commission has authority over a wide range of acts and practices related to financial products and services, many financial service providers – such as banks, thrifts, and federal credit unions – are exempt from the Commission's jurisdiction under the FTC Act. The Commission's jurisdiction under the FTC Act reaches only to non-bank financial companies, including non-bank mortgage companies, mortgage brokers, and finance companies. Similarly, under the FDCPA and CROA, the Commission has jurisdiction over non-bank entities, including debt collectors and credit repair organizations, respectively.

III. FTC's Protection of Consumers of Financial Services

The Commission has intensified its efforts to protect consumers in the financial services marketplace. The FTC has focused on seven critical areas: (1) foreclosure rescue and loan modification scams; (2) mortgage servicing; (3) fair lending; (4) credit advertising; (5) debt collection; (6) debt settlement; and (7) credit repair. Recent major FTC enforcement actions in

each of these areas are discussed below.[2] In addition to law enforcement, the Commission uses consumer and business education, as well as research and policy development, to protect consumers of financial services.

A. Foreclosure Rescue and Loan Modification Scams

With the rapid increase in mortgage delinquencies and foreclosures, the FTC has stepped up its efforts to protect consumers from foreclosure rescue and mortgage loan modification scams. In a little over a year, the Commission has brought eight cases targeting mortgage foreclosure rescue scams, including two cases filed this month.[3] In these cases, the Commission alleges that the defendants promise to obtain loan modifications or stop foreclosure in exchange for an up-front consumer payment, ranging from $500 to $2,000, but fail to obtain the loan modification or stop the foreclosure. In the two cases filed this month, the FTC also charged the defendants with falsely purporting to be affiliated with the non-profit, government-endorsed HOPE NOW Alliance, which provides free foreclosure prevention assistance.[4] Such scams not

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[2] For a more detailed description of recent cases brought in these areas, see the FTC's March 24, 2009 testimony before the House Committee on Energy and Commerce, Subcommittee on Commerce, Trade, and Consumer Protection, which is available at http://www.ftc.gov/os/2009/03/P064814consumercreditdebt.pdf.

[3] *FTC v. Hope Now Modifications*, No. 1:09-cv-01204-JBS-JS (D.N.J. Mar. 17, 2009); *FTC v. New Hope Property LLC*, No. 1:09-cv-01203-JBS-JS (D.N.J. Mar. 17, 2009); *FTC v. National Foreclosure Relief, Inc.*, No. SACV09-117 (C.D. Cal. Feb. 2, 2009); *FTC v. United Home Savers, LLP*, No. 8:08-cv-01735-VMC-TBM (M.D. Fla. Sept. 3, 2008); *FTC v. Foreclosure Solutions, LLC*, No. 1:08-cv-01075 (N.D. Ohio April 28, 2008); *FTC v. Mortgage Foreclosure Solutions, Inc.*, No. 8:08-cv-388-T-23EAJ (M.D. Fla. Feb. 26, 2008); *FTC v. National Hometeam Solutions, Inc.*, No. 4:08-cv-067 (E.D. Tex. Feb. 26, 2008); *FTC v. Safe Harbour Foundation*, No. 08 C 1185 (N.D. Ill. Feb. 25, 2008).

[4] *FTC v. Hope Now Modifications*, No. 1:09-cv-01204-JBS-JS (D.N.J. March 17, 2009); *FTC v. New Hope Property LLC*, No. 1:09-cv-01203-JBS-JS (D.N.J. March 17, 2009) (temporary restraining orders entered in each case pending a hearing on the FTC's motion for preliminary injunction).

only defraud consumers out of desperately needed funds but also may lead them to forgo viable options for avoiding foreclosure.

In tandem with its law enforcement actions, the Commission also has launched a variety of outreach initiatives to warn consumers about red flags for foreclosure rescue scams and to inform them about the legitimate resources available to them. In addition, the FTC participates in task forces in several regions where foreclosures are most prevalent, both to coordinate enforcement and to develop consumer outreach strategies.

B. Mortgage Servicing

The Commission also has focused on deceptive and unfair practices in the servicing of mortgage loans. Our cases have targeted core servicing issues such as failing to post payments upon receipt, charging unauthorized fees, and engaging in deceptive or abusive collection tactics. For example, in September 2008, the FTC settled charges that EMC Mortgage Corporation and its parent, The Bear Stearns Companies, LLC, violated Section 5 of the FTC Act and the FDCPA in servicing mortgage loans, including debts that were in default when EMC obtained them.[5] The EMC settlement required the defendants to pay $28 million in consumer redress, and the Commission has sent checks to more than 86,000 consumers. The settlement also barred the defendants from future law violations and required EMC to establish a comprehensive data integrity program.

C. Fair Lending

Another significant focus in the mortgage lending area is discrimination. Since the ECOA was enacted, the Commission has brought over three dozen cases alleging that large

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[5] *FTC v. EMC Mortgage Corp.*, No. 4:08-cv-338 (E.D. Tex. Sept. 9, 2008).

subprime lenders, major non-mortgage creditors, and smaller finance companies violated that statute. Most recently, the FTC's enforcement has focused on discrimination in mortgage loan pricing. In December 2008, the FTC reached a settlement with Gateway Funding Diversified Mortgage Services, L.P., and Gateway Funding Inc. (collectively, Gateway), after alleging that Gateway violated the ECOA by charging African-American and Hispanic consumers higher prices for mortgage loans than non-Hispanic white consumers.[6] The $2.9 million settlement, which was partially suspended due to Gateway's inability to pay, bars Gateway from discriminatory lending practices and requires it to implement a fair lending training program. The FTC is using the settlement funds to redress African-American and Hispanic consumers who were harmed by Gateway's practices.

D. Credit Advertising and Marketing

The FTC has initiated numerous cases challenging illegal marketing by lenders, brokers, and other advertisers of consumer credit in violation of the FTC Act or the TILA.[7] The Commission has brought actions against mortgage lenders and brokers for deceptive marketing of loan costs[8] or other key loan terms, such as the existence of a prepayment penalty[9] or a large

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[6] *FTC v. Gateway Funding Diversified Mortgage Services, L.P.*, No. 08-5805 (E.D. Pa. Dec. 17, 2008).

[7] *E.g.*, *FTC v. Mortgages Para Hispanos.Com Corp.*, No. 06-00019 (E.D. Tex. 2006); *FTC v. Ranney*, No. 04-1065 (D. Colo. 2004); *FTC v. Chase Fin. Funding*, No. 04-549 (C.D. Cal. 2004); *FTC v. Diamond*, No. 02-5078 (N.D. Ill. 2002); *United States v. Mercantile Mortgage Co.*, No. 02-5079 (N.D. Ill. 2002); *FTC v. Associates First Capital Corp.*, No. 01-00606 (N.D. Ga. 2001); *FTC v. First Alliance Mortgage Co.*, No. 00-964 (C.D. Cal. 2000).

[8] *E.g.*, *FTC v. Associates First Capital Corp.*, No. 01-00606 (N.D. Ga. 2001); *FTC v. First Alliance Mortgage Co.*, No. 00-964 (C.D. Cal. 2000).

[9] *FTC v. Chase Fin. Funding*, No. 04-549 (C.D. Cal. 2004); *FTC v. Diamond*, No. 02-5078 (N.D. Ill. 2002).

balloon payment due at the end of the loan.[10] Most recently, the Commission announced settlements with three mortgage lenders charged with advertising low interest rates and low monthly payments, but failing to disclose adequately that those rates and payments would increase substantially after a short period of time.[11] The Commission also has taken enforcement actions against payday lenders under the FTC Act, the TILA, and Regulation Z.[12]

As to credit cards, the Commission has jurisdiction over very few issuers, although it has jurisdiction over non-bank entities that market credit cards.[13] In June 2008, for example, the FTC sued CompuCredit Corporation for allegedly deceptively marketing its credit cards to subprime consumers nationwide.[14] Last December, CompuCredit agreed to settle this case for an estimated $114 million in credits and cash refunds to consumers.[15]

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[10] *FTC v. Diamond*, No. 02-5078 (N.D. Ill. 2002).

[11] *In the Matter of American Nationwide Mortgage Co.*, FTC Dkt. No. C-4249 (Feb. 17, 2009); *In the Matter of Shiva Venture Group, Inc.*, FTC Dkt. No. C-4250 (Feb. 17, 2009); *In the Matter of Michael Gendrolis*, FTC Dkt. No. C-4248 (Feb. 17, 2009).

[12] For example, in November 2008, the FTC and the State of Nevada charged ten related Internet payday lenders and their principals, based mainly in the United Kingdom, with violations of federal and state law. *See FTC and State of Nevada v. Cash Today, Ltd.*, No. 3:08-cv-00590 (D. Nev. Nov. 6, 2008).

[13] Banks, savings associations, and credit unions issue the vast majority of credit cards, with national banks alone being responsible for approximately 75 percent of credit cards issued.

[14] *FTC v. CompuCredit Corp.*, No. 1:08-CV-1976-BBM-RGV (N.D. Ga. 2008). The Commission worked closely on this case with the FDIC, which brought a parallel action challenging this deceptive conduct.

[15] *See* Press Release, Subprime Credit Card Marketer to Provide At Least $114 Million in Consumer Redress to Settle FTC Charges of Deceptive Conduct (Dec. 19, 2008), *available at* http://www.ftc.gov/opa/2008/12/compucredit.shtm.

E. Debt Collection

The Commission has stepped up its commitment to enforcing the FDCPA, which prohibits third-party debt collectors from engaging in abusive, deceptive, and unfair debt collection practices. Since 1999, the FTC has brought 21 lawsuits to combat illegal debt collection practices. Through these cases, the Commission has obtained strong permanent injunctive and other relief, including substantial monetary judgments and, for some defendants, bans on collecting debts.[16] In a recent example, in November 2008, Academy Collection Service, Inc. and its owner, Keith Dickstein, agreed to pay $2.25 million in civil penalties to settle charges that they violated the FDCPA and Section 5 of the FTC Act.[17] This is the largest civil penalty that the Commission has ever obtained in an FDCPA case.[18]

F. Debt Settlement

Historically high levels of consumer debt have led many consumers to look for ways to manage their debt. Since 2001, the Commission has filed 14 cases against both for-profit debt settlement companies and sham non-profit credit counseling agencies.[19] The defendants in these

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[16] *See, e.g., FTC v. Check Investors, Inc.*, No. 03-2115, 2005 U.S. Dist. LEXIS 37199 (D.N.J. July 18, 2005) (ban on debt collection and $10.2 million judgment), *aff'd,* 503 F.3d 159 (3d Cir. 2007), *petition for reh'g denied,* Nos. 05-3558, 05-3957 (3d Cir. Feb. 6, 2008).

[17] *United States v. Academy Collection Servs., Inc.*, No. 2:08-CV-1576 (D. Nev. Nov. 18, 2008).

[18] The Commission also recently issued a report recommending legislative and other changes to reform and modernize the debt collection regulatory system. FTC Workshop Report, Collecting Consumer Debts – The Challenges of Change (Feb. 2009), *available at* http://www.ftc.gov/bcp/workshops/debtcollection/dcwr.pdf.

[19] For a list of these cases, see Prepared Statement of the Federal Trade Commission on Consumer Protection and the Credit Crisis before the Senate Committee on Commerce, Science, and Transportation (Feb. 26, 2009), *available at* http://www.ftc.gov/os/2009/02/P084800creditcrisis.pdf.

cases allegedly deceived consumers who were seeking workout options for credit card debt into paying large up-front fees for credit card debt relief services that were never provided. These defendants also allegedly falsely represented that, if consumers enrolled in their programs, debt collectors would stop their collection efforts and consumers could stop making payments to creditors without hurting their creditworthiness.

G. Credit Repair

Finally, with the economic downturn, delinquencies, bankruptcy, and other negative information on credit reports have made it even more difficult for some consumers to obtain credit. Fraudulent credit repair companies falsely promise, in exchange for a fee, to remove negative but accurate information from consumers' credit reports. Since 1999, the FTC has brought 43 cases against such "credit repair" companies. Most recently, in October 2008, the Commission and 24 state agencies announced a law enforcement sweep that included ten FTC actions and 26 state actions against credit repair operations.[20]

H. Enhancing FTC Consumer Protection Efforts

The FTC believes that its past efforts have provided important protections to American consumers in the credit marketplace. The agency, however, recognizes that it must do more. To that end, the Commission recommends that Congress make the FTC more effective by providing it with additional authority. First, the Commission recommends that Congress authorize the agency to employ notice and comment rulemaking procedures to establish rules pursuant to the FTC Act that set forth unfair or deceptive acts and practices relating to all financial services. Second, the Commission recommends that Congress authorize the agency to obtain civil

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[20] *See* Press Release, FTC's Operation "Clean Sweep" Targets "Credit Repair" Companies (Oct. 23, 2008), *available at* http://www.ftc.gov/opa/2008/10/cleansweep.shtm.

penalties for unfair or deceptive acts and practices relating to all financial services and authorize the agency to bring suit in its own right in federal court to obtain civil penalties. Third, the Commission recommends that Congress ensure that, because of the Commission's unequaled and comprehensive focus on consumer protection, its independence from providers of financial services, and its emphasis on vigorous law enforcement, the FTC is considered as Congress moves forward in determining how to modify federal oversight of consumer financial services.[21]

In addition, the Commission asks that Congress provide additional resources to the FTC to increase its law enforcement activities related to financial services and to expand its critical research on the efficacy of mortgage disclosures and other topics.

IV. FTC's Competition Agenda and Workload

The Commission actively enforces the antitrust laws in a range of industries of critical importance to American consumers, including health care, energy, technology, real estate, retail, and consumer goods. Although the number of reportable mergers and other transactions has decreased significantly in the past few months – resulting in a significant decrease in offsetting fees collected – the FTC's competition workload has not fallen off. Competition enforcement activities regarding both mergers and non-merger conduct continue to be substantial. In the last year, the Commission pursued over 30 new competition enforcement actions, including cases that added to the agency's already substantial ongoing litigation workload.

With respect to mergers, the past twelve months was one of the most active periods the FTC has ever experienced. The Commission filed a record six merger challenges in court, two

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[21] These recommendations are discussed in greater detail in the FTC's March 24, 2009 testimony before the House Committee on Energy and Commerce, Subcommittee on Commerce, Trade, and Consumer Protection, which is available at http://www.ftc.gov/os/2009/03/P064814consumercreditdebt.pdf.

of which remain in litigation. The Commission resolved another sixteen merger matters by consent order and the parties restructured or abandoned an additional six mergers in the face of the Commission's concerns.

Antitrust merger litigation is highly resource-intensive because the issues litigated increasingly are technically complex and involve sophisticated economic theories; necessarily, over time the size of litigation teams assigned to matters has grown. Thus, when less staff time is needed for processing and reviewing filings under the Hart-Scott-Rodino Antitrust Improvements Act of 1976 (HSR Act), staff time may be reassigned to these litigations and other matters requiring collection and review of information in preparation for litigation or possible litigation. In addition, the FTC continues to look for and review transactions not subject to the HSR filing requirements and transactions where an antitrust problem may arise or become identifiable only after the deal is consummated. The two matters currently in litigation, and two matters in which the Commission recently obtained favorable results, are of these types. Further, the decrease in filings may reflect a decrease in types of mergers that do not raise competitive concerns; we continue to see significant filings that do raise concerns.

On the non-merger side, the FTC has advanced an enforcement program to attack collusive "pay-for-delay" settlements in the pharmaceutical industry, where the brand name drug company pays the generic drug company to delay its entry into the market. These deals cost billions of dollars – for consumers and ultimately the government, which pays almost one-third of the nation's prescription drug costs. The Commission currently has two cases in court challenging patent settlement agreements between branded and generic pharmaceutical manufacturers as anticompetitive agreements to delay generic entry. Other such matters remain under investigation.

The agency also issued five consent orders this year involving allegations of agreements among competitors to fix prices or otherwise limit competition in real estate, health care services, and the retail sale of consumer goods. Finally, pursuant to the Energy Independence and Security Act of 2007, the Bureau of Competition is leading a task force of staff from throughout the agency to examine whether and in what ways the Commission should develop a rule defining and prohibiting market manipulation in wholesale petroleum markets. The Commission published a proposed rule for comment in August, and expects to conclude the proceeding this spring.

V. Resources

Despite its small size and the tremendous breadth of its mission in both consumer protection and competition, the FTC is working hard to protect consumers. Today, the Commission has only about 1,100 full-time equivalents (FTEs). This is considerably fewer than it had at its peak in 1979, when the Commission had nearly 1,800 FTEs.[22] But in the past decades, the demands placed on the agency have continued to grow with the advent of the Internet and e-commerce, and a variety of significant new laws and regulations that the FTC is charged, at least in part, with implementing and enforcing, such as the CAN-SPAM Act, the Fair and Accurate Credit Transactions Act, the Do Not Call provisions of the Telemarketing Sales Rule, the Children's Online Privacy Protection Act, and the Gramm-Leach-Bliley Act.

Congress has responded by providing additional resources. For FY 2009, Congress has provided the FTC with $259,200,000, which supports 1,116 FTEs. Of the 1,116 FTEs, just over 400 FTEs will work exclusively on consumer protection matters (with additional support drawn

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[22] Commissioner Kovacic believes the Commission will need additional resources but he disagrees with certain aspects of the analysis in Section V of this testimony.

from other parts of the agency), which, in addition to financial services, comprises privacy and data security, marketing practices (including spyware, spam, the Do Not Call Registry, deceptive advertising of prepaid calling cards, and enforcement of the Telemarketing Sales Rule) and advertising practices for a broad range of products, from violent video games marketed to children to fake cancer cures to so-called "green" products and services.

In 1979, when the Commission's FTEs were at their peak, the U.S. population was approximately 225 million. It is now 30 percent greater, and although the agency is always striving to do more with less, the size of the agency has not kept pace with the growth in the population and the sophistication of the marketplace. In addition, the FTC anticipates a further need for resources to fund expanded regulation and enforcement for consumer protection in the area of financial services.

As you know, the agency's appropriation (including offsetting HSR and DNC fees) funds the consumer protection mission of the Commission, which includes the substantial and now heightened efforts regarding financial practices, as well as the competition mission.[23] As we saw in FY 2008 and expect to see in FY 2009, shortfalls in these fee collections result in more of the FTC's funding coming from the Treasury's General Fund to support the agency's critical mission.

VI. Conclusion

The Commission is committed to protecting consumers in the broader credit marketplace. The agency has used all of the tools in its arsenal – enforcement, research and policy

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[23] The FTC's appropriation is partially offset by collections of two separate fees. The first offsetting collections are fees collected under the HSR Act and are tied to the number and size of premerger filings. The second offsetting collections are fees collected under the Do-Not-Call Registry Fee Extension Act.

development, and consumer and business outreach – to protect consumers of financial services. To enable the FTC to perform a greater and more effective role protecting consumers in the financial services area, it recommends changes in the law and additional resources to enhance its authority to promulgate needed rules, prosecute cases against law violators, and conduct critical research. The Commission appreciates the opportunity to appear before you today to discuss the FTC's work and your consideration of its views.

MATERIALS IN OTHER LANGUAGES

Mr. SERRANO. Thank you very much for your testimony.

A quick question, are you allowed or do you have the resources to put these materials in languages other than English?

Mr. LEIBOWITZ. Yes, I think most of our consumer protection materials are also in Spanish. I believe this is in Spanish, too—it isn't yet. It will be shortly.

APA RULEMAKING

Mr. SERRANO. Okay. Thank you.

As far as the rulemaking abilities that we gave you in the omnibus, I would like to ask you a few questions on that.

Could you please explain the importance of rulemaking in your enforcement strategy and why it is important that the Commission be allowed to make use of your Administrative Procedures Act process?

Mr. LEIBOWITZ. Well, we are basically an enforcement agency. We do have rulemaking authority, but it is under the Magnuson-Moss Act, which is kind of a medieval form of rulemaking. It places a number of obstacles on the agency to do rulemakings. Rulemakings can take 6 or 8 years sometimes to do.

So, for example, in the context of the mortgage crisis, we had looked at issuing rules. Commissioners talked about this as far back as a year and a half ago. Really before the mortgage crisis entirely kicked in, we had done a sweep of mortgage advertisements on the Internet, and we found 200 companies with facially invalid advertisements. But we knew we could not do a rulemaking in this area.

So in a reauthorization, we will be looking at something closer to APA rulemaking, but it was enormously important that you gave us this authority in the omnibus to do rulemakings in the financial services area for nonbank-issued mortgages, because people are hurting. They need a response quickly, and with APA rulemaking, we can do that.

One of the areas we are going to be looking at is mortgage servicing. The EMC case involved mortgage servicing, and we found lots of hidden fees, lots of problems, and we think we can help to clean up this industry going forward.

Mr. SERRANO. Just a side question. Why does it take so long for the rulemaking process?

Mr. LEIBOWITZ. Because we don't have APA standard rulemaking, which is notice and comment rulemaking. We have Magnuson-Moss rulemaking. And I think Congress designed it, in all fairness, I think it was designed because we are an agency with very, very broad jurisdiction, but fairly limited remedies. I think Congress designed it to create some impediments on our rulemaking authority.

Having said that, whenever you have passed a major law, CAN-SPAM, Gramm-Leach-Bliley, FACTA, you have given us APA rulemaking, and that has made it much easier for us to effectuate what Congress wants us to effectuate. And I think if we had relief as a general matter from Magnuson-Moss, we would be able to move faster and would be more agile.

CIVIL MONEY PENALTIES

Mr. SERRANO. The omnibus also gives the FTC the power to seek civil money penalties when it is enforcing certain mortgage rules, including rules issued by the Federal Reserve. Why is it important that the Commission have this power? Without authority for civil money penalties, what kind of sanctions could you impose on wrongdoers?

Mr. LEIBOWITZ. Well, that is a great question. Forty-seven State Attorneys General have fining authority. We do not, for violations of our bread and butter statute, which is section 5, Unfair and Deceptive Acts and Practices. Without it, we can sometimes get redress for consumers. We can sometimes disgorge profits. But the thing that we can't do without fining authority is punish malefactors. Of course, we have to ask the court to fine someone, unlike the FCC, for example, which can fine someone, and then it just simply goes to an appellate court for review.

And so fining authority is enormously important for us to have an effective deterrent, Mr. Chairman. And we are going to use it here.

Mr. SERRANO. And you are. In all cases?

Mr. LEIBOWITZ. In appropriate cases. Right. Of course, we will have to get the court's imprimatur in order to effectuate a fine. But it gives us more leverage in negotiating settlements. It makes sure that malefactors don't have two bites at the apple.

Mr. SERRANO. Well, my next question was going to be, how did you plan to use it, but I don't know how specific that would be. I mean, what kind of behavior stands out that you want to move on?

Mr. LEIBOWITZ. At 20,000 feet, I think we want to use it aggressively but appropriately. And then we have to look at the facts of each specific potential case. But if a company is clearly ripping off consumers through deceptive advertisements, or through hidden fees, fining might be appropriate. And again, we can't fine a malefactor unilaterally. We have to go to the court.

Mr. SERRANO. Mrs. Emerson.

Mrs. EMERSON. Thank you, Chairman.

PROPOSALS FOR SINGLE CONSUMER PROTECTION AGENCY

I want to ask you two or three questions about the concept of a Financial Product Safety Commission. Since we have had legislation introduced to create one, and I guess the mission would be of such a Commission to ensure that the offering of financial products to consumers is responsible, accountable, transparent. And while you all have some responsibility for that mission for nonbanks, there are obviously other agencies who deal with the banks themselves.

So my questions are, one, is creating a single Consumer Protection Agency for financial products necessary? Then how would such an agency interact with you all at the FTC and bank regulators? And then could one say, possibly, that this proposal creates yet another regulator whose efforts may or may not be coordinated with other financial regulatory agencies?

Mr. LEIBOWITZ. Well, let me just start with this. Those are all good questions. There is a lot of balkanization in the oversight over

mortgages and financial instruments. Mr. Serrano mentioned that we will be enforcing fining authority that the Fed gave us with its APA rulemaking under the FTC Act. We couldn't do APA rulemaking for ourselves without the Congress giving us that specific authority, but the Fed can do it, and we can impose, under the FTC Act, the Fed's rules.

So, if you are a consumer and you have a deceptive loan or have been ripped off by a mortgage company or bank, it doesn't really make a difference to you who ripped you off. You just want to know where to go. And I think the notion—and the Commission believes this, I think, as well—that there should be one entity or one place that consumers can go is probably a good one. Is it necessary? No. Could it be an improvement on the existing crazy quilt patchwork of laws? Probably.

Then the question is how might they work with us? I think it depends.

So, Elizabeth Warren, a professor at Harvard, the leading proponent of this idea, has said it should be either a newly created entity that does consumer protection, or possibly it should reside in the FTC. Of course, our sense is that if you are going to create such an entity, it probably should be within the FTC, because we have experience we can build on; we are a consumer protection agency.

I would say this, speaking only for myself about the banking agencies, if some sort of entity like this is created, and certainly if it is created in the FTC, you may not want to give us safety and soundness authority because that is not something we do well in our core competency. I am not sure, if you look at it in retrospect, that the banking agencies are necessarily very good at consumer protection. That is something we are very good at.

Mrs. EMERSON. Personally, I think it would make more sense to enhance your authorities to do it, as opposed to setting up a whole new agency and adding just one more layer of bureaucracy. It seems you all are on the right track, and rather than do something new, we might as well just give you all an enhancement.

Mr. LEIBOWITZ. Well, Congresswoman, we like to think we are, and it is good to have your imprimatur. So thank you.

Mrs. EMERSON. You are welcome.

CIVIL ENFORCEMENT VS CRIMINAL PROSECUTION

Let me ask you several other questions. During economic downturns like we are in today, do you all see an increase in the number of unscrupulous people taking advantage of those less fortunate through foreclosure rescue schemes, mortgage servicing deception and abusive debt collection actions? And when you come across those, how do you determine when the FTC should take the case to civil court versus referring it to the Department of Justice for criminal prosecution? So if you could just do those two for now?

Mr. LEIBOWITZ. I think the answer is more anecdotal than empirical, but it is a general sense that, yes, when you see an economic downturn like this, you see bad guys and fraudsters preying much more on consumers, so particularly, we are seeing more of this in the financial services area.

A lot of what we do, and this is true both in the financial services area and outside of it, is bring fraud cases civilly, because we can't

get criminal authorities to bring them. If a case is particularly egregious, we have a criminal liaison unit, which was set up by Tim Muris, our first chairman, a terrific chairman under President Bush who started the Do Not Call list, and if a case is particularly egregious, we will try to get the Feds or Justice Department interested in prosecuting it, or we will refer it over to them.

When we do things like phishing cases and a lot of the identity theft cases, we will generally, because those are truly criminal, refer those over through our criminal liaison unit to criminal authorities.

Mrs. EMERSON. Do you have to jump through lots of hoops to get them to agree to do it?

Mr. LEIBOWITZ. You know, it sort of depends. I think it is not, and understandably not, the largest priority or the highest priority for the Justice Department, but they have been pretty good about doing this. I have talked to Eric Holder and his staff about doing more in the civil area. We are resurrecting a working group that was very active in the 1990s between us and State AGs, which is really useful.

So, no, I don't think we always have to jump through hoops. I just think that all of us deal with limited resources, and you have to prioritize them. And generally they have been pretty good over the past few years about taking the most important cases, and we are pretty aggressive in trying to get them to do that.

Mrs. EMERSON. Thank you.

Thanks Chairman.

"DO NOT CALL" LIST

Mr. SERRANO. Thank you. We mentioned the Do Not Call list a lot, and although that is not the focus of the hearing, I just have to ask you: Do you know if there was a period of time of adjustment? I remember, after I signed up, I got calls all the time, and then, now, it is very lonely. No one calls me.

Mr. LEIBOWITZ. Well, we are delighted to hear that. We keep the sanctity of your private phone numbers, we won't release them to the press. But, yes, there was a period of adjustment. I think we might have had a phase-in for a period of time.

Of course, there are still violators. More and more, they are coming from overseas. But it has been very, very helpful in ensuring the sanctity of Americans' dinner hours, and it has worked really, really well for consumers.

It is one of the areas where we feel really, really proud and one of the areas where consumers may not notice it on a day-to-day basis, but I think all of our lives have been improved by the fact that we are not being besieged by telemarketers.

Mr. SERRANO. Except politicians and elected officials.

Thank you very much.

Mr. Edwards.

FTC STAFFING LEVELS

Mr. EDWARDS. Thank you, Mr. Chairman.

Chairman Leibowitz, thank you for being here today and for your important work.

I want to just go back for the record and clarify what the staff levels have been at the FTC, just approximations, if you could.

In 1980, approximately how many FTC staff did we have?

Mr. LEIBOWITZ. I want to say it was something short of 1,800, around 1,752 in 1979.

Mr. EDWARDS. About 1,800, that is a good enough approximation.

How about 1990?

Mr. LEIBOWITZ. A little over 900; 940. I actually have this in my briefing book somewhere.

Mr. EDWARDS. Nine hundred and forty, and today it is around 1,100?

Mr. LEIBOWITZ. It is around 1,100. Starting around the time I came to the Commission, we developed a sort of consensus that we needed to grow the agency. It was down to 894 at its lowest level in 1989.

Mr. EDWARDS. So our country's GDP has grown significantly in the last 29 years; the complexity of our economy has grown much more complex; and yet your staff is almost cut in half compared to where it was in 1980, is that correct?

Mr. LEIBOWITZ. Right. Now we have grown by about 200 since our lowest level and about 100 or a little bit more FTEs over the last 5 years. And we are grateful for that. Again, we think that we can reasonably effectuate our mission with the staff we have. We have terrific attorneys, terrific employees.

But having said that, as you point out, the population of the United States in 1980 was about 225 million. Now it is about 305 million. And because we are known to be a responsible, reasonably competent agency, we are tasked with effectuating or enforcing a lot of new laws. So CAN–SPAM, Gramm-Leach-Bliley, FACTA, these are all laws where we are the lead or a lead enforcement agency, and we are worried that the quality of our work is going to be strained by the quantity of demands placed upon us.

Mr. EDWARDS. Right. My point would be that it should be no surprise to American citizens that we have had a challenge of the title of this hearing being to protect consumers of financial services and promote competition. Without being any reflection on the hard-working boys at the FTC, our Federal government hasn't done a very good job of protecting consumers from financial service problems, and I am not sure we have done a very good job in promoting competition. I would liken it to people working awfully hard with a city on fire, and we are giving you buckets of water. I just want to be sure that we provide the resources that are needed to protect the private enterprise system.

ANTITRUST ENFORCEMENT

I just have a couple of minutes, I want to quickly ask about the antitrust role you play. It seems to me, my own personal observation is, there are two ways you can kill the private enterprise system in this country. One, you can tax it and regulate it to death. The other is you can be like a football game and have no rules and no referees, where an interesting football game with a lot of fans turns into chaos and eventually no one will come to those games, without rules and effectively being regulated.

We are going to have to deal with this whole issue of too big to fail. I used to stay, if they are too big to fail, they are too big not to be regulated. I am beginning to think, if they are too big to fail, maybe they are just too big.

Address that last point. Tell me exactly what the process is, if you would, when a company wants to merge with another company, what role does the FTC have in approving or disapproving of that? What other Federal agencies play a role, if you could? I apologize. We have just a minute or two.

Mr. LEIBOWITZ. Sure. We share jurisdiction with the Department of Justice. There are some areas that have been historically ours; some that have been historically theirs; some where we work out who will get a particular matter. The standard we apply is section 7 of the Clayton Act. That asks whether the deal might substantially lessen competition, as Congressman Schiff knows from The Judiciary Committee, and we challenge the deals we believe do that.

Now, sometimes we win in court, and we won our first preliminary injunction in 6 years 2 weeks ago in a merger of automotive crash estimation companies, and sometimes we don't. But we try to do our best. The Justice Department has been criticized over the last 8 years for not bringing enough cases or appropriate cases. We have not been criticized for doing that. We have called things as we have seen them.

In terms of too big to fail—it is an interesting issue. It certainly may be an issue in the banking area. I have not seen in my 4½ years on the Commission, a case where we approved a deal that could have been described as too big to fail.

But we are going to be very aggressive going forward. We are going to enforce the antitrust laws, because my colleagues and I think the antitrust laws have worked quite well in boom times and in depressions and in deep recessions. There might be an exception for a company that wants to buy a failing company. That is incorporated into the antitrust laws. But we are going to try to do our best to enforce the law.

Mr. EDWARDS. Thank you, Mr. Chairman.

Mr. SERRANO. Thank you.

Mr. Culberson.

Mr. CULBERSON. Thank you, Mr. Chairman.

ABUSES RELATED TO MORTGAGE LENDING

I appreciate your service, Mr. Chairman. Thank you very much for being here with us today.

The 2009 omnibus spending bill contained an authorization in it to give the FTC expedited rulemaking authority to prohibit unfair and deceptive trade practices acts on mortgage loans. Of course, that is a huge concern, and a big part of the problem we face today has come from people being given loans that shouldn't have been in the first place.

Because of the obvious number of unscrupulous individuals that have taken advantage of people making fraudulent or deceptive mortgage loans, could you describe for me, if you could, sir, what are you doing under that authorization language? Tell me about what rulemaking and what kind of rules you are considering? You

have got, I know, under this language authority to obtain civil penalties. How do you determine whether a case goes to civil court? Are you able to make a referral to the Justice Department for criminal, and how do you distinguish?

Mr. LEIBOWITZ. Yes, answering your last question first, if a case is particularly egregious, we may try to refer it to the Justice Department, and if we can get them to bring it, we will.

In the omnibus, you gave us two things. One is fining authority, which is very, very important because we can go after malefactors and we have a real deterrent. Otherwise we probably wouldn't have fining authority in this area.

Mr. CULBERSON. Does the fine go to the Treasury or to the people that have been defrauded?

Mr. LEIBOWITZ. Two things. If we get a fine, it goes to the Treasury. If we get redress for consumers, which we always try to get, that will go back to the consumers. And in fact, one of the cases we are most proud of in recent months is a case against Bear Stearns or a subsidiary that did mortgage servicing. We got 86,000 redress checks back to American consumers, about $350 each, which is, you know, for a middle class family a lot of money, $28 million in all.

How do we determine what we are going to do in the rulemaking? Well, we have 90 days from the time that the omnibus passed to begin the rulemaking. I believe we are going to beat that deadline, and we are going to be in the field, not with proposed rules but with questions to all stakeholders about what kind of rules we should have, I think, within 75 days.

Two areas where we are going to concentrate will be foreclosure rescue scams, which we believe are growing, and mortgage servicing, which was the problem we found in our EMC case. We might look at other things like advertising. But the Fed has actually passed some rules that will strengthen our hands on that, and it may very well be that enforcing those Fed rules on mortgage advertising will be sufficient, with fining authority.

Mr. CULBERSON. When the Federal Trade Commission steps in and you take a case to civil court, does your jurisdiction in addition to causes of action that a person may have individually under State law, do you preempt, does the Federal Trade Commission's authority over these mortgage companies and mortgage scams, is that in addition to State law?

Mr. LEIBOWITZ. We don't generally, certainly by bringing cases, we don't preempt. In fact, the Supreme Court decided a tobacco case early this term that found, and we agreed, that our agreements with tobacco companies didn't preempt State lawsuits. We do have, I think, preemption authority for some of our rulemaking, but it sort of depends. And I think our general approach has been that we like to set a floor rather than a standard.

Mr. CULBERSON. I just want to make sure that your remedies are not exclusive; that a person who has been defrauded can also go to court under State law and hammer these guys.

Mr. LEIBOWITZ. In that sense, Congressman Culberson, they are absolutely not exclusive. And we wouldn't want them to be. And by the way, one of the other things that came in the omnibus is more

ability to work with State AGs, which is very, very important when you are a small agency like ours to sort of leverage your resources.

Mr. CULBERSON. What do you do to go after something I know happened routinely when banks were knowingly making loans to people that couldn't pay them back with the certain knowledge they could unload those loans to the taxpayers, sell them to Freddie and Fannie, who were aggressively marketing, pushing banks to make loans to people that otherwise a bank wouldn't touch. I know what happened. We all know what happened. We all know examples of bankers who in their long history would never have made loans like that, but they kind of turned a blind eye to it. They knew it was going on. They were making big fees, and they knew they could unload the loan immediately on to the taxpayers. And, of course, it has led to the problem we have today.

What remedy, if any, does the taxpayer have to go after bankers like that or people who were pushing and marketing loans like that and unloading them on taxpayers, on our children and grandchildren?

Mr. LEIBOWITZ. Well, I would say this, and I want to go back and get you the right answer. We don't generally have jurisdiction in those instances, although sometimes, of course, we will bring cases on behalf of consumers, as we did in EMC.

Mr. CULBERSON. EMC?

Mr. LEIBOWITZ. EMC, the Bear Stearns case where we got 86,000 redress checks. I think consumers themselves may have recourse to lawsuits. Sometimes, not most of the time, but sometimes, of course, they have been complicit, because they knew they were getting a loan that was too big for them, and that complicates our ability to go after some malefactors.

I think the banking agencies probably have jurisdiction, and where there is criminal activity, I think the Justice Department probably does, too. I would be happy to circle back with you and get you a follow-up answer in writing.

Mr. CULBERSON. It is really difficult to know who to go after.

Mr. LEIBOWITZ. I think this also goes back to the question that Congresswoman Emerson asked which is about the balkanization of jurisdiction here, right? If one of your constituents was defrauded in a loan, it really doesn't make a difference to that constituent whether the oversight is the FTC or one of three different banking agencies. They ought to have one person to call and have all of the right remedies.

Mr. CULBERSON. Thank you, Mr. Chairman.

Mr. SERRANO. Thank you. Mr. Schiff.

FEDERAL AND STATE ENFORCEMENT AUTHORITIES

Mr. SCHIFF. Thank you, Mr. Chairman.

Mr. Chairman, how wonderful it is to see you in this committee and in this role. I appreciate the great work you do. It is good to have somebody with your talents as the Chairman.

I want to follow up on some of my colleagues' questions. I have much the same interest, and that is, in particular, with some of the mortgage relief fraud going on, which seems to be very widespread now. I was reading your testimony that you brought a number of enforcement cases over the last 5 years, a variety of different

kinds. But still, when you total them up, it is about a dozen cases a year across many jurisdictions, this being one of them. I have to imagine there are probably hundreds if not thousands of these frauds going on in a single year now.

My experience, having been a prosecutor in the Federal system, is we generally don't want to bother unless it is a really big case, and these mortgage frauds are all going to be little cases.

Mr. LEIBOWITZ. That is exactly right.

Mr. SCHIFF. I wonder, I guess, a couple things. One, what is sort of the maximum penalty that you are able to assess in a case where someone is defrauded out of maybe $1,000 or $2,000? Two, the Feds aren't likely to take it unless it is like a major mill doing these things, and even then, it may be tough.

Are the State and local district attorneys able to take these as garden variety fraud cases, or do they have to be Federal cases, and do we need to give you more enforcement capability?

Mr. LEIBOWITZ. That is a series of great questions, Congressman.

You are absolutely right. We as an agency cover the waterfront. We are 1,100 FTEs. About half of them do antitrust, and about half of them do consumer protection. We have lots of different consumer protection matters we have to do, from privacy, spam, spyware, Do Not Call, old-fashioned fraud to financial services deception and fraud.

Mr. SCHIFF. Do you do copyright as well?

Mr. LEIBOWITZ. We have occasionally brought copyright-related cases in the context of deception, involving peer-to-peer matters.

Mr. SCHIFF. With our history, I have to throw in copyright.

Mr. LEIBOWITZ. That doesn't surprise me. We do have that history.

Having said that, in the example that you mentioned hypothetically, if a consumer is ripped off for $1,000, we are going to get at most $1,000 back for that consumer in redress, maybe disgorgement of profits from the company. But one of the great things you did for us in the omnibus was giving us both rulemaking authority and fining authority. So with fining authority, you can go after a malefactor and make them pay a price. It has to be approved by a court, but at least there is a real deterrent there.

With rulemaking authority in this area for predatory mortgages and deceptive financial services not issued by banks but issued by non-bank mortgage companies, because there are so many companies out there, we can set a standard. By setting a standard, some of those companies that are sort of dragged down because their competitors are doing it will go up above the watermark, and they will start writing mortgages in a better way.

If we say, the rule is, you can't advertise teaser loans without explaining what they are, most companies will want to be above the standard. They won't want to get in trouble with us, particularly if we have fining authority. So that was very, very helpful.

In our reauthorization, which I think is an area where the Senate and House Commerce Committees are going to legislate or start legislation this year, we are hoping to have some more general relief from our Magnuson-Moss Act which is very cumbersome rule-

making and more fining authority so that we can really have an effective deterrent against malefactors.

Mr. SCHIFF. Do we have an asset forfeiture capability?

Mr. LEIBOWITZ. Do we have an asset forfeiture capability? We do not.

Mr. SCHIFF. In terms of the prosecution side, I am assuming, but I don't know for sure, our local DAs, as opposed to U.S. Attorneys' Offices, do they have jurisdiction to prosecute someone holding themselves out, for example, if you will pay me $1,000, I will renegotiate your mortgage and then they take the money and don't do anything?

Mr. LEIBOWITZ. Sure. State AGs certainly do under comparable State laws. Sometimes they can enforce aspects of the FTC Act. Local prosecutors probably can under parallel laws. I think most States have baby FTC acts. So we can work with them, and we do, and we are going to do more of it going forward.

But, again, as you point out, I like to think that the analogy isn't putting our finger in the dike. I like to think we have made real differences for the people who we have benefited and we have had some deterrent effect. But an increase in resources, would be useful to us so we can decide to bring two cases instead of bringing one and settling another. And then in our authorizing committees—

Mr. SCHIFF. Before the gavel comes down, on the mortgage relief fraud, do local DAs have the power to enforce FTC laws? Should they have it if they don't?

Mr. LEIBOWITZ. The DAs do not. State AGs do under what you have given us in the omnibus.

Mr. SCHIFF. Thank you, Mr. Chairman.

Mr. SERRANO. Thank you.

Mr. Kirk.

ANTI-COMPETITIVE BEHAVIOR INVOLVING NONBANK FINANCIAL COMPANIES

Mr. KIRK. Thank you, Mr. Chairman.

You have extensive anti-competitive jurisdiction, and the administration has proposed a seizure of nonbank financial companies, which is directly in your jurisdiction. So is that decision by Secretary Geithner accurate that FTC has failed in its mission?

Mr. LEIBOWITZ. I don't think we have failed in our mission, Congressman. I think we have made a pretty valiant effort, given the size of our agency. So, for example, in the last 10 years, we have gotten $465 million in redress to consumers in just the financial services area. In the last 5 years, we have brought 70 cases in this area. Just last week we brought more.

Mr. KIRK. But I missed the big ones.

Mr. LEIBOWITZ. Well, I will say this. We don't have rulemaking authority, or we didn't until you gave us that authority in the Omnibus Act. So it is very hard to go after everybody when you can't set ground rules.

I will say this: In the Bear Stearns EMC case, which was a deceptive financial services case involving mortgage servicing, we got 86,000 redress checks to American consumers. Could we have done more? Yes, we could have done more in retrospect.

Mr. KIRK. I am concerned that the Commission, for example, has had very exotic prosecutions, for example, in hospital cases, the same year that they missed AIG.

Mr. LEIBOWITZ. I don't know that we had jurisdiction over AIG. I will get back to you on that.

Mr. KIRK. I read your testimony. It says, "anti-competitive activities for nonbank financial companies."

Mr. LEIBOWITZ. We don't have jurisdiction over insurers. We are carved out under the FTC Act.

Mr. KIRK. I thought the CDSs were ruled as non-insurance products.

Mr. LEIBOWITZ. I will get back to you on that. I just don't believe that is within our jurisdiction.

Mr. KIRK. Would an analysis that an institution is too big to fail trigger your scrutiny for noncompetitive activity?

Mr. LEIBOWITZ. I think our scrutiny on the antitrust side would be to enforce the antitrust laws, and so, in that context, we will look to see whether a merger might substantially lessen competition. There has been some discussion of whether entities are too big to fail. I think we look at market power and whether folks can raise prices. We don't really look at too big to fail as an antitrust doctrine.

Mr. KIRK. Would you say that Goldman Sachs and J.P. Morgan now are too big to fail?

Mr. LEIBOWITZ. I would say that is an interesting discussion to have, but it is probably outside of our jurisdiction.

Mr. KIRK. So for those institutions now, they have a considerable market power, you would agree?

Mr. LEIBOWITZ. They have considerable market power; I would want to see how many other folks are in that area. They certainly have a lot of power, authority, and debt.

Mr. KIRK. Is there a single government-sponsored merger that you have raised an objection to?

Mr. LEIBOWITZ. A government-sponsored merger?

Mr. KIRK. Correct. We have had quite a number of them where we have arranged——

Mr. LEIBOWITZ. No, we don't have jurisdiction in that area. It is the banking agencies that do. And so we have certainly raised objections to mergers, and we have won a PI. We won a case on appeal earlier this year, or late last year. We blocked what we believed to be an anti-competitive hospital merger involving Inova and Prince William Hospital, Inova being the dominant hospital chain in Virginia.

Mr. KIRK. Which may be important, but misses the huge earthquake that just hit this economy that is directly in your jurisdiction, which in your testimony is anticompetitive behavior involving nonbank financial companies.

Mr. LEIBOWITZ. Yes, but not involving insurers, not involving those entities within someone else's jurisdiction. I will get back to you on that. I want to make sure I give you an accurate answer.

Mr. KIRK. Because my question then is, going forward for this committee, do you have the resources necessary to go after too-big-to-fail, nonbank financial companies?

Mr. LEIBOWITZ. I would say we have the resources to do good merger reviews. You may not have been here when we had this discussion at the beginning. We are a much smaller agency than we were in 1980, even though the population has grown. And certainly we have been very pleased that you have given us additional plus-ups in the appropriations over the last few years, because it has been really helpful so we can do our job, which is promote competition and protect consumers.

Mr. KIRK. Within what is in your jurisdiction, have you done a cursory review of who is too big to fail?

Mr. LEIBOWITZ. Within our jurisdiction, we have blocked mergers that we believe to be anticompetitive, or we have gone to court to try to do that. Have we done——

Mr. KIRK. No, no. In your testimony, you say that there is a decrease in filings that may create a decrease in the types of mergers that do not raise competitive concerns, but we continue to see significant filings that do raise concerns as well as——

Mr. LEIBOWITZ. There is concern under the antitrust laws. That is exactly right.

Mr. KIRK. As well as activities outside merger, which you say the Commission——

Mr. LEIBOWITZ. Sure. So our most important antitrust—

Mr. KIRK. Here is my question again. Have you even done a cursory review of institutions within your jurisdiction which are too big to fail?

Mr. LEIBOWITZ. I would say this. Let me just get back to you. Financial services mergers go to the Department of Justice under our clearance agreement. They have the financial services expertise. It is the Department of Justice. Whenever we do a merger review, we have——

Mr. KIRK. No, outside of merger, have you done a cursory review of market activity outside or within your jurisdiction of institutions too big to fail? This is the third time I am asking the question.

Mr. LEIBOWITZ. We have not done a major report on too-big-to-fail doctrine. We incorporate it into all of our—if anyone raises it with us, as some have in the context——

Mr. KIRK. I take it you haven't done a cursory review?

Mr. LEIBOWITZ. We have not done a review.

Mr. KIRK. Even with what we have been reading in the papers?

Mr. LEIBOWITZ. But we have been enforcing the antitrust laws very vigorously, and we have been doing that over the past 8 years.

Mr. KIRK. Mr. Chairman, might I suggest that you do a cursory review within your jurisdiction of institutions in this United States which are too big to fail?

Mr. LEIBOWITZ. I would be happy to do that and get back to you.

Mr. KIRK. Thank you, Mr. Chairman.

Mr. SERRANO. Thank you.

Mr. Fattah.

FORECLOSURE-RELATED PROBLEMS

Mr. FATTAH. Thank you for your testimony, and let me thank you for your work.

Mr. LEIBOWITZ. Thank you.

Mr. FATTAH. These schemes to go after people who are seeking mortgage relief, you are taking some action. I just wanted to delve into this. And I think the new Web site is very helpful in giving people general guidance.

But the Bear Stearns case is a good case in point. There were others in which essentially consumers were offered that someone could help them modify their mortgage note for an up-front payment. That is the essential thing, and then did little or nothing?

Mr. LEIBOWITZ. In the Bear Stearns case, I think it was more the notion of embedded fees in consumers' bills that they did not see in the context of mortgage servicing. EMC was a mortgage servicing company, so they would do the mortgage servicing for another holder of the mortgage.

Mr. FATTAH. The mortgage relief cases, then, I guess are the ones where that happens.

Mr. LEIBOWITZ. The foreclosure rescue scam cases, and in those we have seen a variety of different patterns, yes.

Mr. FATTAH. Now, there are places around the country in which there has been—I guess Florida, California, and Arizona have seen the highest rates of mortgage foreclosures in certain counties, and notwithstanding what my colleague was suggesting, they really are not in the poorest communities. These mortgage foreclosures and activities have been in some of the upper-middle-class communities in these particular States.

And so this rumor, this myth, that somehow poor people are the ones who have drug down the market on mortgages are somehow—is really misplaced. But are we targeting this relief to communities in which these mini-mansions and all other such housing models have really been at the heart of this problem?

Mr. LEIBOWITZ. You know, our approach is fairly utilitarian. We try to do the greatest good for the greatest number of people. So you are absolutely right. It is not just a subprime problem. It is not just a problem with low-income folks.

I would say, I want to go back and get you a dispositive answer, but my sense is we have brought our cases across the boards. But sometimes they are preying on low-income folks and immigrants whose English language skills are not as good as others'. But it is across the board.

Mr. FATTAH. I just wanted to get on the record that, you know, when you look at the survey of foreclosure activity and people behind in their mortgages, it has really been some of the highest-income counties in the States that have been at the very forefront of this, Florida, California and Arizona, and this myth that has been circulating and the kind of discussion here that somehow mischaracterized where the heart of this challenge is, so I just wanted to get that on the record.

I do want to thank you for the Web site. I think it can be useful to many of our constituents. Thank you for your testimony.

Mr. LEIBOWITZ. Thank you, sir.

Mr. SERRANO. Thank you, I would just like to comment on the gentleman's statement. I have also, like so many people, have been troubled by the fact that so much emphasis has been placed on the government's desire to try to get the American dream available to all, and somehow to believe that because maybe some bad loans

were made in the process of making that dream available to all, that that is what threw the market apart, and the way to resolve this problem is to move to a future where we go back not allowing some folks to share in the American dream, which is homeownership.

Ms. Lee.

Ms. LEE. Thank you very much.

PREDATORY LENDING AND MINORITY AND LOW-INCOME COMMUNITIES

Congratulations, Mr. Chairman. Good to see you.

Let me ask you briefly, with regard to the companies that, really, in many ways unscrupulously exhibited a pattern of advertising primarily to minority and low-income communities as it relates to their ads for predatory loans and subprime loans, there was really a distinct pattern of steering minority borrowers into the much more expensive subprime loans than whites with the same credit scores. Study after study has dramatically shown in very glaring ways that there were higher rates of subprime loans with punitive prepayment penalties and outright fraud in loans to minorities. So it is clear that many of these companies targeted the poor and communities of color.

I have a community, for example, in East Oakland, targeted totally by these advertisings, unfair predatory loan strategies, which ultimately ended in what I say is discriminatory lending. So now they are doing the same thing with regard to the foreclosure rescue and credit repair scams, which you have talked about.

But what I want to find out from you, Mr. Chairman, is, you know, we are in this era now where race is pushed under the rug oftentimes; race is not a factor in many. And we want to get beyond race, granted. But when you see practices like this that are targeted specifically to African American and Latino communities, aren't there some issues of civil rights that we have to bring up in terms of racial discrimination and how you address racial discrimination as we try to make sure these communities are not victims again to these type of loan sharks?

Mr. LEIBOWITZ. You are absolutely right, Congresswoman.

In fact, while we have brought a number of financial scam cases, 70 over the last 5 years, we have also brought cases involving discrimination. So a case we brought last year, Gateway, involved a mortgage company that was charging more for African American and Latino borrowers, and they are a Pennsylvania company, than they were for white borrowers. And we are going to do more of that.

But the scams are out there. And about a year-and-a-half or 2 years ago, I will get you the exact date, we did a sweep of Internet advertising for mortgages and we found 200 companies, 200 companies, that were displaying patently false, facially false mortgages, like a 15-year mortgage at 1 percent. We know we would all be getting those mortgages if they really existed. We know they are not valid.

We sent those companies letters. Some of them stopped their inaccurate advertising. We brought cases against some of them. But we need to do more.

One of the things that has been very, very helpful is that your committee gave us rulemaking authority and fining authority in this area.

Ms. LEE. But is there any way to impose penalties on these companies to either compensate the families or the victims of these scams or the communities that were left in shambles as a result, again, based on civil rights law and based on these communities being primarily communities of color.

Mr. LEIBOWITZ. Well, we will try to get redress for all consumers. Now, in the Gateway case, we couldn't do that because the company I believe went bankrupt. We got some relief for consumers, but it was just a fraction, a sizable fraction but a fraction of the harm. And again you have given us fining authority in the omnibus that will be helpful, and I believe under the civil rights laws, which we don't enforce, there is also some ability for the Justice Department; for example, the Civil Rights Division and others, to fine malefactors.

FTC AFFIRMATIVE ACTION PLAN

Ms. LEE. Finally, Mr. Chairman, let me just ask you with regard to your affirmative action plan and your workforce, in terms of ethnic gender breakdown, do you have an affirmative action plan? What is your racial composition, ethnic composition, gender composition of your shop?

Mr. LEIBOWITZ. Let me get back to you with that. We do have affirmative action plans internally in the Commission. We have persons of color who are deputies in divisions and supervisors, and we are going to do more in that area, and of course we have women who are bureau heads.

Ms. LEE. So by pay grade and job title and——

Mr. LEIBOWITZ. Absolutely.

[The information follows:]

FTC Workforce Distribution by Grade and Race/Gender
as of April 13, 2009

	EX	AL	SES	GS/GM 13-15	GS 9-12	GS 5-8	GS 1-4	WG	Total
AMERICAN INDIAN or ALASKA NATIVE - Female				*					*
AMERICAN INDIAN or ALASKA NATIVE - Male									0
ASIAN - Female				28	9	*			39
ASIAN - Male				19	*				20
ASIAN and WHITE - Female					*				*
BLACK or AFRICAN AMERICAN - Female	*			36	68	44			149
BLACK or AFRICAN AMERICAN - Male			*	29	11	8	*	*	51
HAWAIIAN/OTHER PACIFIC ISLANDER and WHITE - Male				*					*
HISPANIC or LATINO - Female				7	4	*			13
HISPANIC or LATINO - Male				15	*	*			17
INDIAN/ALASKA NATIVE - Male				*					*
HISPANIC/LATINO and WHITE - Female				*					*
HISPANIC/LATINO and WHITE - Male				*	*				4
NATIVE HAWAIIAN or OTHER PACIFIC ISLANDER - Female				*					*
NATIVE HAWAIIAN or OTHER PACIFIC ISLANDER - Male				*	*				*
WHITE - Female			11	260	41	9			321
WHITE - Male	*	*	24	336	31	8			401
Total	4	*	36	739	169	74	*	*	1025

Note: Cells containing an asterisk (*) reflect counts of 1, 2,or 3.

Ms. LEE. Standard reporting I would like to look at.

Mr. LEIBOWITZ. Absolutely. And I will say this: OPM did a study of 37 different agencies, and we came out in the top five in three out of the four categories, in terms of competence, and the ability to accomplish our mission. The one area where we did not come out quite so high was in job satisfaction. And if you look at those job satisfaction numbers, we came out I think in the top third but not as high as in others. If you look at the job satisfaction numbers, among our professionals, who are mostly though of course not exclusively white, the job satisfaction is exceedingly high. If you look at job satisfaction among our support staff, which is probably substantially, maybe not mostly, African American and persons of color, it is not so high and that is something we are going to be working on and are going to continue to work on.

Ms. LEE. I look forward to working with you on it. Thank you, Mr. Chairman.

DECEPTIVE ADVERTISING

Mr. SERRANO. Thank you.

These things are coming from everywhere. I was made aware of these packs that you get at home with all the coupons and the coupons are usually about cleaning your rug and now they are about, you know, we buy used houses, all cash settlement in as little as 3 days. Pay all closing costs, get cash now, and move out later. I should be wearing a straw hat. Listen to this: "Do you have a family member or a personal friend selling a home? Easy. Collect $1,000 finder's fee if we purchase."

Mr. LEIBOWITZ. If you would hand that over to us at the end of this hearing, we will follow up with that entity.

Mr. SERRANO. Thank you. And thanks to my staff for that.

Mr. LEIBOWITZ. By the way, this is how we find some of our cases. We had 700,000 complaints last year in our Consumer Sentinel database, but we also see stuff like that and we give it to staff or staff comes up with it. And, again, there is more and more of this, and less and less clean your rug.

Mr. SERRANO. I am old enough to remember Steve Allen, and when you see something like this, you really want to get into a Stevareno routine because he could sell you anything off this, or Groucho Marx could do wonders with this.

Part of this whole issue of financial products has been the issue of lawyers talking to each other; right?

Mr. LEIBOWITZ. We did a lot of work together.

MAKING DISCLOSURE MORE MEANINGFUL

Mr. SERRANO. It is bad enough to have a witness with the title of chairman. Every time somebody says "chairman" I get up.

The whole disclosure issue on financial products has been an issue where in many cases the disclosure often seems to be long, complicated, and hard to interpret and often comes after the customer is essentially committed to the particular choice. Also there is considerable evidence that some mortgage lenders have steered certain buyers, especially minorities, into expensive subprime loans even though they would have qualified for conventional mortgages or better terms. In those cases what is really needed is not just dis-

closure about the terms of the loan that the consumer actually got but also information about the better terms the consumer qualified for and should have gotten.

Do you have thoughts on what can be done to make disclosure more meaningful and more useful?

Mr. LEIBOWITZ. Yes, we do. And we see disclosure problems across the board in our Spyware cases where the disclosures are on the third click on page 15 of the Uniform Licensing Agreement, the ULA. We see it in the context of credit card solicitations, although we don't have jurisdiction over many credit cards anymore because they are mostly issued by banks. And one of the areas I think—I don't want to prejudge our rulemaking, but one of the areas I think that we will look at when we do our rulemaking is better disclosures in this area because, it doesn't solve every problem but if you disclose to consumers what they are really getting and they have the information they need, they can decide whether to take a loan or get a mortgage or not. And so, yes, we are going to be looking at this area. And I would say particularly in the foreclosure rescue area and in the mortgage servicing area, you deal with either deceptive or unfair or buried disclosures, and they don't give notice to consumers. So it is not the only reason we are in this economic mess, but it is not surprising that it is clearly one of the factors. So we are going to look at improving disclosures. It is a great idea.

Mr. SERRANO. I bet you a lot of folks would give you 10, 15 things they saw coming, some on the higher, more serious levels, and others—for instance, when I began to see, I think, in the early '90s, there was a great market for people who could speak very, very fast. These were the guys who would tell you buy this product and then they would give you half a minute of disclaimers on everything this product could cause you. And it was so fast it just didn't seem right. So this disclosure issue is very important.

YIELD-SPREAD PREMIUMS

Let me ask you another question. Last July the Federal Reserve Board finally issued rules using its authority under the Homeownership and Equity Protection Act rules, which the FTC enforces for lenders under its jurisdiction. For high-priced mortgages these rules require better income verification and more consideration of the buyer's repayment ability and prohibit prepayment penalties in many cases. These rules do not, however, address other problematic practices such as yield-spread premiums that basically reward mortgage brokers for steering customers into higher priced homes.

Should mortgage brokers be required to disclose to customers that they have received compensation tied to the interest rate on the customer's loan? Should yield-spread premiums be prohibited entirely, at least in the subprime market, as fundamentally unfair and anti-consumer?

Mr. LEIBOWITZ. You know, that is an interesting question, and one we have been discussing. I don't think they were banned under the Fed's rules. And my staff tells me it is a complex issue, and it is, and we are working with other agencies and we are——

Mr. SERRANO. You think I had an easy time——

Mr. LEIBOWTIZ. And I thank you for that.

It is a complex area, and we worked on mortgage disclosure forms and we have a model mortgage disclosure form that would replace the RESPA and TILA forms and actually would be more beneficial to consumers. Sometimes consumers will look at the yield-spread premium and they will focus on it and they will take a loan with a higher yield-spread premium rather than taking a loan with a lower mortgage, and so it is a very complex issue. It is one we are happy to take a look at.

Mr. SERRANO. Even though it is complex.

Mr. LEIBOWITZ. We do take a look at complex issues. Those are the ones that are most challenging and those are the merger cases, the ones that are complex. The easy ones we either don't do or we let go. So yes, we will take a look at that. We have had discussions at the Commission level. We have had discussions within our bureaus, with our economists arguing for the benefits of yield-spread premiums and I think some of our consumer protection litigators arguing that they can be very misleading, and we are going to work through this issue maybe in the context of our rulemaking.

Mr. SERRANO. This whole exchange reminds me of the SNL skits on President Bush's saying this is a tough job. We pretty much understood that.

FTC STAFFING LEVELS

Mr. Edwards brought up the issue of staffing levels, and we saw the changes and we are trying to make good on our promise to get you back somewhere but still far away. I think the last there was—1,094 was your level at this point and it went up as high as close to 1,800; so we have to find a way to do better.

But during the last couple of years, I mean during this period when they went down, could you mention what new responsibilities you gained which then made the issue more difficult? And if you got the kind of dollars you would like to begin to see, what additional priorities would you take on?

Mr. LEIBOWITZ. That is a great question. We are a pretty well-respected agency, and as a result Congress gives us lots of assignments in the sense that you pass a law and you task us with enforcing the law. So I can think of three laws in the last 8 or 10 years that we are a lead law enforcement agency for: CAN–SPAM, FACTA, Gramm-Leach-Bliley. I will submit a list of others. One of our biggest areas is trying to stop pay-for-delay settlements, where brand pharmaceutical companies pay off their generic competitors to stay out of the marketplace. If I own a gas station and you want to build a gas station across the street, I can't say here's $200,000, go away for 5 years. And yet we are seeing very similar conduct among pharmaceutical companies.

So what we find is sometimes, and this is totally reasonable, we are willing to settle a case instead of going to court or staff will come to us and say, "there are these three interesting investigations. We think there are violations in all of them. Which case would you like us to bring or which two cases would you like us to bring?" And so we have to make decisions that are reasonable decisions on behalf of the consumers we serve and the decisions you want us to make, but they are made within the context of limited resources.

TIPS AND COMPLAINTS

Mr. SERRANO. Let me ask you before I turn it over to my colleagues. You get obviously a lot of tips and complaints every day—even from chairmen of subcommittees.

Mr. LEIBOWITZ. Yes. Those are good ones, by the way.

Mr. SERRANO. And I get the feeling this will be looked at right away, and that is a good thing. How do you follow up on these? Just a fraction of them? Most of them? How do you choose? I mean, obviously, all kidding aside, this one attracted your attention because here we are talking about the present issue that we are facing in people making all these promises, and I must tell you this came to a mailbox of a person who has been in a new house less than a month. So you can imagine what is happening in the whole neighborhood.

Mr. LEIBOWITZ. Well, look, you chaired the Consumer Protection Subcommittee in your State assembly; so you understand——

Mr. SERRANO. You know this.

Mr. LEIBOWITZ. I do know that, yes. We do our homework.

Mr. SERRANO. Who chaired it after I left to come to Congress?

Mr. LEIBOWITZ. That I don't know.

Mr. SERRANO. Jerry Nadler.

Mr. LEIBOWITZ. Jerry Nadler. So it is a rich tradition in that subcommittee. And so you know there are so many more malefactors out there than you can possibly go after and only so much State AGs and the Federal Trade Commission and others in this space can do. So you have to sort of prioritize.

Putting aside Do Not Call, last year we got about 709,000 complaints. They go into a database. We make that database available to criminal authorities and other law enforcement agencies so that they can use our database, and they do. We look at the number of complaints on a particular issue, and that helps us determine both what the biggest problems are, and then we sometimes bring cases out of that—we like to think we usually do—and what the emerging problems are. So we started to see, for example, 4 or 5 years ago more nuisance adware on people's computers and more complaints about that. So, for example, you will see a pop-up ad and you won't know where it came from, and it turns out there are four or five companies that were putting badware on your computers and hiding it. And we started to see more and more complaints about this. It was hard to remove. And we brought two major cases against Zango, and 180 Solutions, and they stopped doing the bad things they were doing. One of them actually ended up going bankrupt. One of them was a case we brought with then Attorney General Spitzer who started the investigation. Attorney General Cuomo brought the case. And as a result, there is less. The problem is not gone, but there is less of a problem with nuisance adware on consumers' computers. One of those companies acknowledged in court papers that they were responsible for 6.9 billion pop-up ads in consumers' computers. And some of that was on the basis of complaints we started to see. Some of it was on the basis of our own observations and our own computers, like where is this stuff coming from? Because we have a lot of smart technology folks.

So you try to do your best. You try to figure out which complaints are the ones you can go after, which ones you can refer somewhere, which ones we can give to other law enforcement agencies. And, again, if we had more resources, we could do a better job of bringing more cases.

And we do other things, too, like write reports on industries. We did a report on the marketing of food to kids and childhood obesity. We do our entertainment industry marketing reports. We do those every 2½ or 3 years because we can't do them more often because we just don't have the resources. But I want to say we are a beleaguered agency. We actually think we do a better job of effectuating our mission, but any help you can give us I think would be deeply appreciated and has been.

Mr. SERRANO. I appreciate that. And you are right when you say you are a respected agency. That is a fact, and you gain respect from both sides of the aisle here. And thank you for remembering my consumer affairs chairmanship. Do you remember when I gave New York item pricing?

Mr. LEIBOWITZ. I know it was a great victory for the consumers of New York, but I can't remember precisely the date.

Mr. SERRANO. How about removing talcum powder from rice?

Mr. LEIBOWITZ. You see, now, that is a problem we don't have to deal with today at——

Mr. SERRANO. Quick story. This is the truth. This is an incredible story. I read a report that Puerto Ricans had less cancer than most other Americans. That was interesting. Why? When they did get cancer, it was stomach cancer. Some researchers had related it to the fact that rice, which is our staple, had talcum added to it before the Panama Canal was built because it needed to make the trip around the Horn and you needed to keep it dry at sea. Talcum kept it dry. Later on if you removed the talcum, it didn't look good and consumers thought that there was something wrong with the rice; so they kept putting talcum in the rice. So I removed talcum from the rice.

I also passed the most unenforced law in New York State. You don't need a credit card to rent a car. The first thing they ask you for is——

Mr. LEIBOWTIZ. Is a credit card.

Mr. SERRANO. It is against the Serrano law. Anyway——

Mr. LEIBOWITZ. Did you give the FTC the jurisdiction to enforce that law?

Mr. SERRANO. Yes. And we may have to talk to Paul.

Mr. Culberson.

Mr. CULBERSON. Thank you.

EDUCATIONAL EFFORTS

Mr. Chairman, if I could ask one question very quickly in an area that I really wanted to go into, if you could answer it, I would be very grateful.

If you could briefly tell the committee, what does the FTC do to promote your educational material to reach as many at-risk consumers as possible? Do you use different strategies to reach rural versus urban or wealthy versus poor? Could you just describe briefly your educational efforts.

Mr. LEIBOWITZ. That is a great question. We spend a lot of time on education. We have a great consumer and business education department. So we use a sort of three-pronged strategy. One prong is our Web site. We have an 800 number people can call so they will get the materials if they want them sent to them. Two is we co-brand with other entities. So our Money Matters Web site is going to be co-branded with AARP, with local community groups, and with a whole bunch of other folks. And then the third thing we do is we try to make sure that when we do launch something like this that we get publicity on it so consumers will know.

ABUSES RELATED TO MORTGAGE LENDING

Mr. CULBERSON. Really the FTC's charge—the area I really wanted to get into is to protect consumers, to protect people from deceptive trade practices, to keep them from occurring in the future and to get restitution, reimbursement, for people who have been defrauded, essentially. And certainly taxpayers are included in that group. And I really mean this line of questioning sincerely because something that we have all been struggling with is how do we compensate taxpayers for this massive fraud that has taken place that is a result of, as we all know, loans being made to people that couldn't repay the loan, the mortgage broker knew that it was a bad risk, the bank knew that it was a bad risk? And I noticed that in a recent report that—this is just from March 24—that the Federal Trade Commission convinced—this is on Dow Jones newswire—FTC convinced the U.S. District Court to order New Hope and Hope Now to stop advertising they are part of a government-endorsed mortgage assistance network. And I recall that Freddie and Fannie were selling themselves as federally guaranteed institutions, that mortgage brokers and banker, we all know, as a part of the subprime marketing scam, were selling these loans to banks. They were pushing these loans on the false assurance that Freddie and Fannie were government endorsed just like these two operations, Hope Now and New Hope.

Certainly you have got authority, you have got broad authority, now particularly under the omnibus, to bring actions to protect consumers in cases where they have been defrauded. In loans you can actually issue rules now governing issuing mortgages, mortgage lenders, as long as they are not a bank. You don't have the jurisdiction over the banks. You have got that kind of broad jurisdiction, Mr. Chairman. I would really like to ask you to seriously consider what can you do to sue or go after mortgage lenders, mortgage brokers, who carry errors and omissions insurance? And, Mr. Chairman, I am a lawyer as well, and as a lawyer professional people carry insurance. We have got errors and omissions coverage. I guarantee you a lot of these mortgage brokers have got some sort of professional liability coverage that could be triggered, and I am very serious. Why couldn't FTC go after a lot of these mortgage brokers and people who were marketing subprime loans to people who that under the circumstances that they would have never have made—I guarantee you if those banks had to personally assume liability for those loans, they would never have made them. They unloaded it on you and me and our kids.

Mr. LEIBOWITZ. That is exactly right.

COMPENSATION FOR FINANCIAL FRAUD

Mr. CULBERSON. The more I think about it, both Mr. Chairmen, I think FTC may be perfectly positioned to bring civil action on behalf of the United States taxpayers who have, all of us, been defrauded massively by these miserable mortgage brokers and lenders who were knowingly making loans to people who couldn't repay and with the assurance, false assurance, just like this New Hope bunch that the Federal Government's guaranteeing Freddie and Fannie, and they knew that wasn't true. And then they sell it to Freddie and Fannie and now all our kids are stuck with it.

It is sort of a broad general question, but it really occurred to me in just listening at the testimony today, Mr. Chairman, and looking at the charge of the FTC that—and I have got three subcommittees. You all have many subcommittees. I really think of all the entities that we have jurisdiction over, the FTC, they may be perfectly positioned to sue some of these guys, trigger their errors and omissions coverage, and recover funds for the taxpayers to help reimburse all of us as a nation for this massive fraud.

So if you will permit me, Mr. Chairman, I kind of throw a lob of a general question out there and I want to plant a seed in obviously the mind of a creative and talented lawyer. Couldn't you put together a massive class action on behalf of the taxpayers of the United States and go trigger some errors and omissions coverage to get us reimbursed in whole or in part?

Mr. LEIBOWITZ. I think, Congressman, it is a great idea and it is something we will take a look at—with a couple of caveats. One is there might be some requirement that is not triggered by the passing up of the clearly deceptive mortgages and bundling them and sending them on to a bank. But I don't know that there isn't. So let us take a look at that.

The other thing I would say is I am not sure we would recover all the money that consumers have been defrauded about in the sense that——

Mr. CULBERSON. It is so massive.

Mr. LEIBOWITZ. It is so massive. Some of it has been depleted. I mean our taxpayer dollars, as you know better than anyone, are now being used to subsidize some of the folks who were involved if not in the deception, in buying the package loans that were virtually worthless or clearly worth much less than what everyone believed they were. But I think that is a great idea. We will go back and do a little research and we will get back to the committee.

Mr. CULBERSON. With your permission, Mr. Chairman, I would like to pursue this with him. I am a pretty creative lawyer myself and I would like to see if we couldn't find a way to help make this happen. You sent the Bear Stearns, people defrauded by Bear Stearns $230 apiece?

Mr. LEIBOWITZ. About 350.

Mr. CULBERSON. They were not entirely compensated. It would be nice, Mr. Chairman, even if we could get 10, 15 percent on the dollar of what the taxpayers were defrauded.

Mr. SERRANO. I have no problems with it as long as you don't blame it on immigrants.

Mr. CULBERSON. Thank you, Mr. Chairman. He is watching me, keeping an eye on me.

Mr. SERRANO. It doesn't take him long to blame immigrants.

Mr. Edwards.

Mr. CULBERSON. He is joking of course.

Mr. Edwards.

Mr. SERRANO. Of course, I am joking.

Mr. LEIBOWITZ. Not unlike our Commission, it looks like it is a very bipartisan committee.

Mr. CULBERSON. A lot of kibitzing.

"PAY FOR DELAY" IN PHARMACEUTICALS

Mr. EDWARDS. Mr. Chairman, you talked about the pay-for-delay settlements in the cases pending vis-a-vis the pharmaceutical industry, where brand name drug companies pay generic drug companies to delay entry into the market. How pervasive is this process of companies trying to delay?

Mr. LEIBOWITZ. Unfortunately, it is becoming a new way of doing business. In the late 1990s and around 2000, 2001 we started to see this in the pharmaceutical industry, and under Bob Pitofsky, who was the Chairman under Bill Clinton and Tim Muris, the first Chairman under President Bush, we stopped these deals cold. And for about 5 years you did not see any more pay-for-delay settlements. When a brand and a generic were involved in litigation, they would settle but they would settle on a date based on the strength of their litigation. And one case in 2003, which is in the Sixth Circuit, said that these deals were, per se, illegal. But then in another case, the Schering case, our Commission found liability. You get to choose your appellate court, and Schering chose the 11th Circuit, which is a very conservative circuit and had some bad case law in this area from our perspective, and the court ruled against us. And we tried to get the case to the Supreme Court. We have jurisdiction to do that, but in a very rare departure from sister agency comity, the Justice Department came out against us and said "don't take this case", and they didn't. And since then two other cases have come down, and they have been very, very permissive in the rules that they have had. So as a result we have seen more and more of these deals. Not every brand and generic agreement where the brand pays some compensation and the generic agrees to stay out of the market for a period of time involves an illegal pay-for-delay settlement, but a lot of them do, and what that means is that generic drugs are not getting to consumers as soon as they should.

So we have two cases, one in district court in the Third Circuit and one in district court in the Ninth Circuit. We are hoping to get one of those to the Supreme Court. At the same time we have a two-pronged strategy for stopping these deals. We also support legislation that would create a sort of brightline test to stop the deals. You could still have settlement; you just couldn't pay compensation. It is a bipartisan bill in the Senate with Senator Kohl, Senator Grassley, and Senator Durbin. In the House it is Mr. Waxman, Mr. Dingell, and Mr. Rush. And it has the support of President Obama. So I think we are going to be able to move it this year. We certainly hope so.

Mr. EDWARDS. Good. I appreciate that information.

Finally, let me ask, what general criteria, and I know you could spend weeks in legal jargon, but just generally what legal criteria do you use in deciding whether to approve or disapprove of a merger?

Mr. LEIBOWITZ. We do a pretty thorough investigation. Under Hart-Scott-Rodino, we get a lot of documents. For maybe 5 or 10 percent of the cases, we ask for follow-up documents called the second request if they are close calls. The standard is, does the deal or may the deal substantially lessen competition? And that is the standard we apply. And if we think that it does, we will go to court and then a court will decide. So we have won some cases and we have lost some cases.

Mr. EDWARDS. Were you involved in any way in the Sirius XM?

Mr. LEIBOWITZ. That was the Justice Department.

Mr. EDWARDS. Explain to me as a layman how having one major provider in this country is not anti-competitive.

Mr. LEIBOWITZ. When you have a marketplace you like to see four or five competitors as a general matter to have real competition. Now the Justice Department, I believe, and I don't want to speak for them, had a broader definition of the marketplace than just satellite radio; so they believed it competed with iPods, and other new technologies. I don't want to say we would have brought that case if it came to us. And I don't want to criticize the folks who were running the Justice Department then because——

Mr. EDWARDS. Go ahead.

Mr. LEIBOWITZ. Because they are very decent people. But you raised a very good question, Congressman.

Mr. EDWARDS. I mean to extend that logic out, I could say it is okay if American Airlines has a monopoly in southwestern United States because people can drive in a car or a bus.

Mr. LEIBOWITZ. You wouldn't want to have one car company. You wouldn't want to have one computer company. You just want to see more competition. I agree with that.

Mr. EDWARDS. That just seemed to me the case to say when have we gone too far? If having just one company in that arena is not anti-competitive, then what is anti-competitive? But, Mr. Chairman, I know that is a broad issue. I think it is one of the big issues the Congress is going to have to deal with. How do we look at this "too big to fail" issue? How do we look at effective regulation of major industries? We have got an airline industry that is more concentrated now than it has ever been, television ownership, satellite company ownership, banking obviously. Some of that is within your jurisdiction; some of it is not. But I thank the gentleman for his comments.

Mr. SERRANO. Thank you. That is an interesting question about the satellite radio. For full disclosure I own three satellite radio subscriptions and as was presented then, the bigger issue supposedly was the fear that on their own each would fail and there would be no satellite radio. That could have been the usual business comment but——

Mr. LEIBOWITZ. Well, the other side of the "too big to fail" doctrine is the failing business doctrine, that if one company is going out of business, if it is not going to survive then another company could buy it even if it might otherwise violate the antitrust laws. But in that context if investors have leveraged too much so that they are going to go bankrupt but the product is still viable, I don't know that that comes within the failing company doctrine because someone else would buy it and you would still have two competitors. So I am not necessarily speaking about XM Sirius because I am not familiar with the details of the case but it is consistent with what you just said.

Mr. SERRANO. I tell you I wasn't happy about losing one of the Spanish channels in the merger. Of course we get the Sinatra channel all the time, and that made up for it.

Mr. CULBERSON. Priorities.

Mr. SERRANO. Yes. Both of our colleagues and the chairman will be submitting questions for the record.

FTC ROLE IN RESTRUCTURED SYSTEM

We have one last question that will give you an opportunity to end this hearing in a perfect way and it just works out that way. And that is there is so much discussion under way about a major overhaul of our system for regulating the financial services industry, and the problem it seems at times is that it is so fragmented, there are so many different agencies with so many different responsibilities. FTC, however, is unique among these regulators because it focuses on the protection of the consumer. So what role do you think the FTC should play in a restructured financial services regulatory system? If that is not a great ending question.

Mr. LEIBOWITZ. That is the kind of question we like throughout the day.

But, look, I would say this. We think it is a discussion that Congress needs to have about whether to eliminate this balkanization of jurisdiction, and we want to work with your committee and we want to work with our authorizing committee. I would just say this and I think this is a consensus on the Commission. We haven't voted on a piece of testimony as we did today but we discussed it a lot. If Congress is to create an entity to do consumer protection across all financial services, we think you should think seriously about putting it in the Federal Trade Commission. We do have some experience. We think we have done good work, not perfect, but we think we have something to build upon. That would require some more resources. If we get close to seeing that day, we will come back and talk to you about that in terms of the resource issue, but we really want to work with you. You are the policy makers, we implement what you want and we will try to do our best.

Mr. SERRANO. Mr. Chairman, we thank you for your testimony today. We thank you for your work. We will be handing to you officially one of your next investigations and we look forward to continuing to work with you.

Mr. LEIBOWITZ. Our next investigation, immediately.

Mr. SERRANO. And we look forward to continuing to work with you and this committee is committed to trying to get you the resources necessary to do the work you have to do.

Mr. LEIBOWITZ. Thank you, Mr. Chairman. We are deeply appreciative of all your efforts.

Mr. SERRANO. The committee is adjourned.

Responses to Questions for the Record from March 31, 2009 Hearing before the Committee on Appropriations Subcommittee on Financial Services and General Government

Questions from Ranking Member Emerson

TARP

Q. The FTC has experience in uncovering unfair and deceptive practices in the mortgage loan and servicing areas. Part of the Administration's Financial Stability Plan is to refinance or modify up to 9 million mortgages. With a program this large, we can expect many bad actors to participate.

- **Did the Treasury Department ask the Commission for input in the formulation of their housing program?**
- **Have you been in contact with the Special Inspector General for the TARP and are you detailing any staff to his office?**

A. The FTC uses law enforcement, rulemaking, consumer education, and research and policy development to protect consumers from unfair and deceptive acts and practices related to mortgage lending and servicing. In its activities, the Commission often coordinates and cooperates with federal and state government officials on matters related to financial services. The FTC, however, was not asked to provide input, and has not provided input or resources to the Treasury Department in the formulation of their housing program or to the Special Inspector General for the TARP.

Technology

Q. The advancement of technology, particularly the Internet, has increased consumers ability to trade and communicate across the world. Yet these technology advancements have also made American consumers vulnerable to fraudulent Internet sites and spam e-mails, and spyware.

- **If there is an Internet site and spam e-mails promoting a fraudulent mortgage rescue plans or other schemes to American consumers being run out of a foreign country, what actions can the FTC and the United States Government take to shut down that web site and recover the American victims' losses?**

Pursuing fraudsters based in foreign countries is a significant challenge for the Commission. As a civil law enforcement agency, the Commission has no authority to compel foreign defendants to appear in the courts of the United States. Moreover, the Commission is foreclosed from utilizing the Mutual Legal Assistance Treaties used by criminal law enforcement to compel businesses and individuals in foreign countries to produce evidence.

Despite these limitations, the Commission has successfully pursued many scams that victimize Americans from beyond our borders. As discussed in more detail below, the US SAFE WEB Act of 2006 has bolstered our efforts in this area. The Commission's Office of International Affairs has forged close relationships with many international law enforcement agencies. By leveraging these relationships, the Commission has been able to bring more than 120 cases with a significant cross-border component. A list of these cases, along with a brief description of each case, can be found at http://www.ftc.gov/bc/international/fedcases.shtm.

With respect to shutting down web sites, the FTC is empowered to seek a federal court order compelling the host or registrar of a web site to make the site inaccessible to the public. The FTC has sought such orders in the past when either the host or registrar is based in the United States, or has a significant U.S. connection. For example, in the recently filed *FTC v. Innovative Marketing* case, the Commission sought and received a Temporary Restraining Order compelling the domain registrar Tucows, Inc. to render hundreds of the defendants' fraudulent web sites inaccessible to the public. Although Tucows is based in Canada, it has a U.S. presence and complied with the Court's order.

The situation is significantly more complicated when both the host and registrar of a web site have no U.S. connection. Although the Commission can request a court order compelling these foreign entities to take action, there are significant jurisdictional and practical barriers to this approach. The primary issue is that neither the court nor the Commission has the power to compel compliance with such an order. Thus, in cases involving wholly foreign entities, the FTC often seeks assistance from foreign consumer protection agencies. The Commission also frequently seeks the assistance of foreign criminal law enforcement authorities, since they often have more powerful enforcement tools at their disposal.

Recovering consumer losses from fraudsters operating outside of the United States also poses significant challenges. While the Commission can seek court orders freezing assets, foreign financial institutions generally do not comply with such orders. As a result, the Commission works closely with the Department of Justice's Office of Foreign Litigation, which can retain foreign counsel and seek recognition of Commission judgments in foreign countries. While the process is lengthy and expensive, the Commission has pursued this strategy with some success.

In some cases, foreign enforcement agencies can seize illegally obtained assets and give them to the Commission for distribution to American victims. In order to encourage this type of cooperation, the Commission has supported foreign enforcement efforts in the United States by providing complaint data, witness statements, and witness travel support.

- **How closely do you work with foreign governments to pursue foreign-located evidence of fraud perpetrated against American consumers?**

The Commission has worked hard to develop strong connections with foreign law enforcement, particularly through its Office of International Affairs. These efforts have been significantly bolstered by the US SAFE WEB Act of 2006, which provided the Commission with

new authority to work with foreign law enforcement, including the ability to engage in mutual investigatory assistance.

The Commission has developed a series of enforcement partnerships and networks, both bilateral and multi-lateral, with international law enforcement agencies. As but one example, the Commission is a party to the Toronto Strategic Partnership, a group of civil and criminal law enforcement agencies seeking to curtail cross-border fraud. A report detailing the Partnership's accomplishments is available at http://www.ftc.gov/os/2008/01/080114canada.pdf.

To improve the collection and dissemination of international consumer complaints, the Commission developed econsumer.gov. This web site allows consumers from around the world to enter fraud complaints into one central database, which is accessible to law enforcement in 24 countries around the world. The Commission maintains an even more extensive complaint sharing system with Canadian and Australian law enforcement agencies.

The Commission has also worked to develop a common understanding about the tools needed to fight cross-border fraud, and was an active participant in developing the Organization for Economic Cooperation and Development's ("OECD") recommendations on cross-border fraud and spam enforcement. For examples of the Commission's close cooperation with foreign agencies on particular fraud matters, see "FTC Shuts Down, Freezes Assets of Vast International Spam E-Mail Network," http://www2.ftc.gov/opa/2008/10/herbalkings.shtm, and "FTC Announces 'Operation Tele-PHONEY,' Agency's Largest Telemarketing Sweep," http://www.ftc.gov/opa/2008/05/telephoney.shtm.

- **How do you keep up with technology to ensure that you are aware of the newest techniques being used against consumers?**

Commission staff rely on a variety of sources to keep pace with the emerging technology employed by today's fraudsters. For example, Commission staff closely monitor the FTC's Consumer Sentinel database, which is the FTC's clearinghouse for consumer complaints. Consumer Sentinel includes complaints received directly from consumers via the Commission's website and call center, as well as consumer complaints referred to the Commission by criminal law enforcement, our international law-enforcement partners, and local Better Business Bureaus, among others. Every complaint with the Consumer Sentinel database is categorized and searchable, which enables Commission staff to closely monitor emerging trends in consumer fraud and detect new methodologies employed by fraudsters.

The Commission also regularly hosts conferences and workshops in order to learn about the latest technological developments and how those advances are being used to both benefit and harm consumers. In January 2009, for example, the FTC hosted a two-day "Fraud Forum," which featured several panels on high-tech fraud. Among other panelists, the Commission heard from representatives of Google, Microsoft, eBay, Verizon, and the FBI's Cyber Initiative and Resource Fusion Unit.

Commission staff also develop and maintain expertise in a variety of high-tech areas by

attending industry conferences, reading trade periodicals, websites and blogs, and consulting directly with industry experts. As a result, Commission staff are able to stay abreast of the latest developments in high-tech areas such as spyware, spam, phishing, and data security.

Identity Theft

Q. I understand that the FTC is a member of the Identity Theft Task Force established in 2007 and that the FTC has extensive educational materials for consumers and businesses on how to prevent identity theft.

- **Approximately how many cases of identity theft occur each year and is it increasing or decreasing?**

The FTC has conducted several surveys in order to assess the prevalence of identity theft and its impact on both the economy at large and individual victims. Our most recent survey was released in 2007[1] and was based on telephone interviews with approximately 5,000 individuals. The survey concluded that approximately 8.3 million U.S. adults, or approximately 3.7% of the adult population, discovered that they were victims of identity theft in 2005. Our earlier, 2003 survey indicated that nearly 10 million Americans, or approximately 4.6% of the population, had discovered that they had become victims in 2002.[2] Although there is a decrease in the overall prevalence between the two surveys, this decrease is not considered statistically significant. The decrease may simply reflect minor variations in the sample and not an actual decrease in the incidence of the crime.

Other entities also have conducted surveys on identity theft.[3] Most of these surveys are generally consistent with the FTC's findings, although some have found an upward trend in the incidence of identity theft.

Accurate statistical data allow us to develop and tailor our identity theft program to changing circumstances. Indeed, the President's Identity Theft Task Force recommended that the Commission expand its data gathering and analysis activities.[4] The FTC therefore has

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[1] Federal Trade Commission, 2006 Identity Theft Survey, *available at* http://www.ftc.gov/os/2007/11/SynovateFinalReportIDTheft2006.pdf.

[2] Federal Trade Commission, Identity Theft Survey, *available at* http://www.ftc.gov/bcp/edu/microsites/idtheft/downloads/synovate_report.pdf.

[3] *See, e.g.*, Javelin Strategy and Research, *2009 Identity Fraud Survey,* brochure *available at* http://www.javelinstrategy.com/uploads/901.R_IdentityFraudSurveyBrochure.pdf; and Gartner ID survey, 2007, http://www.gartner.com/it/page.jsp?id=501912.

[4] *See, Combating Identity Theft: A Strategic Plan*, pp. 70-71, April 2007, *available at* http://idtheft.gov/reports/StrategicPlan.pdf

partnered with the Department of Justice's Bureau of Justice Statistics on its most recent National Crime Victimization Survey. This survey was based on interviews with roughly 40,000 households, and included a supplemental section that focused on identity theft and its impact on its victims. The results are expected later this year, and should produce significant information about the scope and impact of identity theft.

- **How difficult is it for a victim of identity theft to restore their credit and any assets they may have lost?**

The majority of identity theft victims can restore their identity without expenditure of significant time or expense. However, some victims still face extraordinary difficulties in resolving their cases, and in those instances they may spend a fair amount of time and money restoring their identities. More precisely, the FTC's 2006 Identity Theft Survey Report found that in more than 50% of identity thefts, the victims incurred no financial cost. However, in some cases, victims suffered significant losses, with 10% of victims reporting that the theft cost them $1,200 or more. These losses may have been the result of unreimbursed losses associated with fraudulently opened accounts, or the costs of restoring their identity, such as notary expenses or legal fees.

In addition to financial costs, many victims also spend time correcting their credit reports, disputing accounts, and resolving other issues caused by the theft.[5] The 2006 survey found that the median amount of time spent by victims correcting their identity theft issues was four hours, but that 10% of victims had to spend 55 hours or more to correct all of their records.

Although identity theft victims will necessarily have to spend some time to fix their credit reports and dispute fraudulent accounts, certain federal laws provide them with tools to facilitate that process. For example, under the Fair Credit Reporting Act ("FCRA"),[6] an identity theft victim who submits an identity theft report to a consumer reporting company can ask the company to block fraudulent information from her credit report. The consumer reporting company is then required to tell the creditors who reported the debt that it was the result of identity theft. Those creditors may not sell or refer those fraudulent debts to debt collectors. Further, the FCRA also entitles victims to obtain copies of the fraudulent application and other records from the identity theft from the entities that opened the accounts.[7] Frequently those

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[5]Because of the 2003 Fair and Accurate Credit Transactions Act (FACTA), all consumers are entitled to one free credit report each year, from each of the three nationwide credit reporting agencies. *See* www.ftc.gov/freereports.

[6] 15 U.S.C. §§ 1681-1681(u).

[7] 15 U.S.C. § 1681g (e).

documents will help to absolve the victims of any of the debts and correct their credit reports.[8]

In addition, the FCRA allows consumers to dispute fraudulent or inaccurate information on their credit reports.[9] The credit reporting company must then investigate the accuracy of the information and correct or delete any inaccurate information.

Federal law also limits the financial loss of many victims of identity theft. The Fair Credit Billing Act limits a consumer's liability to $50 for fraudulent charges on credit cards, as long as the consumer reports the charges within 60 days after the first bill containing the charge was mailed to the consumer.[10] As a matter of business policy, most card issuers do not hold the consumer responsible for that $50. Similarly, the Electronic Fund Transfer Act limits consumer liability for fraudulent transactions involving ATM cards, debit cards, or other electronic transfers from an account.[11]

Further, the FTC has a full range of resources to assist identity theft victims. A toll free hotline – 1 877 ID THEFT – connects victims with trained telephone counselors who can walk the consumers through the steps to restore their identity. The FTC also hosts the government's central identity theft website – www.ftc.gov/idtheft – where consumers, businesses, and law enforcement alike can find materials in both English and Spanish on how to prevent, mitigate and recover from identity theft. In 2008 alone, more than 300,000 identity theft victims filed complaints with the FTC through these channels.

- **If you are a victim of identity theft, how difficult would it be to obtain a mortgage in the current economic environment?**

In many cases, identity theft can result in fraudulent negative information being added to the victim's credit report. For those victims who have not been able to remove all of the fraudulent information at the time they are applying for a mortgage, the impact on their ability to obtain a mortgage can be substantial. If the thief's activities damaged the victim's apparent credit worthiness, then the victim may be prevented from obtaining a mortgage for which they would otherwise qualify, or may obtain it on less advantageous terms.

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[8] Many of these remedies were established by the FACTA. Commission staff are engaged in a survey of the FACTA remedies to see how well they are working, and whether additional education and/or enforcement is warranted. This survey is another recommendation from the President's Identity Theft Task Force. *See, Combating Identity Theft: A Strategic Plan, supra,* page 51.

[9] 15 U.S.C. § 611.

[10] 15 U.S.C. §§ 1666-1666j.

[11] 15 U.S.C. §§ 1693-1693r.

However, as discussed above, most identity theft victims are able to resolve the problems caused by identity theft relatively quickly. In those cases, as long as the victim corrects his or her credit report prior to applying for the mortgage, the identity theft should have little or no impact on his or her ability to obtain a mortgage. This is why we recommend that consumers check their credit reports before applying for a mortgage; early detection means that consumers can correct any errors or fraud on their report before the errors cause problems.

Child Obesity

Q. As you know, child obesity is a significant problem in this country. The fiscal year 2009 bill requires the FTC to work with FDA and CDC to create an interagency working group to study and develop recommendations for standards for the marketing of food when targeting children. The working group is required to report its findings and recommendations by July 2010. Has the working group been established and has any progress been made to study this issue?

A. On April 1, 2009, Chairman Leibowitz sent a letter to USDA Secretary Vilsack, FDA Acting Commissioner Torti, and CDC Director Besser, inviting their agencies' participation in the Interagency Working Group on Food Marketed to Children. We have proposed that the FTC host the initial meeting of the working group at the Federal Trade Commission in early May.

Questions from Congressman John Culberson

Q. How do we compensate American taxpayers for bailouts due to bad mortgage origination? How can we position the FTC to bring action on behalf of taxpayers to trigger the errors and omissions coverage of unscrupulous mortgage brokers, lenders, and servicers?

A. In providing a response to this question, I am also considering the discussion that took place during and after the hearing on this specific topic. The Commission is committed to acting, within the limits of its jurisdiction, against those who prey on consumers by engaging in unfair and deceptive mortgage lending practices. To date, the Commission's enforcement actions in the area of mortgage lending have focused primarily on deceptive or unfair advertising and marketing conduct that induced the consumer's decision to enter into a mortgage loan agreement. Thus, enforcement actions have been brought against mortgage advertisers, mortgage brokers, other nonbank financial companies, and individuals who failed to make the required disclosures, who made false or deceptive claims regarding interest rates or other aspects of the mortgage, or who otherwise misrepresented or omitted material information that affected consumers' ability to make a fully informed decision. Enforcement actions in these areas have been successful, and as noted in the testimony, have resulted in the return of significant funds to specific consumers injured by specific conduct of specific defendants.

Unfortunately, because of the magnitude of the mortgage crisis, the Commission does not have the resources to pursue each individual case in which consumers were duped into entering

into an adverse mortgage loan agreement. Similarly, other federal and state enforcement agencies are bringing their share of criminal and civil actions against the worst offenders, but the number of transactions and number of injured consumers dwarfs the collective enforcement resources. Accordingly, the suggestion of a large-scale enforcement action is appealing in terms of effective resource allocation, as well as consistent rather than piecemeal results. However, after careful consideration of applicable law and policy, I do not believe that it would be possible for the Commission to pursue such action.

Even if it were otherwise feasible and prudent to bring an enforcement action to recover public funds – *i.e.*, taxpayer monies collected and held by Treasury – expended by the United States in the massive bailout to redress the economic injury caused by bad mortgage origination, the Department of Justice rather than the Commission would be the appropriate agency. *See* 28 U.S.C. §§ 516 ("except as otherwise authorized by law . . . the conduct of litigation in which the United States, an agency, or officer thereof, has an interest is reserved to officers of the Department of Justice"); 519 (". . . the Attorney General shall supervise all litigation to which the United States, an agency, or officer thereof is a party."). The FTC Act does not provide the Commission with the express legal authority to bring a recovery action on behalf of taxpayers.

Similarly, the Commission lacks the legal authority to bring an enforcement action solely to obtain private relief for specific taxpayers – *i.e.*, consumers – who lost funds as a result of mortgage lending and related conduct. Unlike private litigants, whose primary (and sometimes exclusive) motivation is to maximize their financial recovery, the Commission has the broader mandate to act in the public interest with regard to consumer protection matters broadly and consumers collectively. Although the Commission often recovers funds for the benefit of injured consumers, that is not its sole consideration and, in some instances, the Commission may determine that its resources will be better used and that a more effective overall result will be achieved by rulemaking, outreach, or another approach in addition to or instead of litigation. The Commission exercises its expertise in determining how best to proceed with regard to any particular consumer protection issue. *See, e.g.*, 15 U.S.C. §§ 45(b), 53(b). The Commission's expertise is based, among other things, on the knowledge and experience of its Bureau of Consumer Protection and its Bureau of Economics. That expertise strongly suggests that resolution of the mortgage crisis will not be accomplished solely by enforcement actions. As a result, the Commission is also committing resources to other activities intended to have a broader impact on consumer protection and mortgage lending.

In responding to this question, Commission staff also considered the possibility of protecting consumers by bringing a single large-scale enforcement action against those involved in mortgage lending fraud instead of continuing its current practice of bringing individual mortgage lending enforcement actions against the worst offenders. If the FTC were to bring a single enforcement action against all those involved in mortgage lending fraud, top to bottom, the scope of the action – and thus the relief that could be obtained – would be limited because of the Commission's limited legal authority. The statutes that support Commission action in this area – the FTC Act, the Truth in Lending Act, 15 U.S.C. § 1601-1666(j), and the Home Ownership Equity Protection Act of 1994, 15 U.S.C. § 1639 – all specifically exempt banks, savings and loan institutions, and federal credit unions from the Commission's jurisdiction. *See*,

e.g., 15 U.S.C. §§ 45(a)(2), 57a(f). In a large-scale action, therefore, the FTC would not be able to challenge the conduct of most mortgage lenders and many others involved in mortgage-related conduct, and any available monetary and equitable relief would not apply to those consumers who were injured by entities and individuals who were exempt from Commission jurisdiction. Because such a large number of potentially liable entities and individuals, including those with errors and omission insurance, are beyond the Commission's jurisdiction, the Commission would be unlikely to recover significant funds for the benefit of consumers even if insurance policies otherwise applied to fraudulent and deceptive conduct relating to mortgage lending.

Furthermore, based on our experience, it is not apparent that there is a single or small number of fact patterns common to all consumers, much less that there are a small number of consistent claims that could be asserted against all potential defendants in the mortgage lending chain, top to bottom, that would apply broadly to all mortgages that are now in default or at risk of default, and that, if successful, would trigger appropriate monetary and equitable relief for all consumers. Furthermore, any such comprehensive action would need to take into account and perhaps even accommodate the overlapping and potentially competing interests arising from concurrent actions by other federal and state enforcement entities, by private class action counsel, and by the injured consumers themselves.

Such a proceeding would require a significant diversion of already limited resources from the Commission's consumer protection and other missions and would require a significant amount of time to resolve. Given the decline in property values, the current economic environment, the bundling and resale of the mortgages, and the fact that additional government funds are likely to be provided to at least some of the entities who would also potential defendants in such an action, it is not at all apparent that significant independent resources would even be available for recovery – whether from primary defendants or secondary defendants such as insurance carriers, venture capital companies, trusts, or similar entities.

The Commission is committed to obtaining meaningful relief for consumers injured by mortgage-related fraud, and we share the concerns of Rep. Culberson and his colleagues about the high cost to taxpayers of resolving the issues created by the mortgage crisis. As noted during the testimony, the Commission will continue to take enforcement action against specific mortgage advertisers, mortgage brokers, mortgage lenders, and mortgage servicers who violate the FTC Act and other applicable statutes. We will do our utmost to recover all available funds and, when possible, return them to the consumers injured by that specific conduct. In addition, we will continue to dedicate significant resources not only to pursuing mortgage lending enforcement actions in collaboration with our federal and state partners, but also to playing a leading role in the policy discussion, rulemaking, business and industry education, outreach to consumers, and other activities that must take place if the United States is, collectively, to recover from the current mortgage crisis and prevent future consumers from experiencing similar injuries.

Q. What kind of action are you considering for unscrupulous lenders? Does the FTC preempt state authority? How does the FTC work with State Attorneys General in going after mortgage fraud?

A. The FTC conducts investigations and brings actions against mortgage lenders who engage in unfair or deceptive acts and practices in violation of Section 5 of the FTC Act. These law enforcement activities have been a primary focus of the Commission's effort to protect consumers of financial services. In the last five years, the FTC has brought more than 70 financial services–related cases and has returned over $465 million to injured consumers in the past 10 years.

In addition to vigorous enforcement of existing laws, the FTC will be enforcing new mortgage lending rules in the future. The Commission has the authority to enforce new rules that the Federal Reserve Board has issued under the Truth in Lending Act that prohibit a variety of unfair, deceptive, and abusive home mortgage advertising, lending, appraisal, and servicing practices. The Federal Reserve Board's new rules take effect in October 2009. Under the 2009 Omnibus Appropriations Act, the FTC also is directed to commence a rulemaking proceeding to prohibit unfair and deceptive acts and practices with respect to mortgage loans. The Commission anticipates that its rulemaking will address mortgage lending servicing as well as loan modification and foreclosure rescue scams, and the FTC will vigorously enforce any rules that it issues.

The FTC has a long history of working with state officials on consumer protection matters, including those in the financial services area, and we are going to do more. The Federal Trade Commission Act does not preempt state law, including "little FTC Acts" that prohibit unfair and deceptive acts and practices. The Commission cooperates and coordinates with its state partners in law enforcement investigations and prosecutions of mortgage lenders who have violated the law. Note that the states will be able to enforce any new mortgage lending rules that the FTC issues to implement the 2009 Omnibus Appropriations Act.

Chairman Leibowitz and Attorney General Holder recently announced their intent to revive and reinvigorate the Executive Working Group, which will allow a network of federal and state law enforcement and regulatory partners to coordinate and exchange intelligence to ensure a coordinated and comprehensive response to mortgage lending fraud and other consumer protection and competition issues.

Q. How do you promote your educational material to reach as many at-risk consumers as possible? For example, do you use different strategies to reach rural versus urban consumers - or wealthy versus poor - young versus older consumers?

A. The vulnerability of consumers may vary based on the type of fraud or other illegal conduct and, therefore, it is important to conduct outreach to all types of consumer groups. To that end, the FTC has launched partnerships with outside organizations to target a wide range of consumers, including the American Association of Retired Persons (AARP), the American Savings Education Council, and the League of United Latin American Citizens.

In some instances, certain consumer groups, such as American consumers whose primary language is not English, the elderly, and children, are faced with unique circumstances that may

make them more vulnerable to fraudulent schemes. For example, Spanish speakers may be more susceptible to Spanish-language fraud and, if the Spanish speaker is a recent immigrant, he may be a target of immigration-related scams. Other consumers—the elderly and children—may also be vulnerable because of their age. In particular, the elderly may be less familiar with new technologies and the panoply of emerging threats, and they may also be targeted in particular types of fraud, such as deceptive advertisements purporting to cure certain medical problems. On the other end of the spectrum, children are often more susceptible because their young age makes them more vulnerable to certain deceptive tactics.

When appropriate, the FTC develops materials and strategies to reach different populations of consumers or consumers who may be more vulnerable to particular types of fraud or deception. For example, the FTC manages a Spanish-language fraud awareness campaign to reach the large population of Spanish-speaking consumers in the United States. The campaign includes radio public service announcements, a Spanish-language web site, and outreach to more than a thousand community-based organizations in cities with large or growing Latino populations

The FTC has also targeted reports, education, and enforcement to address health and other fraud aimed at the elderly population and, as mentioned above, has partnered with the AARP to help disseminate these educational messages.

The FTC has also launched many initiatives that are targeted to youth. One program is designed to provide financial literacy education to school-aged students. One aspect of this program is a booklet and website, Getting Credit, which is intended to inform teens and young adults about everything they need to know to maintain a good credit report and avoid identity theft. In addition, the FTC created a website with educational materials about the dangers of teen drinking and requirements of alcohol advertising. *See* http://www.dontserveteens.gov. The website allows users to download the consumer education materials to facilitate further distribution to more audiences.

Some Congressional Additions to FTC Tasks Since 1998

The Identity Theft Assumption and Deterrence Act of 1998 makes the FTC a central clearinghouse for identity theft complaints, providing complaint information to other law enforcement agencies and major national consumer reporting agencies, and providing victim assistance. In conjunction with these obligations the FTC also provides training for law enforcement officers on handling identity theft investigations and enforcement actions, and co-chaired the President's Identity Theft Task Force.

The Children's Online Privacy Protection Act, 1998 required the FTC to issue a rule protecting children's privacy by giving parents the tools to control what information is collected from their children online; requires the FTC to review and, where appropriate, approve industry groups' and others' self-regulatory guidelines to govern participating websites' compliance with the Rule; and assigns enforcement responsibility to the FTC.

Gramm-Leach-Bliley Act, 1999 along with several other agencies, required the issuance of regulations for financial institutions to maintain the privacy of consumers' personal financial information, and to safeguard such information. The Act also prohibits obtaining by false pretenses customer information held by a financial institution. The FTC enforces the statute and rules as to entities not specifically assigned by the law to the Federal banking agencies or other regulators.

Scholarship Fraud Prevention Act of 2000 requires the FTC, the Attorney General, and the Secretary of Education to submit annually a joint report to Congress on the nature and quantity of incidents of fraud in the offering of college education financial assistance services. The FTC is also directed to work with the Secretary of Education in maintaining a scholarship fraud awareness site on the Department of Education's website.

Omnibus Appropriations Act, FY 2001 included report language accompanying the Act directing the FTC to investigate the competitive implications of grocery slotting allowances.

Crimes Against Charitable Americans Act of 2001 expands the Telemarketing and Consumer Fraud and Abuse Prevention Act to reach fraudulent charitable solicitations and requires certain disclosures by for-profit solicitors for charities; the Act required the FTC to amend its Telemarketing Sales Rule accordingly, and expanded its enforcement responsibilities.

Appropriations Act, FY 2002 included report language accompanying the Act directing the FTC to engage in consumer research and workshops, underage shopper-retail compliance surveys, and marketing data collection, regarding the marketing of violent entertainment to children. This report language has been included in later appropriations measures. The report language also directed the FTC to monitor minors' access to online gambling sites and to educate parents about the availability of online gambling to children.

Consolidated Appropriations Act, FY 2003 included report language accompanying the Act directing the FTC (1) to study and report on liquor-branded "alcopops"; and (2) to encourage and report on stricter standards for marketing of alcohol to minors.

Fair and Accurate Credit Transactions Act of 2003, amending the Fair Credit Reporting Act (FCRA), adds provisions designed to prevent and mitigate identity theft, and to improve the accuracy and privacy of, and consumer access to, consumers' credit-related records. The FTC was tasked, alone or in conjunction with other regulators, with requirements to issue 20 rules, guidelines, or forms; requirements for 9 studies and reports; and enforcement responsibility with respect to entities not assigned to the Federal banking agencies or other regulators.

Do-Not-Call Implementation Act, 2003 provided for the FTC to collect fees related to the Do-Not-Call Registry, which the Commission then established and continues to administer. The act also required the FTC annually, through 2007, to issue regulations to set the fees. [It also required the FTC to issue annual reports to Congress on the Registry.]

Controlling the Assault of Non-Solicited Pornography and Marketing Act of 2003 (CAN-SPAM Act), establishing requirements for those who send unsolicited commercial email, required the FTC to issue rules on two topics; study and report to Congress on four topics; and enforce the statute and rules.

Medicare Prescription Drug, Improvement, and Modernization Act of 2003 required the FTC to study and to issue a report regarding pharmacy benefit managers; and requires pharmaceutical companies to file settlement agreements with FTC and DOJ, on which FTC reports.

Fairness to Contact Lens Consumers Act, 2003 providing for the availability of contact lens prescriptions to patients, required the FTC to prescribe implementing rules, and assigns the FTC enforcement responsibility; the act also required the FTC to study and report to Congress on the strength of competition in the sale of prescription contact lenses.

Consolidated Appropriations Act, FY 2004 required the FTC to amend the Telemarketing Sales Rule to require telemarketers subject to the rule to "scrub" their calling lists by obtaining from the FTC the list of numbers on the Do-Not-Call Registry every month. It also instructs the Department of Commerce to implement a cooperative program for crab fisheries of the Bering Sea and Aleutian Islands in which individuals receive processing quotas. It requires the Department of Commerce to implement, in consultation with the FTC and DOJ, a mandatory information collection and review process to enable the FTC and DOJ to determine if anyone receiving such a quota has violated any of the antitrust laws. It included report language accompanying the Act directing the FTC (1) to conduct a study concerning anticompetitive practices in commercial trucking fleet card programs; and (2) to educate parents about the content of "teen" and "mature" video games, and work with industry to discontinue their marketing to children and their sale to unaccompanied children.

Sports Agent Responsibility and Trust Act, 2004 prohibits certain conduct and requires certain disclosures by sports agents relating to the signing of contracts with student athletes. The FTC and state attorneys general are responsible for enforcing the act.

Consolidated Appropriations Act, FY 2005 included report language accompanying the Act directing the FTC to investigate and report to Congress regarding pressure on American fishermen not to oppose repeal of country-of-origin labeling requirements for seafood.

Energy Policy Act of 2005 required the FTC to conduct an investigation and report to Congress on whether the price of gasoline was being artificially manipulated. It requires the FTC to issue rules concerning the energy efficiency labeling of certain household appliances. It requires the FTC to submit annually to Congress a market concentration analysis of the ethanol production industry to determine whether there is sufficient competition among industry participants to avoid anticompetitive behavior. It established a five-member interagency task force, with one member from the FTC, required to study and report to Congress on competition within the wholesale and retail market for electric energy in the United States. The Act also authorizes the FTC to issue rules on "slamming" and "cramming" to protect electricity consumers, which the FTC would enforce.

Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 requires the FTC to establish and maintain a toll-free telephone number for consumers seeking information on the time required to repay specific credit balances.

Appropriations Act, FY 2006 required the FTC to conduct an investigation of price gouging after Hurricanes Katrina and Rita, directing the agency to spend at least $1 million on the investigation. It included report language directing the FTC to study and report to Congress on (1) marketing of food to children and adolescents; (2) marketing of violent entertainment to children; and (3) the Children's Online Privacy Prevention Act.

Federal Deposit Insurance Corporation Improvement Act of 1991, as amended 2006 requires, among other things, that the FTC issue a rule prescribing the manner and content of mandated disclosures by non-federally insured depository institutions, in certain locations, documents, and advertising, that the institution is not federally insured; and provides for FTC and state enforcement. (These provisions were subject to a complete bar on Commission use of resources for implementation from 1992 through 2004.)

Unlawful Internet Gambling Enforcement Act, 2006 prohibits any person engaged in the business of betting, as defined, from knowingly accepting credit, electronic fund transfers, checks, or any other payment involving a financial institution to settle unlawful Internet gambling debts. The FTC is responsible for enforcing the Act, and implementing regulations issued by Treasury and the FRB, with respect to payment systems and financial transaction providers not specifically assigned to other regulators.

Sober Truth on Preventing Underage Drinking Act, 2006 formally establishes and enhances the Interagency Coordinating Committee on the Prevention of Underage Drinking, of which the FTC is a member.

Postal Accountability and Enhancement Act, 2006 makes the United States Postal Service subject to FTC enforcement under the FTC Act with respect to unfair methods of competition; and required the FTC to issue a report concerning federal and state laws that apply differently to the U.S. Postal Service with respect to competitive mail products and to private companies providing similar products.

U.S. Safe Web Act, 2006 provides the FTC with a number of tools to enhance its international consumer protection enforcement initiatives and other activities regarding international relationships and enforcement.

Energy Independence and Security Act of 2007 prohibits (1) any manipulative or deceptive device or contrivance in connection with the wholesale purchase or sale of crude oil, gasoline, or other petroleum distillate in contravention of rules or regulations the Commission may prescribe by rule; and (2) certain misleading reports to the government of price-related information for such products. The Act also requires the FTC to issue rules for the labeling of biodiesel or biodiesel blend fuel sold at retail, and to issue rules in specified circumstances concerning energy efficiency labeling for certain additional products and equipment. The FTC is responsible for enforcing these rules and prohibitions.

Do-Not-Call, 2008 The Do-Not-Call Improvement Act requires the FTC periodically to check numbers registered on the Do-Not-Call Registry against other appropriate databases and remove numbers that have been both disconnected and reassigned, and required a report to Congress on continued efforts to improve the Registry's accuracy. The Do-Not-Call Registry Fee Extension Act eliminates the need for annual rulemaking to set Registry fees; it requires biennial reports to Congress.

American Recovery and Reinvestment Act of 2009 requires HHS, in consultation with the FTC, to conduct a study and issue a report on potential privacy, security, and breach notification requirements for vendors of personal health records and related entities. The Act requires the FTC to implement and enforce requirements for non-HIPAA covered PHR vendors and related entities, and requires the FTC to issue separate "interim final regulations," which it would enforce.

Omnibus Appropriations Act, FY 2009 requires the FTC to initiate rulemaking with respect to mortgage loans within 90 days of enactment. It included report language accompanying the Act that (1) directs the FTC, with three other agencies, to establish an Interagency Working Group on Food Marketed to Children to conduct a study and develop recommendations for marketing of food to children; and (2) directs the FTC to issue a consumer alert to parents on the content of virtual reality web programs that is available to children, and to study and report to Congress on virtual reality site content and steps taken to prevent minors from accessing it.

WEDNESDAY, APRIL 29, 2009.

FEDERAL COMMUNICATIONS COMMISSION

WITNESS

MICHAEL J. COPPS, ACTING CHAIRMAN

Mr. SERRANO. The meeting will come to order. We welcome Michael Copps to this oversight hearing on the Federal Communications Commission.

The Administration is expected to submit its budget next month. When it does, we expect to be fully briefed on the FCC budget. A lot of the hearings we are holding now, we are holding without a budget, so we are going to talk about everything except numbers, I guess.

The FCC has policy responsibilities that affect the everyday lives of all Americans. We increasingly rely on the electronic media for our news, information, entertainment, and personal communications. We use cell phones for Internet searches and tweets. Internet connections are increasingly used to distribute programming traditionally on cable.

The communications that we take for granted today result from decisions the FCC made long ago. Decisions that you will make in the near future will affect both the kind of information and how we receive it, for many years to come.

This is a time of transition for the FCC. The White House has nominated Julius Genachowski, did I get that right, to become the next Chairman of the FCC. Mr. Genachowski served as Chief Counsel to the FCC Chairman during the Clinton Administration.

In the interim, our witness today, Michael Copps, is serving as the Acting FCC Chairman. Mr. Copps is well prepared for the task. He has served on the five member Board of the Commission for almost eight years, and he has been part of many 3–2 decisions, I am not going to say on which side, but you know on which side.

On June 12, the Nation is scheduled to complete the delayed transition to digital TV. To assist with that transition, the FCC obtained $66 million from NTIA as part of the recent Economic Recovery Act. With analog signals due to end in just six weeks, we want to hear the FCC perspective on what it is doing and what to expect.

Another important topic before the FCC is broadband. The Recovery Act provided more than $7 billion to assist with broadband deployment in unserved and underserved communities. The Act also directed the FCC to develop a long-range national strategy on broadband policy by next February.

The U.S. trails many other countries in the percentage of households with basic broadband connections. A number of other countries have lower costs and faster speeds than we have. Our lower

income areas, particularly in central city and rural locations, have especially low broadband rates.

Last September, this subcommittee held a hearing on problems public, educational, and governmental, PEG channels, have been having with cable systems. Those problems have not gone away, and new problems have arisen. A number of members have raised concerns also about the auditing procedures by the FCC's IG on recipients of Universal Service Fund money. They claim that the orders are onerous, reduce money from universal service, and have uncovered no fraud.

The last Administration rarely saw a merger that it did not approve, in communications and financial, or any other industry. We have paid a heavy price for the mismanagement of our massive financial institutions in the last year. I am not sure that our communications giants have served us much better.

Our witness today, Mr. Copps, has fought to limit media concentration. Our communications system plays a vital role in our democratic society. We live in an increasingly diverse society that is finding many new and creative ways to communicate. As technology and society change, our communications policy should keep pace.

Mr. SERRANO. Before we turn to our witness, I would like to invite Ms. Emerson, our ranking member and our colleague, to make her statement, please.

Ms. EMERSON. Thank you, Mr. Chairman. Welcome, Chairman Copps. Thank you so much for appearing before us this morning.

Chairman Serrano has said you all at the FCC do play a very important regulatory role in our country's telecommunications, television, radio, Internet, and the cable industries, and these services do touch every, just almost every single American citizen and business, each and every day.

So, ultimately, I will have to bring some balance between providing enough regulation and oversight to ensure that the American people have available communications services, while not slowing the technology progress, or impinging on individual rights. And I know this has got to be a very challenging job, with many business, technology, and consumer groups watching your every move.

Also, as the Chairman has said, I realize that not all of the budget numbers are here, so we will look forward to getting that, but I will also be interested to hear why the Commission is going to request increases to address your technology infrastructure purchase, new public safety vehicles, and to hire additional staff. And you may touch on that in your testimony.

So, thanks again for being here. I look forward to learning more about your budget increases, but also look forward to working with you.

Thank you, Mr. Chairman.

Mr. SERRANO. Thank you. You know, before I begin, one of the things that has changed, I guess, throughout the last generation, is that in many cases, we had members of the Administration before us, where the members sitting here on the panel had very little knowledge or involvement with the work you do. But this is a new generation.

Personally, I have two Blackberries, with cell phone, email, everything. I own two Nanos and one iPod, video iPod, HDTV. I subscribe to Major League Extra Innings. I subscribe to MLB.com for the laptop. You too?

Ms. EMERSON. You can see it on my Blackberry. My own icon. Cardinals icon, I might add.

Mr. SERRANO. See what I am talking about? So, we do have vested interests, and not in a conflict of interest. No different, we are really representative. And this morning, I ran with the Nike Plus, which is a sensor to your sneaker, to your shoe, that tells you how fast you are going and how you are doing, and the lady kept coming on and saying faster, faster. And it was no fun at all. I was very aggravated.

The point is that this particular agency is one that we, whether we know it or not, deal with on a daily basis, and we are interested in the results. We are very much interested in your testimony. And your statement will go fully in the record, and we hope you stay within five minutes. We can grill you through and through.

Mr. COPPS. Thank you very much, Chairman Serrano, and Ranking Member Emerson. With me this morning are our Chief Financial Officer, Mark Stephens, and a few other people from the FCC.

Because I have not appeared here previously, let me first of all thank you both, and the subcommittee generally, for your ongoing support during the past year. I believe, and I hope you agree, that you are seeing a return to the American people on the investment that you have made in the FCC.

FCC has played a critical role in shaping the communications landscape of our country for nearly 75 years. This is our diamond jubilee year, also that of the Telecommunications Act. And as we mark that diamond jubilee, we face new challenges and opportunities that really put us at the epicenter of some of the most critical challenges facing the Nation, and so much of the future, as you indicated in your statement, hinges on our success in bringing the opportunity generating tools of modern communications to all of our citizens.

Our 2010 budget submission steps up to these challenges, and outlines some strategies to meet them. We are going to be requesting, for fiscal year 2010, $335,794,000. Of that, approximately $318 million is to maintain current service levels. That is an increase of some $6 million, to accommodate inflationary increases for salaries and benefits and leasing costs and utilities and other contractual services.

During 2010, the Commission also proposes to take some long-delayed, and I think urgently required steps to modernize the agency, particularly, as you mentioned, our technology infrastructure, for which we are seeking $15 million. First, we will upgrade and integrate our IT systems, to make our processes more transparent and easier for the public to access. Second, we will modernize our antiquated phone systems to address present shortfalls. Third, we will improve internal coordination and information sharing by our staff.

As Commissioner for the past almost eight years, I had a pretty good idea that our agency was a long way from entering the Digital Age, and as Chairman the past three months, now I know it for

sure. While we might be able to muddle through with our outdated and inefficient infrastructure, and force the rest of the world to adjust to us, that is not my vision for an agency that has communications as its middle name.

You know, we have been helping many of our licensees transition into the Digital Age. I think it is time for the FCC to transition into the Digital Age, too. And I believe we need to not only keep pace with the needs of the public and those with whom we do business, but we ought to be really leading the way, and showing the way.

In the few minutes I have, let me just briefly mention two pressing communications issues that I know are on your minds as well as ours. The most immediate is the DTV transition. Since February, when Congress postponed the deadline to June 12, our dedicated staff at the FCC has been hard at work to develop a strategic nationwide program to educate and assist consumers, and to put in place a really coordinated organizational, interagency, public sector–private sector partnership to do that.

We have got better coordination with NTIA, and other government agencies and stakeholders. The White House ramped up our partnerships with the private sector, and we have retooled our consumer outreach, by moving from a general awareness campaign to actually trying to provide help on the ground, or boots on the ground, in-home assistance, to people who really need it, and the most vulnerable would include senior citizens and people for whom English is not their primary language, people with disabilities, those living in rural areas and on tribal lands also. And we have also improved our consumer outreach, and the problems that I think were neglected for far too long, such as digital signal coverage, reception challenges, and antenna issues.

I want to assure this Subcommittee that we will continue to do everything we can to minimize consumer disruption on June 12, but make no mistake, there will be disruption. We cannot fix all of the problems of the past few years in a few short months, but because of the additional time that we have, and the resources we have been given, I think we can make a sizable difference.

Another matter that I want to discuss involves perhaps the most exciting issue the FCC will address this year, or maybe in many, many years, and that is broadband. Broadband can be the great enabler that plays a central role in restoring America's economic well-being, and opening doors of opportunity for all Americans, no matter where they live, the particular circumstances of their individual lives, who they are. It is technology that intersects with all of the cross-cutting challenges that face this country of ours right now, whether we are talking jobs or education or energy, or environment and climate change, or international competitiveness, or healthcare, overcoming disabilities, opening the doors of equal opportunity. The list just goes on and on. Broadband can and will have a tremendous effect in all of those areas.

And it is with that in mind that Congress and the President set out a two-step broadband strategy in the Recovery Act. First, NTIA and the Rural Utilities Service were asked to provide $7.2 billion in stimulus money for projects that will create jobs, spur the economy, and foster the availability of broadband in the near term, and

our role in that at the Commission is largely a consultative role. Second, the Commission was tasked, and this is the exciting part for me, with developing a longer term national plan for broadband, and to present it to Congress by February 17 of next year. And that strategy will look to the future, and design a plan to ensure that every American has access to high speed, high value broadband.

I have been calling for that for eight years, since I came to the Commission. I thought we were the only country on the face of God's green Earth, the only industrial country that did not have a broadband strategy. So, I am particularly pleased that now, we are going to have a plan, and that the FCC is put right at the center of developing it.

So, to get the ball rolling, on April 8, we issued a comprehensive notice of inquiry, to begin a national dialogue on broadband, that is going to reach out to everybody, not just the usual suspects who travel the halls of the FCC. I want to hear from nontraditional stakeholders, as well as traditional. It is going to be far-reaching. We want a lot of data. We just want this to be the best effort that the Commission has ever done. And if we do our job right, this will be the most formative and the most transformative proceeding, I think, in all of the Commission's history. And my team and I are committed to getting this done and done right.

There are a lot of things, as you both indicated in your statement, for us to talk about. My time is limited, so I will just end by respectfully asking the Subcommittee to consider smiling upon our financial year 2010 request, and again, thanks for the support you have given us, and I would be pleased to hear any comments that you might wish to make, or suggestions that you might have, or try to answer any questions that you may have.

[The information follows:]

STATEMENT

OF

ACTING CHAIRMAN MICHAEL J. COPPS
FEDERAL COMMUNICATIONS COMMISSION

U.S. HOUSE OF REPRESENTATIVES

COMMITTEE ON APPROPRIATIONS

SUBCOMMITTEE ON FINANCIAL SERVICES
AND GENERAL GOVERNMENT

THE FCC'S FISCAL YEAR 2010 BUDGET REQUEST

April 29, 2009

Good morning Chairman Serrano, Ranking Member Emerson, and Members of the Subcommittee. I appreciate this opportunity to appear before you today for the first time as Acting Chairman of the Federal Communications Commission to present the Commission's Fiscal Year 2010 Budget Request. I would first like to thank the members of this Subcommittee for your ongoing support during the past year. The funds that you have provided have been essential to the Commission in meeting its many responsibilities. My FCC Team and I are grateful.

The Commission has played a critical role in shaping the communications landscape of our country for nearly 75 years. Today, as we mark the year of our diamond jubilee, the Commission faces new challenges and opportunities that make our role more important than ever—so much of America's future depends upon our success in bringing the opportunity-generating tools of modern communications to all our citizens. Our

Fiscal Year 2010 Budget submission is the product of our awareness of the national challenges that we face in the 21st Century and our assessment of the tools that the FCC needs to help meet them.

With its Fiscal Year 2010 Budget submission, the FCC is requesting $335,794,000, which includes approximately $318 million to maintain current service levels, an increase of approximately $6 million over Fiscal Year 2009. This additional funding is needed to offset inflationary increases for salaries, benefits, leasing costs, utilities, and other contractual services.

During Fiscal Year 2010, the FCC also proposes to take some necessary steps forward to modernize our technological infrastructure, for which we seek $15 million. First, we will upgrade and integrate our IT systems to make our processes more transparent and easier for the public to access. For instance, we will upgrade our website capabilities so that consumers will be able to perform keyword searches of comments filed in ongoing proceedings, thereby permitting and encouraging increased public participation in our decision-making process.

Second, we will modernize our phone system to address present shortfalls that make it difficult, for instance, to route calls throughout the Commission's nationwide footprint. As an example, the Commission's antiquated phone system results in expensive long distance phone bills for frequent intra-agency calls to our Gettysburg call center. These shortfalls result in increased telecommunications costs for conducting our normal coordination and public support activities.

Third, the FCC will improve internal coordination and information sharing by its staff. For example, at present, each of the various Bureaus maintains its own distinct

licensing database. This patchwork of data is inefficient, requiring redundant processing and IT support efforts. Moreover, because our data is stovepiped, it is often difficult for the Commission to extract the information necessary for particular policy decisions. Finally, absent a comprehensive knowledge of each Bureau's system, it is difficult for the parties that participate in our proceedings and for members of the public to navigate the various databases to cull the valuable information that each database contains. The IT Program proposed in the Commission's FY 2010 Budget will move the agency toward a more unified licensing system that will improve our internal efficiency and enhance the ability of outside parties to participate in our proceedings.

In some ways, the easy road would be to muddle through with our outdated and inefficient infrastructure and force the rest of the world to adjust to us. But that is not my vision of an agency with "Communications" in its title. We've been helping many of our licensees transition into the digital world, it's time for the FCC to do likewise. In fact, the Commission's own analog video equipment used for public outreach at Open Meetings and Field Hearings is a decade old and in need of its own digital television transition. Indeed, I believe that the FCC must not only keep pace with the needs of the public and those with whom it does business, it ought to show the way.

Next, the Commission is requesting an additional $1 million to meet its staffing needs. In recent years, we have has lost a broad range of professional expertise due to retirements and other separations. Our goal is to recruit and retain highly-skilled employees— particularly engineers and economists, but also legal, policy and other professional staff. With the right mix of technical expertise, professional experience and

leadership skills, the FCC will be better positioned to deliver the kind of timely, fact-based and transparent decision-making that is rightly expected of it.

The Commission plays an important role in identifying and resolving interference to licensed spectrum users—including interference to public safety entities—and uses specially equipped Mobile Digital Direction Finding vehicles to perform this work. The FCC has used these vehicles to resolve harmful interference to police, fire department, and emergency medical response communications systems, to provide assistance to Public Safety Answering Points that experience interference to wireless 911 and E911 calls, and to various U.S. Government agencies, such as the Department of Homeland Security's Border Patrol and the Department of Transportation's Federal Aviation Administration. We are seeking $900,000 to purchase ten of these vehicles to replace older vehicles in our aging fleet.

As the Subcommittee knows, the FCC conducts auctions to issue spectrum licenses. The Commission is permitted by law to use a portion of the revenue raised through these spectrum auctions to administer the program. During the past six funding cycles, our final appropriations legislation established a cap of $85 million for auction expenses. The FCC is currently reviewing its options for future auctions, and we believe that we can continue to conduct the program with the same level of funding in Fiscal Year 2010.

I also would like to provide the Subcommittee a brief update on some of the most urgent communications issues before the Commission and our country. The one that will be most critical during the coming six weeks is the DTV transition. Since February, when the DTV Delay Act postponed the transition date to June 12, the Commission and its dedicated staff have

been hard at work. We are coordinating with the National Telecommunications and Information Administration (NTIA) and other government stakeholders, and working in stepped-up partnership with the private sector, to deploy a strategic, nationwide program to educate and assist consumers in preparation for the transition. We have retooled our consumer outreach and support program by moving from a general awareness campaign to a coordinated effort to help consumers deal with their specific problems, providing them with specific, locally-oriented information and hands-on assistance. We also have improved our outreach to educate consumers about certain key issues that have been neglected in the past, such as digital signal coverage, as well as reception and antenna issues.

We continue to provide more focused consumer outreach and support, in particular for our most at-risk citizens, including low-income consumers, senior citizens, non-English speaking consumers, members of minority communities, people with disabilities, and those living in rural areas and on tribal lands. We recently teamed with Consumers Union on a DTV-made-easy consumer guide that will help viewers everywhere prepare for the transition. We have also augmented and improved our call center capacity and revamped our transition website, dtv.gov, to make it more helpful and user-friendly. And we are using our resources to more effectively deploy "boots on the ground" to provide walk-in help centers and in-home assistance to those consumers who may need it.

Thanks to the resources provided through the American Recovery and Reinvestment Act, the FCC has been able to revitalize its outreach efforts. The Commission also is seeking $1 million to fund our continued DTV efforts in Fiscal Year 2010. Even after the transition for full-power stations takes place on June 12, 2009, we

anticipate an ongoing need for DTV efforts, not only to deal with the aftermath of the full-power transition but to begin addressing the "next" DTV transition—the transition of the thousands of low-power and TV translator stations across the country that are still broadcasting in analog. I want to thank those who have worked so hard on this transition both inside and outside of government, and look forward to continuing to coordinate with Congress and all stakeholders to ensure that we do everything that we can to minimize consumer disruption on June 12 and that, where disruption does occur, we respond as quickly as possible.

One of the important benefits of the DTV transition is the recovery of the 700 MHz band that full-power television stations will vacate by June 12. The Commission has implemented the Congressional directive that 24 MHz of this returned spectrum be allocated to public safety use, permitting both narrowband and broadband communications. Some state and local public safety agencies are already deploying 700 MHz narrowband networks where no incumbent television stations are operating, and many more will begin operation once the DTV transition is completed.

A related transition goal has been to use some of the returned broadcast spectrum to establish a nationwide, interoperable, broadband wireless network for use by first responders. The Commission previously sought to achieve this objective through a public/private partnership, which would have required the winning bidder of the commercial 700 MHz D-Block license to partner with the nationwide licensee of the public safety broadband spectrum to allow construction of an interoperable broadband network that would serve both public safety and commercial users. The auction of the D-Block, however, did not result in a winning bid. When I took the reins at the Commission in January, I directed Commission staff to develop a range of

options for moving forward, including whether we should continue to require such a public/private partnership, and if so, under what terms and conditions, or if the Commission should chart a different course entirely. While this is a work in progress, it is imperative, particularly in light of the current economic climate, that we study all of our options to ensure that the public safety is served throughout the country, and that we embark upon the best course of action to develop this much-needed resource for our first responders.

Another matter that I want to discuss involves perhaps the most exciting issue that the FCC will address this—or perhaps any—year: Broadband. Broadband can be the great enabler that restores America's economic well-being and opens doors of opportunity for all Americans to pass through, no matter who they are, where they live, or the particular circumstances of their individual lives. It is technology that intersects with just about every great challenge confronting our nation—whether it's jobs, education, energy, climate change and the environment, international competitiveness, health care, overcoming disabilities, equal opportunity—the list goes on.

It is with this in mind that Congress and the President in the Recovery Act set out a two step broadband strategy. First, NTIA and the Rural Utilities Service were asked to provide $7.2 billion in stimulus money to broadband projects that will create jobs, spur the economy and foster the availability of broadband in the near term. Second, the Commission is tasked with developing a longer-term national broadband plan by February 17, 2010. This strategy will look to the future and design a plan to help ensure that every American will have access to affordable, value laden broadband. Eight years ago when I joined the Commission, I saw the need for the development of a national

broadband plan so I am particularly pleased that the Commission has been given such a central role in its development.

In this regard, on April 8, the FCC issued a Notice of Inquiry to commence a national dialogue on how we can make high-speed broadband available and affordable to citizens and businesses throughout the land. It is broad, far-reaching and inclusive in an effort to hear from traditional and non-traditional stakeholders on how best to develop a successful strategy. If we do our job well, this could be the most formative, indeed transformative, proceeding in the Commission's history. We are committed to the task.

I would also like to address the important topic of media ownership. As the United States Supreme Court has observed, a fundamental tenet of our national communications policy has long been that the widest possible dissemination of information from diverse and antagonistic sources is essential to the welfare of the public. Unfortunately, our broadcast industry—and broadcasting is not alone among our nation's media—for all of its many accomplishments, still fails to adequately reflect the rich and varied diversity of this country. Although many broadcasters are trying, until the industry as a whole does a better job of reflecting that diversity, they will not truly reflect America.

At the Commission's open meeting earlier this month, we took a major step forward by improving the Commission's collection of data on the state of minority and female broadcast ownership. It has become painfully clear to me and many others that the Commission's current data collection is too limited in scope and unreliable to provide the rigorous statistical foundation that we need in order to act in any meaningful fashion. The sad truth is that we at the FCC simply do not know the precise state of

minority and female media ownership in this country. If the Commission is to be a data-driven agency, we need better data, and we should not be forced to rely on outside parties, many with their own vested interests, for the basic information we need.

Our action will give us the comprehensive and reliable data that the courts require before more targeted approaches can be adopted to promote minority and female ownership. The data also will help inform our evaluation of our media ownership rules during our next quadrennial review in 2010. It will help us to understand the relationship between media consolidation and the diversity of viewpoints and opinions available to viewers and listeners.

Finally, I know that a number of the members of the Subcommittee are concerned about recent developments regarding the carriage by multichannel video programming providers of PEG channels. I share those concerns. PEG is a valuable source of diverse and local programming that not only provides an outlet for local voices, but also nourishes to the civic dialogue and gives citizens the information they need to govern themselves. The Commission recently received three petitions for declaratory ruling raising industry practices that, the parties contend, may adversely affect subscriber access to PEG programming. In early February, within weeks of my becoming the Acting Chairman, the Commission issued a public notice seeking comment on the matters raised in the petitions. The comment period recently closed and it is my hope that the Commission will take whatever steps are necessary to ensure that PEG remains a vibrant and valuable service.

In closing, I want to pledge to this Subcommittee that, during and after my tenure as Acting Chairman, I will collaborate with my colleagues and with members of

Congress to further the FCC's budget objectives, including maximizing the benefits of the DTV transition, promoting the deployment of broadband services, protecting consumers, increasing competition, enhancing public safety and homeland security, promoting the efficient use of spectrum, reviewing media regulation to foster competition, localism, and diversity, and ensuring the viability of the Universal Service Fund. I also will work to ensure that the Commission and its staff have the tools and training necessary to accomplish our goals and mission.

Thank you again for this opportunity to discuss the FCC's Fiscal Year 2010 Budget request and our work under the historic Recovery Act. I respectfully request that this Subcommittee consider granting the FCC's Fiscal Year 2010 funding request, and I would be happy to hear your comments and suggestions at this point or respond to any questions that you may have.

Mr. SERRANO. Thank you. Thank you for your testimony.

Before I get to my questions, I did notice something in your statements, which I am sure it is an oversight, but it is something that is sort of a mantra with me. You mentioned the different groups you are reaching out to, and one group, if you will, one area that always gets left out are the territories, Puerto Rico and Guam and Samoa and the Virgin Islands, and so on. And I operate under a very simple theory. If you are under the American flag, you should be treated equally.

There are some things about tradition or Constitution you cannot do, and so, it would take some changes, we believe, to allow people to vote for President and to have voting Members of Congress and so on, but when it comes out to handing educational funds or housing funds, or for the FCC to make sure the digital transition is swift, there is nothing in the Constitution or in practice anywhere that does not stop you from making sure, and I know for a while, we were getting a lot of outreach from Puerto Rico and the Virgin Islands on the fact that they were very short on the converter boxes, and the new information.

So, you know, I am not going to stay on that subject, but I am trying to encourage every federal agency, since I became chairman of this subcommittee, to think of the territories. But not only on the other side. I mean, I have done it with the Speaker of the House and the Majority Leader, where the minute they begin to say the 50 States, they look at me, and they say and the territories, because they know what is coming next.

Mr. COPPS. Can I comment for just a second on that?

Mr. SERRANO. Of course.

Mr. COPPS. I know the passion that you bring to that cause, and I think we are really trying to address what you are talking about. Take Puerto Rico, and the DTV transition for example. We have got people on the ground right now in Puerto Rico, trying to help. We know the fact that there is such a high percentage, maybe over half the people there, who are dependent upon over-the-air television.

We are monitoring consumer supplies of the set-top boxes, so that we have an adequate supply, and pushing the consumer electronics folks to make sure that that happens. And we spent a lot of time meeting with folks and considering such things as universal service and satellite coverage and all the rest.

So, I appreciate your calling that to our attention, and I can assure that by not mentioning it in my brief formal statement, in no way means that we are giving them anything but full fledged treatment.

Mr. SERRANO. I appreciate that. Appreciate that.

And we will, in about six weeks, be switching over to DTV, and the FCC recently received $66 million, as you mentioned in your statement, from NTIA to assist with the transition. What is the FCC doing with these funds? How much of a difference do you think you can make? How many folks do you think will still not be prepared to meet the challenge, if you will, the change on June 12, and what else do you think should be doing to make sure we——

Mr. COPPS. Well, it is a tremendous challenge, like you say, and, as I indicated in my statement, I do not think in a few months we are going to be able to solve all of the problems that have been boiling for the past three years. We suffered from the lack of really making this a national priority. We suffered from the fact that we did not have a coordinated interagency effort, like we had on the Y2K proceeding several years before that.

We really did not build, industry has done a lot, and industry continues to do a lot, but there should have been some convening forum and coordinating forum, with all the players. So many of these problems, we learned about a year or two years later than we should have learned about them.

Anyhow, that was then, this is now. We are getting $65.7 million in DT funds. $30 million of that is going to go towards call centers, really, and I think a contract was just recently let for that, so that will be a contractor call center, plus the FCC call center, and we are ramping that up, and giving better training to our folks there, too, so we can handle as many of these calls——

Mr. SERRANO. To be one call center or call centers?

Mr. COPPS. Well, there will be one general number to call into, and then, they will be divvied up and parceled out from there. About $14.5 million of this will go for in-home assistance, and we have got some neat initiatives going on there. Some of it will be contractual. We already have an agreement with the AmeriCorps folks, whereby some of their volunteers will, are being trained, have been trained, and will be going, when requested, into houses to help the elderly and people with disabilities, and other folks, to get that converter box hooked up, to make sure the antenna is working, and to answer whatever other questions, and provide whatever other help they can.

About $11.6 million will be going toward walk-in help centers. I think these are a good idea. It was something that developed right before the February 17 transition, but even with that little notice, they got good traffic, so where people can go, maybe on a Saturday morning, and get advice on how to get hooked up, or apply for the coupons. We will be doing some additional media service, I think to the tune of about $5 million, and then there is some money for travel, publications, and translators. So, that is basically how the money is going to be used.

And I want to salute the partnerships that we have now. I think industry has really stepped up to the plate, running the call centers last time, and just trying to work in partnership. And it is good when we get everybody together to see the enthusiasm for getting this job done.

I have been a little disappointed with the fact that the national media have not done a little better job in talking about what is happening with the transition. You know, there was that one story, when Congress delayed the final transition date from February to June, and I watched the network news that night, and the story was, the transition is delayed. That was basically the story. It did not say anything about a lot of stations would still be transitioning in February, which a number did. Some would be going in April. But it just kind of gave the impression everybody, do not worry, put the boxes back in the closet, or do not go out and get the cou-

pons right now. It was really unfortunate, because there still is a lot of urgency attached to this.

Only about 2.5 percent of the American people live in the areas that are fully transitioned right now. So, we have got all those other people still to be covered by the stations that are going to be transitioning.

Mr. SERRANO. Yeah, I have noticed a lack of coverage by the so-called national media. In fact, I was going to comment that the Spanish-language networks, Telemundo and Univision, have done quite a job. I mean, every two minutes, there is something on telling you this is happening, and you must get this box. And you know, obviously they want to get their stations through, but it is working.

A question, do they do that on their own? Are they prodded by the FCC? It is obviously in their best interests to have people switch.

Mr. COPPS. Well, I think a little bit——

Mr. SERRANO. Are those commercials paid for by themselves?

Mr. COPPS. No, no. I salute them, and most of the commercials are paid for by themselves, and I salute Univision and Telemundo for the work they have done. But there is a bully pulpit at the FCC and in the government to try to encourage this, and there are also requirements of stations in the rules for the transition. But the ones that they have been airing over the last couple of months, are from our requirements for certain amounts of education on the transition, and not just raising general awareness about the transition, but now, how to prepare. And now, we are moving along to make sure that some folks, who are, no matter what happens, no matter all the steps they go through, they are still going to be deprived of some signal coverage at the end of the day, that they know that. They are not going to be happy, but my impression is that if you tell people the truth, they will forgive a lot more than they will if you do not tell them the truth. So, it is a hard message for broadcasters to put out, to ask them to put out, you know, go tell your viewers that some of them are going to lose signal coverage. But I think it is a minimum that we have to expect.

Mr. SERRANO. Let me move on briefly to the broadband issue. The obvious question for many of us is, why do we lag so far behind other countries? I mean, we have always discussed in healthcare and other issues, but everybody thought that it would be Japan and the U.S., for some reason, that would be number one, and we are not.

Two, as you move ahead, how do you assure that the usual group that gets left out, the elderly, the minorities and so on, get full use. And what does the FCC today consider broadband? Because I mean, there are some people who think that anything more than 56 is broadband, but it is not. What do you consider broadband?

Mr. COPPS. In answer to the first question, why are we in the dire straits that we are in, either 15th or 20th or 25th as a nation, I think it is because we never made a national commitment to broadband, and we never had the kind of national strategy that I talked about before, that I have been urging. Most every other country was ahead of ours in understanding the importance of this.

We are finally getting beyond that, but for all the years I have been at the FCC, we are under charge by Congress to do Section 706 reports every couple of years, to render a verdict on whether the deployment of advanced telecommunications, broadband, is proceeding in a reasonable and timely fashion. And every year, these reports come across my desk, and they say yes, because they describe broadband as 200 kilobits upstream and downstream, but you know, that is an early 1990s kind of definition. We are just starting to move away from that right now.

And then, the logic was that, if one subscriber in a zip code signed up for that 200 kilobit broadband, that means the deployment of broadband is proceeding in a reasonable and timely fashion. You know, that is like kind of if you fly into a strange city, and you come out of the airport doors, and the first car you see is a Cadillac, are you supposed to conclude that everybody in that area drives a Cadillac, because one person does? It was that kind of logic. So we had a commitment, you know, the President talked about having a commitment to get it out by 2007, but a commitment does not mean anything if you do not have a strategy to implement it. And that is what we are finally getting to now: in 2009, the FCC is going to be doing it, and it should have been probably a dozen years ago.

And part of that strategy will be emphasizing what I said. You have got to get this stuff out to all of our people, and I always underline that word, all. If you are elderly, if you are in the inner city, or you are out in the rural countryside, if you have a disability, if you are rich or you are poor, I do not think it makes any difference.

This is the opportunity—creating technology that all of our citizens need to have to be productive as people, contributing to the country, and capable of fulfilling themselves in their own capacities, and other people have it. It is not just some kind of feel-good social do-good, or Copps is going down some wild liberal track, or something like that. I think it is business for the United States. I think it is competitiveness for our country. That person out in rural Missouri or somewhere, or in the inner city in New York, trying to start a small business, and do not have access to this kind of technology, how are they going to compete with somebody who does, either in this country, or worse, overseas?

And then, in response to the final question, the appropriate definition of broadband, we finally announced, a year or so ago, that we were going to move away from this 200 kilobit definition, and now, we have kind of a range, and I do not have all of the numbers in here, but there are six or seven different plateaus of broadband. But this will be something that we need to come to terms with in developing the broadband plan by next February. And it is going to be something that NTIA and RUS are going to have to come to terms with from their perspective, in trying to administer these grants over the period of the next year or so.

Mr. SERRANO. Well, I can tell you, that MLB.com is coming through loud and clear on HD on the laptop. And at $2,500 a Yankee Stadium seat, $149 a year for 2,000 games is a pretty good deal. I should not say that. They will probably raise the prices now.

Ms. Emerson.

Ms. EMERSON. Yes. I will tell you, Mr. Chairman, that the reason that I also got the baseball channel on my TV was because at Cardinals Stadium, not even for the good seats, it is $89 a seat now, instead of the $27 that my old season tickets had, so——

Mr. SERRANO. Well, the Yankees just reduced their top tier tickets, and they think they did people a favor, from $2,600 to $1,250 a ticket, not a season, a seat.

Mr. COPPS. Oh, my goodness.

Ms. EMERSON. Well, they will never get that stadium paid for, then, Joe.

Anyway, let me, I want to continue the discussion of broadband, Chairman Copps, while we are at it. And I have several questions. Obviously, with the $4.7 billion to the Department of Commerce and $2.5 billion to Ag, to expand broadband access through the stimulus bill, I think that is a good thing, on the one hand. But simultaneously, they have a year to spend the money. You have a year in which to develop a national broadband plan to provide access to broadband capabilities to all Americans. And I guess Commerce gets two years now, to develop a nationwide inventory map of existing broadband services.

So, that is all kind of juxtaposed against each other, and I mean, obviously, I would think you do the plan first, have the inventory first, do the plan, and then, spend the money to see where it is going to go, as opposed to backwards. But do you think it is, I mean, just from that philosophy, is it premature to expand access before you all have even developed a plan, and before we even have an inventory?

Mr. COPPS. No, I think it is really just responding to the dire plight that we are in, as much as anything else. And it is kind of a two-pronged approach. There is a stimulus effort out there, obviously reflected in the bill, to get some money into the system. We know that there are huge needs for this kind of technology, so why not start it now, where we know we can put it, where we know it is needed, and try to create some immediate feedback.

But to me, personally, I see that as more of a down payment on a much large commitment, and from my standpoint, I think getting this longer term strategy right is crucial. When we really get into those areas that, initially, they look like they are close in needs, but they have some little different needs, how do we have the path for navigating through that, and how do we really define unserved and underserved, and decide what technologies go where.

All of these questions are going to be horribly complicated. You cannot answer them all, I do not think, in time to completely inform the NTIA and the RUS grants. I wish we could. We are trying to coordinate with both of these agencies, because the legislation directs us to, and we should be doing that regarding these definitions, but I do not see the consultation that we give to those agencies as being the final biblical word on these things. They will have to make some of those decisions.

Ms. EMERSON. So, how does the coordinating process work? Or how have you all set it up to work, with Ag and with Commerce? And do you think it makes sense to have three agencies coordinating this?

Mr. COPPS. Yes—I think more than three agencies are involved. A lot of the folks that are sitting behind me here from the FCC are in daily consultation with NTIA and with RUS, and they are having meetings yesterday and today and tomorrow. We conducted a proceeding, asking questions on some of these things, about unserved and underserved populations, and compiled a large record on that. We put together about 150 pages of comment summaries, which we are delivering to NTIA this week.

I think we have got the lines of communication with NTIA and to RUS pretty clear now. But if you are going to have an effective strategy going forward from there, it involves much more, and I think that is where the role of the White House really becomes important, because, as the Chairman of an independent agency, I cannot necessarily say, I think it would be nice if all these agencies would come down here today and talk to me about broadband. Some will come, some will not come. However, if that word comes from the White House, they are a little bit more likely to come. I saw that when I worked in the Commerce Department in the Clinton Administration. There was a lot of interagency coordination then, so I welcome that kind of role, but they all have to be there. I mean, certainly, Housing and Urban Affairs should be there, if we are talking about rural housing or inner city housing, and when new construction goes up, it should be wired for this kind of stuff.

Ms. EMERSON. Do you feel confident that the White House will convene these meetings?

Mr. COPPS. I do. They are doing so.

Ms. EMERSON. Okay. And I know that Commerce is supposed to give you all some money for expenses related to the program. How much do you anticipate——

Mr. COPPS. I do not think we have a figure on that. We just got through with $65 million funding for our DTV efforts, and now, we are turning to this, and we are having active discussions. Again, there is good two-way communication on what our roles will be in mapping, with the primary responsibilities on them.

But you know, we are the expert agency, so we are trying to figure out who is going to be doing what there. So I think we will probably have something to say on this matter. We probably have something a little more definitive to say about what kind of funds might be transferred to the FCC in a couple of weeks.

Ms. EMERSON. Do you have any fears that public investment and public moneys would crowd out private sector investment in deployment of broadband, and if so, is it possible that that expansion could be compromised by increased government regulations?

Mr. COPPS. I think the key is how you craft those incentives, to make sure that they work for both the private sector and for the public sector both. That is critically important. I think there are some areas where private investment is not going to occur by itself. Again, in inner city or rural America, where we have got the experience, we have seen for the last ten years, while lots of Americans have access to broadband, in these difficult to reach spots, there is no market solution there. And that is our problem. I think we always thought the market could handle all of this.

And you know, that is such a departure from American history, generally. If you go back to the earliest times of our country, when

we moved from the Eastern seaboard, and finally spilled over to the mountains, and we had an infrastructure challenge. And how do you get the produce from over the mountains to the markets? So, we figured out ways, as a country, to do that, by building turnpikes and roads and canals and bridges, and making harbor improvements. Later on, in the early and mid 19th Century, we built regional railroads to bind the country together.

When we became an industrial power, the big transcontinental need was, how do you bind that country together? We constructed the transcontinental railroads. We found ways for the public sector and the private sector to work together in getting electricity out to rural America, and getting plain old telephone service out to rural America, and developing the interstate highway systems. Yet, we got to this big infrastructure challenge of the 21st Century, which is broadband, and many maintained that we do not need such an effort. Just forget about the history of the country. It will take care of itself. Let the good times roll. Now, we finally have recognized that did not work, and we are really not going off on some great new departure.

We are returning to the formula of public/private partnership that worked for America and that built this country over the years. It makes me happy to see us returning to that.

Ms. EMERSON. What about the regulatory side? Do you think that we are going to have all sorts of new regulations with regard to deployment activities, that could hamper the private sector?

Mr. COPPS. I do not think so. I certainly hope not. That does not mean that there will be no regulation, because I believe, in some cases, regulation is justified. But I think that if we really can develop this public/private partnership that I am talking about, really understand the needs of the private sector, and the private sector understands the needs of the American people and the government, we can work our way through this in a cooperative fashion.

Now, it is not going to be without controversy. I am not trying to paint that kind of picture. In all these earlier infrastructure challenges that I talked about over the course of our history, we did not have an automatic consensus. There were hellacious debates pro and con, are we going to do this, or are not we going to do it. My point is, we usually found ways to do it, and I think we can find those ways here, too, if we are inclusive, and if we are really data centered. So many of the wrong-headed decisions that have been made by the Commission and others have occurred because we lacked proper data. I think our Commission has become too dependent on outside data and on industry supplied data, or special interest supplied data.

We are the expert agency. We ought to have that information. We ought to have the databases, and I hope that is one of the things that will come out of this broadband exercise.

Ms. EMERSON. Thank you.

Mr. SERRANO. Thank you. Now, we will recognize members under the five minute rule, starting with our colleague, Ms. Wasserman Schultz.

Mr. COPPS. Good morning.

Ms. WASSERMAN SCHULTZ. Good morning, Mr. Copps.

Mr. COPPS. Good to see you.

Ms. WASSERMAN SCHULTZ. Good to see you, too. Why is the chairman glaring at me on the five minute rule?

Mr. SERRANO. That was not a glare. That was a sign of admiration.

Ms. WASSERMAN SCHULTZ. Okay. Thank you. It is good to see you, and there is a couple things I wanted to ask you. First, Mr. Chairman, though, I have two questions that I did want to ask unanimous consent to submit for the record, if I might.

Mr. Chairman, I have two questions.

Mr. SERRANO. I am sorry, go ahead.

Ms. WASSERMAN SCHULTZ. If I can submit two questions that I will not ask publicly for the record, and ask unanimous consent to do that.

Mr. SERRANO. Sure, absolutely.

Ms. WASSERMAN SCHULTZ. Thank you. Last year, Vice President Biden and I, when he was in the Senate, passed the Protect Our Children Act, which deals with pursuing Internet predators who engage in child pornography. And I spoke to then Chairman Martin about the need to make sure that we were focused on crafting rules for managing the computer networks that have become indispensible to our lives, but making sure that we, while we limit those management practices, and make them practical and implementable, that at the same time, effective in blocking unlawful content, like pirated music, movies, and particularly, child pornography. And that is a very difficult balance to find.

Mr. COPPS. It is.

Ms. WASSERMAN SCHULTZ. What I would like to know is do you, as the acting Chairman, maintain the position of former Chairman Martin, when he stated last year that it is imperative for ISPs and network managers to have the important ability to block the distribution of illegal content, including pirated movies and music and child pornography?

Mr. COPPS. I do, and I think that is imperative that we assist in these efforts. Early on, I was probably as responsible as anybody for getting the Four Principles of an Open Internet accepted by the Commission, the right to access content of your choice, and attach devices, and run applications and all that. And all of that is premised on the fact that we are talking about accessing lawful content and doing lawful things, and there is no escape valve, or loophole for people to drive through. The question becomes how do you have sufficient oversight, without overly interfering with the Internet, to make sure that that happens? But it is hugely important. I have been concerned——

Ms. WASSERMAN SCHULTZ. How do we do that?

Mr. COPPS [continuing]. About the welfare of children in media generally, including the Internet, and it is something we really have to face up to, as a country.

Ms. WASSERMAN SCHULTZ. Do you have any ideas, or does the Administration have any ideas, in terms of how to continue Internet innovation, but at the same time, that the really explosion of Internet content that is illegal and, I mean, but what we are talking about when, particularly with child pornography, is the transmission of crime scene photos. I mean, child pornography is not pornography, per se.

Mr. COPPS. Right.

Ms. WASSERMAN SCHULTZ. It is acts, unspeakable acts committed against children, and there is 500,000, in the United States alone, known individuals who are trafficking in child pornography on the Internet. And we know how to go get them, and hopefully, the Protect Our Children Act will be provided with the resources this year to begin to do that. But we need the policy and the technology to be able to do that.

Mr. COPPS. First of all, I would emphasize that I am running an independent agency and do not speak for the Administration. We will be looking at its policies, and doing what we can. Obviously, the Justice Department and a lot of people are involved in pursuing things like this, but I think we can play a positive role.

We do not have answers for all of these questions right now. As you know, one of the significant dialogues we really need to be having in this country is, as we move all of our communications, away from broadcasting—it is all going on the Internet. How do you protect the public interest in this new medium that everybody says is so dynamic and liberating and open, yet you do not want to unduly interfere with it. There is a legitimate interest in making sure, if broadcast is going to be there, we can regulate broadcast a little differently than we regulate the Internet.

Fast forward five or ten or how many years it is going to take, and assume that most of this material is on the Internet. How do you ensure the public interest is alive and well? How do you make sure that there is news, real, honest to God news, on that Internet, and that there is investigative journalism, that there are the resources to do it? How do you make sure that the American people have the breadth and depth of information in their civic dialogue to make intelligent decisions for the future of their country?

We have not really stepped up to that. How do you protect journalism in this new world of the Internet, and make sure that it is vibrant? How do you protect children in this new medium? I am saying everybody has to have access to this, put it in the schools, put it everywhere the child goes. But yet, it has that ability to be abused.

Now, I will tell you another part of this, and this maybe gets beyond your question, so shut me up if you want to.

Ms. WASSERMAN SCHULTZ. That is okay. I have another question——

Mr. COPPS. Part of this, long-term, is that we have to step up and have a media literacy program in the United States of America. And I think it needs to be from kindergarten right through high school. There is something interesting that you can teach kids at every step of the way, and it is not just how to use this technology, but it is how does this technology use or misuse you. And that is a big order. We have a very decentralized system of education. You cannot just mandate that from Washington, but I think, again, we can think creatively, and do some progressive things there.

Ms. WASSERMAN SCHULTZ. Thank you. Is my time expired?

Mr. SERRANO. Yes.

Ms. WASSERMAN SCHULTZ. Apparently so. Thank you.

Mr. SERRANO. Thank you. Mr. Crenshaw.

Mr. CRENSHAW. Thank you, Mr. Chairman.

Just, you know, the questions that were just asked. You raised a lot of questions yourself. I mean, and those are good questions, like, so I would really like you to answer your own questions.

Mr. COPPS. I thought I was doing a public service just asking the questions.

Mr. CRENSHAW. You know, I saw Tuesday, where the Supreme Court said that I guess the fleeting expletive policy was not unconstitutional, kind of what we are talking about. And just to hear your thoughts on how we begin with all this advancing technology, not just, you know, radio and television, but the Internet that you are talking about. What are your thoughts on what the role of the Federal Government ought to be, the FCC, to protect, I think I read where you said that the Supreme Court case was kind of a victory for families and protection of children.

And some of the questions you just asked rhetorically, what, how are we going to do that, as we look ahead?

Mr. COPPS. Well, what I do not necessarily want to see is that the Federal Communications Commission, kind of hunkers down and goes through all kinds of programs, to see if they cross the line, and spend too much time on that. This is important; we all take an oath to enforce the statutes, including decency, and this is something I think I was one of the first Commissioners to raise, when I became a commissioner in 2000.

So, yes, I think program material has been coarsened, and I think there are some things to do about it, but it is not just over getting your badges out and going after people. Part of it is a bully pulpit. How do you encourage the broadcasters to return to some kind of voluntary codes of conduct, like they used to have years and years ago, and try to move away from this kind of excessive violence or language, or sexual innuendo, or more than innuendo, on their broadcasting material.

Part of it, I think, really has come from a loss of localism in our broadcasting. I am not a fan of the media consolidation that has occurred in this country over the last 30 or 40 years, and I think one of the results of that has been kind of a homogenization or nationalization of program matter. Community values get lost in that, because the programs are coming in from far away from a station's particular community. So, I think that may be one of the problems. I do not see that more consolidation is really in the interest of the American people.

Mr. CRENSHAW. Well, just quickly on broadband, we talked a little bit about that. It seems like a lot of times, the Federal Government kind of picks winners and losers, you know, and even as you figure out how to implement all this broadband, I mean, you got, like I represent a district in Florida. You got some urban areas, you got some rural areas, and so, people always wonder, you know, when am I going to get served? Are you going to spend money upgrading some of the urban areas that maybe are slow. Are you going to say that is not money well spent, we are going to go out to the rural areas that do not have broadband at all? I mean, how do you kind of make those decisions, and what are your plans in that regard?

Mr. COPPS. Well, I want to make sure that the winners are the American people. One way we do this, is that in crafting this broadband strategy, we have some workable definitions of what is an unserved area and what is an underserved area, although I think, in all truthfulness, you can probably make the case that the United States as a whole is an underserved area when it comes to broadband. But that being said, there are areas that are way ahead of others, but all need attention. I mean, somebody has 500 kilobits or 786 kilobits, is that what we are talking about for 21st Century broadband? Is that what this national broadband strategy is supposed to be directed at? I do not think so, but we have to work out some kind of consensus, and again, talking with the industries, talking with all the stakeholders on what is achievable.

We are not going to be building, in the next two years, the broadband that we will have in 2075 or 2090. So, we cannot just say we want all of this right now, but rather something that will ensure that we are competitive with the rest of the world, and leading the rest of the world, and that gets us out of being ranked 15th or 20th, and puts us back in the forefront of nations. I think that needs to be our goal.

There will be some difficult choices to make, but like you, I think picking winners and losers is not a good role for the government. I guess sometimes it does happen, with the choices that are made. If we try to be as technologically neutral as we can, if we try to be open to innovation and encourage entrepreneurship, we can avoid some of those pitfalls.

Mr. CRENSHAW. Well, on that, just real quickly, I have read that in some of the big companies that are saying the stimulus money has a lot of restrictions, you know, the typical, I guess, complaint that too many regulations, too many restrictions, and they are concerned, are they going to use some of that stimulus money. Do you hear those concerns, and are they real, and if they are——

Mr. COPPS. Well, I think we have heard them. I think we will have to make judgments. I would like to see everybody looking proactively and innovatively at this program, and see if they can make a contribution, whether they are large or small companies. Obviously, competitive considerations will inform those decisions, but they do not necessarily have to be the only considerations that are made.

Mr. CRENSHAW. Thank you. Thank you, Mr. Chairman.

Mr. SERRANO. Thank you. It is some rule of the House. It is the rule that will go very good back in my district.

Mr. KIRK. I guess Topic A for today is the 6 point drop in the U.S. economy that was reported this morning, and it is interesting to me that our subcommittee is relatively new, kind of sleepy, but the biggest spending.

Mr. COPPS. Biggest what?

Mr. KIRK. Biggest spending of this Congress is coming out of the jurisdiction of this subcommittee, through the TARP and Treasury programs. And the biggest asset of the United States is under the jurisdiction of this subcommittee, which is the spectrum. Just an old estimate, total value of the gold in Fort Knox is $45.5 billion. Total value, old estimate, of the unused spectrum is $771 billion.

So, you have got this 2010 plan, but I get the sense that we are kind of on autopilot now, not connecting the vast borrowing of the United States that is required to support the stimulus, without any examination of this asset, which could and, in my view, should be sold to sponsor and foster economic growth of the United States. It is almost to the point where if we just gave it away, the economic performance of the United States would pick up enormously. If we sold a huge amount of it, we would be able to lower the borrowing requirement of the United States by a significant amount.

My sense is there is no big thinking like that happening in this 2010 report.

Mr. COPPS. Well, as I have said publicly, I think that the first thing we need to do with that spectrum is to understand it. These are decisions that Congress has to make about selling spectrum, but I think we have to understand how much of that spectrum is being used today, April the 29th, at 11:00 in the morning. For what purposes, and how we can do a better job of allocating and putting it to good economic use.

Mr. KIRK. The NTIA chart is pretty complicated. The New America Foundation chart actually lays it out the way even a Congressman could understand, and it shows how much has been unsold, and the value of the bits that are off. And I am worried, because DOD will tell you over and over again that we need all the spectrum, but my experience in Afghanistan was that when we rolled into combat, many times, our radios were not working. And so, the first thing we did before we rolled out is get everybody's Roshan cell phone number in all the other platoons. And if the comms did not work on DOD's side, we would just call the other guy on civilian. Showing that already, the civilian sector, in Afghanistan, was more flexible and dynamic than the military system.

And this amount of spectrum in Uncle Sam's hands is really enormous weight. This morning, is it this morning we are doing the next big auction? Or is it tomorrow morning? So, this morning, I think we are going to borrow about $90 billion in the Bureau of the Public Debt. And it is, I think it should be increasingly bizarre that we are sitting on this dead asset, while we are attempting to borrow from China, already been told that the Central Bank of China is not going, is going to get 95 percent out of purchasing U.S. debt.

And so, I would just urge you, is there a way, and I know you are acting and everything, is there a way to begin to think much bigger?

Mr. COPPS. Yes, I think we are, and I have talked about it.

Mr. KIRK. This requires a jihad against Secretary Gates, because my read on the earring of the Pentagon is they are all dead thinking over there, and somewhat out of touch with how actual soldiers——

Mr. COPPS. Well, I think it is realistic to have a spectrum inventory, and I think that inventory should encompass both the civilian private sector spectrum and the government spectrum, so we can actually see what is being used at this moment in time, and what is available for productive economic purposes now.

I do not know exactly where our broadband plan at the FCC will come out on this, but I do know that we have teed up specific spectrum questions in that NOI that went out a couple of weeks ago.

So, we are very, very much open to that. I think an enlightened spectrum allocation plan, based on a good inventory, has to be an important part of a viable, forward-looking broadband plan for the 21st Century.

Mr. KIRK. This is a conversation that, if I had the chance with the President, I think most people look at the assets of the United States, and have no idea that the spectrum is the most valuable asset of the U.S. government, in terms of marketability, have no idea.

And the idea that we would borrow money, China is out of the game, so now, we are borrowing money from largely other foreign investors, like today, to provide rural broadband, and not sell this instead to support the program, seems fairly bizarre. I think the rural broadband program is $478 per person benefited, you know, when you take Chairman DeLauro's appropriation in the stimulus, and divide it by the number of Americans she claims to serve in the report to the stimulus bill, it is about $470 a person, and not to release this spectrum, which would A, significantly reduce the economic decline of the United States, and B, generate enormous, but I get the sense that here is very little appreciation, and I ask you, is there any appreciation that you have seen in the White House at all on this?

Mr. COPPS. Again, I am representing an independent agency, so you know, I am not going to——

Mr. KIRK. And hopefully, you talk to them.

Mr. COPPS. I am not going to try to speak for the Administration. I think they are very much onboard with the kind of approach that we have taken on the broadband inquiry, and trying to launch that proceeding, and I think they are looking at the bigger picture and are very much aware of the fact that the spectrum is a huge resource, and that this industry is absolutely essential to the future wellbeing of the country.

Shortly after I got to the FCC, the telecom market basically collapsed. I hope there was not a direct relationship with my going there, but I said, even then, that this industry is going to be back. It is the central infrastructure driver of the 21st Century, and it did come back. And it will be back again. It is still growing, even in terms of the economy where we are right now, so I think you are absolutely right to talk about the stunning economic potential there.

Mr. KIRK. Mr. Chairman. Spending some time on the Pakistan border with China. It is the most remote part of China, and pull out your China Telecom, and solid bars across. Which is not present in the United States, and my hope is that this subcommittee could help the Administration think a lot bigger, with regard to the principal asset that it owns and is not using.

Mr. COPPS. I am encouraged by the fact that the Administration is thinking bigger for the first time, stepping up to the plate and making a commitment to broadband, with a determination to develop a viable and comprehensive broadband plan that is the product of reaching out and talking to the private sector, the nontraditional stakeholders. We have been charged to conduct international comparisons, to go around the world, and see what is working, and try to learn from what other people are doing, and learn from fail-

ures overseas. This is going to be data-driven. It is going to focus on spectrum and all these things, so I am hopeful that we are going to take advantage of this opportunity. As I say, I have been pushing this for eight years, asking why we cannot have this kind of opportunity to formulate a strategy. So, I am determined now to do it right. I think we have got it launched in a satisfactory fashion. Now, I am trying to make sure that we go out and get the kind of input that we really need to get it done.

Mr. KIRK. Mr. Chairman.

Mr. SERRANO. Thank you. Let me just take a second to slightly differ, in a friendly manner, with my friend, Mr. Kirk, who called the committee sleepy.

I think one of the things that is happening, as you well know, is that the unprecedented amount of money that we gave out has made both parties, if we are willing to admit it, sort of search around now, and say okay, what is the next step. And any committee that has jurisdiction over the Treasury has to find out what it is, and how it is that we are going to supervise, rather than just supervise for the sake of supervising. It is all new to us, and I do not know how many chairmen of committees or subcommittees you will get to publicly admit that, what I just admitted, that we are looking to see what our role should be under this unprecedented time.

However, any committee that is trying to make the IRS more friendly towards taxpayers, and does so in its dollar allocation and language, is not sleepy. Any committee that is trying to make the District of Columbia be treated as an equal partner and not as a colony, as this committee has done, is not sleepy. And any committee that was a year ahead of our great new, young President, Mr. Obama, on the issue of Cuba, as Ms. Wasserman Schultz, who did not totally agree, can attest to, is rather sleepy. Let us just say they were mellow and not abrasive.

And speaking of issues, Mr. Kirk, that we have been very strong on, is the whole issue of my next question, which is, quiet.

Mr. KIRK. I just would urge you that we never seen this much money under the jurisdiction of this, at an unprecedented rate. And so, what I am urging for, in a mellow way, is I would expect that the number, significantly higher than what we have. Because so much is happening. We have not had that many hearings at all.

Mr. SERRANO. Right, and the reason we have not had that many hearings, is because we do not have a budget. We do not have budget figures. We just expected the first summer hearing of the new Administration. It will not be like this in the future.

Mr. KIRK. And you and I both have significant concerns about the content.

Mr. SERRANO. Right. Yes. We do. We share that. We share that.

And an issue that this subcommittee is leading on. Last fall, this subcommittee held a hearing on the problems that some public, educational, and government, known as PEG, channels are facing with some cable systems. There was bipartisan appreciation for the value of PEG channels, and support for continued fair treatment of those channels.

Since then, there have been more stories about restrictions on PEG channels on some cable systems. Has the FCC been looking at this issue? What might the FCC consider doing to address it?

Now, I have to be honest. When I first saw cable TV come into New York City, and as you know, New York City may be the leader in many things, but when it came to cable TV, it was one of the last places to get, even though some people claim it was invented to get New York City stations elsewhere in the Nation, but we got it last, because in New York, it meant tearing up sidewalks and everything, and they do not want to do that, and there were other issues. But we were under the understanding that you could not get a franchise unless you set aside, specifically, channels, programming, assistance for programming to put these shows on the air, and that is how local folks were able to get their shows on the air, educational, entertainment, and otherwise.

Now, we find out that this was, in many cases, or nationwide, something they were encouraged to do, but did not have to do, and little by little, they are not doing it, by either saying no, or on a program that has 300 channels, putting the PEG channels at 298, 299, and 300. What can we do? Because this is the only ability the public really has to be a player.

Mr. COPPS. Well, I am concerned. I am, like you, a strong advocate of public, educational, and governmental programming. I think it needs to be encouraged in this age of media consolidation that I referenced before. I think these channels are often, along with low power stations, the last bastion of localism, and reflecting the diversity of the community. And I think they are under pressure, and some cable operations have allegedly moved PEG channels to digital early, and that requires people to go out and get a box, to be able to see the programs. You mentioned maybe PEG channels being put on a different channel somewhere, and then, you have to go through some kind of a drop down menu, and it becomes a navigational challenge of the first order just to find a PEG channel, and each one you want to get, you have to go through that again.

So, we are aware of the complaints. We have three petitions before us for a declaratory ruling to do something about it. The case has also gone to the court. We are in the process of answering questions on PEG channels, from the city of Dearborn that were requested by the court and I am trying to expedite those and get them back to them. But I think this is something that we need to step up and address; we just cannot afford to see these PEG channels go by the board. They are too valuable. They are too wedded to the public interest, and I want to make sure that the Commission is as proactive as it can be in maintaining, sustaining and encouraging them.

Mr. SERRANO. And I hope you do so. And let me just tell you that I am concerned, and I think this is a concern that is shared by the full committee, that if we do not move fast on this, it is just going to go by the wayside, and there are other issues that will come up, and the PEG issue will not be as important. You did say proactive, and this brings me to a side issue, and this is just an observation on my part. You can correct me, if I am totally wrong, but there seems to be a feeling that the FCC now is waiting for the new Chairman to come into place before it deals with some issues.

Well, as you know, that has become a political hot potato, and that they are tying, the minority party wants to tie in their selection, which is fine. They have a right to have a selection, selections, and now, it might be a while before we get a Chairman. Now, my understanding is that you are constituted fully now, not fully in membership, but you are totally legally able to move ahead and do a lot of things. Am I correct?

Mr. COPPS. I feel empowered. I am the Acting Chairman of the Commission. I think, I am trying to approach my role in a realistic fashion. I think there are some issues, like the future of universal service, for example, in which Congress has a great interest. I think the Administration does, too, and while we can do some things around the edge, that is not something I would call to a vote tomorrow morning.

I do not consider the PEG channel issue that way. I think that is something we need to act on. We have tried to act on a number of issues at the Commission. We are clearing out thousands of backlogged items that could actually make a difference in helping the economy right now, really tens of thousands, to be truthful. I think we are an active Commission. I think we are getting things done. The longer the interval goes on, until a new Chairman is confirmed, the questions cannot wait. So, yes, I am not reluctant to, I am not going to shy back from doing that, but again, just so you know, I think you have to kind of——

Mr. SERRANO. Well, I understand what——

Mr. COPPS [continuing]. Realistic fashion.

Mr. SERRANO. I understand that some issues are new, and the magnitude so large that you might want to wait until you have the full Board.

Mr. COPPS. It is really——

Mr. SERRANO. For example, this PEG one, which has been around a while.

Mr. COPPS. I will give you another example. We were talking about public safety before, and we spent a lot of time, under the previous Chairman, and we tried to work together with him, on what do you do with this D block. And how do you get an interoperable broadband public safety network built in the United States of America? It is almost eight years after 9/11, four or five years after Hurricane Katrina, storms and emergencies occur across the Nation all the time, and first responders still cannot communicate with one another.

So, we spent a couple years trying to put together some kind of a private/public partnership, but for many reasons, which I would be happy to go into if you want me to, we were not able to bring that off.

I do not think we can afford to wait, but I am not about to rush ahead with a decision on this. But what I have told our bureaus and offices to do, is we have got a new Chairman coming in. I want you to go back to square one on this, and look at all of the options for building this public sector—private sector, interoperable broadband safety network. Take nothing off the table. You have got proposals to let the government pay for it. I do not think that is going to happen, to just give the spectrum away, or auction it off, and a lot of area in between.

So, I want to have ready for the new Chairman, I do not think it slows down business. I think it expedites it. I want to have ready for him an options paper, so we can move ahead right away, and I will be pushing to move ahead, to get that done. But that is one of those things on which we can make a lot of progress before he arrives, even though we perhaps do not make a final decision.

Mr. SERRANO. Well, I just would encourage you to continue to be bold.

Mr. COPPS. Okay.

Mr. SERRANO. Because it might be five, six, seven months. We do not know how this is going to be resolved, this thing of the new Chairman and the new membership. And we need to move ahead.

Mr. COPPS. You know, we really have tried to be. To be frank, we received letters from Capitol Hill towards the end of last year saying your job is basically the DTV transition, and try to avoid controversy. That kind of got cranked into the equation for a while, too. Just another factor.

Mr. SERRANO. Just ignore those letters. This is a perfect question to ask, surrounded by two female Members of the House. Earlier this month, Mr. Copps, you announced a new initiative to increase the diversity of broadcasters. You will improve data collection and ownership by minorities and women, and you will create a Diversity Advisory Committee. To what extent do minorities and women own broadcast facilities today? Does their programming differ from other broadcasters? And I do not mean better. That might be forgiven, right? How might the FCC do to increase these percentages?

Mr. COPPS. This is an area in which we are moving ahead, but it is not without controversy. I have launched this, and I am determined to do something. I think this is a huge problem. To what extent do women and people of color own broadcast properties? It is a shockingly and appallingly paltry percentage. You know, we are a country that is over a third minority right now; we will probably be half by the middle of the century. Yet, people of color own 3.6 percent of all full power commercial television stations in the United States of America, 3.6 percent.

Should we be surprised at the lack of programming dealing with issues of importance to women and people of color, noting the contributions that various minority and diversity groups are making to the country, or relating good stories about minority communities instead of all the bad stories? We should not be surprised if women and minorities are not managing those stations, do not hold the good executive jobs, and most importantly of all, do not have an opportunity to own those stations. We need to remedy the problem.

So, I am for being really aggressive on this. I know you can get pushed back by courts pretty easily on some of this, but we have got to be a lot bolder on everything from ownership to equal employment opportunities at the Commission, and I am pushing those matters. I have reconstituted the Diversity Advisory Committee, which is going to have its first meeting next week. I plan on going and really charging them to be aggressive. I am going to say we are on the cusp of doing meaningful things on women and minority ownership, but we want to make sure we have the so-called Adarand studies up to date, so we can justify what we do to the courts. We want to make sure that we have the data. I want to

look at ideas like full file review as something more aggressive to make people eligible to participate in the few incentive programs that do exist.

So, you know, this is one area where I am not holding back at all. I think it is a huge priority. It has been ignored for too long. It is a national embarrassment, and we need to do something about it. We need to do it now.

Thank you.

Mr. SERRANO. Ms. Emerson.

Ms. EMERSON. It is hard to believe, given there are more women in this country than men, too. So, I do not know, maybe it needs to start, lower levels of education to try to entice young people to get involved.

Let me ask you, if I could, Mr. Chairman, about media ownership. Given, you know, every week we are reading another story about this newspaper is folding, this newspaper is going bankrupt. There is only one newspaper now in Seattle, one newspaper in Denver. And so, I would like you to, number one, comment on the state of the newspaper industry, at least from your perspective, and I also would like to know how people are impacted when their local newspaper does go out of business, or the news coverage that they have traditionally been provided is reduced. And then, my last question is, given the state of affairs for print media right now, do you think that the rules, the 2007 rules of cross-ownership should be revisited?

Mr. COPPS. There is no question that newspapers are facing problems right now. I do not think we have a completely accurate handle on how many companies are making money and how many are not. I have read two long, long pieces in the New York Times in the last few weeks. Tucked away in the print was a little sentence in each one that said, of course, most newspapers in the United States are still making money. We do not hear that very often. More often, we hear that most of them are going under. And I am not trying to downgrade the pressures that they are under, because I understand that.

I think, to some extent, some of the consolidation that we underwent created some of these problems. I was not a fan of the Tribune takeover, and I warned at the time that amassing that kind of a debt could be inimical to the future well-being of that concern, and that has come to pass.

Certainly, the rise of the Internet has challenged them, and maybe some of their problems were self-created by just putting content up, free, on the Internet. The health of newspapers is beyond my purview, as Chairman of the Federal Communications Commission, but where it does come into play is when we look at some of the newspaper broadcast connections, and increasingly, newspaper and broadcast come under the same management. Maybe there are some efficiencies in that. I generally look at that with some level of skepticism, because, when you close a newsroom, you have lost another independent voice and independent news and independent judgment in a community.

So, I am afraid, as I read in an article yesterday, there is not much in the way of acquisitions going on right now. I am not so sure that, when the economy begins to turn around, that situation

will persist. And I think you will probably see more people wanting to consolidate.

I think you have to look at each case on an individual basis. What really galled me and did not appeal to me, was when Michael Powell tried to change the rules on ownership, kind of flashing an always on green light, you know, you can always come to the FCC, and we will approve a merger. I have never said that I oppose all mergers, and I am always willing to look at the facts in each individual market. If a duopoly or some kind of a different cross-media takeover means the difference between a station going dark or staying on the air, I am willing to look at that, and I think we should do so. But let's do it, again, with some attention to the details. Look at the needs of a particular market, rather than just flashing that always on green light.

The fact is that most people still get their news and information from television and from the newspaper. The latest figures I saw say probably two thirds, in spite of the fact that the Internet is becoming more and more popular. But I am seriously worried about the decline of broadcast journalism and newspaper journalism. I am not convinced that shrinking these newspapers into little minipapers is necessarily the way to success, and I am even less sure that that will serve the public interest.

So, this is a dialogue we need to have. When I was up in New York City a couple of weeks ago, I learned of a group convening up there, through one of the universities, to really take a close look at this. I applaud Congress taking a close look at it. You are raising the appropriate questions. I think there is going to be a hearing on the Senate side, on the future of journalism, too, and that is a dialogue that we really need to be having, because that is what the public interest is all about. If we do not have a viable system of journalism, newspapers, and take advantage of all the technologies we have to increase the civic dialogue, then we are losing a wonderful opportunity to help our country progress.

Ms. EMERSON. I appreciate that, Chairman. Just because I think we are going to have votes, I will stop now.

Mr. SERRANO. We have votes. I wonder if history will indicate that during a difficult time for the newspaper industry, that Members of Congress, who usually get treated very badly by them, actually care that they are still alive. Ms. Wasserman Schultz.

Ms. WASSERMAN SCHULTZ. Thank you, Mr. Chairman. The other issue I wanted to focus on was with the digital television transition, and some of the unique issues that we face in South Florida, and other areas where natural disasters are prevalent. And last year, I got a rather unsatisfactory answer from Chairman Martin, when I asked him about the issue of analog, portable analog, battery operated televisions, and whether or not a converter was going to be available commercially for people who rely on those, like in my district and in my region, when we get hit by a hurricane. Many people have, the only access that they have to information about emergencies is through that type of television.

Chairman Martin said there were no plans to actually solicit or create a converter for those types of televisions, and I was hoping that you would be able to say that that has changed, and now, we have moved in that direction.

Mr. COPPS. I do not have a completely satisfactory answer. The fact is that a lot of those analog portable sets are not going to be working after the transition. If they have the right connections, it is possible to attach a converter box to them, but then, in point of fact, they cease being portable. At least one company now is starting to produce a digital portable set. It is expensive, about $150, maybe more than that.

I have tried to talk about this wherever I go, and tried to jawbone, and encourage the production of these. I suppose, in the final analysis, the private sector is going to make some judgment upon whether there is a market there around the country to, for $150 to $200 sets, or if they produce enough of them, the price will come down. But I can tell you, when I go to Florida, lot of the stations are going to transitors in June, when it is hurricane season. So, it could be an ugly problem. Again, this is one of those things that we did not realize until too late, or folks could have been on top of it much sooner.

Ms. WASSERMAN SCHULTZ. Can the Commission encourage more aggressive development of that type of technology, or——

Mr. COPPS. Well, I think we can encourage by jawboning and asking questions.

Ms. WASSERMAN SCHULTZ. Jawboning.

Mr. COPPS. I do not think we can dictate that——

Ms. WASSERMAN SCHULTZ. $150, is that, $150, $200 television sets, you know, for an emergency situation, is really, you know, not accessible, and there will literally be thousands of people who will be without access to the information, you know, but for a portable radio.

Mr. COPPS. Yes.

Ms. WASSERMAN SCHULTZ. You know, it is not quite the same. The other issue is last year, we dealt with the issue of consolidation, particularly in South Florida, when the Washington Post, Newsweek company——

Mr. COPPS. Right. Right.

Ms. WASSERMAN SCHULTZ [continuing]. Proposed to purchase WTVJ, and the issue there was the Prometheus Radio Projects versus FCC, and the fact that you have the six station, that six station rule, and what allowed WTVJ, post-Newsweek, to argue that the two Spanish language stations in South Florida, in addition to the four English language stations, were equivalent, and that WTVJ was sixth, including those two stations, while at the same time, they argued actually that, WTVJ argued, in order to be able to have a duopoly with the Spanish language station, they argued the opposite. So, you cannot have your cake and eat it too.

But I know you cannot specifically talk about that case, and that sale was terminated.

Mr. COPPS. Right.

Ms. WASSERMAN SCHULTZ. Fortunately, for my constituents in South Florida. But does the FCC have plans to reexamine the loophole that would allow higher rated Spanish language TV stations to diminish the standing of English language stations, for the purposes of facilitating a common ownership duopoly? Because you are really comparing apples to oranges when you are comparing those stations. They have different audiences.

Mr. COPPS. I think we should be doing that. I think we should be attuned to the concerns of what some of these consolidation deals raise. I suppose you learn as you go along. People always figure out new ways to get around the rules. So yes, I think we could be looking at some of these issues. I think you can approach some of the problems by looking at the broadcast ownership limits.

It is very difficult to do, in an economy like we are in right now, but I think we need to keep addressing those problems. This goes a little bit beyond your question, but I also think there is a lot we can do to remove, what I would call behavioral rules, and just making sure stations are serving the public interest, and have a little more rigorous kind of licensing system with some public interest guidelines attached to them, like we had once upon a time. Now, you just send in a postcard every eight years, and you get your broadcast license renewed. I do not think that is sufficiently protective of the public interest.

Ms. WASSERMAN SCHULTZ. Mr. Chairman, before my time expires and we adjourn for votes, I am going to just throw out a provocative question, which is an extension of Congressman Kirk's question. Why do not we charge for broadcast stations, for the spectrum that they use?

Mr. COPPS. Well, I think the original deal was there is a quid pro quo involved here, and licensees got the spectrum in return for serving the public interest, and that is what allows the——

Ms. WASSERMAN SCHULTZ. Serving the public interest in the way that it was intended to be.

Mr. COPPS. I think a lot of stations are. I think there are still a lot of broadcasters in the United States who work hard, and in whose breasts the flame of the public interest still brightly burns, but as we go down this road to more consolidation, and we went through all the deregulation for 20 years, I think there are——

Ms. WASSERMAN SCHULTZ. I wonder if they would start, if someone filed legislation to require them to pay. Just saying.

Mr. SERRANO. Well, you may get me to join you on that for a very strange reason. I pay great attention to the Spanish networks. Their policy, their behavior, their entertainment, their politics is Miami-based.

So, if you are in New York, L.A., Texas, and you disagree with that policy, and we know what we are talking about, that may come to an end soon. It so happens we have all been involved in that issue. It is, if you are a New Yorker, what you get from radio, on Univision Radio, and I say it publicly, and from TV, is something that is politically attuned to Miami. And if you are a New Yorker and disagree with it, so be it, you get 24 hours of that. And that is, the whole Spanish language thing is another issue. Nobody, I think, monitors that.

Mr. COPPS. And look at the lack of ownership of stations in New York.

Mr. SERRANO. Now, we are going to adjourn, rather than recess, because you have been wonderful, but I want to get in one last question that I know is of interest, even though I did not check with them, to all three of us.

It is a baseball question, and it has to do with two local teams for our second home, which is the Washington area. And it is this

whole issue of the Mid-Atlantic Sports Network, engaged in a dispute over whether Time-Warner Cable will resume carrying the Orioles and the Nationals in the North Carolina region, which they see it as a local issue, that it is a local team.

As you know, baseball is always broadcast regionally, so if you were in New York, you were lucky. But if you were somewhere else, you chose a team that was close to you, and that is what happens. And so, it is not out of the question to say that our two local teams in our second home here belong somewhere in that area.

Ms. WASSERMAN SCHULTZ. Baltimore is a local team in Florida.

Mr. SERRANO. And what is interesting about it is that the FCC Media Bureau ruled in October in favor of Madison, and two arbitrators have ruled in favor of Madison. So, my question to you would be do you have any sense of how long it will take for the Commission to make a final decision, whatever that decision is?

Mr. COPPS. I think that is something we can push. Let me just start by saying it is a restricted matter, so I am precluded from saying too much about the substance of it. I can talk to you a bit about the——

Mr. SERRANO. And I want to make sure that I am saying whatever that decision is.

Mr. COPPS. Right, right. This went to arbitration initially, and the arbitrator found in favor of MASN, and then, Time-Warner would appeal that, and the Bureau denied the appeal, and then, Time-Warner filed an application for review before the full Commission, and that is now pending at the full Commission. I am trying to talk to the Bureau folks, and make sure they are of the same opinion still, and look at the record of it. I think it is something that deserves an answer, and we will try and move forward on that.

Mr. SERRANO. Okay. Because the folks are missing another season, and I can tell you from a personal viewpoint, I know most people think of New York as this big, not necessarily great, for some people, a big place that takes care of everything that it has. We went a season without the Yankees on TV, because the ES Network had not been cleared for the local cable package. And I was the most miserable guy in the Nation, even more than the folks in Carolina, who——

Ms. WASSERMAN SCHULTZ. That is funny. You should have used your Slingbox.

Mr. SERRANO. Please. Chairman Copps, we want to thank you for your testimony. We want to thank you for your service to our country. We want to encourage you to continue to move ahead of that holdup past longer than 24 hours. It might be a long time, but we take great interest in the work that the FCC does. We know how important it is to our society and to our government, and we thank you for your testimony today.

Ms. EMERSON. Before you gavel, may I just ask, I have some, I would like unanimous consent to submit some questions for the witness.

Mr. SERRANO. And so do I, and that is without objection, and so do you.

Ms. WASSERMAN SCHULTZ. Yes. Thank you.

Mr. SERRANO. Thank you so much.

Mr. COPPS. Thank you, sir. I appreciate it.

Ms. EMERSON. Thank you.

QUESTIONS FOR THE RECORD
HOUSE SUBCOMMITTEE ON FINANCIAL SERVICES
AND GENERAL GOVERNMENT

REPRESENTATIVE ANDER CRENSHAW

Recently, the FCC opened its national broadband policy proceeding and has worked very hard to foster new technologies. Examples of these new technologies are: 700 MHz networks, broadband over power lines, fiber to the home, municipal broadband, white spaces and others.

Question: Is there a possibility of anything impeding the implementation of these technologies from reaching their potential and, if so, what can we do to prevent that from happening?

Response: For far too long, we have been without a coordinated policy framework for the deployment and adoption of broadband. That is why I am pleased that Congress recognized, in both the 2008 Farm Bill and the American Recovery and Reinvestment Act (the "Recovery Act"), that a coordinated and comprehensive broadband strategy is urgently needed. I recently submitted to Congress, pursuant to the 2008 Farm Bill, a Rural Broadband Strategy Report that addresses some of your concerns about potential impediments to technological deployment. The Report recommends that all federal agencies review both their broadband and non-broadband programs to identify ways that deployment of cutting edge technologies can be improved. The Report also identifies a number of pending Commission proceedings that have the potential to break down barriers to broadband deployment. The Commission also has adopted a Notice of Inquiry that seeks comment on these issues, and will examine them on a broader, national scale in creating the national broadband plan required by the Recovery Act. With respect to the 700 MHz Band, as soon as the digital broadcast television transition is completed on June 12, 2009, the new 700 MHz licensees can begin using that spectrum to deploy advanced broadband technologies. The Commission adopted stringent build-out requirements to ensure that commercial 700 MHz licensees deploy their networks rapidly and provide new wireless services to rural, as well as urban, areas of the country. In addition, the licensees for a third of the spectrum are required to provide services on an innovative open platform that will allow customers, device manufacturers, third-party application developers, and others to use any device or application of their choice on these networks, subject to certain conditions. Through these efforts, we expect that a myriad of new and emerging technologies will become available to all Americans.

REPRESENTATIVE ROSA DELAURO

Last week, the New York Times journalist David Barstow was awarded a Pulitzer Prize for his reporting that revealed how some retired generals, working as radio and television analysts, took part in a Pentagon program aimed at generating positive news coverage of the war in Iraq, conditions at the Guantanamo Bay detention center and other activities associated with the Global War on Terror, and

that many of these analysts also had undisclosed ties to defense companies that benefited from the policies they defended.

Following Mr. Barstow's report, my colleague John Dingell and I wrote to the FCC seeking an investigation into this domestic propaganda program. We were concerned, and I am concerned, that by not revealing the outside financial interests of many of these military analysts, the networks may have violated the Communications Act, which requires that "when anyone provides or promises to provide money, services or other consideration to someone to include program matter in a broadcast, that fact must be disclosed in advance of the broadcast." Moreover, the program may have also violated sponsorship identification rules surrounding "any political broadcast matter or any broadcast matter involving the discussion of a controversial issue of public importance."

When we sent that letter, you stated that Mr. Barstow's reporting didn't inspire a lot of confidence that the military-industrial complex President Eisenhower warned of hasn't morphed into a military-industrial-media complex. The FCC has since opened an investigation into the matter.

Question: Can you update me on the status of this investigation, whether you have the resources to conduct a thorough investigation and if you have any further thoughts on the issue?

Response: As you note, the Commission's sponsorship identification rules require the airing of an announcement disclosing any arrangement to transmit material in exchange for money or other valuable consideration. In the case of sponsored material relating to a political or controversial issue of public importance, announcements must be made at the beginning and end of the airing of that material. We take any allegations of violations of our sponsorship identification rules very seriously. At the same time, however, we must be mindful of the First Amendment, particularly when investigating activities related to news gathering and reporting.

After receiving your referral, the Enforcement Bureau sent letters of inquiry to the news organizations and the military analysts identified in the New York Times article entitled *Behind TV Analysts, Pentagon's Hidden Hand.* The parties provided detailed responses to the Bureau's letters of inquiry. In their responses, the networks assert that they regularly checked their analysts' financial backgrounds for conflicts of interest, that the government briefings and travel to restricted locations provided to the analysts were substantially similar to courtesies provided to news media journalists, and that the sponsorship identification rules do not apply in any event. The military analysts assert that the views expressed during their television and radio appearances were their own, and that those views were not procured by the Department of Defense.

The Bureau has reviewed the responses to the letters of inquiry and is considering next steps. I intend to meet with the Bureau in the near future to discuss its findings and recommendations. If it appears that anyone has violated our sponsorship identification rules, we will not hesitate to take appropriate enforcement action. Finally, the

Commission is confident that it has the resources to fully and thoroughly investigate and address these issues.

RANKING MEMBER JO ANN EMERSON

Fairness Doctrine

Question: Has there been any discussion by the Commission of bringing back the Fairness Doctrine?

Response: I am aware of no discussion at the Commission aimed at bringing back the Fairness Doctrine.

Digital Conversion

The stimulus bill provided $650 million to the Department of Commerce for the digital TV transition. The Administration has informed the Committee that $65.7 million of these funds will be transferred to the Commission to educate the public regarding the transition. This is a significant amount of funding in comparison to the $20 million requested by the Commission in fiscal year 2009, when the transition was scheduled for February.

Question: How many households do you estimate are unprepared for the transition and do you anticipate the Administration will ask for an additional delay in the transition date?

Response: While I cannot speak for the Administration, I do not anticipate a further delay in the transition date. Since the enactment of the DTV Delay Act extending the digital transition date from February 17, 2009, to June 12, 2009, the Commission has been hard at work preparing the public and coordinating our efforts with those of the National Telecommunications and Information Administration ("NTIA"), as well as with state and local agencies and private stakeholders. We have used funds from the American Recovery and Reinvestment Act (the "Recovery Act") to secure various contracts that augment our in-house resources for services such as the Call Center, walk-in help centers and in-home converter box installations. While this is a national effort, we have specifically targeted 49 "Hot Spot" markets that have a demonstrated need for assistance and high levels of at-risk consumers (e.g., senior citizens, non-English speaking consumers, minority communities, individuals with disabilities, low-income individuals, and consumers living in rural areas and on tribal lands). The available figures on consumer readiness reflect the significant progress that we have made during the past four months.

We rely on a variety of sources, including NTIA and The Nielsen Company ("Nielsen"), to obtain the most accurate picture possible of the number of households that remain unprepared for the DTV transition. Based on Nielsen data, the number of completely unready television households (that is, those that rely solely on over-the-air reception of local stations using older, analog television sets and have not yet connected to converter boxes) has significantly declined since the DTV Delay Act was passed. Nielsen estimates that, as of February 15, 2009, about 4.4 percent of the 114.5 million television

households, or about 5.0 million television households nationwide, were completely unready. In contrast, as of May 24, 2009, Nielsen estimates that about 2.7 percent of U.S. television households, or about 3.1 million television households, remained unready, a drop of 39 percent from the February "unready" figure.

While the available data reflect this positive trend, we will continue to closely monitor the level of preparedness for the DTV transition until and, if necessary, beyond June 12, 2009.

Question: Can the FCC realistically spend $65.7 million on education before the transition in June?

Response: In its Recovery Act Plan for Digital Television, the Commission specified the types of services it would procure with Recovery Act funds. The contracts associated with these services have now been awarded and, to date, the Commission has obligated more than 65 percent of the $65.7 million to meet the potential expenditures associated with these contracts. Because many these contracts contemplate volume-related payments, it is not possible to determine total actual funding until performance is complete. For example, the largest contract that has been awarded from a potential funding perspective is with TeleTech Government Solutions for Call Center services. The actual total payment required on this contract will depend on the number of calls ultimately handled by the vendor. While the Commission anticipates using the total Recovery Act allocation, we will determine the total spending amount after the completion of vendor performance.

The various programs for which the Commission is using the Recovery Act funds are as follows:

Call Center Support Services. The Commission has contracted with Tele-Tech Government Solutions to augment the Commission's own Call Center operation. Tele-Tech will provide additional trained Call Center staffing, e-mail services and telecom equipment, including call processing equipment, and facilities and network services, for responding to calls regarding the DTV transition to the Commission's nationwide, toll-free DTV Call Center number (1-888-CALLFCC).

In-Home Digital-to-Analog Converter Box Assistance. The Commission has entered into a number of contracts for in-home digital-to-analog converter box ("converter box") assistance, each for defined geographic areas throughout the country, with a focus on providing assistance in the "Hot Spot" markets that are most in need of converter box installation assistance and certain rural areas. The contracts contemplate differing levels of assistance—basic and expert. Basic assistance involves the installation of up to two converter boxes to existing in-home antennas and analog televisions, providing a minimal level of assistance in connecting and orienting such antennas, performing scanning to receive area digital broadcast television stations, and providing the consumer with basic guidance on the operation of the converter boxes (including the use of closed captioning features). In addition to providing these basic services, an installer providing expert service can make significant physical adjustments to and movement of antennas,

including the possibility of recommending new antennas and/or mounting antennas in various locations inside a consumer's home, scanning and rescanning to locate the maximum number of digital broadcast channels available, and integrating a VCR into a converter box installation to allow a consumer to watch one broadcast program while recording another. An expert installer can also help the consumer identify and troubleshoot loss of broadcast television signal issues not resolved by antenna and scanning adjustments.

Community Walk-In Help Centers. The Commission has entered into agreements for static and mobile community walk-in help centers to provide services to the public, including demonstrations of converter box installation and operation, distribution of DTV transition consumer literature, and on-line access for NTIA converter box coupon applications. Each contract is for a defined geographic area, with a focus on providing assistance in 49 "Hot Spot" markets and at-risk consumer groups.

Media Services. On May 5, 2009, the Commission selected media-relations firm Burson-Marsteller to provide advertising and public relations expertise, a variety of media services, publications, and targeted distribution services that will supplement and expand the Commission's consumer education and awareness campaign. At-risk populations also will be reached through local, regional and national print publications, which will provide essential messaging to consumers about how to receive assistance to make the digital transition, emphasizing the 1-888-CALLFCC national toll-free Call Center number.

Question: What safeguards are you putting in place to ensure that this funding is used effectively and not subject to waste, fraud, and abuse?

Response: The Commission is subject to the Federal Acquisition Regulations ("FAR") for its contracting activities, which are reviewed by its Office of General Counsel to ensure proper acquisition of services. For the contracts that have been awarded with the Recovery Act funds, the Commission requires vendors to follow certain reporting procedures to ensure that all invoices are connected with auditable information regarding services rendered. In addition, we have provided Recovery Act training to our Contracting Officer Technical Representatives ("COTRs") to assure that they are prepared to monitor each vendor's performance and can verify that invoices are accurate prior to payment. This routine and frequent contact between the COTRs and vendors ensures that the Commission can immediately identify and address any potential problems. Commission staff also will visit DTV walk-in help centers to ensure that vendors are meeting contract requirements. In the case of in-home assistance for converter box installation, the COTRs are contacting a sample of customers to ensure that the installations occurred and that each vendor met the Commission's applicable contract requirements.

Finally, the Recovery Act requires vendors to periodically report on their activities, providing information for the general public on funds expended and services rendered. While the Office of Management and Budget's online system for posting this information

(www.federalreporting.gov) is not yet available to the public, the Commission requires vendors to post to that system so that the information will be disclosed when that system is launched. In the interim, the Commission posts weekly reports on www.fcc.gov/recovery that include aggregated data concerning funds obligated and expended to date and actions planned and completed.

Your digital transition spending plan includes $11.6 million to establish 775 community-based walk-in installation centers, and $14 million for in-home installations.

Question: How will you select the locations of the walk-in installation centers?

Response: From our experience with early market-wide DTV transitions in Wilmington, North Carolina and Hawaii, as well as with individual stations that transitioned on February 17, the Commission learned that many consumers require hands-on assistance to successfully complete the transition. To meet this need, the Commission has sought and entered into a number of agreements for community walk-in help centers to provide services to the public. These agreements are for defined geographic areas throughout the United States where data suggests that additional assistance is necessary to allow consumers to successfully prepare for the DTV transition. In addition to geographic considerations, the Commission placed a high priority on a contractor's ability to serve the most at-risk consumer groups.

Question: What type of services will these centers provide?

Response: Walk-in help centers provide in-person, hands-on demonstrations of how to connect converter boxes and antennas to analog TVs, how to properly position antennas for the best reception of local broadcast stations, how to perform channel scans and re-scans of converter boxes, how to connect a VCR or other recording device to the set-up, and how to use features such as closed captioning. Consumers also can watch educational videos regarding converter box installation, antennas, reception and coverage issues. Walk-in help centers also provide printed literature regarding the converter box coupon program, connection guides for converter boxes, guides for antenna and reception issues, DTV publications for those with disabilities, and local broadcast station coverage maps. In addition, the walk-in help centers have an Internet connection, to allow consumers to apply for NTIA converter box coupons online and access other DTV transition information.

Question: Are walk-in installation centers more effective than your call centers?

Response: Walk-in help centers complement the activities of the Commission Call Center. In addition to answering questions and providing information about the DTV transition, taking consumers through the converter box installation process, and troubleshooting problems with converter boxes, Call Center operators direct consumers to helpful local resources in their area, including walk-in help centers. While the Call Center is a valuable resource for consumers to get general information and assistance

with the DTV transition, walk-in help centers can provide in-person assistance that can be very specific and locally-oriented, including providing information on local station coverage areas.

Questions: How will you use the $14 million planned for in-home installations? Will anyone in the country be able to have a professional come to their home? Will the in-home installations be primarily focused on large population centers?

Response: The Commission has entered into a number of agreements to provide in-home assistance to consumers to prepare for the DTV transition. The contracts were issued to provide these services in "Hot Spot" markets, and in consideration of other factors, such as the installation services being geographically dispersed and a contractor's ability to service rural areas. These contracts provide for the two distinct types of in-home assistance, basic and expert, as described above. In addition to these agreements, the Commission has entered into contracts with AmeriCorps-National Civilian Community Corps and the International Association of Fire Chiefs to supplement the efforts of the other contractors to provide in-home installations for consumers, particularly in areas of greater need. By entering a zipcode on the FCC's DTV website, www.dtv.gov, a consumer can identify and obtain contact information for contractors that provide in-home installation services in the consumer's area.

Universal Service Fund

Several Members have raised concerns with the Committee that the FCC IG's audits of the Universal Service Fund are expensive and have identified no instances of fraud or gross non-compliance within the program's parameters.

Question: Please describe the FCC's oversight of the Universal Service Fund. Are you aware of these concerns and is there a better way to oversee the program?

Response: The Commission engages in a multi-faceted and extensive oversight program with respect to the Universal Service Fund ("USF"). The Commission has a Memorandum of Understanding with the Universal Service Administrative Company ("USAC") that specifies reporting relationships, regularly-scheduled deliverables from USAC, standard operating procedures to ensure that USAC administers the USF in accordance with all applicable rules and regulations, and appropriate standards and procedures for resolving issues that may arise. The Commission works to ensure that USAC has a sufficient internal control structure over its operations (including finance and accounting activities) to comply with all applicable federal financial and accounting requirements, to comply with the Debt Collection Improvement Act, and to provide appropriate review of applications for USF support and implementation of a Continuity of Operations Plan. The Commission provides guidance to USAC on management and administration issues pertaining to administration of the USF, including: billing and collection of USF contributions; disbursing USF support; processing applications for USF support; reporting accurate data; recovery of any funds that have been identified as improperly disbursed; website maintenance; accounting for transactions of the USF in accordance with government accounting standards; and seeking guidance from the Commission when the rules are unclear. The Commission receives data,

performance measurements and a multitude of program reports that are used to provide rigorous oversight of USF matters. The Commission continues to work with USAC to improve the quality of performance measures, the quality of data gathered in response to those measures and the usefulness of that data in monitoring and enhancing USAC's performance. The Commission has directed USAC to take steps to prevent or reduce improper payments, including linking executive compensation to improper payment reduction, requiring increased public transparency into USAC payments, and directed USAC to strengthen its internal controls. The USF is included in the Commission's financial statements which are audited by outside, independent auditors.

The Commission's Office of Inspector General ("OIG") conducts and/or oversees an annual independent audit of USAC to examine its operations and books of account to determine, among other things, whether the Administrator is properly administering the USF in accordance with Government accounting standards and to prevent fraud, waste, and abuse. The OIG also conducts or oversees audits of USF contributors, beneficiaries, and service providers, and provides support to the Department of Justice in ongoing criminal and civil investigations. The Commission is aware of concerns that the OIG's audits are costly and burdensome. It is important to note that the audits of USF beneficiaries have previously identified instances of fraud in the USF program and the current audits have led to other ongoing investigations of possible fraud in the program. In addition to any fraud or program non-compliance that these audits uncover, the USF community's knowledge of the OIG's rigorous audit program works to deter fraud from occurring in the first instance. Having said that, auditing and oversight must not only be significant but effective as well. The Commission is constantly looking to improve oversight of the USF program, including ways to render the audit process more efficient and less costly, without sacrificing the substantial public benefits the audit program provides. In that regard, the Commission is mindful that some concerns have been expressed by the Government Accountability Office, Members of Congress, and others concerning USF audit and oversight processes. To address some of these concerns, by Notice of Inquiry released on September 12, 2008 (FCC 08-189), the Commission initiated a proceeding for ensuring a "Comprehensive Review of the Universal Service Fund Management, Administration, and Oversight." Through this proceeding, the Commission sought comment on mechanisms to further strengthen management, administration, and oversight of the USF, to define more clearly the goals of the USF, and to identify any additional quantifiable performance measures. The Commission anticipates that this proceeding and the processes described above will further inform its approach to these important oversight responsibilities in the future.

Questions: Does the Universal Service Fund need to be reformed? Should the uses of the Fund be expanded to include broadband costs?

Response: Comprehensive USF reform is necessary to meet the overarching communications challenge of the 21st Century. That challenge, both by statute and by necessity, is to encourage the deployment of basic and advanced telecommunications to all of our citizens and to ensure that the universal service system, which accomplished so much in the last century, can facilitate the broadband build-out we need in the coming years. One critical element is re-tooling the universal service system with broadband

deployment as its mission. I believe that the universal service system should be reformed so that it will enable all Americans—rural, urban and everyone in between—to have access to increasingly vital broadband services. And while there are a variety of ways to comprehensively reform the system, adding broadband to both the contribution and distribution sides of the ledger, eliminating the identical support rule, and conducting effective auditing and oversight, along with a Congressional change to include intrastate as well as interstate revenue as part of the fund, would accomplish a great deal in addressing the sustainability and integrity of the fund for the long term and promote broadband in the areas served by the fund.

Question: How do schools and libraries use these funds?

Response: The E-rate program provides eligible schools, libraries, and consortia that include them with discounts on telecommunications services, Internet access, and internal connections, including data transmission wiring and components. Among other things, the program enables educators to provide high-speed Internet access and distance-learning capabilities to all schools within a district, increase the Internet connection speed to allow for enhanced educational courses, implement data and voice networks, or simply afford basic Internet and telecommunications equipment. Schools and libraries use these services for educational purposes, such as distance learning, student assessments, teacher development and student and patron Internet-based research. For example, Internet access and network equipment purchased with E-rate funds have enabled students to conduct online research at school. Prior to receiving these funds, students might have had to travel to a distant library to access the Internet; now, Internet access is available in most classrooms. Further, with the Internet access purchased with the E-rate funds, many other on-line educational resources are now more easily available to teachers and students.

Question: Have the results of the program been evaluated?

Response: Yes. In March 2009, the Government Accountability Office ("GAO") released its report to Congress on the E-rate program. The GAO analyzed and evaluated data from the first year of the program, surveyed a sample of participating schools and libraries, reviewed agency documents, and interviewed agency officials and program stakeholders.
It assessed issues related to the E-rate program's long-term goals, including: (1) key trends in the demand for and use of E-rate funding and the implications of these trends; (2) the rate of program participation, participants' views on requirements, and the FCC's actions to facilitate participation; and (3) the FCC's performance goals and measures for the program and how they compare to key characteristics of successful goals and measures.

Question: Are schools and libraries able to improve the use of technology as a result of the program?

Response: Since the inception of the E-rate program, schools and libraries have received more than $23.7 billion in funding commitments. The program has had a dramatic effect on the availability of modern telecommunications and information services in our nation's schools and libraries. E-rate funding has provided millions of school children, teachers and library patrons access to those vital resources. In a study released in 2006, the National Center for Education Statistics ("NCES") found that nearly all public schools in the United States had Internet access, and 97 percent of them used broadband connections to access the Internet. Today, Internet access in public schools is nearly ubiquitous; before the E-rate program was established in 1997, only 78 percent of public schools had Internet access, with only 27 percent of public school instructional classrooms with Internet access. Classroom access increased to 94 percent in 2005. A 2006 Florida State University study found that 99 percent of public library branches are connected to the Internet, 98 percent of which offer public Internet access. Having said that, there is still much more for the E-rate program to accomplish. As equipment begins to age or become obsolete, and as internet speeds and the importance of on-line resources increases, the value of the E-rate program to our nation's schools and libraries remains as important as ever.

Questions: Has the rural healthcare program been successful in implementing telehealth networks in many communities? How many rural communities is this program supporting?

Response: In response to the underutilization of the rural health care program established by the 1996 Telecom Act, the Commission recently established the $417 million Rural Health Care Pilot Program to stimulate the deployment of the broadband infrastructure necessary to support innovative telemedicine services to rural America. The 66 projects participating in the program cover 42 states and three U.S. territories. These projects are eligible to receive funding for up to 85 percent of the costs associated with the deployment and maintenance of broadband networks and connecting to nationwide Internet backbones or the public Internet.

To date, projects receiving funding commitments cover broadband telehealth networks that will link hundreds of rural hospitals in communities throughout Iowa, Minnesota, Montana, Nebraska, North Dakota, Oregon, South Carolina, South Dakota, Wisconsin, and Wyoming. In addition, funding has been approved for the design of a telehealth project in Alaska. Collectively, these projects are eligible to receive $66 million in reimbursement for the engineering and construction of their regional telehealth networks. Other projects have posted requests for proposals and are considering vendors to build out their broadband networks to health care providers in rural communities, and still others are preparing their requests for proposals.

Question: Have the results of the program been evaluated?

Response: Upon completion of the Pilot Program, the Commission will issue a report detailing the results of the Program, its status, and any recommended changes. To assist in this task, participants are required to submit quarterly reports which will serve as a

guide for further action by informing the Commission's understanding of cost-effectiveness and efficacy of the different state and regional networks funded. Included within the data will be information detailing hospitals in rural communities receiving support under the program and how the Pilot Program has advanced the benefits of telemedicine for each project.

FY 2010 Budget Increases

The fiscal year 2010 budget request includes a $15 million increase to modernize your technological infrastructure, including IT and phone systems. So many agencies working to update their IT systems have failed, at a great cost to the American taxpayer.

Question: Do you believe the Commission's staff has the program and contract management, and technical expertise to successfully implement and maintain IT systems?

Response: The Commission is committed to ensuring that its information technology ("IT") investments are successful. In recent years, the Commission has taken steps to increase the effectiveness of its IT project management framework. It has made the strengthening of its IT capital planning and investment control and project management a top priority. The priority placed on this effort is evidenced by the Commission's establishment of an Information Technology Tactical Management Plan to track its investments and ensure that those investments make the best use of Commission resources. The IT Planning Team meets bi-weekly to review the status of the projects in the IT Tactical Management Plan. The results of these efforts are also monitored by the FCC's IT Steering Committee, which oversees the recently revised IT Strategic Plan. By revamping the IT Strategic Plan and implementing the IT Tactical Management Plan, the Commission has made progress in bringing its investments under a sustainable IT project management framework. This framework will assist the Commission in implementing long-term IT goals that best support its overall mission and performance goals. The investments requested in the FY 2010 Budget request would be subject to this management framework.

Finally, as part of the FCC's IT planning efforts, the Commission also has been performing an inventory of its IT Project Managers and working to ensure that the Commission's IT Project Managers are developing and strengthening demonstrable technical, leadership, and project management skills. The Commission also appointed a new permanent Chief Information Officer in FY 2008 and has elevated the visibility of the CIO position within the agency through the centralized IT management practices noted above.

REPRESENTATIVE BARBARA LEE

Auctioning of New Spectrum Licenses

The FCC must ensure that the American taxpayer will get the best possible return, both in terns of revenue as well as in terms of the final products and services that result from the auctions of spectrum that will be freed up due to the transition.

We are rightly focused on the availability of interoperable radio communications systems for our first responders, but what about maintaining enough flexibility in the access to spectrum to ensure that there is access for smaller companies that may be in a better position to innovate and bring new products and services to our airwaves.

Question: Are we doing enough to ensure that the leasing of the public's airwaves will not be dominated by a few entrenched players and that enough smaller and nimble companies will be able to enter the markets in the future?

Response: We still have a long way to go to create adequate incentives for small entities to gain access to public airwaves. Our telecommunications market has, as you note, become increasingly consolidated and it becomes very challenging for small entrepreneurs to break into the markets and for the Commission to provide effective tools to ensure such an outcome. This needs to be a higher FCC priority.

In the process of reviewing any proposed license transfers and assignments involving large wireless service providers, the Commission has the obligation under the Communications Act to examine whether approval of the transaction would be in the public interest. With ongoing changes in the marketplace, I believe it critically important, as part of this public interest analysis, to give particularly close scrutiny of the competitive effects on the marketplace of each proposed transaction to ensure that consumers are protected.

The Commission has implemented a number of measures to encourage the participation of a variety of providers, including smaller companies, in the spectrum auctions that have been held over the last fifteen years. The Commission has adopted band plans to address the needs of smaller businesses for different types of spectrum blocks and geographic license areas. Designating for auction a mix of geographic areas and spectrum block sizes, including spectrum for licensing facilities serving smaller and rural geographic areas, promotes access to spectrum by new entrants, smaller carriers, as well as rural telephone companies. The Commission also has offered bidding credits (15, 25 or 35 percent discount) to participants in auctions of wireless licenses that would qualify as a small business or as a "new entrant" in auctions for broadcast construction permits. Moreover, the Commission facilitates the participation by small entities in spectrum auctions by employing a user-friendly, Internet-based bidding system that enables bidders with varying levels of experience to participate in the auctions from anywhere in the country. The system also assists all auction participants by providing them with tools to assist in their bidding.

Aside from auction participation, new entrants do have some other options to acquire spectrum, thereby allowing them to bring innovative products and services to the public.

Entities can acquire smaller partial licenses, more tailored to the companies' specific needs, in the secondary markets through the use of geographic partitioning and/or spectrum disaggregation. The Commission also has adopted rules to facilitate access to spectrum by permitting licensees and entities seeking spectrum access to enter into spectrum leasing arrangements, which similarly can be tailored to particular needs, with minimal transaction costs. To expedite the use of these options, the Commission provides for immediate (*i.e.,* next-day) processing of certain classes of spectrum leasing arrangements and applications for license transfers and assignments.

Moreover, the Commission has provided that licensees for one large block of commercial spectrum in the 700 MHz band will be subject to an "Open Platform" condition. Accordingly, those licensees are required to provide an innovative open platform that will allow customers, device manufacturers, and third-party application developers to use or develop the devices and applications of their choosing on these networks, subject to certain conditions.

As mentioned, much more needs to be accomplished. I will continue to look for additional ways for ensuring that smaller and creative companies continue to have access to spectrum. Indeed, I am hoping that the recent Notice of Inquiry on developing a National Broadband Plan may lead to some additional ideas worth considering in this regard.

The Broadband Plan
We are way behind in the race for access to fast internet speeds.

Japan and South Korea dominate the rest of the world in both the speed of their broadband, as well as the integration of high speed internet applications in both the home and at work.

Questions: What is the FCC's definition of broadband? What is the minimum download and upload speed that qualifies as "broadband?"

Response: I agree that our country is not nearly where it needs to be when it comes to broadband. That is why I am so pleased that Congress charged the Commission with the development of a national broadband plan by February 17, 2010. In past reports to Congress, from which I dissented, the Commission defined "advanced telecommunications capability" as 200 kilobits per second (kbps) in the both upstream and downstream directions, and "high-speed" as services with over 200 kbps in at least one direction. The term "broadband" is often used to refer to the more inclusive high speed services. Last year, the Commission defined services with 200 kbps in at least one direction to be "first generation data" and identified services with at least 768 kbps to be "basic broadband." The Commission now collects data in a tiered approach, including speeds far in excess of these modest definitions. As the Commission evaluates its broadband policies and develops a national broadband plan for our future, I will continue to seek to make affordable, competitive broadband a priority, including clarifying and updating the Commission's definition of broadband.

Question: Can you tell us why you believe that Japan and South Korea have average internet speeds over 60 megabits per second and 46 megabits per second respectively and the United States languishes at somewhere between 2 to 4 megabits per second?

Response: It is sad that the country that invented the Internet has fallen so far behind in broadband. Broadband deployment is an issue for which we long ago should have developed a national strategy. We are finally beginning to take positive steps toward the formulation of such a plan. While I would like to answer your question on international comparisons more directly, the Commission simply has not previously collected sufficient data to make such comparisons more than mere speculation. There could be a broad array of reasons for our broadband shortfall, including different rules of competition in the marketplace as between countries.

The Commission currently has underway, pursuant to the Broadband Data Improvement Act, an effort to collect more data and information and to conduct a thorough international comparison of broadband deployment and policies. However, even with solid data, a thoughtful set of goals and a plan to accomplish those goals are needed. I am pleased that the Commission's consideration of a national broadband plan, including goals and the mechanisms by which it plans to achieve such goals, is finally in progress.

Question: What is your plan for increasing Americans' access to affordable high speed internet access?

Response: I believe that it is our duty to ensure that all Americans gain access to affordable broadband Internet services. In the American Recovery and Reinvestment Act, Congress appropriated $7.2 billion for increasing broadband infrastructure deployment, and to increase access and use of broadband through education, training, and other means. While this is a significant down payment on our broadband future, it will not by itself solve the problem. In my recent Rural Broadband Strategy Report, I identified a number of barriers to deployment and adoption, and made recommendations for overcoming those barriers. I hope the Commission builds on these initial recommendations as it continues its ongoing work on a comprehensive national broadband plan. I commend Congress for providing the Commission the task of developing such a plan. The Commission initiated this process in April with the adoption of a Notice of Inquiry and will conclude its inquiry with a report to Congress next February.

Question: Does the FCC include a plan to address the persistent "digital divide?"

Response: America has no room for a digital divide. In my recent Rural Broadband Strategy Report, I identify a number of reasons for the digital divide and made recommendations for overcoming it, including digital literacy training. In addition, as the Commission develops a national broadband plan, it is considering how to ensure

affordable access to make broadband access available for every American, including minorities and those living in low-income communities.

Question: Are municipal, state or federally sponsored wide-area wireless networks a part of the FCC's overall broadband plans?

Response: In the development of a national broadband plan, the Commission is considering all aspects of its wireless policy to determine how to best provide America with affordable, robust broadband service. The National Broadband Plan Notice of Inquiry noted that some communities have developed their own broadband projects where private sector competition has not yielded sufficient results. The Notice sought comment on the efficacy of encouraging the development of local and municipal broadband projects. Cooperation is crucial between all levels of government, as well as partnerships between the private and public sectors. The Commission has considered nationwide and smaller wireless networks in its spectrum allocation decisions. As the Commission continues to address these issues, their importance to a cohesive broadband plan will become ever more important. Moreover, as we develop plans for the future, we should consider the successes and other lessons learned regarding wireless and other broadband networks, including municipal projects.

Small Business and Diversity in Media Ownership

Question: You have expressed thoughtful concerns regarding media concentration. Given the rapidly shrinking number of traditional newspapers and other traditional routes of funding for independent journalists, does the FCC have a role in protecting or promoting the survival of journalism as we know it?

Response: The Commission has always played a role—direct or indirect—in ensuring that the American people have access to the news and information they need to make intelligent decisions about their lives. Indeed, the three core values of our media policy from time immemorial—localism, diversity and competition—are really aimed at a single goal: to ensure that the American people have access to a wide range of information on issues of public concern.

I believe we're in trouble on this score and we are skating perilously close to depriving our fellow citizens of the depth and breadth of information they need to make intelligent choices about their future. Hyper-commercialism and high quality news make uneasy bedfellows. As my hero FDR said in a letter to Joseph Pulitzer, "I have always been firmly persuaded that our newspapers cannot be edited in the interests of the general public from the counting room." Broadcast journalism is no different. Readers, viewers and listeners are citizens to be informed and entertained, not products to be sold to advertisers. This is not to say that good journalism is incompatible with making a profit. But when TV and radio stations are no longer required to serve their local communities, when stations or newspapers are loaded down with crushing debt or owned by huge corporations preoccupied with cutting costs through economies of scale, it should come as no surprise that some things precious get lost.

I expect that the Commission will take a close look at the state of broadcast journalism in its next quadrennial media ownership review. But the Commission need not wait for 2010 to begin looking at these issues that are so important to our democratic dialogue.

As newspapers shrink, there have been new opportunities on the Internet. With the auctioning of digital spectrum, there will be an increase in the number of broadcast channels and, hopefully, an increase in the diversity of voices and ownership in the digital TV space.

Question: What steps will the FCC take to ensure access by small business to broadcasting and increasing minority media ownership, including access to financing and spectrum?

Response: One of my top priorities at the Commission has been to reverse the shameful state of female and minority broadcast ownership in this country. For example, one recent set of studies found that, while minorities comprise 34 percent of the U.S. population, they own only 3.15 percent of full-power commercial television stations and 7.7 percent of full-power commercial radio stations, and, similarly, while women comprise 51 percent of the U.S. population, they own only 5.87 percent of full-power commercial television stations and 6 percent of full-power commercial radio stations. I believe the Commission can and should do far more to change those numbers.

Although the Commission adopted a Diversity Order in December 2007 seeking to promote ownership by "eligible entities," the Commission majority adopted a "small business" definition of eligible entity that diversity advocates argued would do little or no good for women and minority-owned businesses. The Commission majority asserted that it lacked a sufficient record to provide the necessary legal justifications for a more targeted approach. But if we lacked the data, we had no one to blame but ourselves. The Commission made no attempt in recent years to gather it.

Since becoming Acting Chair in January, we have begun laying the groundwork for a more targeted approach. On April 8, the Commission adopted a Report and Order to revise the ownership report forms that full-power commercial radio and television licensees must file biennially. Our revisions will enable us to obtain more useful information about minority and female broadcast ownership. We also ensured that the data that we collect will be more comprehensive by extending the biennial filing requirement to include additional categories of licensees that previously were not covered. We also adopted a uniform filing date to allow periodic snapshots of the state of minority and female ownership. I hope and expect that these data will be crucial in helping the Commission establish and maintain more targeted policies.

Similarly, on May 7, the Commission re-chartered its Diversity Advisory Committee to assist it in formulating and implementing sound, legally sustainable policies to promote media ownership by minorities. At its first meeting, I asked the Committee to develop recommendations quickly on the studies that can and should be done and whether the Commission should adopt a "full file review" process as an interim step.

Question: Does the FCC plan to reevaluate existing newspaper-broadcast cross-ownership rules in order to assess their impact on minority media ownership and increased media consolidation?

Response: The Telecommunications Act of 1996 requires the Commission to review its media ownership rules every four years to determine whether each of the rules is necessary in the public interest as the result of competition. Therefore, the Commission will review the newspaper-broadcast cross-ownership rule as part of its 2010 Quadrennial Review proceeding. The Commission's media ownership rules are designed to foster the Commission's policies of competition, diversity, and localism. Within the context of those goals and as part of this statutory mandate, the Commission reviews its rules to determine whether they promote and preserve our core objectives. In addition, I believe that it is a good idea for the Commission to have a policy to deal with future requests for Commission approval of additional mergers.

Reversing the dismal state of minority media ownership has been one of my top priorities since I became Acting Chair. Our improved data collection requirements will allow us to engage in an accurate, reliable, and comprehensive assessment of minority and female broadcast ownership in the United States. We will use this data to undertake studies of minority and female ownership and to develop the record evidence needed to adopt more targeted measures.

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