

**STATEMENT OF THE HONORABLE ERIC M. THORSON  
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DEPARTMENT OF THE TREASURY  
BEFORE THE  
COMMITTEE ON APPROPRIATIONS  
SUBCOMMITTEE ON FINANCIAL SERVICES  
AND GENERAL GOVERNMENT  
U.S. HOUSE OF REPRESENTATIVES  
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Chairwoman Emerson, Ranking Member Serrano, and Members of the Subcommittee, thank you for the opportunity to appear before you this afternoon with my friend and colleague, Treasury Inspector General for Tax Administration Russell George. I appreciate that the Subcommittee is looking to us to help identify savings and promote efficiency in the Treasury Department. With that in mind, I will give you an overview of Treasury's more significant programs and operations under our jurisdiction as well as our perspective on the most serious management and performance challenges facing it. I will also discuss some of our more recently completed and ongoing oversight work. Before discussing this work, however, I will first briefly tell you about my office and our budget request.

**Treasury Office of Inspector General**

I have served as the Treasury Inspector General since 2008. The office that I lead provides independent audit and investigative oversight of the Department's programs and operations and that of its bureaus, except for the Internal Revenue Service (IRS) and the Troubled Asset Relief Program (TARP). I also chair the Council of Inspectors General on Financial Oversight. That Council was established by the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) to facilitate information sharing among the nine financial Inspector General (IG) members, provide a forum for discussion of IG member work as it relates to the broader financial sector, and evaluate the effectiveness and internal operations of the Financial Stability Oversight Council (FSOC) chaired by the Secretary of the Treasury.

My office is staffed with about 190 employees and has three mission components: the Office of Audit, the Office of Investigations, and the Office of Small Business Lending Fund (SBLF) Program Oversight. The Office of SBLF Program Oversight, under the leadership of a Special Deputy Inspector General, conducts, supervises, and coordinates audits and investigations of the SBLF, which has invested more than \$4 billion in community banks, as well as the \$1.5 billion State Small Business Credit Initiative (SSBCI).

Our fiscal year 2013 budget request is \$28.59 million, a decrease of \$1 million from our fiscal year 2012 appropriation. Our request recognizes the government-wide need to rein in spending but maintains what I believe is an adequate oversight presence consistent with our legislative mandates. It should be noted that our Office of SBLF Program Oversight is funded through the SBLF.

As I discuss our priorities and work, I would like to make two observations about Treasury that are important when contemplating ways in which improved efficiencies and/or cuts can save government funds. As the first observation, several bureaus within Treasury do not receive one penny of appropriated funds for their operations. Those bureaus include the Office of the Comptroller of the Currency (OCC), the Bureau of Engraving and Printing (BEP), and the U.S. Mint. Instead, OCC collects fees from the banks it regulates and these fees are used to fund OCC operations. BEP and the Mint are principally reimbursed by the Board of Governors of the Federal Reserve System (FRB) for the currency and coins they produce. It should also be noted that, beginning on July 21<sup>st</sup> of this year, the Office of Financial Research (OFR), created by Dodd-Frank to support FSOC, and FSOC itself, are to be funded by assessments of bank holding companies with total consolidated assets of \$50 billion or greater and nonbank financial companies supervised by FRB.

As the second observation, Treasury's fiscal year 2013 budget request, absent the IRS and those funds allocated for the three Inspectors General, is about \$35 million less than last year, but continues to support an expansive and critical level of responsibilities that are to be carried out by 4,800 full-time equivalent employees (at the Treasury appropriated level). Treasury's responsibilities include, among other things, waging the Nation's fight against terrorist financing and money laundering; administering foreign sanction programs; managing the trillions of dollars in federal collections and payments; maintaining government-wide financial accounting records; managing and accounting for the public debt; collecting annual tax revenues of \$24 billion on alcohol, tobacco, and other products; providing domestic assistance through the Community Development Financial Institutions Fund; as well as promoting national security and other U.S. interests through multilateral financial institutions.

## Treasury's Management and Performance Challenges

In accordance with the Reports Consolidation Act of 2000, I annually provide the Treasury Secretary with my office's perspective on the most serious management and performance challenges facing the Department. My October 2011 memorandum to Secretary Geithner identified four management and performance challenges, which I will briefly describe and provide some updated information.

### Transforming Financial Regulation

Dodd-Frank established a number of new responsibilities for Treasury and the Secretary. As mentioned earlier, it created the FSOC, chaired by the Secretary, whose mission is to identify risks to financial stability that could arise from the activities of large, interconnected financial companies; respond to any emerging threats to the financial system; and promote market discipline. As required, FSOC issued its first annual report in July 2011. The report contained recommendations to (1) heighten risk management and supervisory attention in specific areas, (2) make further reforms to address structural vulnerabilities in key markets, (3) take steps to address reform of the housing finance market, and (4) ensure interagency coordination on financial regulatory reform. FSOC still has work ahead to meet all of its responsibilities, including designating nonbank financial companies for consolidated supervision and recommending heightened standards for large interconnected nonbank financial companies.

Dodd-Frank also established two new offices within Treasury: OFR, mentioned earlier, and the Federal Insurance Office (FIO). OFR is to be the data collection, research, and analysis arm of FSOC. As an illustration of the significance of OFR to Treasury, the fiscal year 2013 budget request shows OFR's estimated expenses at \$138.22 million which, in just its third year of operation, is already greater than that of several Treasury bureaus, including the Financial Crimes Enforcement Network (FinCEN) whose 2013 budget request is \$102.41 million.

Other regulatory challenges still remain within the Department. Specifically, since September 2007, 118 Treasury-regulated financial institutions failed, with estimated losses to the Deposit Insurance Fund of about \$35 billion. We have completed 52 material loss reviews and 52 other reviews of these failures. Our work found that OCC and the former Office of Thrift Supervision (OTS) often identified unsafe and unsound practices at the failed institutions; however, the regulators were slow to force corrective action. Furthermore, the irresponsible lending practices of many institutions are now well-recognized. At the same time, many of the failed banks also engaged in other high-risk activities, including high asset concentrations in commercial real estate and overreliance on unpredictable wholesale funding to fuel growth. In certain cases, investment holdings in Fannie

Mae and Freddie Mac securities and complex collateral debt obligations were also contributing factors.

### Managing Treasury's Authorities to Support and Improve the Economy

Congress provided Treasury with broad authorities to address the financial crisis under the Housing and Economic Recovery Act (HERA) and the Emergency Economic Stabilization Act (EESA) enacted in 2008, the American Recovery and Reinvestment Act of 2009 (Recovery Act), and the Small Business Jobs Act of 2010. Certain authorities in HERA and EESA have now expired but challenges remain in managing Treasury's outstanding investments. To a large extent, Treasury's program administration under these acts has matured.

SBLF and SSBCI The Small Business Jobs Act of 2010 created a \$30 billion SBLF within Treasury and provided \$1.5 billion to be allocated by Treasury to eligible state programs through the SSBCI program. Both programs were slow to disburse funds to intended recipients, with Treasury approving the majority of SBLF and SSBCI applications during the last quarter of fiscal year 2011. In this regard, just over \$4 billion of SBLF investments were approved of the \$30 billion authorized. Now that Treasury has completed the approval process for these two programs, the challenge will be to exercise sufficient oversight to ensure that funds are used appropriately by participants, SBLF dividends owed Treasury are paid, and the programs achieve intended results. To date, our Office of SBLF Oversight has issued four reports finding weaknesses in early SBLF investment decisions, the process used to evaluate applicants, the cost estimate for the SBLF program, and Treasury's oversight and compliance framework for the SSBCI program. We are currently evaluating the accuracy of small business lending activity supporting initial SBLF dividend rates and the soundness of investment decisions that were made in the months preceding the SBLF disbursement deadline. We are also conducting audits of the use of SSBCI funds by several participating states.

Recovery Act Programs Treasury is responsible for overseeing an estimated \$150 billion of Recovery Act funding and tax relief. Treasury's oversight responsibilities include programs that provide payments for specified energy property in lieu of tax credits, payments to states for low-income housing projects in lieu of tax credits, grants and tax credits through the Community Development Financial Institutions Fund, economic recovery payments to social security beneficiaries and others, and payments to U.S. territories for distribution to their citizens.

It is estimated that Treasury's Recovery Act payments in lieu of tax credit programs, for specified energy property and to states for low-income housing projects, will cost more than \$20 billion over their lives. As of January 2012,

Treasury had awarded approximately \$16 billion under these programs. We conducted a number of audits to determine whether specified energy property payments were properly awarded. We have found some questionable claims totaling several million dollars. As such, our Office of Investigations has reviewed hundreds of suspected fraudulent applications related to the disbursement of Recovery Act funds under the Specified Energy Property 1603 Program. These reviews have resulted in the initiation of numerous federal criminal investigations which are ongoing and have ensured that millions of dollars have not been disbursed and/or lost to suspected fraud against the program. We are continuing our work in this area and will report on instances of program abuse as necessary.

Fannie Mae and Freddie Mac Under HERA, Treasury continues to address the distressed financial condition of Fannie Mae and Freddie Mac which are under the conservatorship of the Federal Housing Finance Agency. Among other things, in order to cover the continuing losses of the two entities and their ability to maintain a positive net worth, Treasury agreed to purchase senior preferred stock as necessary, and as of September 30, 2011, invested \$183 billion in the two entities. We are currently auditing the process for determining the investment amounts and ensuring compliance by the entities for terms governing Treasury's investments. Even with Treasury's assistance, the future of both entities remains in question and prolonged assistance may be required. Just last month, Fannie Mae posted a \$2.4 billion loss for the fourth quarter of fiscal year 2011. Additionally, the legislative process for housing finance reform is in an early stage and it is difficult to predict what lies ahead for winding down the Fannie Mae and Freddie Mac conservatorships and reforming housing finance in the long run.

TARP Treasury's challenge in this area has changed from standing-up and running TARP programs to winding them down and recovering its investments. To date, Treasury has reported positive returns from the sale of its investments in the banking industry and has begun reducing its investment in American International Group. In this regard, I want to note that TARP is under the jurisdictional oversight of a Special Inspector General, who has issued a number of reports on TARP.

#### Combating Money Laundering and Terrorist Financing and Enforcing the Bank Secrecy Act

Ensuring that criminals and terrorists cannot use our financial networks to sustain their operations and/or launch attacks against the U.S. continues to be a challenge. Treasury's Office of Terrorism and Financial Intelligence (TFI) is dedicated to disrupting the ability of terrorist organizations to fund their operations. Treasury carries out its responsibilities to enhance financial transparency through the Bank

Secrecy Act (BSA) and USA Patriot Act. FinCEN is the Treasury bureau responsible for administering BSA.

Over the past decade, TFI has made progress in closing the vulnerabilities that allowed money launderers and terrorists to use the financial system to support their activities. Nonetheless, significant challenges remain. One challenge is ensuring the continued cooperation and coordination of all the organizations involved in its anti-money laundering and combating terrorist financing efforts. Many of these entities also participate in efforts to ensure compliance with U.S. foreign sanction programs administered by Treasury's Office of Foreign Assets Control (OFAC). Neither FinCEN nor OFAC has the resources or capability to maintain compliance with their programs without significant help from other organizations. To this end, Treasury has entered into memoranda of understanding with many federal and state regulators in an attempt to build a consistent and effective process. While important to promote the cooperation and coordination needed, it should be noted that these instruments are nonbinding and carry no penalties for violations.

Last year, financial institutions filed approximately 15 million BSA reports, including over 1.3 million Suspicious Activity Reports. While the number of Suspicious Activity Reports has been increasing since 2001, FinCEN needs to continue its efforts to work with regulators and examining agencies to ensure that financial institutions establish effective BSA compliance programs and file accurate and complete BSA reports, as required. Furthermore, FinCEN still needs to complete work to issue anti-money laundering regulations as it determines appropriate for some non-bank financial institutions, such as vehicle dealers; pawnbrokers; travel agents; finance companies; real estate closing and settlement services; and financial services intermediaries, such as investment advisors.

BSA data was maintained by IRS with access to the database handled through an IRS system. FinCEN's \$120 million BSA Information Technology (IT) Modernization program, begun in 2008, is being built to ensure efficient management, safeguarding, and use of BSA information. We believe the program is needed. While a prior attempt by FinCEN, from 2004 to 2006, to develop a new BSA system ended in failure with over \$17 million wasted, indications from our audit work are that project management for BSA IT Modernization is much improved and FinCEN advised that historical BSA data was successfully migrated to FinCEN from IRS in December 2011 and January 2012. The program is now at the critical point of broad-based integration testing. It is also highly dependent on continued funding, a challenge for many programs today. We noted that the Conference Report to our fiscal year 2012 appropriations requires us to monitor the BSA IT Modernization program and we expect to issue our first report at the end of March 2012.

## Managing Capital Investments

Managing large capital investments, particularly IT investments, is a difficult challenge for any organization, public or private. After several years of attempting to centrally manage large infrastructure investments at the Department level, Treasury announced that it will de-consolidate all infrastructure investments to the bureaus. This move is intended to improve efficiency and transparency, cost savings and avoidance, and overall governance. In prior years, we reported on a number of capital investment projects that either failed or had serious problems. This year, we continue to identify challenges with ongoing IT investments. For example, Treasury has reported that the \$147 million Treasury Enterprise Identity, Credential and Access Management system, which will implement requirements for a common identity standard, is \$40 million over planned costs. As part of OMB's Federal Data Center Consolidation Initiative, Treasury has been closing some of its data centers. During fiscal year 2011, Treasury closed 3 of its over 60 data centers and plans to close 12 more by 2015. Treasury's ability to successfully accomplish this is contingent on adapting shared infrastructure services. Furthermore, it remains to be seen whether Treasury's decision to de-consolidate all infrastructure investments will improve efficiency and transparency, cost savings and avoidance, and overall governance as intended.

As a final point, I would like to highlight that information security at Treasury is an area of increasing concern. We reported information security as a serious management and performance challenge for a number of years but removed the challenge in 2009 based on the significant strides Treasury made in improving and institutionalizing its information security controls. We believe that remains the case today. However, notwithstanding Treasury's strong security stance, cyber attacks against federal government systems by foreign governments and the hacker community are unrelenting and increasing. Treasury's information systems are critical to the Nation, and thus potential targets of those wishing to do grave harm. Accordingly, this is a very troubling situation that requires the highest level of continual attention to ensure that information security policies remain current and practices do not deteriorate.

### **Completed and Ongoing Oversight Work**

With respect to our Office of Audit, I have already mentioned work related to failed banks, Treasury's non-IRS Recovery Act programs, Treasury's assistance to Fannie Mae and Freddie Mac, and FinCEN's BSA Modernization Program. I also discussed the work by our Office of SBLF Program Oversight. Some other examples of recently completed and in progress audit oversight are discussed below.

BEP We reported on the production failure at BEP that resulted in the production of 1.4 billion new NexGen \$100 Notes that were not accepted by FRB. Putting

these new notes into circulation has now been delayed for over a year and no new date has been established. Additionally, when we first started looking at this, we found that many of the printed and partially printed notes were not being stored in secured vaults; BEP did promptly take corrective action when we brought this deficiency to their attention. In another audit at BEP, our IT auditors, through social engineering, gained access to all 23 employee user accounts attempted and were able to enter a secured area without the proper badging. We also noted other security vulnerabilities with BEP systems.

OFR and FIO As important new offices within the Department, OFR and FIO have been identified for review by my office. In fact, we are currently reviewing the Department's progress in standing up OFR, and plan to review FIO going forward.

Solyndra Because Treasury funded the \$535 million loan to Solyndra guaranteed by the Department of Energy and was to be consulted before the loan guarantee was announced, we are reviewing the consultative activities that occurred.

Mortgage Foreclosures In response to the robo-signing and other problems with home mortgage foreclosures, we undertook two reviews at OCC. One review is looking at OCC's examination coverage of national bank foreclosure activities. The other review is looking at how OCC is monitoring compliance with the April 2011 formal enforcement actions against eight national bank mortgage servicers and two third-party servicer providers for unsafe and unsound practices related to residential mortgage loan servicing and foreclosure processing.

FSOC As a CIGFO working group project led by the Federal Deposit Insurance Corporation's Inspector General, Jon Rymer, we, in conjunction with the other financial IGs, are assessing controls over sensitive and proprietary information at FSOC and member federal agencies.

OTS Transfer of Functions As a Dodd-Frank requirement, we and the Inspectors General of the Federal Deposit Insurance Corporation and FRB are reporting every 6 months on the transfer of OTS functions, employees, funds, and property to OCC, Federal Deposit Insurance Corporation, and FRB. To date, we have issued two reports on this on-going work.

U.S. Gold Reserves We are observing the Mint's inventory of the U.S. custodial gold reserves held by the Federal Reserve Bank of New York.

Other Congressional Requests We have undertaken work in response to congressional requests related to last summer's debt limit crisis and OCC's supervision of community banks.



Over the last 18 months, our Office of Investigations has embarked on several important investigative initiatives to combat fraud against the Department. Our Bank Failure, Money Service Business, and Check Forgery Insurance Fund initiatives all target vulnerabilities that lie within our nation's financial infrastructures or allow for the improper payment of government funds. These initiatives have resulted in numerous arrests, indictments, and recoveries. They also serve as a deterrent to fraudulent activities aimed at Treasury.

In closing, I'd like to express my appreciation to the Subcommittee for its strong support of our office over the years. I would be pleased to answer any questions that you may have. Thank you.