

**FINANCIAL SERVICES AND GENERAL GOVERNMENT
APPROPRIATIONS FOR FISCAL YEAR 2011**

HEARINGS

BEFORE A

SUBCOMMITTEE OF THE
COMMITTEE ON APPROPRIATIONS
UNITED STATES SENATE

ONE HUNDRED ELEVENTH CONGRESS

SECOND SESSION

ON

S. 3677

AN ACT MAKING APPROPRIATIONS FOR FINANCIAL SERVICES AND
GENERAL GOVERNMENT FOR THE FISCAL YEAR ENDING SEPTEMBER
30, 2011, AND FOR OTHER PURPOSES

**Commodity Futures Trading Commission
Consumer Product Safety Commission
Federal Trade Commission
Office of Personnel Management
Securities and Exchange Commission
United States Postal Service**

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FINANCIAL SERVICES AND GENERAL GOVERNMENT APPROPRIATIONS FOR FISCAL YEAR 2011

THURSDAY, MARCH 18, 2010

U.S. SENATE,
SUBCOMMITTEE OF THE COMMITTEE ON APPROPRIATIONS,
Washington, DC.

The subcommittee met at 2:40 p.m., in room SD-192, Dirksen Senate Office Building, Hon. Richard J. Durbin (chairman) presiding.

Present: Senators Durbin and Collins.

UNITED STATES POSTAL SERVICE

**STATEMENT OF HON. JOHN E. POTTER, POSTMASTER GENERAL,
CHIEF EXECUTIVE OFFICER**

OPENING STATEMENT OF SENATOR RICHARD J. DURBIN

Senator DURBIN. My apologies to those of you who were here on time when we weren't. I would like to blame the Senate leadership, except I'm part of it.

And we had a rollcall that went a little bit longer than we expected.

Good afternoon. And I'm pleased to convene this hearing before the Senate Appropriations Subcommittee on Financial Services and General Government. Our focus today is on the financial circumstances facing the United States Postal Service (USPS). This is the first in a series of hearings which we're planning this spring as we start to develop our fiscal year 2011 spending bill.

I'm glad that my friend and fellow member of the subcommittee Senator Susan Collins of Maine is here today. And other colleagues may join us, as their schedules allow.

We are all familiar with that famous maxim, "Neither snow nor rain nor heat nor gloom of night stays these couriers from the swift completion of their appointed rounds." Its origin is a reference to the ancient courier service of the Persian Empire in Herodotus' "Histories," dating to 450 B.C. It's also inscribed over the James Farley Post Office in New York City. And it has, over time, been an often-spoken but unofficial motto ascribed to the dedicated work of the men and women of the United States Postal Service.

America's Postal Service has enjoyed a vibrant history, dating back to the system instituted by Benjamin Franklin, as chairman of the committee of the Second Continental Congress in 1776. This history is rooted in a single, stalwart principle, that every person

in the United States, no matter who, no matter where, has the right to equal access to secure, efficient, and affordable mail service.

Today alone, letter carriers and truckers will drive 4.1 million miles to deliver 584 million pieces of mail to more than 150 million residences, businesses, and post office boxes across our Nation. Today alone, 1.1 million customers will go online to the Postal Service Web site to conduct \$608,000 worth of postal business, and another 7 million customers will go into a physical post office building. Today alone, \$224.4 million in revenue will be received, 584 million mail pieces will be processed and delivered, 115,000 plus address changes will be processed, 3,000 plus new addresses will be added to the postal network, and 402,000 plus gallons of fuel will be consumed. And today alone, like each day of the year, no tax dollars will be used to operate the United States Postal Service.

Even amid these captivating day-in-the-life statistics, we continue to witness a remarkable, even revolutionary, transformation of the modes of personal communication and business interchange, from electronic mail and online bill paying, to instant messaging and social networking, via the Internet. As a result, mail volume has continued to spiral in decline, dropping from 213 billion pieces in 2006 to 177 billion pieces last year. Couple this with an economic recession, and you see circumstances that have dramatically impacted the ability of the U.S. Postal Service to thrive and to meet its goals.

The Postal Service recently unveiled an action plan of proposals to address grim realities that its expenses will likely continue to outpace revenues. It is prudent that we engage in a thoughtful and open national dialogue on the wisdom of the solutions proposed by the Postal Service.

Monday through Saturday mail delivery dates back to 1863. It's been mandated in our annual appropriations bill for over a quarter of a century. I didn't know that. I knew it was in there, but nobody ever talked about it until there was a proposal to go to 5-day service, and then they said, "Senator Durbin, Senator Collins, this is your issue." And that's why we're here today.

Serious questions need to be asked and answered before Congress simply changes the course and embraces major changes in mail delivery. Who will benefit? Who is going to be harmed? Can we mitigate the impact? What savings will actually be gained? How reliable are the estimates that we're working with? What will we sacrifice? Will it drive mailers away or divert more commerce to the Internet or postal competitors? Have all the options been identified and explored? Will a reduction in delivery service enhance, or will it hinder, the long-term position of the Postal Service as a vital component of America's economy, a \$900 billion industry? Even if the delivery frequency is changed, is the Postal Service still contemplating a rate hike and closing or consolidating facilities? What will be the impact on the postal workforce? I think these issues are just the tip of the iceberg. We'll start talking about them today.

As the chairman of this subcommittee of jurisdiction, which provides a small stream of annual reimbursement payments, known as "revenue foregone," and the current author of the bill that carries

the nearly 30-year-old mandate that 6-day delivery and rural delivery of mail shall continue at no less than the 1983 level, I welcome the opportunity to provide this forum. I'm also interested in learning more details about the array of proposed reforms. I am going to welcome the Postmaster General, after I yield to my colleague, the ranking member of this subcommittee, Senator Susan Collins of Maine.

STATEMENT OF SENATOR SUSAN COLLINS

Senator COLLINS. Thank you, Mr. Chairman.

Let me begin by expressing my appreciation to you for holding this important hearing to discuss the dire and declining financial condition of the Postal Service, an institution that is critical to our economy and our way of life.

The Postal Service, as the chairman has pointed out, is one of our oldest institutions. It is the lynchpin of a \$900 billion mailing industry that employs close to 9 million people in businesses as diverse as paper manufacturing, printing, catalog companies, publishing, newspapers, and financial services.

I must say, Mr. Chairman, that I'm experiencing a sense of déjà vu in attending today's hearing on this topic. The Homeland Security and Governmental Affairs Committee has held 14 hearings related to the Postal Service and its financial crisis since 2003, and I chaired the vast majority of those hearings. I want to commend you, Mr. Chairman, for holding another hearing to address this complex and seemingly eternal issue.

Nine years ago, in 2001, the Government Accountability Office (GAO) first placed the Postal Service on its high-risk list, because it faced formidable financial, operational, and human capital challenges that threatened its long-term viability. Five years later, as the result of the passage of postal reform legislation in 2006, which I authored with Senator Carper, the GAO removed the Postal Service from the high-risk list. But, last year the Postal Service, losing billions, and facing a crisis, once again was added to the high-risk list.

Approximately every 3 years—in 2003, in 2006, and again last year, in 2009—the Postal Service has come to Congress seeking relief from its financial obligations in exchange for promises of future profitability. The Postmaster General's request to Congress for relief from its retiree health benefit payments and from its obligation to deliver mail 6 days a week is just the most recent in a long history of Postal Service requests for financial assistance in exchange for the promise of becoming financially solvent—someday.

In 2003, Congress passed postal reform legislation—I coauthored—that reduced the Postal Service's pension costs by approximately \$9 billion. In 2006, the Postal Accountability and Enhancement Act that Senator Carper and I authored relieved the Postal Service of a \$27 billion obligation, primarily by transferring the Postal Service's obligation for retirement benefits for its employees with prior military service to the Treasury Department. In 2009, Congress voted, at the Postal Service's request, to reduce by \$4 billion a retiree health benefits payment that was due on September 30. I reluctantly supported this reduction, too—in fact, I cast the

deciding vote—because the fact is that the Postal Service simply could not make the full payment.

My point is, and my frustration is, that, over and over again, the Postmaster General has promised that if only Congress would allow the USPS relief from its financial obligations and take other actions, it would be on a solid financial footing. But, time and time again, I've been disappointed in the results after I've agreed to these requests; indeed, led the fight on these requests.

During the past year, the Postmaster General has been particularly critical of the payment stream set up in the 2006 law in exchange for the elimination of the expense of the escrow requirement and the transfer of the retirement obligations for employees with previous military service to the General Treasury. Yet, this very payment obligation from which the Postal Service now seeks relief was part of a recommendation from the Postal Service to prefund its future retiree health benefits. When the law passed in 2006, here's what the Postal Service said, and I quote: "The new law directs the Department of the Treasury to resume the funding of military pensions for postal employees and abolishes a federally mandated escrow requirement, directing those monies to prefund retiree health benefits. Over the next decade, these changes will free the Postal Service of future legacy costs. We are now on firm financial footing for the future."

Now, after the Postal Service, in my judgment, has been slow to take advantage of the increased flexibilities also provided by the 2006 law, the Postmaster General has once again returned to Congress seeking billions in relief from its liabilities and once again making promises of improvements.

I will, of course, carefully consider the Postmaster General's latest request. I've already proposed stretching out the payment schedule to ease the burden. But, we simply cannot just wish away these liabilities, or pretend that they do not exist.

I also support allowing the Postal Service more flexibility in determining its infrastructure needs. It may well be more convenient for customers, as well as less expensive for the Postal Service, to locate postal services within a grocery store or a pharmacy within some communities.

With respect to 5-day delivery, the Postal Service will have to present a compelling case that reduced delivery will not further depress volume, setting off a death spiral. It's going to take all the members of the postal community, including the postal management, its dedicated employees, members of the mailing community, Congress, and the administration, to contribute to the solution to this financial crisis.

I look forward to today's dialogue and hope it will not be a prelude for a similar discussion 3 years from now.

And I thank the chairman for his indulgence.

Senator DURBIN. Thank you, Senator Collins.

Our first witness is Postmaster General John Potter, who's served since 2001. He is America's 72d Postmaster General, starting as a career postal employee in New York in 1978, and he leads the second-largest civilian workforce in the United States.

Postmaster General Potter.

SUMMARY STATEMENT OF JOHN E. POTTER

Mr. POTTER. Good afternoon, Chairman Durbin and Ranking Member Collins. I appreciate the opportunity to discuss the serious financial situation of the United States Postal Service.

Today, we stand at a critical juncture. I see both challenges and opportunities ahead for the Postal Service and all of our stakeholders.

In the short term, the Nation's economy has experienced the worst decline in decades, a decline that significantly affected most every sector of the U.S. economy, especially large mailers in the financial and housing sectors, and caused the largest reduction in mail volume history.

The Postal Service faces further reductions in volume due to a tremendous revolution in technology, a revolution that has fueled a global transformation from an Industrial Age to an Information Age, a transformation that was accelerated by the downturn in the economy. This situation has resulted in the diversion of traditional mail to electronic mail and in the rise of online bill paying and other practices. We also face severe challenges, some deriving from mandates imposed over time through regulation and legislation.

As a result, the Postal Service finds itself on a fiscal course that is unsustainable. This situation could not have been avoided, and no one is to blame. No one could have envisioned the economic crisis that has rocked this country and the mail. At just about halfway through fiscal year 2010, we project a loss of approximately \$7 billion. In 2006, we reached a record level of 213 billion pieces of mail. For fiscal year 2010, we expect volume to be about 166 billion pieces. That means one in five pieces of mail has disappeared. As a result, the cost of delivering a piece of mail has risen. Our revenues are simply not keeping up with the cost of supporting a system designed to serve a much larger volume of mail.

The declines in mail volume and revenue have caused us to rethink everything that we're doing. We've managed aggressively and took actions within our control. We took aggressive cost-cutting measures and reduced costs by \$2.8 billion in 2008, by more than \$6 billion in 2009, and this year we plan to take out another \$3.8 billion in costs. Postal employment, which was over 800,000 10 years ago, is now below 600,000, and with the help of our unions and management associations, we did this without layoffs. But, we are rapidly reaching the point of diminishing returns. Only so much can be cut before service suffers. Overcoming our financial challenges will be an enormous undertaking. If we are to succeed, rapid, aggressive, and fundamental changes are absolutely necessary.

Accordingly, we have developed a plan for action—a plan of action for the next decade that is bold, but is also balanced, in that it considers the interest of all stakeholders in the mail. To help develop our plan, we engaged three of the world's most experienced and respected management consulting firms: McKinsey & Co., The Boston Consulting Group, and Accenture, LLC. We asked each firm to independently conduct studies, talk with stakeholders, and produce ideas that would help close the growing gap between our revenues and expenses without undue impact on our customers.

The consultants projected that there will be 150 billion pieces of mail in 2020, and that without significant changes, cumulative losses could exceed \$238 billion by that time.

Drawing from the consultants' recommendations, we crafted a balanced and reasonable plan for a financially sound future. Our solutions are: to restructure the prefunding of retiree health benefit payments; adjust the number of mail delivery days; continue to enhance and expand all alternate access to our products and services; establish a more flexible workforce; apply the consumer price index cap to all market-dominant products, as opposed to just by class; introduce more new products and services, consistent with our mission; establish more clearly defined, appropriate, and agile oversight. Some of these solutions could be implemented quickly, while others require more time to achieve. And no one solution is the answer to reversing our financial condition.

The financial position—picture for the Postal Service is grim, and without changes, will surely worsen. We urgently need your help and legislative change. No matter which decisions are made, it's absolutely critical that they be made in a timely fashion.

The two most urgent changes which we'd like you to consider are a restructuring of the funding payments for retiree health benefits and a change in the frequency of mail delivery.

Regarding the retiree health benefits, the Postal Act of 2006 requires us to prefund 73 percent of all future retiree health benefits, a 75-year liability, in just a 10-year period of time. The aggressive annual prefunding payments average \$5.6 billion, along with separate insurance payments that average \$3.4 billion annually. Although we recognize our obligation to prefund retiree health benefits, in this economic environment, we no longer have the ability to pay at the accelerated pace. The trust fund holding our payments had a balance of more than \$35 billion at the end of 2009, which is sufficient to pay the premiums for all of our roughly 500,000 currently participating retirees, through their expected lifetimes.

Another large financial burden is a statutory requirement for 6-day mail delivery. There is no longer sufficient volume to sustain the cost of the 6-day delivery network. Reducing delivery frequency would substantially reduce our annual costs by approximately \$3 billion. Recent independent surveys show that consumers support this change.

In anticipation of a possible change, we've developed a comprehensive operations plan for 5-day delivery that will address all possible impacts. We will seek an advisory opinion from the Postal Regulatory Commission at the end of this month. Should Congress allow a change, we would provide 6 months' notice, prior to putting a change in place, ensuring a smooth transition for our customers and our employees.

Although changes in retiree health benefits and delivery frequency will go a long way to helping alleviate our financial pressures, they will not be enough to make the Postal Service profitable. We also need an improved model of oversight, and that provides us with the management flexibility to adjust our operations network to reflect the rapid decrease in mail volume, expand our products and services, that we may react more rapidly and aggres-

sively to market-driven environment, base prices for our market-dominant products on demand and cost of each individual offering.

We require and need the help of Congress, because many of the solutions that we just described, those with significant changes, are not within our control. We do not have the unilateral power to change employee wages or benefits, change the legacy costs of retiree health benefits, change delivery frequency, diversify our products and services, change prices, or address Civil Service Retirement System (CSRS) overfunding.

Our plan is a path to a future in which the Postal Service will remain a vital driver of the American economy and an integral part of every American community. Even in an increasingly digital future, the mail, which is projected to total about 150 billion pieces in 2020, will remain a powerful delivery and marketing channel, a preferred means of commercial and personal communication for many purposes, and a complement to e-commerce.

PREPARED STATEMENT

Thank you for your support of our ongoing efforts to ensure a solvent and sound Postal Service. I look forward to working with you and other Members of Congress to achieve the passage of legislation that will address our near-term and future challenges, and I would be pleased to respond to any questions that you may have. [The statement follows:]

PREPARED STATEMENT OF JOHN E. POTTER

Good afternoon, Chairman Durbin, Ranking Member Collins, and members of the Subcommittee. I appreciate the opportunity to discuss the serious financial situation facing the United States Postal Service and to provide details of our plan for reducing the number of mail delivery days, should a frequency change be approved by Congress. I also would like to share aspects of our new action plan for the next decade titled, "Ensuring a Viable Postal Service for America."

For over 235 years, the Postal Service has provided trusted, affordable universal service to the nation. Our goal is to continue to do so. As the members of this Subcommittee are well aware, the Postal Service is in a dire financial situation. The situation has occurred despite the efforts of Congress through passage of the Postal Accountability and Enhancement Act of 2006 (Postal Act of 2006). Our current financial circumstances have come about in spite of the massive efforts of Postal Service management and employees who have adopted aggressive cost-cutting measures to save over \$1 billion each year since 2001. For 2009 alone, the savings exceeded \$6 billion.

Our financial situation has many causes: a severe national recession that significantly affected the financial and housing sectors, which were important users of the mail; the powerful and rapid evolution of new technologies that have diverted mail to other channels; and the changing use of the mail to communicate and conduct business. This situation could not have been avoided and no one is to blame. No one could have envisioned the economic crisis that has rocked this country.

Further complicating the fiscal health of the Postal Service are limitations under which we operate, including:

- A statutorily mandated requirement to provide 6-day a week delivery.
- Accelerated annual payments to pre-fund a significant portion of our retiree health benefit obligation.
- A restriction to not close Post Offices solely on an economic basis.
- The requirement to submit to binding arbitration to finalize labor contracts.
- Constraints on our ability to restructure and streamline our processing and distribution networks.
- Restrictions on the types of products and services the Postal Service can offer.
- A lack of clarity between the role of the Governors of the Postal Service and the Postal Regulatory Commission (PRC), and an oversight model that adds unnecessary burden and time to decision-making.

Without critically needed fundamental changes, the Postal Service expects significant losses in fiscal year 2010 and in each year into the near future. Our fiscal year 2010 financial plan estimates a revenue decline of roughly \$2 billion and a net loss of approximately \$7 billion. These projections assume there will be no changes this year in the number of mail delivery days per week or in the current retiree health benefits prefunding schedule. If we were not to react and simply move forward with business as usual, the Postal Service is likely to have a cumulative loss of \$238 billion by 2020.

The Postal Service ended fiscal year 2009 with a net loss of \$3.8 billion, despite cost-cutting efforts that yielded more than \$6 billion in cost savings and a \$4 billion reduction in the required 2009 payment to the Postal Service Retiree Health Benefits Fund (PSRHBF) provided by the enactment of Public Law 111–68. We are very grateful to Congress and the Administration for that legislation. However, Public Law 111–68 did not restructure the PSRHBF payments beyond 2009, and the Postal Service continues to be in financial crisis. We urgently need retiree health benefits legislative restructuring from Congress.

In fiscal year 2009, mail volume continued to drop. At 177 billion pieces, volume was down 26 billion pieces or 12.7 percent from the previous year—representing the largest volume decline in Postal Service history. Our volume losses continue against a backdrop of an ever growing mail delivery network that presently has more than 150 million delivery points.

The \$6 billion in savings we successfully achieved during fiscal year 2009 included a reduction of 115 million workhours—the equivalent of 65,000 full-time employees. For fiscal year 2010, our plan is to cut an additional \$3.8 billion of costs, including the elimination of approximately 90 million more workhours. In addition to workhour reductions, our targeted activities will include maximizing operational efficiencies, re-negotiating contracts with major suppliers, continuing the freeze on construction of most new facilities, and using our pricing flexibility to grow new revenue. We have also worked closely with our union representatives to agree on adjustments that reduced costs and increased delivery efficiency. We also will continue to aggressively pursue initiatives to generate new revenue.

Given that the mail volume declines and financial pressures will continue throughout the next decade, the choices for overcoming this serious situation are not easy and there is no single remedy that can return the Postal Service to good financial health. But we do have an action plan for the next decade—one that is both ambitious and aggressive. Through a careful and comprehensive effort, we have identified a set of the most reasonable business choices for the Postal Service and the customers we serve.

To help develop our plan we engaged three of the world’s most experienced and respected management consulting firms: McKinsey & Company, The Boston Consulting Group, and Accenture, LLC. We asked each of these firms to act independently and to conduct studies and have conversations with postal customers, mailers, labor associations, regulators, and mailing industry stakeholders. We wanted them to gather information to help us determine the likely state of the mailing industry and the Postal Service over the next decade. Our expectation was for the consultants to produce ideas that would allow the Postal Service to close the growing gap between our revenues and expenses without undue impact on our stakeholders.

The consultant’s key findings included the following:

- Without fundamental changes, the Postal Service’s losses will continue. By 2020, cumulative losses will exceed \$238 billion.
- Mail volume will decline by roughly 15 percent to about 150 billion pieces in 2020, from a 177 billion pieces in fiscal year 2009.
- The mix of mail received by the Postal Service will change; First-Class Mail will fall sharply and Standard Mail will stay fairly flat. First-Class Mail contributes more toward covering institutional costs, which supports the processing and delivery network.
- The Postal Service could close the gap by as much as \$123 billion, without statutory or regulatory changes, by taking product and service actions, by continuing to improve processes and productivity, by adopting workforce flexibility improvements, and by pursuing purchasing savings. Achieving this level of savings will be extremely challenging.
- Key areas were identified and options provided to close the remaining \$115 billion gap. However, legislative and regulatory changes are needed to achieve them.
- The best way to address the financial challenges and preserve the strength of the Postal Service and the entire mailing industry is through a comprehensive approach that balances the needs of all key stakeholders.

The Postal Service created its plan—Ensuring a Viable Postal Service for America—upon thorough review and consideration of the consultant’s recommendations. The plan provides options to address the challenges we face and is a balanced and reasonable approach to creating a financially sound future. No single option will be able to close the whole \$115 gap; if it came to pass that only one option were used to close the gap, it would likely cause severe disruptions that would have significant adverse impacts. To implement the plan, a number of fundamental changes are necessary, some of which would require legislative changes from Congress. Our solutions are as follows:

- Restructure the Prefunding of Retiree Health Benefits.*—We request that Congress permit these payments to be deferred and shifted to a “pay-as-you-go” system comparable to what is used by the rest of the Federal government and the private sector. This would provide the Postal Service with an average of \$5.6 billion in cash flow per year through 2016. In addition, overpayments to the CSRS pension fund by the Postal Service also need to be resolved.
- Delivery Frequency.*—We request that we be permitted to adjust the number of mail delivery days to better reflect current mail volumes and customer usage.
- Expand Access.*—We will continue to modernize our channels for alternate access by providing services where our customers are. We also will continue to increase and enhance customer access through private sector retail partnerships, kiosks, and improved online offerings. However, the Postal Service needs to be relieved of the statutory prohibition against closing a Post Office for solely economic reasons.
- Workforce.*—We will work during our upcoming collective bargaining negotiations to establish a more flexible workforce that is better positioned to respond to changing needs of our customers and take advantage of the over 300,000 voluntary separations projected to occur over the next decade. We would also ask that Congress pass legislation that requires an arbitrator to take the financial health of the Postal Service into consideration in making an arbitration determination.
- Pricing.*—We request that Congress apply the Consumer Price Index price cap to the entire basket of Market-Dominant products, rather than the current restriction which caps prices for every class at the rate of inflation. This will allow pricing to respond to the demand for each individual product and its costs. In addition, we will use our existing flexibility to pursue an exigent price increase. Assuming other parts of our plan can be implemented, the exigent price increase will be moderate and not occur before 2011.
- Expand Products and Services.*—We ask that Congress permit us to evaluate and introduce more new products and services consistent with our mission. This will allow us to better respond to changing customer needs.
- Oversight.*—We ask that Congress provide us with more clearly defined, appropriate, and agile oversight and more streamlined processes. This will help to achieve the solutions in our action plan.

As you can see, some of these solutions could be implemented relatively quickly within the short-term, while others would require much more time to achieve. No one solution is the answer to reversing our financial condition. And doing nothing—the status quo—is not an option. We believe a balanced approach that provides the Postal Service with the flexibility to respond to market dynamics and the speed to bring products to the market quickly, and that incorporates initiatives focused on cost, service, price, new product, and changes in the law would be the best approach. It is also the one that is most likely to perpetuate a financially sound Postal Service, able to meet the needs of the American people.

We are ready to proceed with our plan. But we need Congress to provide the legislative reform necessary for us to begin our recovery and move forward.

Now, I would like to discuss in greater detail the financial burden the Postal Service faces with respect to retiree health benefits. A provision established in the Postal Act of 2006 requires the Postal Service to prefund 73 percent of all future retiree health benefits—a 75-year liability—in just a 10-year period ending in 2016. This prefunding mandate is not shared by other Federal agencies or private sector companies. The aggressive schedule, a product of budget scoring rules, requires the Postal Service to make annual prefunding payments averaging \$5.6 billion into the PSRHBF. In addition, the law requires the Postal Service to make separate insurance premium payments for retirees that average \$3.4 billion annually through 2016.

When the prefunding payment schedule was being considered in 2006, the Postal Service envisioned that it would be able to make the payments, while knowing it was a challenging goal. Since then, however, circumstances have changed dramatically. Between 2006 and 2009, mail volume fell by 17 percent and revenue fell by

6 percent. We no longer have the ability to meet this unique statutory requirement to prefund retiree health benefits at the accelerated pace. The enormous obligation costs the Postal Service and its customers—not taxpayers—\$55 billion in prefunding over the 10 year period. The Postal Service recognizes its obligations to fund its retiree health benefits; however, our financial circumstances must be recognized. I would note that the trust fund holding the Postal Service's payments had a balance of more than \$35 billion at the end of fiscal year 2009. Thirty-five billion dollars is sufficient to pay the premiums for all of our roughly 500,000 currently participating retirees through their expected life times.

The Postal Service greatly appreciates the action taken by Congress last year to enact legislation that restructured the payment for 2009. However, for 2010 and beyond, there is no assurance that similar adjustments will be granted. A restructuring of the payment obligation is urgently needed to allow the Postal Service to continue to fulfill its mission now and in the future. Legislative change would also reduce the need for the Postal Service to borrow funds from the U.S. Treasury for the sole purpose of depositing the money into the PSRHBF. We recognize there are a number of options, ranging from making no changes to the statutory payments schedule to adopting the Postal Service's Inspector General (IG) recommendation that Congress remedy a Postal Service over-funding of its Civil Service Retirement System obligation. The Postal Service supports the IG's recommendation. However, what the Postal Service needs is a relatively quick decision by Congress on how this issue will be addressed to provide the Postal Service clarity as we consider other options to close the gap.

Next, I would like to provide greater details on our request to change the frequency of the number of mail delivery days each week. The statutorily mandated requirement for 6-day mail delivery has been in existence since 1983 and it places a very large financial burden on the Postal Service. Due to the unprecedented decline in mail volume, there no longer is sufficient volume to sustain the cost of the current 6-day delivery network. The number of pieces of mail per delivery has declined from an average of 5 pieces in 2000 to 4 pieces in 2009, which represents a 20 percent reduction. Assuming a scenario of 5-day delivery and fiscal year 2009 mail volume, the amount of mail per delivery would increase to more than 5 pieces. Revenue per delivery point dropped by 24 percent between 2000 and 2009, because our largest volume declines occurred in profitable First-Class Mail.

Moving to 5-day delivery is absolutely necessary to ensure financial viability, both now and into the future. Reducing the frequency of delivery is the single most effective way for the Postal Service to substantially reduce operational costs—allowing us to reduce annual net costs by approximately \$3 billion. It would greatly assist us with regaining a portion of our financial footing and help to ensure that affordable universal service is maintained nationwide.

Market surveys conducted independently and on behalf of the Postal Service show that customers want to see the Postal Service survive and flourish. Most are willing to accept the elimination of Saturday delivery to reduce the Postal Service's losses. And, most would rather have Saturday delivery eliminated than have stamp prices increased significantly, as would be needed to ensure the Postal Service's financial stability. I would also like to cite the results of a Gallup survey conducted in June of 2009. The survey showed that 66 percent of those polled favored a change to 5-day delivery "as a way to help the Postal Service solve its financial problems" over other alternatives such as increasing postage prices or closing local Post Offices. This result was echoed by studies conducted by Rasmussen in 2009 and 2010.

In anticipation of a possible change, we have conducted extensive stakeholder outreach through dozens of meetings with customers. We identified mailer issues and ensured their consideration in our planning. These exchanges helped us to understand and address the needs of the mailing industry and the public concerning a potential change in the frequency of mail delivery. The Postal Service has developed a comprehensive operations plan for 5-day delivery that addresses all possible impacts from required software programming modifications to workforce adjustments and that addresses issues raised by our customers, to the extent possible. Two major assumptions guided the development of the concept: existing service standards would be maintained and any changes would comply with existing collective bargaining agreements.

Our plan for 5-day delivery, which we will file with the PRC later this month, will present an overview of our 5-day delivery concept and include cost and revenue impacts. As currently envisioned, our concept for 5-day mail delivery service would include the following:

- Residential and business delivery and collections would be discontinued on Saturday.
- Post Offices that are usually open on Saturdays would remain open.

- Post Office Boxes would receive mail delivery on Saturday.
- Express Mail would continue to be delivered 7 days a week, including Saturday and Sunday.
- Remittance mail (bill payments) addressed to Post Office Box and Caller Service customers would be made available to recipients 7 days per week.
- Firm hold outs (mail that a business picks up at the Post Office) would be available for Post Office Box addressed mail Monday through Saturday, nationwide.
- No mail pick-up from blue collection boxes on Saturdays except for dedicated Express Mail collection boxes.
- Acceptance and drop-shipping of destinating bulk mail would continue on Saturday and Sunday.
- Alternate contract locations would remain open 7 days a week on their normal schedules.
- Access to all of our online services via usps.com would continue to be available 24/7.

The Postal Service is fully aware that before a change in the number of delivery days could be adopted, legislative action would be required by Congress to amend the appropriations language that mandates 6-day a week delivery. Should Congress approve a change that grants us the latitude to change the frequency of mail delivery, know that we are committed to implementing an in-depth communications plan for our customers and our employees to make the transition as smooth as possible. Upon approval, we intend to provide our customers with 6 months notice prior to implementing a change which we estimate would be no earlier than mid-2011. The impact on our employees would be minimal and it would occur through attrition, not layoffs.

Another issue for the Postal Service involves limitations that delay or prevent adjustments to our network operations and workforce. Despite these constraints, we are continuing to identify, pursue, and implement various solutions and strategies to make operational activities more efficient and reduce costs to help mitigate the impact of our financial difficulties. Some of the efforts we have adopted to improve efficiency and produce cost savings include consolidating functions, adjusting delivery routes, and restructuring administrative and processing operations—all while continuing to maintain excellent service levels.

The Postal Service needs more flexibility to respond quickly to a changing business environment. We need legislative and regulatory changes to allow us to modernize our network of facilities to meet changes in customer needs and mail volume. We are completing a process of reviewing retail facilities located in larger urban and suburban areas to identify sites where we have a number of facilities in close proximity. This process will help us determine where consolidations are possible so that we may conserve our resources and adapt our customer access to current needs. Related to these efforts, on March 10, 2010, the PRC issued an Advisory Opinion to the Postal Service concerning our Station and Branch Optimization and Consolidation Initiative. In its opinion, the PRC agreed with our approach and made a number of recommendations which we are in the process of reviewing.

Business processes that involve evaluating and relocating or consolidating retail outlets are reasonable and warranted practices used by many companies to streamline their operations and reduce costs. Often when a business is losing money, they resort to selling a portion of their assets, closing locations, or other options such as laying off employees. Here are just a few examples of business actions taken by private companies to improve their financial condition:

- In 2009, Sears closed 62 underperforming stores and initiated an aggressive global digital strategy.
- In November 2009, L.L. Bean announced it would be closing an outlet store in Portland, ME.
- In September 2009, a news item reported that Citigroup was considering shutting or selling some of its 1,001 branches in North America following a \$45 billion Federal bailout. In 2008, Citigroup announced it was cutting its workforce, worldwide, by 14 percent, through the sale of some units or through layoffs.
- In 2008, Starbucks announced it was closing 5 percent—more than 600—of its stores. In 2009, it announced it would close an additional 300 stores.
- In 2009, GM told 1,100 dealerships that it would drop them from its retail network effective October 2010; GM also discontinued the Saturn, Pontiac and Hummer lines of cars.
- A January 2010 news item reported a 10 percent cutback in the number of available airline seats, caused by airlines using smaller planes or reducing the number of flights.

If the Postal Service were provided with the flexibilities used by businesses in the marketplace to streamline their operations and reduce costs, we would become a

more efficient and effective organization. Such a change would also allow us to more quickly adapt to meet the evolving needs, demands, and activities of our customers, now and in the future.

The Postal Service is committed to continuing to fulfill the needs of customers. To help alleviate the concerns of our customers and to better match their changing retail needs, we have been emphasizing the easy and convenient availability of our expanded alternate access points. Today, 30 percent of retail revenue is generated by means other than a Post Office counter. Increasingly, customers are paying for postage stamps and conducting business at thousands of supermarkets, drug stores, and other postal retail partners, and by using our automated kiosks, and our website, usps.com. Our world class web site is available 24/7 to everyone with online access. The Postal Service continues to be committed to fulfilling the needs of customers. Postal customers now can access the services they need using a variety of readily available options including free carrier pick up of outgoing mail at every address. For many customers, these alternatives are simply more convenient and more suited to their lifestyles. Largely as a result of changing customer preferences, Post Offices had 117 million fewer transactions in 2009 than in 2008.

Throughout this difficult period, our employees continue to deliver very high levels of service.

As just one example, during quarter one of fiscal year 2010—and for the fifth straight quarter—our employees attained a score of 96 percent for the on-time delivery of single-piece overnight First-Class Mail. Our dedicated and hard working employees deserve tremendous credit for their successful efforts to provide excellent service under very challenging conditions.

Even so, the financial picture for the Postal Service is grim and without changes the situation will surely worsen. Mail volume has sharply declined from a peak of 213 billion pieces in 2006 to 177 billion pieces in 2009. Despite extraordinary efforts to cut costs, the Postal Service incurred multibillion dollar net losses in the last 3 years. With many fixed operational costs that cannot be eliminated without diminishing service levels, we are running out of ways to cut more costs.

Nonetheless, the Postal Service is continuing to pursue available options to grow revenue during these challenging economic times. We understand that to best serve the American people in 2020 and beyond, we must be able to quickly offer products and services that meet the mailing and shipping needs of our customers. However, at present we must work within the framework provided in the Postal Act of 2006.

One excellent example of how we employed the full range of strategies available to us to successfully compete and generate revenue was our popular Priority Mail Flat Rate Box promotional campaign during 2009. The campaign offered customers a simple, economic way to ship their goods. We used a highly integrated media plan that incorporated TV, direct mail, print and digital advertising and we encouraged our retail clerks, letter carriers, and other employees to actively participate in and support the campaign. By being aggressive, we managed to avoid the double-digit revenue declines in the expedited market. We attribute this success to the pricing freedoms provided to us under the Postal Act of 2006, proven advertising, and outstanding customer service.

In 2009, we also introduced our first Summer Sale. Working with the PRC, we developed the Summer Sale concept that provided a 30 percent price discount on incremental volume of advertising mail available for 3 months during the summer. Over 400 of our largest customers participated in the sale and mailed a significant number of incremental pieces of Standard Mail.

The success of the Summer Sale led to the design and launch of a similar stimulus program for First-Class Mail. This program offered a 20 percent credit on the volume of presorted and automation First-Class Mail cards, letters and flats exceeding an established threshold. We know that mail is a powerful tool to help businesses grow. These sale programs help to ensure our customers know that they matter to us and we want to help them grow their business.

Another positive aspect of the Postal Act of 2006 has provided the Postal Service the ability to offer contract pricing to commercial customers. Prior to this time, everyone paid the same price no matter how much volume they shipped. With contract pricing, we can now compete somewhat more effectively with private carriers on price, which has allowed us to grow our profitable package business. Contract pricing has become a key strategy to grow our commercial business with large and medium sized customers. However, these pricing freedoms fall short of the freedoms our competitors enjoy, since each postal contract must be approved by both by our Board and our regulator, the PRC, in advance of implementation. Streamlining these requirements would enable us to capture more revenue opportunities with sufficient oversight to limit risk.

By 2020, the Postal Service plans to expand products and services across targeted mail and package segments to increase profits by \$2 billion. We will continue to work to increase direct mail use among small and medium-sized businesses, and to increase volumes in both First-Class Mail and advertising mail through targeted promotions. We also will continue to leverage our last-mile network to deliver packages to all households, forming partnerships with others serving the growing e-commerce industry. We also will continue to grow other retail services, such as passports and Post Office Box rentals to increase revenue. However, if we had the authority to offer a wider range of products and services consistent with our business, we could bring in more new revenue.

We urgently need legislative change from Congress. Without it, the Postal Service may have difficulty paying all of the obligations due this year. At present, our financial situation raises significant uncertainty about our ability to generate sufficient cash flows to fund the large cash obligations due in September. In addition, we believe the liquidity of the Postal Service will be seriously threatened beginning in early fiscal year 2011, to the point where it will impact our ability to meet payroll and other financial obligations, as we will come dangerously close to running out of cash.

At present, the two most immediate changes the Postal Service urgently needs from Congress involve legislation that provides a restructuring of the prefunding payments for retiree health benefits and allows the Postal Service to reduce the frequency of mail delivery. Although these two changes will go a long way in helping to alleviate the financial pressures facing the Postal Service, by themselves they will not be enough to make the Postal Service profitable. The Postal Service must address the fact that mail volume is declining, especially First-Class Mail volume which has historically made a substantial contribution to support the overall network. Therefore, we need the flexibility to adjust our operations network to reflect this rapid decrease in today's mail volume, which will continue to decline for sometime into the future. We also need the ability to expand our products and services, and ensure prices for our Market-Dominant products are based on the demand and cost of each individual product. And finally, all of these changes need to be reinforced with more clearly defined and appropriate oversight roles for our many regulators and with more streamlined processes.

We understand that to best serve the American people now and in 2020 and beyond, the Postal Service must be leaner and have the ability to quickly respond to customer mailing needs.

Our action plan is a path to a future in which the Postal Service will remain a vital driver of the American economy and an integral part of every American community, and will continue to deliver the greatest value of any comparable post in the world. If given the flexibility to respond to an evolving marketplace, the Postal Service will continue to be an integral part of the fabric of American life for a long time to come.

The mail and the Postal Service will continue to play a vital role in the personal and commercial lives of all Americans over the next 10 years and beyond. Even in an increasingly digital 2020, the mail will remain a powerful delivery and marketing channel; a preferred means of commercial and personal communication for many purposes; and a complement to e-commerce. In order for this to happen, today's constraints must be removed so that over the next decade the Postal Service can become as dynamic and adaptive as the marketplace and customers we serve.

Thank you for your support of our ongoing efforts to ensure a solvent and sound Postal Service.

I look forward to working with you and other members of Congress to achieve the passage of legislation that will address our near-term and future challenges.

I would be pleased to respond to any questions you may have.

POSTAL SERVICE BUSINESS MODEL

Senator DURBIN. Thank you, Mr. Postmaster.

Let me just ask a few questions. First, I'm trying to step back and look at your brand, what the American consumer sees when you say "The U.S. Postal Service." And I'm sure there are a lot of things they can point to. First, the fact that I can take that Mother's Day card, put it in an envelope, put an address on it, and, for 44 cents, expect it to be delivered in a timely fashion to virtually any place in the United States of America. Forty-four cents. That is still an amazing bargain, by any modern standards. Second, that

you do reach every corner of this country. Third, that there's reliable service. Now, occasionally there will be people who will complain, and I've complained about service in parts of my State, but, by and large, our Postal Service is as reliable, if not more reliable, than most any in the world. It is a system which people trust. They develop an ongoing working and social relationship with the men and women who work for the Postal Service.

I know David Lasley, my personal mailman in Springfield. I've known David since he was in college, and he's a friend of our family. He's done little favors for us that go way beyond his responsibilities in the Postal Service. That helps a lot, in terms of explaining who you are and what you mean to so many people.

Your competitors—the Internet—it's going to be up 24/7 no matter what you do. Those e-mails are going to be there Sunday at midnight, delivered back and forth. The people who deliver packages will deliver on Saturdays, and may charge a premium for it, which I think you're suggesting, too, as part of 5-day service.

But, I guess what I'm getting to is, tell me what your business model looks like. When you start reducing your contact with postal customers and consumers, when you decide that you'll only be there 5 days instead of 6, tell me what it looks like to them, in terms of your long-term goal and your economic model, what your brand's going to be as you cut back on the service that's available to the people of this country.

Mr. POTTER. Well, we are very concerned about that, and that's why there were a number of surveys done of the American public to talk about the Postal Service and options that were facing the Postal Service. And, there was, for example, one of the things we surveyed was, we could save money by changing the location of your mailbox from your door or your curb to a street corner. That could save us almost \$3 billion. But, over 90 percent of Americans said, "Absolutely not." That would be considered a major diminution in service. When they were asked about the frequency of delivery and the fact that we were considering going from 6-day to 5-day delivery, every survey I've seen—and there have been many done around the country—people look at that as a favorable option, versus either raising rates or doing something on the order of what I just described to you.

They also recognize that they use and receive less mail. Today, the average address in America gets four pieces of mail a day.

Senator DURBIN. Boy, we're above average.

Mr. POTTER. And it's true. But, I think that oftentimes people look at their own mailbox and don't think about the averages. But, back in 2000, it was five pieces of mail per delivery per day. Today it's four, and we project that in 2020, it will be three.

And the other thing that's interesting is you have the volume of mail that's going to every address. In addition to that, it's the mix of mail. In 2000, more of what was delivered to your home was first class than today; today, there's more advertising. So in 2000 dollars, we delivered \$1.80 to every door, every day in 2000. Today, we're delivering \$1.40 to every door, every day. And in 2020, the projection is, because the mail mix will continue to move in the direction of more advertising mail and less first-class mail, that we will be delivering \$1 to every door every day.

FIVE-DAY DELIVERY

Now, when you look at that, the question becomes, How can you improve the efficiency of delivery to make up for the fact that the revenue that you're bringing to every door, every day, changes? And working with our unions, we have done that. But, we have not been able to close the entire gap. And that's what's led us to the conclusion that one way to make delivery more efficient is to eliminate that one day of delivery. And again, surveys were done of the American people, and that were positive, not in the sense that everyone would prefer that we not change, but I think people understand that, given their use of the mail and the fact that it's declining, that a change has to occur, and this is one that was acceptable to them.

Senator DURBIN. So, let me ask you about specifics you must have taken into consideration. If there's a 3-day gap in delivery from Friday to Monday—in regular mail delivery—have you considered the impact on the delivery of pharmaceuticals and medicines, perishables, live animals, government checks such as Social Security checks and disability checks, holiday season issues? Some times of year, I know I'm flooded with Christmas cards and other cards that come in, where you're going to have a larger volume, where you're cutting down, for 3 straight days, that delivery. And will public desire for Saturday delivery migrate to post office boxes? And will that mean that you'll have to have a larger volume of those? Are you anticipating that possibility?

Mr. POTTER. Let me just say that we have been doing a lot of research around 6- to 5-day delivery. We've reached out to 40 stakeholder groups, major users of the mail, to determine how the elimination of a 6-day delivery might impact their businesses. The vast majority of people have told us that they will make arrangements.

So, for example, pharmaceuticals: If you have an immediate need for prescription drugs, you go to your local pharmacy and get that filled. You're not relying on the mail. People who are in the mail are the ones who are getting their regular prescriptions on 90-day fulfillment, and so, there's time there for delivery. When it comes to other things, like advertising, magazines, Time has just moved their magazine delivery from Monday to Saturday, because they thought there was an advantage in the marketplace. We've worked with Time magazine, and they have said yes, they can make an accommodation and make a change.

Now, what we've done in this process of reaching out to stakeholders is, we've changed our plan around 6- to 5-day delivery to make sure that we minimize the impact. So, initially, we just said we were going to close—not deliver on Saturday at all, including to P.O. boxes. Well, we heard back from people who receive remittances, and we're going to continue to process the mail and deliver it to P.O. boxes on Saturday.

Senator DURBIN. What do you anticipate would be the increase in volume to post office boxes if you went to 5-day delivery?

Mr. POTTER. We don't have a specific increase, because most of the folks who do receive bill payments in large quantity already have some kind of an arrangement where they have to pick up mail

at a plant before it even gets to the post office, or they pick mail up at a post office, so they can get it early in the morning, as opposed to receiving it later. But what we're embarking on now—we will file, with the Postal Regulatory Commission (PRC), our complete plan for 6- to 5-day delivery. They will review that plan. I know that they are planning to have an outreach to customers, maybe those that we have not reached out to, and they will give us an advisory opinion on our plan. So, there will be a public forum for consideration.

Over the last 6 months, we have modified our original plan to try and accommodate as many of the concerns that were raised by mailers, and I think we've truly narrowed the gap somewhat.

Now I don't want to mislead anyone to think that we could satisfy everybody. There are certain people, for example, newspapers that have 6-day delivery, if we're not delivering on Saturday, we won't be able to accommodate. Some customers were concerned about, you know, would they be able to pick up their packages on Saturday. The post offices that are open Saturday today will be open Saturday in the future.

So, again, where accommodations could be made, they have been made. It wasn't perfect. We do think that we will lose revenue. That is part of the plan that will be submitted, and it will be validated by the Postal Regulatory Commission. So, we do know there will be a revenue impact, but the net impact will be \$3 billion in savings.

Senator DURBIN. So, that represents a little over 4 percent of your annual budget?

Mr. POTTER. Yes.

Senator DURBIN. And I assume you've taken a look at some other options to save money, other than cutting that 6-day service.

Mr. POTTER. Without a doubt. We have built into our plan \$123 billion in savings over the next decade. So, this is—after we cut as aggressively as we could. And part of that plan includes consolidation of our processing facilities. We are concerned that there may be some oversight that would attempt to slow those processes down. But, you know, we know those opportunities exist, and we're ready to go after them.

Senator DURBIN. Let me go into another area here. You mentioned in your opening testimony the impact of changing mail delivery frequency, "The impact on our employees would be minimal, and it would occur through attrition, not layoffs." On what basis do you believe the impact would be minimal? Can you quantify the number of people working for the Postal Service, either as rural letter carriers, city letter carriers, other postal employees—all of the people that make up the Postal Service today—can you quantify the number of jobs that will be lost to save the \$3 billion that you're talking about?

Mr. POTTER. Yes, that's part of the plan that will be submitted. Let me just make sure that I'm 100 percent clear on how we would achieve that. When I talk about employees, I'm talking about postal career employees. And so the way we would address the downsizing as a result of going from 6- to 5-day delivery will be first to eliminate overtime where it exists in the letter carrier craft. Second, it will be to eliminate some noncareer jobs that exist in the

two crafts that are—rural letter carriers, as well as the city letter carriers.

Senator DURBIN. How many jobs would be lost in those areas?

Mr. POTTER. There are 13,000 rural—city letter carrier noncareer employees today—somewhere around 13,300, in that neighborhood. In the rural carrier area, we have some 40,000 people who work 1 day a week. We would have to sit down with the union and work through what role they would play after we move from 6-day to 5-day delivery. And that's the reason we get the advisory opinion from the Postal Regulatory Commission, and after the law changed, there would be a 6-month period where we work through the issues around employment, as well as giving our customers the opportunity to change their operations to accommodate the 6- to 5-day delivery.

Senator DURBIN. But, I want to make sure I understand. When you use the word "minimal," do you have a number in mind, or a percentage in mind, when it comes to any of these employee groups?

Mr. POTTER. In terms of noncareer? In terms of career—

Senator DURBIN. Do both.

Mr. POTTER. In terms of career employees, I don't anticipate we'd have to lay anybody off.

Senator DURBIN. And noncareer?

Mr. POTTER. And noncareer, we would eliminate jobs.

Senator DURBIN. Do you have a number in mind?

Mr. POTTER. Thirteen thousand noncareer jobs for—

Senator DURBIN. Oh, I see what you're saying.

Mr. POTTER [continuing]. City carriers and 45,000 people who work 1 day a week in the rural area.

Senator DURBIN. Okay.

Mr. POTTER. Okay.

Senator DURBIN. Senator Collins.

Senator COLLINS. Thank you, Mr. Chairman.

Let me pick up on the issue of 5-day delivery. One of the major problems that the Postal Service is facing is a reduction in volume. Would you agree with that?

Mr. POTTER. Yes.

Senator COLLINS. And I believe your testimony indicates that there was a 12-percent reduction in volume last year. Is that accurate?

Mr. POTTER. Yes.

Senator COLLINS. The—what is your estimate for the further volume reduction that would be the result of going to 5-day delivery?

Mr. POTTER. I don't have a specific volume number. I do know that we would lose \$200 million in profit. But, there is a detailed plan that lays that out by class of mail.

Senator COLLINS. It's my understanding that the Postal Regulatory Commission hired some consultants to look at the reduction in revenue which reflected a 2-percent reduction in volume. Are you familiar with those studies?

Mr. POTTER. Yes, I am.

Senator COLLINS. Do you disagree with that estimate?

Mr. POTTER. I think there's a slight difference between the Postal Service estimate and the Postal Regulatory Commission estimate.

Senator COLLINS. There's a considerable difference in the estimates of savings. You have estimated that the Postal Service would save more than \$3 billion annually by going to 5-day delivery. Is that correct?

Mr. POTTER. Yes.

Senator COLLINS. And it's my understanding that in 2008, when the Postal Regulatory Commission looked at this issue, it estimated that savings under the plan would only be \$1.9 billion and that the Postal Regulatory Commission is now estimating savings of approximately \$2 billion. That's a big difference; \$3 billion to \$2 billion. Why is your estimate of savings significantly higher than the PRC's?

Mr. POTTER. Ours is significantly higher because of the estimate for how much of the work that moves from Saturday to either Friday or Monday could be absorbed by operations. Our experience—because we have holidays today—when that occurs, 90 percent of the workload is absorbed. The number that the Postal Regulatory Commission used was somewhere, I believe, in the neighborhood of 67 percent. We based our analysis on our actual experience. We have that experience today with holidays. And so, we are going to present, by the way, that information, as part of our plan, to the Postal Regulatory Commission. We hope that they'll review that information and that I anticipate that the data will prove our assumptions to be correct.

Senator COLLINS. Well, that remains to be seen.

Mr. POTTER. It does.

Senator COLLINS. But, it is—

Mr. POTTER. There's a process, and we'll follow it.

Senator COLLINS. And I appreciate that, but that is a notable difference. You mentioned when you have holidays—one of the problems with eliminating Saturday delivery is we have, what, 10, 11 Monday holidays each year, on which there is no mail delivery. So, we're really talking about, in many months, there being a time where there would be delivery on Thursday and the next delivery would not be until Tuesday. You have talked about reaching out to the stakeholders, and that you were confident that you could mitigate the impacts. I'm confident that you're going to lose volume. And, I think all of us would agree on that. The question is how much, and whether the tradeoff is worth it.

I've talked to weekly newspaper publishers in my State that put their newspapers in the mail on Thursday. It's delivered on Saturday. They're only publishing once a week, and what they tell me is, if the news doesn't get to their customers until Tuesday, in the case of a week where there's a Monday holiday, their customers are not going to subscribe to the paper. It's also a problem for daily newspapers, for obvious reasons. But, I think it's an even bigger problem for the weekly newspapers. And I've had the publishers say to me, they don't know what they're going to do, but they're going to explore alternatives to using the Postal Service. That's a real problem for you.

Similarly, there's a lot of advertising mail that's time-sensitive. The sale is that weekend. Netflix. I've got to believe that Netflix, which relies on daily delivery of its movies, although I know you're talking to them, and I know that they're looking at being able to

stream their movies, is concerned about what this would mean for their business model. And, by the way, isn't the result going to be that a company whose business model relies on daily delivery, like Netflix, is going to start streaming those movies and no use—no longer using the Postal Service at all? Those are the issues that concern me.

So, let me ask you what is the bottom-line question, and this was one that the GAO is asking, as well. And that is, How would eliminating Saturday delivery affect the Postal Service's efforts to grow mail volume and encourage commercial mailers to expand their use of the mail?

Mr. POTTER. Well, first of all, I agree with every question that you had, and I am as concerned as you are about those issues. The local newspaper that mails and, right now, expects to have delivery on Saturday—obviously they have a choice on whether or not they want to deposit a day sooner and get the mail into the home on Friday. One of the things, when we talked last year about this—one thing I didn't realize, when we first had our discussion about this, was how many of the advertisers have actually moved to try and get mail delivered by Friday, because of what you just described. People shop on Saturday. Bill presenters want the bill in people's hands by Friday, so that they can pay over the course of the weekend. So, to be truthful, mail was moving in the direction away from Saturday anyway, because of the fact that they want—folks want the mail in people's hands so they can act on it over the course of the weekend.

Now, one of the things that we have to consider is—and one of the things that we responded—because there was very fair criticism, by yourself and others last year, that we did not present a broad-based plan and that we were focused on one or two things. And that's why we hired the consultants, so that we could come and look at this from a broad-based perspective. And when you look at the future, a lot of the people that—you know, you just described Netflix—their business model is to move away from the mail today anyway.

Senator COLLINS. Well, I can tell you, you're encouraging them to move faster.

Mr. POTTER. They might accelerate that pace. On the other hand, the people who do intend to be with the mail—and this is the key point—we have to keep mail affordable. So, price is very, very important to a lot of the advertisers who use the mail; in particular, cataloguers and others who use us for advertising. Price is extremely important. And when it comes to looking at advertising channels, you know, we're competing with the Internet. We're competing with mobile apps. We're competing with newspapers, television. And so, we have to keep our price competitive.

And so, yes, something will be lost as a result of moving from 6- to 5-day delivery, but I look at what's being protected. What's being protected is the 150 billion pieces of mail that we anticipate being in the system. And it's a balancing act. I'm not going to say that it's not judgmental and it's not without its share of risk, but, given what we have going forward, I think it's a risk we have to take.

Senator COLLINS. Well, when I look at financially troubled businesses—and there are, unfortunately, many in today's economy—

they're trying to grow their business. They're trying to expand their service. They're trying to entice more customers. And it seems like you're choosing a route that goes in the opposite direction.

Go ahead.

Mr. POTTER. Let me assure you, we're very much focused on growth. You know, we've had our first sale ever. We're out aggressively advertising priority mail. And I know that you would like us to do more, and we do intend to do more.

Senator COLLINS. And the summer sale worked; it increased—

Mr. POTTER. Right.

Senator COLLINS [continuing]. Your volume—

Mr. POTTER. And we're going to—

Senator COLLINS [continuing]. Which should tell you something.

Mr. POTTER [continuing]. Which we're going to do again this year. We're also working with the cataloguers who want year-over-year sales, not just specific seasonal sales, and we're going to do that, Senator. But, the real challenge here is a \$7 billion gap.

Senator COLLINS. I know, but let me switch—

Mr. POTTER. Sure.

Senator COLLINS [continuing]. Because I know I don't have much time left.

One of the best sources of cost-saving ideas are from your employees; they're the ones on the front lines. And as you know, the President of the National Association of Postmasters, last year, made a very specific suggestion to you. He said, "I encourage the Postmaster General to negotiate with our unions about cross-craft training. An agreement in this area would augment the skills of individual postal employees, and enable postmasters to more effectively utilize the talents of their employees." He argues that this would save you money, enhance skills. What have you done to implement that proposal?

Mr. POTTER. First of all, I 100 percent agree with him. We have our negotiations with our unions—two of our unions, the Rural Letter Carriers and the American Postal Worker's Union (APWU), begin this summer. The other two unions, the Mail Handler Union and the National Association of Letter Carriers, is the following year. And we intend to work on those issues during the course of those negotiations. They're a nonstarter, outside of negotiations.

EMPLOYEE-RELATED COSTS

Senator COLLINS. And I guess that brings me to my final question. The GAO says that 80 percent of the Postal Service's costs are employee related. Is that accurate?

Mr. POTTER. Yes.

Senator COLLINS. The GAO also says that the Postal Service pays a considerably higher percentage of the employees' health insurance and life insurance, compared to the average Federal agency. I realize you're not a Federal agency, but you're participating in the same programs. It's a—the exact same programs. I believe, in the case of health insurance, although it's declining by 1 percent, it's about 83 percent versus 72 percent. In the case of life insurance, the Postal Service, I am told by the GAO, pays 100 percent of the premium, and I believe for Federal employees it's about one-

third of the premium. Are—is your cost structure in line for what it should be, given where the money's being spent?

Mr. POTTER. Well, Senator, thank you for recognizing that we did negotiate, in the last round of negotiations, with all four of our unions. That—on an annual basis each year, the percentage that's paid by the employer would be reduced by 1 percent.

Senator COLLINS. For health insurance.

Mr. POTTER. For health insurance. And that, again, is recognition of the—of what you just described, the fact that we are out of line with what's paid for, in terms of the Federal Government—what they pay for an employee's healthcare. Our unions and management recognized this problem, and we negotiated the change into our contracts. What we agreed was fair was that we'd make this change over time, as opposed to doing it in one move. And so, that's why we went the 1 percent per year.

Now, some people have said we should have been more aggressive and gone the 3 percent a year or 2 percent a year. Well, the fact of the matter is, we got that through collective bargaining. If we didn't reach agreement with the unions—and we were very happy that they worked with us to make that change—that issue would have gone to binding arbitration. And so, the decision wouldn't have been made by either party; it would have been made by an arbitrator.

So, again, we recognize what you just described as a difference between the Federal Government and the Postal Service, and we're working to move in that direction. It will be the subject of negotiations once again this summer and the following summer.

Senator COLLINS. Thank you, Mr. Chairman.

Senator DURBIN. Mr. Postmaster, if I can ask you just a series of quick questions.

Have you considered doing pilot tests on 5-day delivery, to see what the reaction would be, what the impact would be on volume?

Mr. POTTER. We could, but by law, we can't.

Senator DURBIN. Well, we make laws.

Mr. POTTER. Okay. We would be willing to test it.

Senator DURBIN. Okay. I think that might be an interesting thing, to see if some of the surveys and opinion polls actually end up in consumer satisfaction, with the approach on 5-day service, and we'll talk about that possibility.

In 6 months, the next annual statutory installment payment of \$5.5 billion is due to the Postal Service retiree health benefit funds. Are you going to make that payment?

Mr. POTTER. We're going to ask for relief from that payment. Not because we don't have enough cash to pay it this year, but we're very concerned about cash flow in October and November of next year, because of payrolls and because of workers' comp costs. So, we are going to ask for an adjustment. We will have enough cash, if we had to pay it, but we'd run the risk, just similar to last year, of running out of cash in the fall 2010.

CIVIL SERVICE OVERPAYMENT

Senator DURBIN. Well, the inspector general says you've overpaid \$75 billion into the Civil Service Retirement System. If this is accu-

rate, could you use this as a source for retiree health benefits and some of the other economic issues you're facing?

Mr. POTTER. Yes, sir.

Senator DURBIN. Are you trying?

Mr. POTTER. Are we trying?

Senator DURBIN. Are you trying to recover the \$75 billion?

Mr. POTTER. Well, back in 2000—now, I can't remember, Senator, whether it was 2003 or 2006—the Senator, in her legislation, provided an opportunity for us to appeal a decision—that was made by the Office of Personnel Management (OPM); and back then, the board of actuaries determined that the conclusion was that we would have \$17 billion in overpayment, rather than the \$92 billion outlined by the inspector general, was the right number. We are working, and have appealed to OPM and the Office of Management and Budget (OMB), to reopen this very matter. If it were to happen, it would literally, I think — we would almost be in a fully funded mode on our Retiree Health Benefit Trust Fund, because the \$75 billion that would—would be, probably, directed there. It would take a lot of pressure off. If that were to happen, we wouldn't have to go to 6- to 5-day delivery.

Senator DURBIN. What's the timeframe for that to be decided?

Mr. POTTER. It's beyond me. There's no schedule.

Senator DURBIN. But, you're saying if the \$75 billion is found, you wouldn't have to cut the frequency of service?

Mr. POTTER. Right.

Senator DURBIN. We might look into that.

Let me ask you about the way you market your products and services. Postal Service has 36,500 retail branches; more than McDonald's, Starbucks, Walgreens, and Wal-Mart combined. An average postal branch sees 600 customers each week; an average grocery store, 20,000 weekly customers. I know that more people are doing things over the Internet, in their homes and at desks, but I wonder if the Postal Service is providing its products and services where people are, and whether or not there's good reason for you to start building your facilities as part of other places that draw much larger crowds of people.

Mr. POTTER. Sir, that's our proposal. Today, we cannot close a post office for economic reasons. So, as other businesses—if you go into a large grocery store, you see banks, coffee shops, other things that are housed along with those grocery stores. That's where we would like to be. We would like people to have access 7 days a week. We would like them to have access 24 hours a day, in some cases. However, we're precluded from closing post offices.

And let me just say this, that when it comes to post offices, part of the 600 folks who walk in on a weekly basis—part of the reason it's only 600 is because over 30 percent of people today buy what they had come to a post office for—they either buy it online or they buy it at grocery stores—

Senator DURBIN. Thirty percent?

Mr. POTTER [continuing]. Over 50,000 grocery stores sell stamps today. And our anticipation is, in the next decade, that that 30 percent will probably move to 60 percent, because we're working very hard to improve our Internet, our Web site.

We have put up—just to show the interest in the Postal Service—we created a postal mobile app, and within 3 weeks, it went to the top of the charts, in terms of the most-used mobile app. That was to look up locations of post offices, ZIP Codes, and the like. So, we know there's a big interest in the Postal Service. We'd like to be where people are; online or in locations where they're already conducting their business.

Senator DURBIN. Taking the downtown Chicago Post Office out of this conversation—the old one—do you have excess property and real estate that is in a valuable location that you could consider selling to try to come up with some of the revenue the Postal Service needs?

Mr. POTTER. Yes, and we are aggressively pursuing that. In some cases, what we're doing—for example, in San Francisco, we're consolidating delivery units and selling our buildings and moving our retail into a location in a very proximate area to where our current location is. We have done that, historically. It's been a slow-moving process, for a whole host of reasons. As you know, in big cities, transactions tend to take a lot longer, even though they're much more lucrative—but, they do take a long time. We worked very close on that Chicago Main Post Office, as you know, but if opportunities—

Senator DURBIN. You offered me—

Mr. POTTER [continuing]. Exist, we do pursue them.

Senator DURBIN. I don't know if it was in jest, but you offered me the Chicago Main Post Office for a dollar once. I don't know—

Mr. POTTER. Only because it was costing us \$14 million a year to maintain it, even though we no longer had a presence there.

Senator DURBIN. Thank you.

Senator COLLINS.

Senator COLLINS. Thank you, Mr. Chairman.

Mr. Chairman, I want to follow up on the issue you raised about the inspector general's report, which indicates an overfunding to the Civil Service Retirement System, because it is such an important issue.

Mr. Potter, it's my understanding that the OPM and the GAO both strenuously disagree with the inspector general's conclusion. Is there a change that's happened since those disagreements?

Mr. POTTER. To the best of my knowledge, no.

Senator COLLINS. Okay. So, the administration has stuck to its belief that there is not the kind of overpayment that the inspector general has found.

Mr. POTTER. To the best of my knowledge, no. But, I would prefer that they respond—

Senator COLLINS. Right.

Mr. POTTER [continuing]. Obviously. But—

Senator COLLINS. I just wanted to bring that—

Mr. POTTER. Right.

Senator COLLINS [continuing]. To the chairman's—

Mr. POTTER. Right.

Senator COLLINS [continuing]. Attention.

RETIREE HEALTH BENEFITS

I personally don't know who's right. This is a case where different actuaries have come to different conclusions. But, I do know that OPM considers itself to be expert in how you fund retirement programs.

On that point, and switching to your retiree healthcare benefits, you talk about that the money that's currently in the fund—the \$35 billion—is sufficient to pay the premiums for all of our roughly 500,000 currently participating retirees, through their expected lifetimes. Doesn't that ignore the fact that you're going to have a huge wave of retirees coming? I—the reason I know this is the chairman and I fly back and forth, and people sit next to us on the plane and take advantage of that opportunity to educate us on issues.

And I sat next to the postal district manager, who I believe told me that something like one-half of your workforce is eligible to retire in the next decade.

Mr. POTTER. Right. No, what that was meant to say—that there's a sizable amount of money there. And so, when you're looking at funding obligations going forward, there's a thing, I learned about in the last couple years, called "normal cost." In fact, I was educated by OPM on this, which is—basically, you begin to pay into the Retiree Health Benefit Trust Fund, based on how many employees you have, against what their anticipated cost is in the future, versus—as we both know, the payment schedule that we're on now, was more linked to a scoring issue than the normalization. And so, that's what that was meant to imply, that there was a way of looking at this a little differently.

Senator COLLINS. I just don't want to lead what—leave what would be a misleading—

Mr. POTTER. Oh, no.

Senator COLLINS [continuing]. Impression. The fact is, you've got billions of dollars of future liabilities that they—

Mr. POTTER. There's still a \$50 billion gap. I'm not trying to—

Senator COLLINS. That's correct—

Mr. POTTER. Okay. Yes.

Senator COLLINS [continuing]. And I think that's a really—

Mr. POTTER. Okay.

Senator COLLINS [continuing]. Important point.

Mr. POTTER. I didn't mean to mislead anyone, but just to say that there is a sizable amount of money there.

Senator COLLINS. Right.

Mr. POTTER. Because, when we started on this process, years ago, the concern was that, at some point in time, the Postal Service might not be an ongoing concern, and the liability would fall back on the Federal Government.

Senator COLLINS. Correct.

Mr. POTTER. When you look at normalization, what you look at—in addition to just how many employees you have, you look at what would happen if the business were to go under. And the fact is, if it were, not all of our employees would be eligible for retiree health benefits. Only those who are eligible to retire could do that. And

so, you know, again, it was just because I've become educated, in the last couple years, on other approaches that could be taken.

Senator COLLINS. I just wanted to make sure that was very clear for the—

Mr. POTTER. Right.

Senator COLLINS [continuing]. Record. I would also note that, back in 2006, when Senator Carper and I authored our bill, we initially had a 40-year amortization schedule. And it was only in the final negotiations with OMB where the amortization schedule was truncated considerably.

What I don't want to see is another year like this past year—and I voted to allow you to do it—where the payment is significantly reduced. That is not a good situation. That is just wishing away liabilities. But, I do think that we should stretch out and smooth out the amortization schedule for this unfunded liability.

I'm tempted to ask whether you'd agree with that, but I'm not sure what you would say.

Mr. POTTER. No—

Senator COLLINS. I'll ask anyway.

Mr. POTTER. First of all, let me assure you that we're not walking away from the obligation for retiree health benefits for our employees. I hope to get that benefit in the future. So, I—we want to make sure that that's fully funded. I would agree that the timing, in terms of the pace at which you pay for that, obviously the current situation has to be taken into consideration. The amortization over a longer period of time does give us welcome relief. And we all know that, although we were in agreement about a 40-year amortization back in 2006, that option was taken off the table—

Senator COLLINS. Correct.

Mr. POTTER [continuing]. Not by either party, but by a third party.

Senator COLLINS. Right.

Mr. Chairman, just one final comment for this witness, and that is, whatever plan we adopt, we have to make sure that it truly positions the Postal Service for the future and that we're not back here, 3 years from now, once again facing billions of dollars in annual losses, huge unfunded liabilities, declining volume, and being in no different a place. And that means that there needs to be a new business model and some very tough decisions made.

I vowed, in 2006, that I would never do a major postal bill again, because it was so difficult to get all of the stakeholders. And we thought that we had put the Postal Service on track for viability. And that was your testimony. I read part of it at the time. GAO removed you from the high-risk list. And I just don't want to see this movie again.

Thank you, Mr. Chairman.

Senator DURBIN. I'd say to my colleague that I agree with her completely.

Mr. POTTER. Well, I would, too.

So, I'll second what she just said. But, the only thing—

Senator DURBIN. But, I'd just add—

Mr. POTTER. The only thing we didn't anticipate was this recession—

Senator DURBIN. I was going to say—

Mr. POTTER [continuing]. Of the magnitude that we had, and a tipping point that it affected—how it affected the mail.

Senator DURBIN. As a precautionary note, I don't think any of us could have predicted the depth and seriousness of the current recession on every aspect of our lives. And, second, you are in a field that is being affected by this galloping change in technology and the change in habits by the American people. Who would have guessed, 10 years ago, American newspapers would be flat on their back at this point and struggling to survive. And it's a reality. And so, there's this change in technology. You are right in the middle of this competition, and I understand that part. But, we're going to try to make some decisions, or help you make some decisions, which will give us a breather—maybe 4 years before we see you again.

Mr. POTTER. Let's hope it's a little longer than that.

Senator DURBIN. Then maybe even a little longer.

Mr. Potter, very much for your testimony.

Mr. POTTER. Thank you.

Senator DURBIN. I'm going to welcome the second panel to take their place at the table.

ADDITIONAL SUBMITTED STATEMENTS

And while they do, I note that the subcommittee has received prepared statements from a number of postal labor organizations: the National Association of Letter Carriers; the National Rural Letter Carriers Association; the National Postal Mail Handlers Union; the American Postal Workers Union; the National Association of Postmasters of the United States; and the National Association of Postal Supervisors. And, without objection, their statements will be made a part of this record and reviewed carefully by us and our staff.

[The statements follow:]

PREPARED STATEMENT OF THE NATIONAL ASSOCIATION OF LETTER CARRIERS

Thank you, Chairman Durbin, for holding this important hearing on the financial situation facing the United States Postal Service. On behalf of the 295,000 members of the National Association of Letter Carriers, I submit this statement for the subcommittee's consideration.

Overview

There is no doubt that the Postal Service faces the worst crisis since the Great Depression of the 1930s. The collapse of the housing bubble and the financial meltdown of 2008–2009 affected the most mail-intensive sectors of the economy. This occurred at a time when the impact of electronic diversion of traditional letter mail caused mail volume to stagnate after peaking in 2006. Yet the deep recession and the negative impact of the Internet on postal volumes are not the most important causes of the Postal Service's large deficits in recent years. Unfortunately, the main driver of the USPS's current financial distress stems from a policy decision, albeit well-intentioned, adopted by the U.S. Congress in 2006 to require the Postal Service to massively prefund decades of future retiree health benefit obligations in just 10 years. This requirement has cost, and will continue to cost, the Postal Service some \$5.6 billion per year until the year 2016.

That's right. This immediate crisis was initiated in 2006 when Congress, in cooperation with the Bush administration, included the prefunding requirement in the Postal Accountability and Enhancement Act (PAEA). What appeared to be affordable in 2006 is clearly unaffordable today. Over the past 3 years, as the economy slipped into the worst recession in 80 years, the Postal Service has had to pony up \$12.4 billion to prefund future retiree health benefits—on top of some \$6 billion for current retiree health benefits.

No other agency—including the United States Congress—or private company faces such a legal obligation to prefund. Indeed, such prefunding is not even required by the Financial Accounting Standards Board (FASB), which establishes accounting rules for both private and public organizations. And as an annual survey conducted by Watson Wyatt found in 2009, only about a third of Fortune 1000 companies voluntarily prefund retiree health obligations at all—and those that do have set aside much less than the Postal Service has already.¹

What makes this situation worse is that the size of the prefunding payments is grossly inflated due to actuarial methods adopted by the Office of Personnel Management (OPM). These methods, which have been exposed by a series of reports by the Office of Inspector General of the USPS, not only shortchanged the Postal Service Retiree Health Benefits Fund (PSRHBFB) by tens of billions of dollars when it was established in 2007, but also greatly exaggerated the USPS's future liability for retiree health benefits—which prompted the Congress to establish a completely unrealistic schedule of prefunding payments in the PAEA.

The USPS has responded with tremendous resilience to the challenges of the recession, which began in 2006 for our industry when the credit crunch hit. And my union, the NALC, has been a responsible and reliable partner in helping it react to the steep decline in mail volume. Working together at the bargaining table, we strove to negotiate flexible and fair means for adjusting all 160,000 city carrier routes to ensure 8-hour assignments, boosting efficiency and saving hundreds of millions of dollars. In fact, we adjusted every city carrier route in the country not once, not twice, but three times over the past 18 months. Using the traditional method of route evaluation would have taken more than 5 years to adjust every route.

In fact, the Postal Service has been so successful in cutting costs to align work hours with recession-level volumes that it would have earned a net surplus of \$1.6 billion over the past 4 years in the absence of the onerous prefunding burden. This burden is directly responsible for the dramatic rise in the Postal Service's outstanding debt. See the chart below.

REFUNDING PAYMENTS, NET INCOME AND DEBT OF THE U.S. POSTAL SERVICE

[In billions of dollars]

Year	Payments to the Postal Service Retiree Health Benefits Fund	Net Income	Debt Increase
2006	0.9	2.1
2007	5.4	-5.1	2.1
2008	5.6	-2.8	3.0
2009	1.4	-3.8	3.0
Totals	12.4	-10.8	10.2

Notes: (1) A modified version of H.R. 22 was enacted in 2009, slashing the prepayment from \$5.4 to \$1.4 billion; (2) In 2005 the Postal Service had no debt at all.

Congress Should Fix the Prefunding Policy First

Today your subcommittee is going to hear a lot about 10 and 20-year predictions about future mail volume and the mega-sized postal deficits that will occur if we do nothing. You will no doubt also be asked to embrace draconian suggestions developed by the Postal Service's consultants and perhaps other witnesses. The 200,000 men and women who deliver the mail on city carrier routes today urge you exercise great caution and to stop and consider the real cause of the immediate crisis: The unworkable and unreasonable pre-funding policy adopted in 2006.

Congress should correct the retiree health prefunding policy first—it is the single most effective step you can take to stabilize the Postal Service's finances. We urge you to fully implement the recommendations contained in the two OIG reports on this issue.² (See the attached fact sheets prepared by the NALC's Department of

¹ See Figures 29 and 30 in "Accounting for Pensions and other Postretirement Benefits 2009, Reporting Under FAS 87 and FAS 106 Among the Fortune 1000, A Watson Wyatt Survey Report," pages 21–22.

² USPS Office of Inspector General study: "The Postal Service's Share of CSRS Pension Responsibility," January 22, 2010, see http://www.uspsoig.gov/foia_files/RARC-WP-10-001.pdf; and USPS Office of Inspector General report: "Estimates of Postal Service Liability for Retiree Health Benefits (Report Number ESS-MA-09-001(R)), July 22, 2009, see http://www.uspsoig.gov/foia_files/ESS-MA-09-001R.pdf.

Legislative and Political Affairs.) While we appreciate the efforts undertaken last year by the Obama administration and other Senate leaders to offer limited relief from the pre-funding burden in S. 1507, that bill does not go far enough and its adoption by the Senate Committee on Homeland Security and Governmental Affairs was marred by an antiunion amendment that would permanently and unfairly tilt the interest arbitration process in favor of postal management. NALC urges the Senate to start over with a fresh approach suggested by the USPS OIG.

Congress Should Retain 6-Day Delivery

The Postal Service is too important to the country to make rash decisions in an environment of financial distress. NALC believes it would be unwise to downsize to meet recessionary levels of demand before we know how soon and how well the economy and the postal market will recover. Specifically, we believe that eliminating Saturday collection and delivery services would be penny-wise and pound-foolish. No business has ever restored itself to health by offering slower service and turning customers away—too many businesses (including mail order merchants, online pharmacies, DVD and game rental companies and newsmagazines) rely on 6-day delivery to simply leave them in the lurch. Rather than saving the Postal Service money, 5-day delivery could worsen its bottom line over time as a result of further volume and revenue losses. And it would needlessly destroy 50,000 good jobs at a time of extremely high unemployment. (See the attached fact sheet on Saturday delivery prepared by the NALC's Department of Legislative and Political Affairs.)

Eliminating Saturday collections and delivery should be a last resort policy, not a first resort policy. It certainly should not be considered until we see the impact on demand for postal services when the economy recovers—as well as the results of the next round of postal collective bargaining. Nor should it be considered before Congress corrects the deeply flawed prefunding policy adopted in 2006. In any event, the Postal Service has not yet presented its 5-day collection and delivery proposal to the PRC for review, as mandated by law. Congress and this subcommittee should await the results of that review and conduct extensive hearings to ensure it understands the full implications of eliminating Saturday delivery before debating changes to the annual appropriation legislation that mandates 6-day services. The data and assumptions in the Postal Service's plan yet to be scrutinized and special attention must be given to the impact of service cutbacks on tens of millions of small businesses, including those in rural communities and economically distressed neighborhoods.

Conclusion

We know that prefunding reform may not be enough to secure the long-term viability of the USPS. We know the Postal Service's business model deserves a serious and comprehensive debate. However, NALC and the other postal unions are prepared to deal with the lingering effects of the recession and the negative impact of the Internet at the negotiating table, just as we have adapted to varying business conditions for some 40 years of successful collective bargaining. And we believe that it is only in the context of financial stability that a serious and careful legislative debate can take place. That will require us to do our part at the bargaining table and for Congress to do its part on retiree health prefunding reform.

NALC is committed to preserving a strong and viable Postal Service that can meet the evolving needs of the American people and American businesses. We look forward to working with this subcommittee and the entire United States Senate to find a sensible and realistic way forward. Thank you for inviting us to submit this statement.

NALC FACT SHEET—STRENGTHENING THE POSTAL SERVICE: REFORM ITS RETIREE HEALTH PRE-FUNDING SCHEDULE

The Postal Service is facing a financial crisis in the midst of the worst recession in 80 years. Congress spent much of 2009 debating short-term financial relief for USPS in the form of reduced prefunding payments for future retiree health benefits. On September 30, 2009, Congress adopted a measure which reduced the level of USPS prefunding in 2009 from \$5.4 billion to \$1.4 billion and reduced the Postal Service's operating loss from \$7.7 billion to \$3.7 billion. While it was helpful last year, this type of last-minute relief will not adequately address the larger problems caused by the prefunding requirements. In 2010, Congress must reform the prefunding schedule adopted by Public Law 109-435 to provide for long-term financial stability. The current schedule is unaffordable and unfair:

—The USPS is the only enterprise in the country required by law to prefund retiree health benefits while most Fortune 1000 companies (two-thirds) don't prefund at all.

- The annual payments required are extremely onerous, requiring the USPS to effectively prefund 80 percent of a 75-year liability in just 10 years, and are based on flawed calculations by the Office of Personnel Management (OPM).
- The actuarial methods used to determine the retiree health benefit liability are deeply flawed and inequitably overstate the Postal Service’s liability. Congress should mandate a new prefunding schedule based on fair and accurate actuarial calculations.

Background on Prefunding

The Postal Accountability and Enhancement Act of 2006 established the Postal Service Retirees Health Benefit Fund (PSRHBF) by calling on OPM to calculate the “postal” surplus in the Civil Service Retirement System and to transfer it to the PSRHBF in 2007. The law also dictated 10 annual payments into the Fund averaging \$5.5 billion each between 2007 and 2016, also based on OPM calculations.

In establishing the Fund and setting the payment schedule, Congress sought to minimize the “budget score” of the legislation and relied on the OPM estimates of the value of the CSRS surplus and the cost of future retiree health benefit liabilities. A study conducted by the USPS Office of Inspector General shows that OPM underestimated the size of the postal CSRS pension surplus by roughly \$75 billion.¹ Furthermore, the Postal Regulatory Commission has found that OPM’s healthcare inflation assumptions are overstated.² As a result of these calculations, the Postal Service has been saddled with an unaffordable prefunding schedule that threatens its future viability.

A Fair Calculation of the Postal CSRS Surplus

In 2003, OPM made the initial determination of the postal pension surplus in order to implement a CSRS funding reform law (Public Law 108–18). This process, which was repeated in 2007 under the PAEA (with the Treasury taking responsibility for CSRS military benefits), required the OPM to allocate the cost of CSRS benefits earned by postal employees between the Treasury (taxpayers) and the Postal Service (ratepayers) for all workers who performed service before and after July 1, 1971. That was the day the Post Office Department (POD) was reorganized and became the U.S. Postal Service, an independent agency of the government separate from other cabinet agencies. Unfortunately, OPM shifted much of the cost of CSRS benefits earned by POD employees to the Postal Service by making the USPS responsible for any and all increases in the value of benefits accrued for POD service due to wage increases after July 1, 1971. Any fair calculation of benefits accrued before postal reorganization in 1971 should have included some recognition of normal wage increases in the future, since CSRS benefits are based on end-of-career earnings. Instead, OPM froze the value of accrued benefits at July 1, 1971, pay levels—effectively shifting much of the cost of pre-reorganization service to the Postal Service. The OPM also failed to recognize that the CSRS benefit formula is backloaded and unfairly assigned the low-cost early years to the POD and the high cost later years to the Postal Service.

By overstating the Postal Service’s liability for CSRS benefits, the OPM understated the value of the postal surplus in the CSRS by as much as \$75 billion, according to a review by the OIG. As a result, the Postal Service was short-changed when the surplus was transferred to the PSRHBF in 2007. Under OPM’s method, the fund was credited \$17 billion. Using the more fair and accurate method advanced by the OIG, however, the postal surplus may have exceeded \$80 billion, more than enough to cover all of the Postal Service’s future retiree health liability.

Adjusting the OPM’s Health Inflation Rate

The OPM has also inflated the cost of the Postal Service’s prefunding payments by assuming an extremely high rate of long-term healthcare inflation—some 7 percent annually for 75 years. Most Fortune 1000 companies use a 5 percent long-term rate, while Medicare and Medicaid assume costs will rise by 6.25 percent annually. Both the Inspector General and the PRC have concluded that more accurate inflation assumptions could reduce or eliminate the Postal Service’s PAEA-required payments. The OIG’s report concluded that “[t]he Postal Service could pay an average of \$4 billion less each year from fiscal years 2009–2016 to prefund its retiree health benefits and still achieve the same level of prefunding [80 percent] anticipated under OPM assumptions.”

¹Postal OIG study, “The Postal Service’s Share of CSRS Pension Responsibility”. Jan. 20, 2010. http://www.uspsog.gov/foia_files/RARC-WP-10-001.pdf.

²Postal Regulatory Commission study, July 30, 2009. http://www.prc.gov/Docs/63/63987/Retiree%20Health%20Fund%20Study_109.pdf.

The current long-term cost assumption is inaccurate and places an unfair burden on the Postal Service, its employees and ratepayers. It must be adjusted to more accurately reflect the reality of the Postal Service's future obligations.

Eliminating Saturday Delivery Not the Answer

Correcting OPM's actuarial calculations involving the CSRS postal surplus and the long-term cost inflation rate would significantly reduce the \$5.5 billion prefunding payments mandated by the Postal Accountability and Enhancement Act of 2006. It would also strengthen the financial stability and future viability of the Postal Service.

Adopting a more accurate and affordable prefunding schedule should be given the highest priority in any postal reform legislation considered during the remainder of the 111th Congress. This step should certainly be taken before Congress considers more radical measures such as the elimination of Saturday delivery.

NALC FACT SHEET—SAVE THE POSTAL SERVICE: DEMAND FAIRNESS IN USPS PENSION AND RETIREE HEALTH FUNDING

As the economy struggles to recover from the worst recession in 80 years, the Postal Service continues to face a financial crisis. The loss of revenue resulting from declining mail volume is compounded by a provision in the 2006 postal reform that requires the Postal Service to massively prefund its future retiree health benefits at a cost of \$5.6 billion annually. The requirement has resulted in mounting losses, rising debt and destructive job and service cuts.

The unprecedented prefunding provision—no other agency or private enterprise is required to prefund by law or by widely accepted accounting standards—was made worse by how it was implemented by the Office of Personnel Management. The OPM's calculations to determine the initial balance in the Postal Service Retiree Health Benefit Fund (PSRHBF) and the size of the Postal Service's future retiree health liability were deeply flawed. Studies conducted by the Office of the Inspector General of the Postal Service (OIG)¹ and the Postal Regulatory Commission² have shown that the "postal surplus" in the CSRS pension fund, which was transferred to the retiree health fund in 2007, was grossly undervalued by OPM. As a result, USPS was shortchanged by as much as \$75 billion when the PSRHBF was created.

Returning these surplus funds to the postal retiree health fund would greatly alleviate the Postal Service's financial stress. In fact, doing so would fully fund the Postal Service's 75-year liability for future retiree health benefits and the current prefunding requirements would be unnecessary.

In 2010, in order to rectify the unfair, inequitable and financially destructive impact of the prefunding policies resulting from the OPM's methods, Congress must:

- Demand that OPM recalculate the postal pension surplus using actuarial methods that are fair to the Postal Service and its ratepayers, as proposed by the OIG;
- Require that OPM transfer the corrected surplus fund to the Postal Service Retiree Health Benefits Fund; and
- Repeal the prefunding requirement found in Section 8909a of Public Law 109–435.

The long-term viability of the USPS will require all stakeholders to adapt and innovate and may require Congress to adopt further legislative changes to allow the Postal Service to provide new services and to generate new revenue. But reform of the prefunding provisions cannot wait until a consensus forms on a new business model. Congress must act this year.

NALC FACT SHEET—ELIMINATING SATURDAY DELIVERY IS NOT THE ANSWER

The U.S. Postal Service faces the worst crisis in its history. It expects to lose \$6–\$7 billion in 2009. Although the collapse of the housing and financial sectors in late 2008 is responsible for the largest decline in mail volume since the Great Depression in the 1930s, the main cause of the financial crisis is the decision advanced by the Bush administration in the postal reform law of 2006 to require the USPS to prefund its future retiree health benefits, a 75-year liability, in just 10 years. The cost of this unaffordable prefunding payment, \$5.4 billion in 2009, accounts for most of the projected loss this year. The annual cost will rise to \$5.8 billion by 2016.

¹ USPS Office of Inspector General report: Estimates of Postal Service Liability for Retiree Health Benefits (Report Number ESS–MA–09–001(R)). See http://www.uspsig.gov/foia_files/ESS-MA-09-001R.pdf.

² Postal Regulatory Commission Review of Retiree Health Benefit Fund Liability as Calculated by the Office of Personnel Management and the U.S. Postal Service Office of Inspector General, July 30, 2009. See www.prc.gov/Docs/63/63987/Retiree%20Health%20Fund%20Study_109.pdf.

While the NALC is working with postal management to address the crisis with the Interim Route Adjustment Process, Congress must take action to relieve this prefunding burden to preserve affordable, universal service. See the NALC Fact Sheets on H.R. 22 and S. 1507.

Postal management's proposal to deal with the crisis—eliminating Saturday mail delivery—is not a sensible solution to the USPS's financial crisis

The Postal Service estimates that by eliminating one-sixth of its delivery service, it can cut operating expenses by \$3.4 billion or 4.6 percent—not the 16.6 percent you might expect. The model it used to estimate potential savings is based on many unproven assumptions and did not specifically study the elimination of Saturday delivery, the day most Americans are home to receive packages.

To date, no study has been conducted to estimate how a reduction in delivery days would affect mail volume and delivery costs in the remaining 5 days or how different types of mailers would be affected.

A study conducted on behalf of the Postal Regulatory Commission suggests that total cost savings by eliminating one of delivery could be as low as \$1.9 billion or just 2.5 percent of total postal expenses.

The Postal Service is rushing to judgment

In letters to employee groups dated June 11, 2009, USPS management requested input on a study of the feasibility of weekday-only delivery with replies due back by June 19, 2009. In July it informed the unions that it planned to finish its review in 3 weeks. The USPS appeared to be recycling an old IBM study it used for the PRC Universal Service investigation. A more thoughtful and serious study is needed.

The proposed reduction in delivery services would be the most radical change to postal operations in the 230-plus year history of the U.S. Mail. No such policy decision should be made after just a few weeks consideration, much less without a comprehensive study of its effects.

Six-day delivery makes the Postal Service unique

One of the defining characteristics of the U.S. Postal Service is its policy of nationwide uniform pricing with 6-day delivery. Competitors charge don't deliver or charge high premiums for Saturday delivery while the USPS provides affordable universal as mandated by the Constitution.

American businesses value 6-day delivery

Business in the United States is conducted 6 days—and in many sectors 7 days—per week. Small and large businesses alike, from individual entrepreneurs to large-scale financial firms, rely on the delivery of the mail 6 days per week to operate successfully. Saturday delivery is especially important to growing companies like eBay, Netflix and Caremark, and has long been vital for news magazines. The elimination of Saturday delivery will make the USPS less valuable to business and accelerate electronic substitution.

American citizens value Saturday delivery too

Billions of prescriptions are delivered through the mail each year—a 2-day delay in their delivery would seriously inconvenience senior citizens and others. Delayed delivery of payments, subscriptions and food products would adversely affect millions of households.

Rural communities would be disproportionately affected

Americans living in rural areas where the Postal Service's competitors do not deliver or where broadband connectivity is not available rely especially on 6-day USPS delivery and would be adversely affected by any service cuts. Farmers rely on the delivery of seeds and other products through the mail and citizens who live far from retail outlets need the USPS for mail-order delivery.

Broad coalition of stakeholders favors 6-day delivery

According to the PRC's 2008 study of universal service, parcel shippers, direct marketer, magazine publishers and other major mailers along with consumer advocacy groups and the seven postal employee groups agreed: The elimination of 6-day delivery would hurt business and consumer interests while costing thousands of jobs.

PREPARED STATEMENT OF THE NATIONAL ASSOCIATION OF POSTAL SUPERVISORS

Chairman Durbin, Ranking Member Collins and Members of the Subcommittee: Thank you for holding this hearing on the financial crisis afflicting the United States Postal Service and the current proposal to eliminate 6-day mail delivery to American households and businesses. The current mandate upon the Postal Service to deliver 6-days-a-week, as you know, is contained in the annual appropriation law covering the Postal Service.

The National Association of Postal Supervisors, which represents the interests of the 33,000 supervisors, managers and postmasters who are responsible for mail operations throughout the Postal Service, wants to express our deep concern about the merit of introducing 5-day delivery.

I should note at the outset that our association represents Postal Service supervisors who are doing their share to help the Postal Service modernize and change. We support changes in the law, infrastructure and operations of the Postal Service that make sense and will modernize and sustain Postal Service operations, products and services.

However, we believe that the elimination of 6-day delivery will be devastatingly counter-productive to the Postal Service and its customers. It will pose problems for thousands of business mailers who depend upon Saturday delivery, who likely will adopt alternative delivery measures that only accelerate the migration of business mail to the Internet. Elimination of Saturday delivery will be harmful to the millions of household customers of the Postal Service, including the elderly who rely upon the timely receipt of their Social Security checks and the sick who rely upon the timely receipt of medicine and other medical products.

More fundamentally, elimination of 6-day delivery will damage the Postal Service brand, the competitive position of the Postal Service and cyclically draw down volume faster. Business competitors will fill the vacuum and offer Saturday delivery at premium prices, thereby gaining overall market share against the Postal Service.

Congress should refrain from changing current law and granting approval to 5-day delivery, at least for the time being. Five-day delivery should be the last resort, not the first. Better options are available now to preserve the health and vitality of the nation's postal system.

Foremost among them is Congressional passage of legislation that mandates the re-calculation of the Postal Service's pension obligation to the Civil Service Retirement System pension fund, using more equitable, reasonable and financially-stable calculation methods and assumptions; and credits to the Postal Service \$75 billion for an overcharge in its payments into the CSRS pension fund and transfers that credit to satisfy the Postal Service's obligation to the Postal Retiree Health Benefit Fund, which will fully fund all mandated payments through 2016.

In addition, Congress and the Postal Service should adopt new ways to increase revenues and cut costs. Congress should confer greater authority to the Postal Service to introduce and sell new products and services that expand the definition of "mail," as well as provide wider pricing flexibility. This should involve re-examination of the Postal Service business model and its underlying legal and regulatory framework.

The Postal Service also needs to continue to cut costs, reduce excess postal facility capacity, and eliminate wasteful programs—continuing the steps taken thus far that already have generated billions of dollars in savings.

During the past several years, our organization has collaborated with the Postal Service on major organizational changes to cut costs and increase efficiencies. Some of these changes have eliminated management and supervisory jobs. In 2009 alone, nearly 3,600 management positions were eliminated in the Postal Service. These changes have dramatically impacted the lives of management employees represented by our organization. Nonetheless, we acknowledged the necessity for these changes because of their underlying merits.

In contrast, the elimination of 6-day delivery lacks business sense and is counter-productive. Reducing delivery days now, when other steps are available, will only degrade the value of mail services for households and the mailing industry that use and rely upon the Postal Service.

Thank you for your leadership and your consideration these comments.

 PREPARED STATEMENT OF THE NATIONAL ASSOCIATION OF POSTMASTERS OF THE UNITED STATES

Chairman Durbin, Ranking Member Collins, and Subcommittee members, my name is Robert Rapoza. I am President of the National Association of Postmasters of the United States (NAPUS). My organization represents the managers-in-charge

of Post Offices throughout the United States. I am pleased to share with you NAPUS' thoughts regarding the finances of the United States Postal Service, with specific attention to necessity of maintaining a universal Postal Service.

Presently, there are about 27,000 Post Offices in the country; at the turn of the 20th century approximately 77,000 Post Offices dotted our cities and heartland. Although the numbers of surviving Post Offices are a mere fraction of their past magnitude, they continue to serve as the sole threshold to government services for millions of citizens and businesses situated in rural areas, small towns, and isolated communities. Simply stated, these treasured public facilities have been, currently are, and will continue to be an essential communications and commercial lifeline for America. Eight percent of this nation's Gross Domestic Product is postal-related, employing approximately 800 million Americans. The Post Office and its influence will reach far into the future, in spite of the digital juggernaut and the cataclysmic impact that the recent recession has had, and continues to have, on the U.S. Postal Service and its customers. As Postmasters, we interact on a daily basis with citizen mailers, destination point postal customers, and small businesses. While these customers may not be the so-called "major mailers", they are the foundation of the American postal system, and the reason why the Postal Service remains the most trusted, respected and valued governmental institution. It is important that Congress work to strengthen and not weaken the Postal Service's ability to continue to perform its historic and vital mission.

NAPUS recognizes the financial challenge confronting the Postal Service, but closing Post Offices, as being suggested by the Postmaster General and others within the agency should be one of last options. In recent speeches and visits to editorial boards, the Postmaster General has advocated the deletion of the statutory prohibition against closing a Post Office "solely for economic reasons." On behalf of the many communities for which a self-sustaining Post Office is beyond the means of a community, NAPUS strongly opposes the Postmaster General's pitch. There are reasons, other than financial, in which a Post Office may be closed. In fact, the Postal Regulatory Commission is presently reviewing a Postal pattern of circumventing the rules under which a Post Office may be "temporarily suspended." Impacted communities are sharing their insight with the PRC, within the context of a case initiated by Hacker Valley, West Virginia.

In the report accompanying the fiscal year 2010 Financial Service and General Government Appropriations Bill, this Subcommittee reaffirmed Congress' strong commitment to rural America in stating that "none of the funds provided [in the Act] be used to consolidate or close small rural and other small post offices." The subcommittee went on to say "These are services that must be maintained in fiscal year 2010 and beyond." Postmasters and Americans fervently believe that Post Offices are key linchpins that bind our nation together. America agrees with this view. A June 2009 Gallup Poll illustrated that 55 percent of Americans oppose the closing of Post Offices; that number escalates to 88 percent if the target is their Post Office.

NAPUS believes that the Subcommittee should consider appropriating the statutorily authorized postal public service subsidy; it amounts to a modest \$460 million. The authorization dates back to 1971, yet the Postal Service has not requested it since 1982. The motivation for the provision is obvious, and it highlights the value that Congress bestows on Post Offices. Section 2401(b)(1) of Title 39 states that the appropriation is to provide "a maximum degree of effective and regular postal service nationwide, *in communities where post offices may not be deemed self-sustaining . . .*" [Emphasis added] Congress cannot be more succinct in setting aside funds to assist small and rural Post Offices. The PRC estimated that closing all small and rural Post Offices would have shed only \$549 million in postal operating costs, in fiscal year 2008.

One of the most vexing quandaries is how to accurately and fairly evaluate the Postal Service's retiree health and Federal annuity obligations. The Committee Report that accompanied the fiscal year 2010 Financial Services and General Government Appropriations Bill acknowledged the problem. This Subcommittee documented that Office of Postal Inspector General projected the Postal Service to be on a schedule which would "result in a 6 percent overpayment to the [Postal Retiree Health Benefits] Fund by the end of 2016." Consequently, the Report directed the Postal Service, in conjunction with the Office of Personnel Management and Office of Management and Budget, to develop legislation to address the prefunding issue. It does not appear that there was a meeting of minds between the Postal Service and the Administration. We urge the Committee to direct the Office of Personnel Management to calculate the FEHBP inflation rate consistent with the methodology used by other large employers and by Medicare. This would reduce the FEHBP index by 2 percent and provide much-needed breathing room for the Postal Service.

Compounding the healthcare pre-funding inequity suffered by the Postal Service is the Postal IG conclusion that the Postal Service has overpaid \$75 billion into the Civil Service Retirement and Disability Trust Fund. This is the result of not correctly allocating the pension costs of pre-1971 postal employees. Ironically, if this pension overpayment were to be applied to pre-funding the Postal Retiree Health Fund, the health liability would be wiped away.

NAPUS understands that remedial legislation may have budget implications. This byproduct of postal relief impact stems from entanglement of postal operations, the unified budget and budget score-keeping. We believe that it should be made clear, through legislation and through credible representations, that postal funds paid into the Retiree Health Fund and the CSRS Fund are not taxpayer-generated, and, as a consequence, should not impact the Federal budget. The only reason the transactions “score” is because the Postal Fund is an “off-budget” account, while the health and retirement funds are “on-budget”, and CBO incorrectly asserts that relief increases postal spending. We believe that congressional budget rules should not penalize the Postal Service for overpaying into the funds, and should not exploit the Postal Service as a cash-cow for the government—particularly since the agency has no milk to give.

Thank you.

PREPARED STATEMENT OF THE NATIONAL RURAL LETTER CARRIERS' ASSOCIATION

Chairman Durbin, and members of the Senate Appropriations Subcommittee on Financial Services and General Government, my name is Don Cantriel, and I am President of the National Rural Letter Carriers' Association (NRLCA), which represents 123,000 bargaining unit rural letter carriers. Our members work in rural, suburban, and urban areas throughout the United States and function as a “post office on wheels” because rural letter carriers offer Postal customers all of the services performed over the counter at a post office. We sell stamps and money orders, accept express and priority mail, offer signature and delivery confirmation, registered and certified mail, and, of course, collect our customers' parcels.

Mr. Chairman, first and foremost, I would like to thank you for allowing me to submit a written statement for the record. Our country is experiencing a myriad of economic challenges, and the Postal Service has not been immune to these difficult financial times. The typical mailers who represent a large portion of the mailing business—the financial, mortgage, and credit card industries—have all scaled back their mailings as a direct result in cost cutting measures by businesses and the American consumer, resulting in unusually low mail volumes. This unusually low mail volume has caused the Postal Service to take drastic steps to change its business model and its operations.

One drastic step the Postal Service proposes is to eliminate Saturday mail delivery. Mr. Chairman and members of the Financial Services and General Government Subcommittee, I urge you in the strongest and most forceful way not to eliminate the congressionally-mandated 6-day delivery language provision. The provision stating “That 6-day delivery and rural delivery of mail shall continue at not less than the 1983 level” must be included once again in the 2011 Financial Services and General Government Appropriations bill.

The Administration's Budget Proposal recommends the inclusion of the mandated 6-day delivery provision. The Administration recognizes that the Postal Service, through no fault of its own, is facing real financial challenges. The Administration has pledged to work with the Postal Service, the employee unions, Congress, and other stakeholders to make sure that the Postal Service remains viable and a pillar of the economy. I encourage you to follow the Administration's lead by including the mandated 6-day delivery language in the 2011 bill and allow the Postal Service to do what it does best—serve the American public.

The Postal Service cannot expect that by working less it will achieve more. There is a dispute between the Postal Service and the Postal Regulatory Commission (PRC), which has regulatory oversight of the Postal Service, over how much money may actually be saved by eliminating a day of delivery. The Postal Service claims it will save \$3.5 billion if it were to eliminate Saturday delivery. The PRC disagrees, reporting the savings will be only \$1.9–\$2.1 billion. Either number represents a very small savings compared to the amount of revenue the Postal Service will lose as businesses or consumers find other methods of delivery to have their mail, packages, and products delivered. Recent history supports my contention that there will be a major loss of revenue if the Postal Service is given the green light to stop Saturday delivery. After passage of the Postal Reorganization Act of 1970, the Postmaster General essentially gave away the parcel business, because the Postal Service be-

lieved that its future was going to be in the collection and delivery of letters—not parcels. The Postal Service thereafter created an Express Mail product, only to give that business away—once again—to private delivery companies. The Postal Service has been fighting ever since to regain a share of each of those markets.

The point I am trying to make Mr. Chairman, is that consumers and businesses will not use a Postal Service that reduces service by 1 day a week or 17 percent. Once consumers and businesses find an alternative—and they surely will—they likely will stay away from the Postal Service for good. The vacuum that would be left by shutting down delivery operations on Saturdays is sure to be filled by a competitor and once we lose that business, we will forever be fighting—at even greater expense—to get it back. This is why I urge you to include the mandated 6-day delivery provision in the 2011 Financial Services and General Government Appropriations bill.

There is an easier way to put the Postal Service on firm financial footing that does not involve eliminating Saturday delivery. First, something must be done about the pre-funding of the Future Retirees Health Benefits Fund (FRHBF). When the 2006 Postal Accountability and Enhancement Act (PAEA) was passed, the Postal Service was experiencing high mail volumes and record revenues. Much has changed since then. Under the PAEA, the Postal Service's statutorily-required payment schedule is too much to bear and is patently unfair during these trying times. No other government agency or corporation is required to pre-fund their retiree health benefits—let alone required to almost fully pre-fund them at an accelerated pace. Reducing the amount of money the Postal Service is required to pay into the FRHBF has the potential to save the Postal Service billions of dollars and still not put employee pensions at risk.

Moreover, the Inspector General reported that the Postal Service has been overcharged \$75 billion on its CSRS Pension Fund responsibility. According to the OIG report, this overcharge has been used to pay the retirement costs of Federal employees, not just postal employees. The report continues to say that if the overcharge was used to prepay the FRHBF; it would fully meet the retiree healthcare liabilities and eliminate the need to continue for the Postal Service to continue paying \$5 billion annually as mandated by the PAEA. The Postal Service should be permitted to have the monies it was overcharged returned.

Finally Mr. Chairman, I ask that the Postal Service receive its limited appropriation reimbursement as mandated by the Revenue Forgone Reform Act of 1993. Revenue is considered forgone when Congress mandates the Postal Service provides mail services for designated mailers at free or reduced rates; such as free mail for the blind and overseas absentee balloting materials. Congress typically then appropriates money to reimburse the Postal Service for that revenue. While this amount will vary from year to year depending on actual usage, the Postal Service is still owed this revenue and I ask that Congress appropriate the proper amount the Postal Service is owed in forgone revenue.

Once again, I thank you for allowing me to submit a statement for today's Subcommittee hearing. If you have any questions, please do not hesitate to contact me at your convenience.

PREPARED STATEMENT OF THE NATIONAL POSTAL MAIL HANDLERS UNION

Thank you, Chairman Durbin, for holding this timely oversight hearing. The Postal Service's financial situation has been garnering lots of headlines and editorials recently, but not all of them have been accurate or fair. These hearings certainly are an important part of gathering the facts, and starting the process necessary to provide financial and other relief to the nation's postal system.

The National Postal Mail Handlers Union (NPMHU) represents 50,000 mail handlers. Our members are located in all of the major mail processing facilities. Mail handlers load and unload the trucks; cancel, prepare, sort, and dispatch the mail; and perform most of the allied duties necessary to the processing of mail. It is difficult and sometimes dangerous work.

In recent years, the NPMHU has worked diligently with Postal Service management on a variety of cost-saving initiatives. We have been meeting on a regular basis, at every level where results can be achieved, from the workroom floor to USPS headquarters at L'Enfant Plaza. We have adopted voluntary programs to improve safety, prevent accidents, and cut ergonomic injuries; we have produced joint interpretation manuals to reduce labor-management disputes and the overall number of grievances and arbitrations; we have agreed to early retirement programs, both with and without incentives; and we have cooperated with USPS efforts to automate and save costs while processing the mail more quickly. Mail handlers also

have experienced substantial decreases in the number of career employees, as well as cuts in hours and overtime; and we have had thousands of our members involuntarily reassigned or excessed into other hours, onto other tours or days of work, or into other facilities, sometimes in far off locations.

The NPMHU recognizes that the current economic environment may require additional responses. We do not believe, however, that eliminating Saturday delivery is change for the better. Saturday delivery anywhere in the United States is a hallmark of the Postal Service, and weekend processing and delivery of mail is vital to maintaining the postal network.

The Postal Service acknowledges, as it must, that the elimination of Saturday delivery will adversely affect some of its current business. There are numerous examples: Netflix is one of the Postal Service's largest customers. Many of your constituents look forward to that Saturday delivery of a DVD, as it provides entertainment for the weekend. What about the delivery of VA or Social Security checks, particularly if there is a Monday holiday? Businesses, particularly small businesses, often rely on Saturday delivery and weekend processing for their financial well-being. There are just too many ways that this proposal is wrong for the Postal Service to allow it to go forward. The NPMHU simply cannot agree that artificially accelerating the loss of volume is a good idea.

Thus, eliminating Saturday delivery is a last resort that should not be seriously considered when there are better solutions available that will not degrade the Postal Service. Several alternatives are obvious, and require action by Congress:

First and foremost, Congress must fix the wholly unrealistic, but statutorily required, schedule for the pre-payment of retiree healthcare benefits. The provisions of the 2006 Postal Accountability and Enhancement Act (PAEA) that established the Retiree Health Benefit Fund (RHBF) may have made sense in 2006 when the economy was healthy and the USPS was growing, but today they need to be modified. Congress and the White House need to step up to the plate and make changes to the RHBF. No Federal agency or significant private entity has any yearly liability remotely resembling the \$5 billion burden now imposed on the Postal Service. Those who want the Postal Service to run more like a private business should allow the USPS to do what businesses are allowed to do: let the Service postpone and adjust its payments to reflect the economic realities currently presented.

Furthermore, the size of the future liability for retiree health was calculated improperly. Gross errors were made on the number of retirees and the annual rate of inflation for healthcare, to name the two most prominent examples. These should be fixed, as the adjustments will provide an important lifeline to the Postal Service.

In short, protestations to the contrary, whether in the halls of Congress or publicly, do not change the actual facts: the calculations underlying the Retiree Health Benefit Fund, and the repayment schedules established by the PAEA, are to blame for a large part of the Postal Service's current financial woes.

Second, the USPS portion of the CSRS pension fund also was improperly calculated. The Office of Personnel Management must be directed to recalculate the USPS liabilities using actuarial methods that are accurate and fair, and then must initiate an inter-governmental transfer of the resulting surplus to the USPS and its ratepayers.

The NPMHU also urges support for the "vote-by-mail" legislation currently before the Senate.

We also urge Congress to grant the Postal Service more flexibility in developing new, innovative ways of conducting its business and increasing its customer base.

With regard to specific legislation, the NPMHU supported the original version of S. 1507, which had a realistic approach to the RHBF funding schedule. Had that legislation passed as introduced, this entire proceeding would have a different character to it. The original version of S. 1507 was legislation that most parties agreed was acceptable. However, the bill was amended into a vehicle to tilt the collective bargaining process in favor of management, despite the fact that the process for four decades has functioned as it was intended, without any labor stoppages, lock-outs, or similar labor-management strife since its inception. The changes added to S. 1507 about the financial condition of the Postal Service were an unnecessary block to constructive resolution of these serious funding issues.

As noted, the financial situation facing the Postal Service calls for immediate resolution, and that resolution rests with Congress and the Executive Branch. Congress must act to ensure that changes to the Retiree Health Benefit Fund and the calculation of the CSRS overpayments are made, so that the Postal Service is able to follow rational accounting methods and commonsense budgeting while it struggles to remain solvent during these tough economic times.

Thank you, again, for holding this oversight hearing.

PREPARED STATEMENT OF THE AMERICAN POSTAL WORKERS UNION, AFL-CIO

Mr. Chairman and members of the Subcommittee, my name is William Burrus, President of the American Postal Workers Union, AFL-CIO. On behalf of the 260,000 members of my union, I thank you for holding this hearing today to examine the financial condition of the United States Postal Service (USPS), and for providing the APWU an opportunity to submit testimony.

Since 1775, the Postal Service has sorted, transported and delivered mail throughout the nation. The Service began as a conduit for communication between the Continental Congress and our armies during the Revolutionary War. In 1863, pursuant to statute, the USPS began delivering mail to certain addresses if postage was enough to “pay for all expenses of the service.” By 1896, the Postal Service was making deliveries to certain rural and urban homes 6 days a week. In some cities, in fact, delivery occurred more than once per day until 1950. In other more remote rural areas, deliveries continued to occur fewer than 6 days per week. Today, the USPS delivers to 146 million homes and businesses, 6 days a week. Throughout the Service’s history, however, there have been discussions about reducing the number of delivery days to conserve fuel and reduce costs.¹

The Postal Service’s mission is to provide the nation with affordable and universal mail service. However, the USPS’ authority was revised on December 20, 2006, with the enactment of the Postal Accountability and Enhancement Act (PAEA). Through this legislation, Congress sought to provide the USPS with tools and mechanisms to help ensure that the USPS is efficient, flexible, and financially sound, but the law has had the opposite effect.

USPS Financial Condition

The PAEA has forced the Postal Service virtually into insolvency. It imposed on the Postal Service a \$75 billion obligation to pre-fund retiree health benefits, a liability that is not borne by any other Federal agency.

This requirement, more than any other single factor, has created a USPS deficit of alarming size. A 2008 GAO report found the USPS’s \$5.3 billion shortfall in fiscal year 2007 was caused primarily by this provision of the PAEA.²

If the USPS were to release financial records showing liabilities minus this obligation, such documents would clearly demonstrate the disastrous effect the legislation has had. Absent this pre-funding burden, the Postal Service would have experienced a cumulative surplus of \$3.7 billion over the last 3 fiscal years, despite declining mail volume, an economy in chaos, and electronic diversion.

The APWU is compelled to ask: If funding future healthcare liabilities meets sound accounting standards, why isn’t this requirement applied to all Federal and private enterprises? Why doesn’t every branch of government, including Congress, pre-fund future healthcare liabilities?

The PAEA was a mistake, a gross miscalculation, which provided no new revenue stream for the Postal Service while imposing massive, artificial new costs. The pre-funding provision is the central cause of USPS financial difficulties, and we urge Congress to correct it. If this single requirement were rescinded, the elimination of Saturday mail delivery would be unnecessary.

USPS Share of CSRS Pension Responsibility

We also strongly urge Congress to give serious consideration to the USPS Office of Inspector General’s findings that the methodology for determining the Postal Service’s contribution to the Civil Service Retirement and Disability Trust Fund is flawed.

For employees who began their career before the Postal Reorganization Act of 1970, pension responsibility is shared between the Federal government and the USPS. The Office of Personnel Management (OPM) established the methodology to be used in determining the contribution of both entities. The USPS OIG commissioned the Hay Group, a well-known actuarial firm, to review the allocation of liabilities for postal pensions between the Federal government and the USPS. The Hay Group’s findings, “Evaluation of the USPS Postal CSRS Fund for Employees Enrolled in the Civil Service Retirement System,” describes the results of its analysis.

Among the findings in the report is that if “the more equitable years-of-service allocation methodology had been used to determine the value of the Postal CSRS Fund, the OIG estimates its value on September 30, 2009, would have been approximately \$273 billion rather than \$198 billion—a difference of \$75 billion.” The \$75

¹Congressional Research Service, The U.S. Postal Service and Six-Day Delivery: Issue for Congress, July 29, 2009, p. 1.

²U.S. Government Accountability Office, U.S. Postal Service: Mail-Related Recycling Initiatives and Possible Opportunities for Improvement, GAO Report GAO-08-599, June 2008, p.1.

billion overpayment would allow the Postal Service to pay a \$10 billion unfunded liability, pay off its remaining debt, and add approximately \$55 billion into the Retiree Health Benefits Fund, which already has an approximately \$35 billion balance. With \$90 billion, the Postal Service would be positioned to fully fund the PAEA obligation.

There is no dispute that the USPS faces a serious financial challenge as a result of the requirement to pre-fund retiree healthcare liabilities and the flawed pension allocation methodology. A more equitable allocation of pension liabilities would offer the USPS stability, which could delay any reduction in the number of mail delivery days and other policies that would undermine its ability to provide universal service at uniform rates to American citizens.

The APWU urges Congress to develop a legislative solution to correct the formula which so unfairly requires postal customers to subsidize pension obligations that should be covered by the Federal government.

Recently, Postal Service announcements have included projections of a \$238 billion deficit over the next 10 years. Frankly, these predictions are outlandish and unsupported. The USPS has offered no justification for these wild claims, and, unfortunately, the media has failed to challenge them.

Six-Day Delivery

Following the USPS briefing on March 2, 2010, I was critical of USPS proposals to reduce mail delivery to 5 days per week, writing to APWU members, "It would be the beginning of the demise of the Postal Service."

In 2008, both the PRC and the USPS conducted studies of mail delivery. The USPS study concluded that the elimination of one delivery day could save the Service \$3.5 billion per year, while the PRC finding was savings of \$1.93 billion.

Congress considered the reduction in service delivery days more than 30 years ago in response to an earlier study by the USPS. After holding a dozen hearings with hundreds of witnesses, the House of Representatives approved a resolution opposing the service reduction by a vote of 377–9.

Then, as now, the key question was: Is the USPS a profit-driven organization, or a public service?

In 1980, Postmaster General William F. Bolger appeared before Congress insisting that reducing the number of delivery days was necessary to ensure the Postal Service's economic stability. He estimated that the switch to 5-day delivery would result in the loss of 15,000 to 20,000 Postal Service jobs. Based on statements reported by participants in a 2010 meeting of the Mailers Technical Advisory Council, the 2010 version could result in the loss of as many as 199,000 good-paying, middle-class USPS jobs.

However, the APWU's opposition to eliminating Saturday delivery is not based on a concern about losing jobs. (Approximately 2,500 jobs in positions represented by the APWU would be affected.) We are concerned about protecting the vitality of the USPS for the future, and we support the right of every citizen—including those without Internet access and the disabled—to receive high-quality mail service.

Former Postal Regulatory Commission Chairman Dan G. Blair addressed some of the dangers of the proposal in testimony before the Senate Subcommittee on Federal Financial Management, Government Information, Federal Services, and International Security on January 28, 2009. Senator Susan Collins stated that the decision to further reduce postal services would cause "an even bigger drop" in mail volume that could lead to a "death spiral" for the USPS.

New Services

It is easy to suggest that the Postal Service should offer new services in order to remain financially sound while ignoring free-market obstacles. However, it is unlikely that a single new service or product would be accepted without challenge by private-sector competitors; furthermore, it is unlikely that such services would result in short-term profits for the USPS.

In testimony before the House Subcommittee on Federal Workforce, Postal Service, and the District of Columbia on November 5, 2009, GAO officials said, "Allowing USPS to compete more broadly with the private sector would raise risks and concerns. As with USPS's non-postal ventures before PAEA was enacted, new non-postal ventures could lose money; and even if they were to make money, issues related to unfair competition would need to be considered."

How can the USPS be expected to fund new enterprises that would require significant start-up costs while it is saddled with a \$75 billion debt? The reality is that requiring a payment averaging \$5.6 billion annually for 10 years would bankrupt any American corporation.

Savings and Collective Bargaining

In recent years, the USPS has achieved unprecedented savings through productivity increases, a series of cost-cutting initiatives, and sacrifices by workers. More than 100,000 jobs have been eliminated through attrition over the last 2½ years, and workers have begun paying an increased share of health insurance premiums.

In addition to 5-day mail delivery, the USPS has proposed numerous changes that relate directly to workers' rights and benefits and are governed by collective bargaining. We reject any effort to influence the process with threats of severe work-rule changes. Contract negotiations for both the American Postal Workers Union and the National Rural Letter Carriers Association begin in the fall.

We believe it is unreasonable to single out a handful of provisions achieved through bargaining that benefit workers (such as protection against layoffs) from the host of negotiated stipulations that are contrary to workers' objectives.

Conclusion

Mr. Chairman, we believe the rush to 5-day mail delivery is an ill-conceived reaction to declining mail volume during an economic slowdown. While volume may never return to 2006 levels, even a modest return, coupled with repeal of the requirement to pre-fund retiree health benefits, would go a long way toward sustaining the Postal Service for many years into the future.

STATEMENT OF HON. RUTH Y. GOLDWAY, CHAIRMAN, POSTAL REGULATORY COMMISSION

Senator DURBIN. I might also say to those in attendance that our next panel includes Ruth Goldway, Chairman of the Postal Regulatory Commission.

We're glad you're here.

She's the longest-serving full-time Senate-confirmed Presidential appointee within the executive branch of the United States Government.

Congratulations.

Also appearing is David Williams, independent inspector general for the U.S. Postal Service since 2003. He's served as inspector general for a number of agencies: the Nuclear Regulatory Commission, Social Security Administration, Department of the Treasury, and the Department of Housing and Urban Development, held top posts at Labor and Transportation Security agencies, former special agent with the Secret Service, and a decorated veteran, and, I'm proud to note, a native of Illinois, graduate of Southern Illinois University in Edwardsville, where my wife attended, and holds a master's in education as a graduate of the University of Illinois, Champaign.

Phillip Herr joins us from the U.S. Government Accountability Office. He's Director in the Physical Infrastructure Team of the GAO. Since joining GAO in 1989, he's managed reviews of a broad range of domestic and international programs. His current portfolio focuses on programs at the U.S. Postal Service and the Department of Transportation. And prior to joining the GAO, he worked in management consulting, and holds a Ph.D. from Columbia University.

Thanks, to each of you, for being here.

I'm going to allow each of you an opportunity to make an opening statement. Your entire statement will be made part of the record.

Ms. Goldway, why don't you proceed.

SUMMARY STATEMENT OF HON. RUTH Y. GOLDWAY

Ms. GOLDWAY. Thank you. Thank you, Chairman Durbin and Ranking Member Collins. Thank you for the opportunity to testify today.

I'm pleased to represent the Postal Regulatory Commission and to explain our role in whether or not the Postal Service should reduce mail delivery to 5 days.

Under the Postal Accountability and Enhancement Act, whenever the Postal Service considers a nationwide change in the nature of postal services, it must submit a proposal to the Commission requesting an advisory opinion on the change. Under Commission rules, such a request must be filed no fewer than 90 days before the date the Postal Service proposes to make the change effective.

The Commission provides a public, on-the-record hearing process so that mail users and the public can test the Postal Service's proposals and offer supporting or opposing views. Then the Commission issues an opinion that balances all applicable public policies, especially the need to maintain adequate and effective universal service and the need to provide services in an economic and efficient manner.

In this specific instance involving a plan to eliminate Saturday delivery, the Postal Service must also seek congressional approval, because, for over 25 years, since 1983, the delivery levels of that year have been specified as the minimum annual appropriations legislation.

For comparison, just last week the Commission issued and distributed another advisory committee—commission—another advisory opinion in which we reviewed a proposal regarding the process for closing the more than 4,000 retail facilities it denominates as classified stations and branches. There was an overwhelming public support for the maintenance of post offices from all of our participants in the hearing process. The Commission advised the Service to make significant improvements in the process, which would result in a more accurate, comprehensive, and balanced financial projection and would ensure the rights of affected customers who should have a meaningful opportunity to provide input before a decision to cut service is made. Congressional review in this matter could be helpful, but is not required.

When the Postal Service requests our opinion on elimination of Saturday delivery, it will have to provide comprehensive evidence to justify this change. The Commission will follow well-established administrative procedures to analyze the evidence. This includes an opportunity for us to question the Postal Service and an opportunity for the public to provide its views. The Postal Service and participants will have the opportunity to file briefs and issue briefs and submit reply briefs.

The Commission expects to hear from a wide variety of businesses and associations that are dependent on, or make significant use of, the Postal Service. We will build a comprehensive record on the potential cost savings, on volume declines, and on impacts on maintenance of timely and reliable service.

On this important matter, the Commission will also expand participation to include both individuals and groups representing average citizens. As we have done before, we will hold field hearings in cities around the country to learn about specific experience that give meaning to the broad national trend data that we generally rely on.

The Postmaster General's testimony, filed here today, describes a complex plan for 5-day delivery. It is difficult to say precisely how much time will be necessary to develop a thorough advisory opinion. Depending on the completeness of the information presented by the Postal Service, and the issues and the motions raised by individual business participants, a rough estimate would be 6 to 9 months.

The Commission studied the cost savings associated with 5-day mail delivery in 2008 as a part of our "Universal Postal Service and Postal Monopoly" report to Congress. In that report, the Commission presented an estimate that cutting Saturday delivery would have saved the Postal Service \$1.9 billion in 2007, about \$1.6 billion less than the Postal Service calculation at that time. About one-third of the difference was because the Postal Service didn't figure in any volume losses. We estimated a 2-percent reduction in volume, caused by a reduction in service. The Service also didn't account for the added costs of delivering pieces that otherwise would have been delivered on Saturday.

But, neither the Postal Service nor the Commission was quantifying a fully developed change of the type outlined today. We will carefully analyze the Postal Service's filing that should include, when it's filed, a sophisticated and comprehensive presentation of potential cost, volume, and revenue changes to support its estimates of net savings. Hopefully, it will also explore the impacts of 5-day delivery on the Postal Service and on the economic and social interests of its customers. I believe our conclusions will be of help to you and inform your deliberations on legislation.

Today, you also asked witnesses to comment on the current financial situation facing the Postal Service. We hope to discuss our Commission's annual compliance determination with you when it is issued late this month. It will provide a solid analysis of the Postal Service's precarious finances, and in the context of the rate and service performance of fiscal 2009. Suffice it to say that the situation is serious and we are unanimous on the—in the Commission in our hope that Congress will address the retiree healthcare benefit issue promptly.

PREPARED STATEMENT

Thank you again for providing me the opportunity to testify. I would be pleased to respond to any questions that you have today.
 Senator DURBIN. Thanks, Ms. Goldway.
 [The statement follows:]

PREPARED STATEMENT OF RUTH Y. GOLDWAY

Chairman Durbin, Ranking Member Collins and members of the Subcommittee, thank you for the opportunity to testify. I am pleased to represent the Commission today, and to explain its role in the process of reviewing the coming Postal Service proposal for a reduction in the mandated mail delivery frequency. This proposal impacts virtually every citizen in the Nation, and this Subcommittee is wise to turn

its attention so quickly to this issue. Today, I hope to provide you with a clear understanding of the Postal Regulatory Commission's statutory obligation and how we intend to fulfill it.

When the Postal Service determines that there should be a change in the nature of postal services which will generally affect service on a nationwide, or substantially nationwide basis, it must submit a proposal to the Commission requesting an advisory opinion on the change. This requirement was established by the Postal Reorganization Act of 1970, and was retained by the Postal Accountability and Enhancement Act of 2006. Our rules provide that such a request must be filed with the Commission no less than 90 days in advance of the date on which the Postal Service proposes to make the change effective.

The Commission is responsible for providing a public, on-the-record, hearing process so that mail users and other interested members of the public can test the Postal Service's proposal and offer supporting or opposing views. The Commission will then provide an opinion that takes into account all applicable public policies, such as the need to maintain adequate and effective universal service, and the need to provide services in an economic and efficient manner.

While we have not yet received a formal proposal from the Postal Service to eliminate Saturday delivery, we have been told to expect one this month. In this specific instance, the Postal Service must also seek approval from Congress, since for over 25 years, 1983 delivery levels have been specified as a minimum in annual appropriations legislation, thereby requiring maintenance of 6-days-a-week city and rural delivery.

Last week, on March 10, the Commission submitted an advisory opinion on another service change proposal. The Postal Service requested a review of its process for closing the more than 4,000 retail facilities it denominates as classified stations and branches. The Commission found that significant improvements should be made to this process. These improvements would result in more accurate, comprehensive, and balanced financial projections as a basis for Postal Service decisions, and would ensure the rights of affected customers who should have a meaningful opportunity to provide input before a decision to cut service is made. Copies of that opinion have been provided to members of this Committee. I believe this case is representative of the thorough review and constructive advice the Commission provides in response to Postal Service requests.

When the Postal Service submits the request for an advisory opinion on elimination of Saturday delivery, it will provide evidence explaining why it believes this change is justified. The Commission will follow established procedures and create a schedule to analyze that evidence. The schedule will include an opportunity to question the Postal Service, and an opportunity for the public to provide its views, both informally and as part of more formal, technical presentations. The Postal Service and interested members of the public will have the opportunity to brief issues and submit reply briefs.

Based on recent experience, I expect the Commission will receive detailed and thoughtful comments from a wide variety of businesses and associations that are dependent upon, or make significant use of, the Postal Service. To the extent necessary, the Commission will issue information requests so that a comprehensive record exists to support conclusions on potential cost savings, volume declines, and impacts on the maintenance of timely and reliable service.

Additionally, the Commission will expand its outreach efforts to encourage participation by both individuals and groups representing businesses and average citizens affected by the proposal. In recent cases, the Commission has found that going outside of Washington, DC, and holding field hearings in such places as The Bronx, New York, Independence, Ohio, St. Paul, Minnesota and Flagstaff, Arizona has proven extremely helpful. During these hearings, we learn about specific experiences that give meaning to the broad national trend data we generally rely on.

As we have not yet seen the actual Postal Service proposal, it is difficult to estimate precisely the amount of time that will be necessary to develop a thorough advisory opinion. Depending on the complexity of the issues raised both by the Postal Service and by individual and business participants, a rough estimate would be 6 to 9 months.

The invitation to testify today also sought witness comments on the current financial situation facing the Postal Service. Suffice it to say that we are all well aware of the seriousness of the Postal Service's current situation, and hopeful that Congress may see fit to address the retiree healthcare benefit issue promptly. The Commission will issue its Annual Compliance Determination later this month that will provide a full analysis of the Postal Service finances in the context of its rate and service performance in fiscal year 2009. I will make certain that each member of

this Committee is immediately provided with a copy of the Annual Compliance Determination.

As a point of reference, the Commission recently had occasion to approximate the cost savings associated with 5-days-a-week mail delivery. In December 2008, the Commission submitted a report to Congress entitled "Universal Postal Service and the Postal Monopoly", as required by the Postal Accountability and Enhancement Act of 2006. Specifically, the Act required the Commission to estimate the costs of the Universal Service Obligation and the value of the existing monopoly.

The Commission accepted as reasonable an estimate developed by a team of outside consultants that reducing the frequency of delivery from 6 to 5 days would have increased the Postal Service's fiscal year 2007 profits by \$1.9 billion. This was about \$1.6 billion less than a Postal Service calculation at that time. About one-third of the difference was due to the fact that the Postal Service assumed no mail volume would be lost as a result of the reduction in service. The consultants' estimates reflected a 2 percent reduction in volume due to the reduction in service. The other major difference related to the costs of delivering pieces that otherwise would be delivered on Saturday.

However, neither the Postal Service nor the Commission were quantifying a fully developed change proposal of the type the Postal Service has said it will be providing later this month. I look forward to carefully analyzing a Postal Service proposal that includes a sophisticated presentation of potential cost and revenue changes to support its estimates of the impact of elimination of Saturday delivery both on the Postal Service and on the economic and social interests of its customers.

Thank you again for providing me the opportunity to testify today. I would be pleased to respond to any questions Subcommittee members may have.

Senator DURBIN. Mr. Williams.

STATEMENT OF HON. DAVID C. WILLIAMS, INSPECTOR GENERAL, OFFICE OF INSPECTOR GENERAL, UNITED STATES POSTAL SERVICE

Mr. WILLIAMS. Thank you, Mr. Chairman and Senator Collins. I appreciate the opportunity to discuss the Postal Service's current financial condition.

The Postal Accountability and Enhancement Act of 2006 set the Postal Service on a visionary, imaginative course to behave with the agility and customer responsiveness found in the private sector. However, the act's incentives and pressures served to illuminate chronic business-model problems that required rapid correction. Also, the recent economic downturn hit the postal community very hard. Last, the Digital Age has entered a creative-destructive phase, disrupting numerous industries, including the Postal Service.

The Postal Service is moving in the right direction, but its velocity is insufficient to avoid an economic catastrophe that will severely challenge its viability. Actions are needed now in several key areas.

Each year, the Postal Service pays \$7 billion more than is warranted for its benefit funds. This overcharge is the result of exaggerated healthcare inflation percentages, a transfer of Federal pension responsibilities to the Postal Service, and excessive prefunding targets for retiree healthcare and pension funds. Addressing this overcharge could allow needed time to plan and integrate large-scale cost-reduction initiatives. The large network of post offices, plants, and administrative apparatus is financially burdensome. To its credit, the Postal Service has streamlined some of its network, reducing over 130,000 employee positions since 2003 and cutting \$6 billion in costs for 2009 alone.

The Postal Service must accelerate its infrastructure optimization plan while balancing its commitment to service. The Postal

Service's complex workforce rules do not always match mission requirements. The ebb and flow of mail in the processing plants suggest the need for a more flexible staff willing to perform a wider range of duties. The current method of paying carriers by the hour requires closer management than is possible and disincentivizes optimal performance.

We, along with the Postal Service, have recognized the need for a simplified, modernized pricing structure. The Postal Service has three primary product lines: letters, flat mailings, such as magazines, and packages. Yet, it has thousands of price variations for them. Additionally, 24 of the 135 work-share discounts exceed costs avoided, and other discounts may no longer be of value. A simple pricing structure could be easier to use and allow more accurate charges to customers.

A recent poll indicated that reducing 6-day delivery to 5 days has the support of mail recipients, though mailers have expressed concerns. Mail pieces per mailbox have declined significantly, from six pieces per day to four. And reducing delivery days would seem to balance cost by restoring the number of pieces being delivered. Additionally, with the Nation's 40-hour workweek—managing resources for a 5-day business cycle is much simpler than for 6 days. The Postal Service needs to weigh potential savings against possible decreases in revenue and loss of its competitive advantage, since other companies charge premiums for Saturday delivery.

Last, my office is concerned that the Postal Service build-down could be so rapid that the dynamics within and among the large initiatives are not fully understood. Adding 5-day delivery changes to infrastructure optimization, management of the FSS investment, and intelligent mail barcode implementation is daunting. Perhaps a test, beginning in the quieter summer months, would provide a great deal of useful information.

To conclude, I'm not aware of a business in the world that could forfeit \$7 billion annually before its doors open, and survive. Benefit prefunding overcharges should be fixed. Additionally, the Postal Service should aggressively right-size its infrastructure without delay. The clock is ticking, and this may be their last shot. Work rules should be better aligned with mission requirements. A simplified pricing structure should be implemented to bring in new business and enable accurate calculation of revenues due.

The world is in the midst of a digital revolution, and it's a wild ride for the Nation's entire communications infrastructure. Globalization and the Digital Age are providing exciting opportunities, but only for some. Tech centers in India and China are tightly surrounded by people pulling ploughs with water buffalo, people who have been completely left behind.

America has taken many actions in the past, such as land-grant universities, TVA, rural mail delivery, and interstate highways, to ensure that people are not left behind. The powerful and unpredictable events facing the communications industry may require such action, to assure that all Americans have universal access and the opportunity to take part in this exciting new world.

Our communications infrastructures have to recover from the shock and trauma of a changed world to assure their readiness to play both traditional and emerging roles in support of our citizens.

Thank you.
Senator DURBIN. Thanks a lot.
Mr. Herr, your turn.

STATEMENT OF PHILLIP HERR, DIRECTOR, PHYSICAL INFRASTRUCTURE ISSUES, GOVERNMENT ACCOUNTABILITY OFFICE

Mr. HERR. Thank you, Chairman.

Chairman Durbin and Ranking Member Collins, I'm pleased to participate in this hearing on the U.S. Postal Service.

Today, I will briefly discuss its financial condition and forecast. I will also provide GAO's perspective on the Postal Service's need for restructuring, as well as highlight questions for Congress to consider regarding changing delivery from 6 to 5 days.

Turning first to the Postal Service's financial condition. As mail volume declined by 35 billion pieces in fiscal years 2007 through 2009, the Postal Service's financial viability has deteriorated, leading to \$12 billion in losses. Current forecasts, discussed earlier, are that mail volume will decline to 167 billion pieces this fiscal year, the lowest levels since 1992. The Postal Service projects a record loss of over \$7 billion this fiscal year, while taking on \$3 billion in debt. Its outstanding debt will increase to \$13.2 billion, close to its \$15 billion statutory limit.

The Postal Service does not expect total mail volume to return to its former levels when the economy recovers. Simply put, the economic downturn and continuing shift to electronic communications and payments has changed how mail is used. By fiscal year 2020, the Postal Service projects further volume declines of about 16 percent, to 150 billion pieces, the lowest level since 1986. First-class mail volume is projected to decline by another 37 percent over the next decade, as seen in figure 3 of my written statement. And less-profitable standard mail, primarily advertising that's subject to economic fluctuations, is projected to remain roughly flat over the next decade.

Turning to restructuring and 5-day delivery. As Senator Collins noted, in July 2009 GAO added the Postal Service's financial condition to our high-risk list again and reported that action is urgently needed in multiple areas so that the Postal Service can achieve financial viability. Such actions should include restructuring its operations, networks, and workforce to reflect changes in mail volume and revenue. The longer it takes for the Postal Service and Congress to address these challenges, the more difficult they will be to overcome.

We believe that no single change will be sufficient to address the Postal Service's pressing challenges, and have identified key actions the Postal Service and/or Congress could take. Compensation and benefits costs represent 80 percent of the Postal Service's costs, as Senator Durbin mentioned earlier. Cost-savings opportunities are possible with regard to personnel and benefits.

In terms of retirements, annually through 2020, about 5 percent of Postal Service employees will be eligible and are expected to retire. That represents approximately 300,000 employees, about one-half the current workforce. In terms of benefit costs, postal employees have 80 percent of their health benefit premiums covered, 8 percent more than most Federal employees.

Consolidating processing and retail networks is also needed, given mail volume declines. Removing excess capacity is necessary in the 600 processing facilities, where first-class mail processing capacity exceeds needs by 50 percent.

In the retail area, approximately 30 percent of revenue currently comes from purchases at nonpostal locations, such as grocery stores, indicating that consumers have begun shifting to alternatives. The network of 36,500 retail facilities can also be reduced. Maintenance has been underfunded for years, resulting in deteriorating facilities and a backlog.

Another opportunity for savings is consolidating the postal field administrative structure by reviewing the need for 74 district offices and eight area offices. And because cost-cutting alone will not ensure a viable Postal Service, generating revenue through new or enhanced products is needed to maximize profitable mail volume.

Two additional options that would require congressional approval involve, first, the funding requirements of retiree health benefits. As mentioned today, last-minute congressional action was needed this past September to reduce the Postal Service's required payments from \$5.4 billion to \$1.4 billion. And, second, reducing delivery from 6 to 5 days.

Questions we have raised that Congress might wish to consider regarding changing delivery from 6 to 5 days include: How would eliminating Saturday delivery affect efforts to increase volume? How would delivery service standards be affected? How will consumers and business customers be affected in their operations? And how much leadtime would be needed to modify postal operations and financial systems for this actually to take place?

Such issues must be addressed so that stakeholders fully understand the potential ramifications of these changes. GAO also expects to analyze this proposal when it becomes available.

Mr. Chairman, in conclusion, the longer it takes for the Postal Service and Congress to realign the Postal Service to the changing use of the mail, the more difficult change will be. Toward that end, GAO has an ongoing review to evaluate options for long-term structural and operational reforms and we plan to issue our report in April.

PREPARED STATEMENT

This concludes my prepared statement, and I'm pleased to answer any questions.

Thank you.

[The statement follows:]

PREPARED STATEMENT OF PHILLIP HERR

HIGHLIGHTS

Why GAO Did this Study

The U.S. Postal Service's (USPS) financial condition and outlook deteriorated significantly during fiscal year 2009. USPS was not able to cut costs fast enough to offset declining mail volume and revenues resulting from the economic recession and changes in the use of mail, such as electronic bill payment.

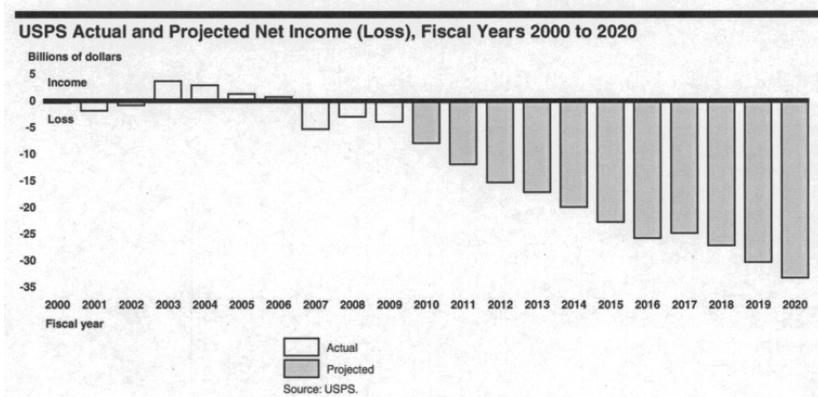
In July 2009, GAO added USPS's financial condition and outlook to its High-Risk List and reported that USPS urgently needed to restructure to improve its financial viability. Declines in mail volume and revenue, large financial losses, increasing debt, and financial obligations will continue to challenge USPS.

This testimony provides (1) information on USPS's financial condition and forecast and (2) GAO's perspective on the need for USPS restructuring. In addition, questions and issues are included for Congress to consider regarding USPS's proposal to reduce delivery from 6 to 5 days. This testimony is based on GAO's past and ongoing work, including its work on postal reform issues, its report adding USPS's financial condition and outlook to its High-Risk List, and updated information on USPS's financial condition and outlook.

FINANCIAL CRISIS DEMANDS AGGRESSIVE ACTION

What GAO Found

As mail volume declined by 35 billion pieces (about 17 percent) in fiscal years 2007 through 2009, USPS's financial viability deteriorated, with close to \$12 billion in losses, and it does not expect total mail volume to return to its former level when the economy recovers. USPS forecasts that total mail volume will decline to 167 billion pieces in fiscal year 2010—the lowest level since fiscal year 1992, and 22 percent less than its fiscal year 2006 peak. It also projects a record loss of over \$7 billion. Further, USPS has halted construction of most new facilities and expects to borrow \$3 billion in fiscal year 2010, which would bring its total outstanding debt to \$13.2 billion, close to its \$15 billion statutory limit. Looking forward, USPS projects that by fiscal year 2020, total mail volume will further decline by 16 percent, to the lowest level since 1986. Absent additional actions to cut costs and increase revenues, USPS expects financial losses will escalate over the next decade.



Action is urgently needed in multiple areas by USPS and Congress to address USPS's pressing challenges so that it can achieve financial viability, including restructuring USPS operations, networks, and workforce to reflect changes in mail volume, revenue, and use of mail. The longer it takes for USPS and Congress to address USPS's challenges, the more difficult they will be to overcome. When GAO placed USPS's financial condition and outlook on its High-Risk List, it identified the following key actions USPS and/or Congress could take: reduce employee compensation and benefits; consolidate retail and processing networks; consolidate administrative field structure; generate revenue through new or enhanced products; change funding requirements for retiree health benefits; and realign delivery services. GAO will analyze USPS's proposal to reduce delivery from 6 to 5 days when it becomes available. Included in this testimony are questions and issues for Congress to consider regarding delivery changes. GAO will also be issuing its report later this spring that provides its perspective on USPS's financial crisis, as well as additional options for restructuring.

Mr. Chairman and Members of the Subcommittee: I am pleased to participate in this hearing on the U.S. Postal Service's (USPS) financial condition, a topic we have been continually monitoring given USPS's deteriorating financial condition during fiscal year 2009. My statement will provide (1) information on USPS's financial condition and forecast and (2) our perspective on the need for USPS restructuring. In addition, we provide questions and issues for Congress to consider regarding USPS's proposal to reduce delivery from 6 to 5 days.

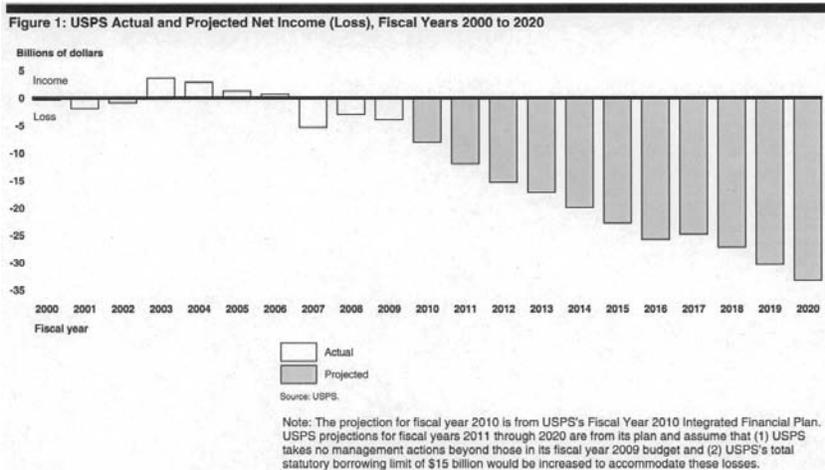
My statement is based upon our past and ongoing work, including our work on postal reform issues, our report adding USPS's financial condition and outlook to our High-Risk List, and updated information on USPS's financial condition and out-

look. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

USPS'S FINANCIAL CONDITION HAS DETERIORATED AND ITS OUTLOOK IS POOR

As mail volume declined by 35 billion pieces (about 17 percent) in fiscal years 2007 through 2009, USPS's financial condition deteriorated, with close to \$12 billion in losses, and it does not expect total mail volume to return to its former level when the economy recovers. This volume decline was largely due to the economic downturn and changing use of the mail, with mail continuing to shift to electronic communications and payments. In July 2009, we added USPS's financial condition and outlook to our High-Risk List and reported that USPS urgently needed to restructure to address its financial viability.¹ Despite \$6.1 billion in cost savings in fiscal year 2009 as well as congressional action that relieved USPS of \$4 billion in mandated payments to prefund postal retiree health benefits,² USPS still reported a loss of \$3.8 billion for the year. Also, USPS debt increased by the annual statutory limit of \$3 billion, bringing outstanding debt to \$10.2 billion at the end of fiscal year 2009.

These declines along with large financial losses, increasing debt and financial obligations, are projected to continue to challenge USPS. Most recently, total mail volume for the first quarter of fiscal year 2010 was down almost 4.5 billion pieces, a decrease of almost 9 percent over last year. For fiscal years 2010 and 2011, USPS is projecting annual deficits exceeding \$7 billion and additional pressures to generate sufficient cash to meet its obligations. Further, USPS has halted construction of most new facilities and has budgeted \$1.5 billion in capital cash outlays (mostly for prior commitments), which is down from the average of \$2.2 billion in the previous 5 fiscal years. USPS also expects to borrow \$3 billion in fiscal year 2010, which would bring its total outstanding debt to \$13.2 billion, close to its \$15 billion statutory limit, which it could reach as early as fiscal year 2011. USPS projects that financial losses will escalate over the next decade, with cumulative losses of over \$230 billion by fiscal year 2020 if its planned cost reduction and revenue generation initiatives are not implemented. (see fig.1).

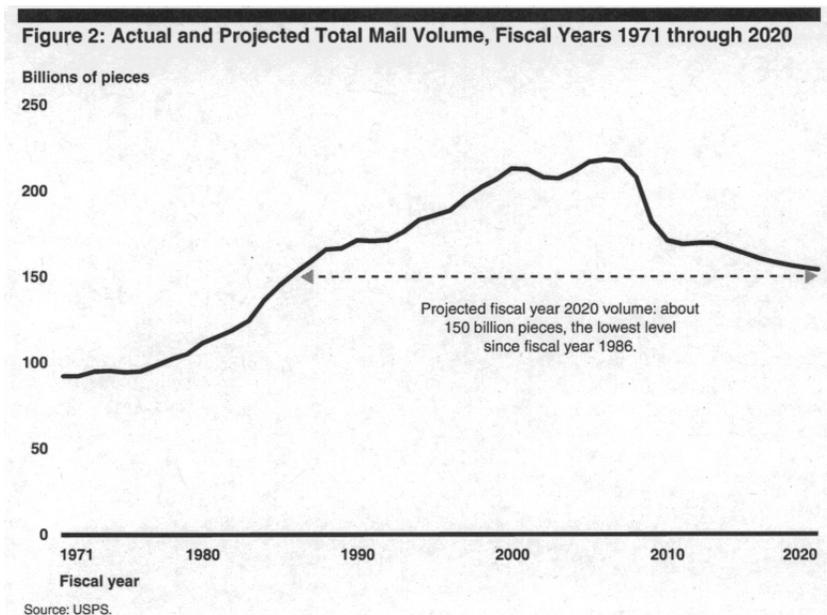


Further, USPS does not expect total mail volume to return to its former levels when the economy recovers. It projects that total mail volume will decline to 167 billion pieces in fiscal year 2010—a level not seen since fiscal year 1992, and 22 per-

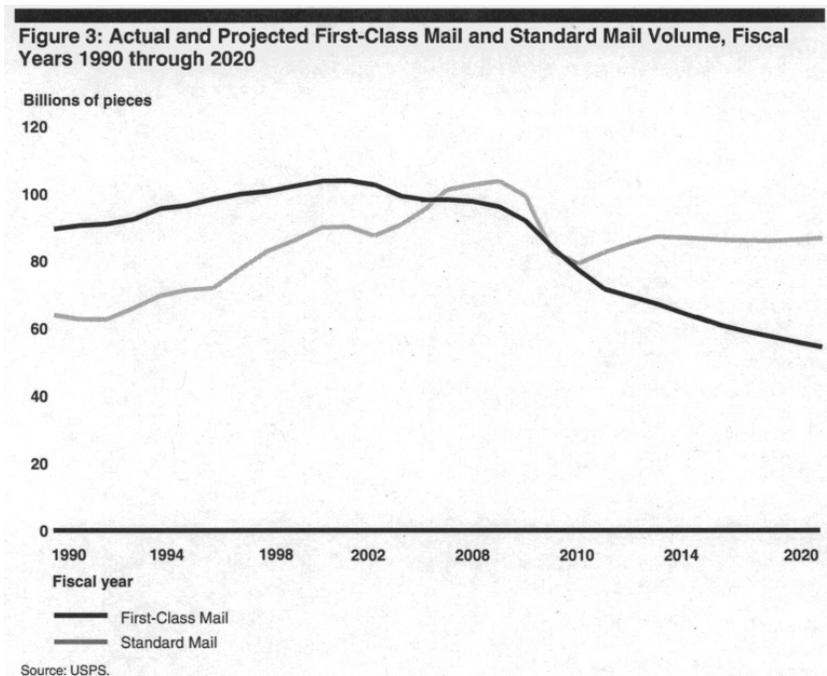
¹ GAO, *High-Risk Series, Restructuring the U.S. Postal Service to Achieve Sustainable Financial Viability*, GAO-09-937SP (Washington, D.C.: July 28, 2009).

² A looming cash shortfall in 2009 necessitated last-minute congressional action to reduce USPS's mandated payments to prefund retiree health benefits from \$5.4 billion to \$1.4 billion. Pub. L. No. 111-68, § 164, 123 Stat. 2023 (Oct. 1, 2009).

cent less than its fiscal year 2006 peak. By fiscal year 2020, USPS projects, at best, further volume declines of about 16 percent, to about 150 billion pieces, the lowest level since 1986 (see fig. 2).



- First-Class Mail volume has declined 19 percent since it peaked in fiscal year 2001 and USPS projects that it will decline by another 37 percent over the next decade. (see fig. 3). This mail is highly profitable and generates over 70 percent of the revenues used to cover USPS overhead costs.
- Standard Mail (primarily advertising) volume has declined 20 percent since it peaked in fiscal year 2007, and is projected to remain roughly flat over the next decade. This class of mail is profitable overall but lower priced, so it takes 2.5 pieces of Standard Mail, on average, to equal the profit from the average piece of First-Class Mail. Standard Mail volume was affected by large rate increases in 2007 for flat-sized mail, such as catalogs, and the recession that affected advertising such as mortgage, home equity, and credit card solicitations. These solicitations appear unlikely to return to former levels. Standard Mail also faces growing competition from electronic alternatives, increasing the possibility that its volume may decline in the long-term.



In addition to the projected losses caused by declining mail volume, USPS believes that stagnant revenue, costs of providing universal service, and rising workforce costs will also lead to losses.

USPS AND CONGRESS NEED TO ACT AGGRESSIVELY TO ADDRESS FINANCIAL CRISIS

USPS urgently needs to restructure to improve its current and long-term financial viability. On March 2, 2010, USPS addressed these issues in its plan, entitled “Ensuring a Viable Postal Service for America: An Action Plan for the Future,”³ which identified seven key areas where-in it would need legislative changes or congressional support. Improving its financial viability is critical because USPS plays a vital role in the U.S. economy, and is at the core of a mailing industry valued at about a trillion dollars, according to USPS. Moreover, it is the largest civilian Federal agency, employing approximately 599,000 career employees as of December 31, 2009 and operating a total of about 38,000 facilities nationwide as of September 30, 2009.

We have previously concluded that restructuring is needed in multiple areas, including action and support by Congress, since no single change will be sufficient to address USPS’s pressing challenges. According to USPS, even if it took all of the actions it could under existing law, it would still face unsustainable losses of at least \$115 billion by 2020. A major challenge for USPS is to cut costs and restructure quickly enough to offset unprecedented volume and revenue declines—particularly costs related to its workforce, retail and processing networks, and delivery services—so that it can cover its operating expenses. We have an ongoing review, as mandated by the Postal Accountability and Enhancement Act of 2006,⁴ to evaluate options and actions for the long-term structural and operational reforms of USPS. Due to the urgency of the USPS financial crisis, we plan to issue our study in April 2010, ahead of the December 2011 statutory deadline.

When we placed USPS’s financial condition and outlook on our High-Risk List, we identified the following key actions USPS and/or Congress could take:⁵

³ USPS’s plan and related material are available at <http://www.usps.com/strategicplanning/futurepostalservice.htm>.

⁴ Pub. L. No. 109-435, § 710 (Dec. 20, 2006).

⁵ GAO-09-937SP.

- Reduce compensation and benefit costs through
 - retirements: Annually through 2020, about 5 percent of USPS employees will be eligible and expected to retire, according to USPS. That represents approximately 300,000 employees, about half of the workforce as of March 2, 2010.
 - lower benefit costs: USPS pays a higher percentage of employee health benefit premiums than other Federal agencies (80 percent versus 72 percent, respectively). In addition, USPS pays 100 percent of employee life insurance premiums, while other Federal agencies pay about 33 percent.
 - Consolidate retail and processing networks
 - Remove excess capacity in the 600 mail processing facilities nationwide, where processing capacity for First-Class Mail exceeds processing needs by 50 percent.
 - Maximize use of lower-cost retail alternatives: Approximately 30 percent of USPS retail revenue currently comes through alternate channels, such as stamps bought by mail, on the Internet, and at grocery stores, indicating that customers have begun shifting to such alternatives.
 - Reduce the network of 36,500 retail facilities, where maintenance has been underfunded for years, resulting in deteriorating facilities and a maintenance backlog. USPS recently reported that it has more retail facilities than McDonalds, Starbucks, and Walgreens combined. Further, it stated that its post offices average about 600 visits per week, representing only 10 percent of average weekly visits to Walgreens.
 - Consolidate field administrative structure: Review the need for 74 district offices and 8 area offices.
 - Generate revenue through new or enhanced products: Use its pricing and product flexibility to maximize profitable mail volume.
- In the past, we have also discussed, and the Postal Service has recently proposed, additional options for restructuring that would require congressional approval:
- Change funding requirements for retiree health benefits.*—USPS asked Congress to revise the funding requirements for its retiree health benefit obligation. USPS had difficulty making its required payment to prefund retiree health benefits in fiscal year 2009 and has warned that it may have similar difficulty for fiscal year 2010. As noted, in fiscal year 2009, a looming cash shortfall led to last-minute congressional action to reduce USPS's required payments to prefund retiree health benefits from \$5.4 billion to \$1.4 billion.
 - Realign delivery services with changing use of mail.*—USPS has asked Congress to allow it to reduce delivery from 6 days to 5 days per week, stating that eliminating Saturday delivery would provide annual savings of about \$3 billion.⁶ The Postal Regulatory Commission (PRC) estimated in 2008 that eliminating Saturday delivery would result in savings of about \$1.9 billion, based on somewhat different assumptions regarding the likely effects on mail volume and costs. The Postmaster General stated in March 2010 that USPS plans to request a PRC advisory opinion on this change, which would lead to a public proceeding that would include input by interested parties. Before this plan could be implemented, Congress would need to stop including statutory restrictions contained in USPS annual appropriations that mandate 6-day delivery. Congress might wish to consider several questions regarding such a change:
 - How would eliminating Saturday delivery impact USPS's efforts to grow mail volume and encourage commercial mailers to continue using the mail?
 - How would eliminating Saturday delivery affect mail processing costs? Salary and benefits for mail processing employees and carriers?
 - What will be the expected effects on delivery service standards?
 - How will consumers and business customers be affected by a move to 5-day delivery? How does USPS plan to mitigate these effects?
 - How does USPS plan to communicate eliminating Saturday delivery and other related changes to mailers and the public?
 - Will there be sufficient P.O. boxes to handle a potential spike in demand for those customers wishing to pick up mail on Saturdays?
 - How much lead time would be needed for USPS to modify its operations and financial systems before eliminating Saturday delivery?
 - What other options has USPS considered that could significantly reduce costs without reducing delivery service?
- These issues need to be addressed in the expected USPS 5-day delivery proposal so that stakeholders fully understand the potential ramifications of these changes.

⁶USPS plans call for continuing providing window retail service and delivery to post office boxes on Saturday, as well as remittance mail service for business mailers.

More broadly, USPS faces larger issues with regard to restructuring and its financial viability. The longer it takes for USPS and Congress to address USPS's challenges, the more difficult they will be to overcome.

Mr. Chairman, this concludes my prepared statement. I would be pleased to answer any questions that you or other Members of the Subcommittee may have.

Senator DURBIN. Thanks a lot, to the panel.

Now, we all understand what's happened to the Postal Service—the loss of volume, the loss of revenue and such—but, Mr. Williams thinks he's found a winning lottery ticket here, for \$75 billion. And before we start talking about the pain of cutting, I've got to ask Ms. Goldway what the Postal Regulatory Commission is doing about this opinion of Mr. Williams and the \$75 billion.

Ms. GOLDWAY. The Postal Service has asked, under a provision in the Postal Accountability Act, to—asked the Commission to hire an independent actuarial firm to review this issue and to provide a report to the Commission and to the public on the reliability of the inspector general's estimate. And we have issued a statement of work and expect to get a contract with an independent actuary in place in a little more than 30 days, perhaps 45 days, and we'll determine, then, just how long it takes, but we certainly want to be part of the discussion about the financial reliability of that proposal before it moves forward.

I should also mention that, as part of a request that was made by Chairman Lynch of the House subcommittee last year, we were asked to look at the Healthcare Retiree Benefit Fund, and our actuarial review of that issue pointed to a position where the Postal Service, under assumptions that were somewhat different from the OPM's assumptions, but more in line with general actuarial assumptions, could be paying at least \$2 billion less each year, and still have the same amount of funding for the retiree health payments at the end of the 10-year period that was required under the law. So, I think that, in both cases, the research that we provide can give you options in the decisions that you might make about how to proceed.

Senator DURBIN. So, can you tell me the timetable there on the \$75 billion issue?

Ms. GOLDWAY. Well, unfortunately, we don't have a response from the actuarial yet as to how much time it will take. We think we can do it within 45 days. We're certainly going to work with our bidders to see who can provide us that information as quickly as possible.

Senator DURBIN. And what is the next step after PRC has made its judgment on this estimate?

Ms. GOLDWAY. We report the—our findings to the Postal Service and share it with the public. And then, it's really up to the other players, the—in the administration or in Congress, to determine what information they feel is most reliable to act on.

Senator DURBIN. So, let's assume, for the sake of discussion, that you find it's true, they've overpaid—

Ms. GOLDWAY. Right.

Senator DURBIN [continuing]. \$75 billion. Can the Postal Service recapture that money?

Ms. GOLDWAY. I think if we find that, we will certainly present an argument that it would be fair for the Postal Service to recapture that money. Just how it's done, in terms of transferring funds

from year to year or all at once, would be something that I think the Congress and OPM and OMB would have to participate in.

Senator DURBIN. Mr. Williams, you didn't mention the \$75 billion in your testimony. Are you having second thoughts?

Mr. WILLIAMS. We are not having second thoughts, sir. The—I—actually, I did try to allude to it, but I was trying to cover as much ground as the hearing title suggested.

Senator DURBIN. And so, I won't go into a great deal of detail on that, but I assume that that is what's being debated currently, with the independent actuaries and such, at the Postal Regulatory Commission.

Mr. WILLIAMS. It is. After our finding on the healthcare overpayment, Congress asked that OPM and OMB and the Postal Service get together to try to come up with a fiscally responsive—responsible proposal for legislation. I believe this issue has been added to that issue so that there'll be a comprehensive solution that's to be developed by the three of them and presented to Congress.

Senator DURBIN. One of the things you talked about is a—and I underlined it—"exaggerated healthcare inflation percentage." It was—which Senator Collins is more aware of than I am.

Mr. WILLIAMS. Yes.

Senator DURBIN. But, are you suggesting that the anticipated cost of the healthcare system of the Postal Service should be lower, that they have anticipated more expenses than you believe are warranted?

Mr. WILLIAMS. OPM has set a growth rate for the—for future costs, of 7 percent a year. We benchmarked that against the private sector, and we discovered that it was the general consensus—the overwhelming general consensus—that 5 percent was a more realistic growth rate. That's also what the Department of Health and Human Services (HHS) uses for Medicare growth rate. That—the delta there was \$13.2 billion. OPM set about downgrading its estimates much more closely to that growth rate, and then they've gone into these three-party talks to try to understand what to do.

Senator DURBIN. And if it is decided to take a lower growth rate, then, of course, the annual payment is going to be reduced accordingly.

Mr. WILLIAMS. Yes, sir.

Senator DURBIN. And what's the timetable on that decision?

Mr. WILLIAMS. There was not a timetable set. I believe the meetings have begun. There have been one involving the principals, and I believe there'll be some followup meetings—

Senator DURBIN. Well, it sounds to me like we have two or three major issues outstanding here that will determine whether or not we have to make this decision about reducing service.

Mr. WILLIAMS. These are very large, very serious—

Senator DURBIN. Seventy-five billion dollars overpayment—question mark—Postal Regulatory Commission. Two billion dollars that you mentioned, Ms. Goldway, that may be an overpayment. Perhaps an exaggeration on the anticipated healthcare benefits down the line. So, it seems to me that before we start making dramatic changes in the Postal Service, some of these questions need to be answered. I would think that would be reasonable.

But, Mr. Herr, I think what you're saying is, "But, if you look at the economics of Postal Service"——

Mr. HERR. Right.

Senator DURBIN [continuing]. "Let's get real."

Mr. HERR. Well, I think part of it, looking at the long-term analysis—that was part of the study the Postal Service just released in March, they had some consulting firms make a projection out to 2020, and one of the things that we noted there is that they're expecting a long-term decline, in terms of the more profitable mail and how mail is used. So, as we stand back and look at it, we think that it's a good opportunity to take that footprint into consideration, in terms of the network and workforce.

Senator DURBIN. I'm going to violate every law—or every rule that I learned in law school and ask you a question anyway. How big a problem is Congress, when it comes to this issue about the future of the Postal Service?

Mr. HERR. Well, as you know, there's often instances where there are prohibitions put in place, in terms of closures and things of that nature.

Senator DURBIN. Guilty, as charged.

And it's a tough issue. And we realize that it's a difficult issue, but it's also one that—I think, as you look at these broader, longer-term trends, it's important to look at the Postal Service and then think about what the Service is, and how that could be realigned with the demand for mail.

I tried to pose this question to the Postmaster General, about the business model for the Postal Service in this changing world. And I know that's a challenge. I don't know that many executives with his responsibility could really envision how to reinvent, to keep up with it. And you kind of see some elements here that are obvious, in terms of infrastructure and the future.

Mr. HERR. Well, and I think—in the hearing today, there's been some good discussion about retail alternatives, in terms of moving some of those into places like supermarkets or pharmacies, where people are already going, that would be an opportunity to save. Also, on the processing side, just looking at what's needed to handle the mail volumes now, and then what's projected.

Senator DURBIN. Thanks a lot.

Senator Collins, we have two votes starting at 4:15, so——

Senator COLLINS. I'll be fast.

Senator DURBIN [continuing]. Proceed.

Senator COLLINS. The witnesses will be happy about that.

Ms. Goldway, just for clarification, the process that you go through, which may take as long as 6 months or 9 months—assuming Congress changed the law to allow the Postal Service to make its own decision on delivery, would the Postal Service be precluded from going ahead with that decision until the PRC has given its judgment?

Ms. GOLDWAY. It's my understanding that the Postal Service has to seek our advisory opinion. It doesn't have to follow that opinion, but it has to seek our opinion. And the process of public input becomes really valuable.

So, for instance, in this recent case, where the Postal Service wanted to close what they call "stations" and "branches," the level

of public participation and concern that was raised about the fact that customers weren't getting the input that they wanted, and that they wanted postal services maintained in the offices, slowed down the Postal Service's decisionmaking, and they began to rethink just how they were going to realign their postal network, and the public process was helpful.

We believe the public process will be helpful regardless of what the Congress does. But, we do think that the public process will probably help you, because this is a very serious issue. And as you had said earlier, the brand of the Postal Service, its commitment to having people on the street 6 days a week, its notion of what it is in the future, is really threatened by the reduction from 6 to 5 day.

One of the interesting figures we heard was that young people value 6—the 6th day more than older people, even though they don't use the mail as much, that's the day they want it. So, if you want young people to keep going into the mail, this process may not be the right business model.

Those of the kinds of issues we are going to explore when we have our hearings.

Senator COLLINS. Thank you.

Mr. Williams, I am troubled, obviously, by the prospect of the Postal Service laying off 13,000 people in this terrible economy, letter carriers all across the United States. And I'm particularly troubled by that because there are reports—and you have done, I believe, one of the reports—concluding that what is out of whack in the personnel costs of the Postal Service are the benefit levels for health insurance and life insurance. I mentioned the 100-percent payment for premiums for life insurance, versus 3—33 percent for the Federal employees.

Has there been any analysis done of relative savings? For example, if you cap the 6-day delivery and didn't have to lay off 13,000 people who are going to have a hard time finding work, but instead, you brought the benefit structure into line with the benefits that Federal employees receive who are participating in the same kinds of programs. Has there been any sort of relative analysis?

Mr. WILLIAMS. To my knowledge, there has not been. We're—the actual proposal is 2 months away, and it may contain something like that. We're unaware of its contents that will go to the PRC.

We did do that body of work, and that was our finding. We would be pleased to work with your staff to try to make a—that sort of determination. That would certainly be an interesting discovery.

Now, those agreements are contained in the labor—

Senator COLLINS. Yes.

Mr. WILLIAMS [continuing]. Agreements, and would have to be shifted. But, at this point, I know that the leadership of the unions is certainly looking out for the well-being of their people, and they might well be interested in that, as well, and—when they go into negotiations.

Senator COLLINS. I think that would be helpful information for us to have.

Mr. Herr, have you looked at that issue, by chance? The—

Mr. HERR. We have not looked at it. I remember at the Senate hearing last January, you and Senator Carper were there—I think

the Postmaster General offered an estimate of a \$700 million annual savings if something like that were to be adjusted. But, we've not done any specific analysis on that.

Senator COLLINS. Okay. Thank you.

OVERPAYMENT

I want to clarify two issues, just to make sure that I personally understand the issues before us. Mr. Williams, when you came up with your \$75 billion estimate of an overpayment, is that an overpayment for the pensions of retired postal workers, not to be confused with the money that goes into the Retiree Health Benefits Fund?

Mr. WILLIAMS. It is, Senator; that regards—there was an earlier report that had to do with the inflationary growth and the overpayment into the Healthcare Fund. This most recent report, regarding the \$75 billion, regards the Pension Fund.

Senator COLLINS. I think that's very important for us—

Mr. WILLIAMS. Yes.

Senator COLLINS [continuing]. To understand, that we're talking about two different pots of money here.

And, Mr. Herr, what is your analysis on both of these issues, on whether or not there is an overpayment of such a staggering amount to the Pension Fund for retirees? Let's deal with that issue first.

Mr. HERR. On that particular issue, I've asked our financial folks and our chief actuary to look at this, and they noted—and it's also noted in the back of the inspector general's report—that the board of actuaries reviewed that, and we believe that their assessment is correct, that OPM's methodology was valid and was consistent with the law.

Senator COLLINS. And so, you would disagree with OPM's assessment, in—

Mr. HERR. No, we believe that OPM's assessment is correct.

Senator COLLINS. I'm sorry. So, you agree with OPM, and you do not agree with Mr. Williams' assessment, that his study—I'm not trying to create conflict here, I'm just trying to get an understanding. I'm really not.

Mr. HERR. Yes.

Senator COLLINS. Is that accurate? Okay.

And it's my understanding, though—we'll go back to OPM—that OPM has stuck to that decision, as has OMB.

I would note, Mr. Chairman, that in our conference report last year, we asked the Postal Service to work with OPM and OMB to come to us with a proposal and an answer to this, and I think we need to push them and follow up on that.

Mr. Herr, the second issue is the payment to the Retiree Health Benefits Fund—

Mr. HERR. Right.

Senator COLLINS [continuing]. And that is the stream of payments established by the 2006—

Mr. HERR. Yes.

Senator COLLINS [continuing]. Act. And I would like your best judgment on, what should we do about that issue? I won't go on with my opinion, but I'd like your best judgment.

Mr. HERR. Yes.

Senator COLLINS. What's the best way for us to handle that issue?

Mr. HERR. Senator Collins, we have a report—I mentioned our business model report—that we're expecting to release in about 3 weeks, that has a discussion of that. We talk about several approaches for Congress to consider. One, we take a look at what the Postal Service has proposed, which is a pay-as-you-go model. We also looked at a reamortization and we lay out in a table what that would mean, in terms of the costs. We provide, I think, a clear explanation, so Congress has a sense of what's involved here, what the magnitude of the funding is, to help you make some really tough policy decisions about where things are now, where they stand, and then where you might want to go, going forward.

Senator COLLINS. And we'll get that study shortly, then?

Mr. HERR. Yes, you will.

Senator COLLINS. Great. I think that's going to be very helpful.

My final question, since I know our time is short. Mr. Herr, isn't it a problem if we come up with an amortization schedule that suspends payments for several years and then ramps them up? Is there any reason to believe that the Postal Service, given what you've described about the projections for its volume and the pressure, would be able to better afford a greater payment, say, beginning 4 or 5 years from now, than would be the case under the current law?

Mr. HERR. Everything we've seen suggests that they're going to have difficulty, now or in the future, with some of these payments. They're large numbers, but they're also very large obligations—500,000 current retirees; we talked about 300,000 people going into retirement in the next 10 years. So, it's really important to assess what they're able to do and then try to find the amount that will be a reasonable payment toward those obligations.

Senator COLLINS. Thank you very much.

Thank you very much, Mr. Chairman.

Senator DURBIN. So, Ms. Goldway, as I understand it, the Postal Service asked the Postal Regulatory Commission to study the 5-day service model.

Ms. GOLDWAY. Yes.

Senator DURBIN. And I think you concluded by saying, "But, they don't have to pay much attention to what you conclude."

Ms. GOLDWAY. The Postal Regulatory Act—the Postal Regulatory Commission, under the act, gives us some very clear, specific responsibilities and some advisory responsibilities. And in this case, with regard to the nature of service, we have an advisory responsibility.

On the other hand, every year we have to make a report on whether the Postal Service has complied with the law, and that means whether it's met its obligations to provide an efficient and fair level of universal service.

So, if they don't take our advice on this, and, at the end of the year, they've entered into an activity that we deem has—is less than universal service, we could find them out of compliance and require them to start up some new activity again. But, we could not tell them, at the time of our advisory opinion, what to do.

So, it's—our—we—just as the Postal Service is trying to learn how to operate under this new law, which has given them price flexibility and product flexibility, but at the time of the—of a recession, we are learning, as well, how to regulate the Postal Service with both new law—new responsibilities and power, but less power than we had in certain areas with regard to rates, before. It's a balancing act that we will have to implement.

Senator DURBIN. I'd ask who wrote the law, but I know. So, if the Postal Service ignores your advice, they may have a day of reckoning ahead of them, when you make your annual report and have the power to order them to do certain things.

Ms. GOLDWAY. That's right.

Senator DURBIN. And I guess I'd have to say, bluntly, that Congress can ignore both of you. And for 27 years, we've been including a sentence, which no one has noticed, in this appropriation bill, which is, "Maintain 6-day service and rural service across America at 1983 standards." I don't think it was ever brought to my attention until a few weeks ago, because it became so routine. But, it is within the power of Congress in general, perhaps this subcommittee, to make that decision, regardless of what the PRC, Postal Regulatory Commission, or the Postal Service decides. I don't want to speak for—

Ms. GOLDWAY. Right.

Senator DURBIN [continuing]. Anyone else on the subcommittee. I certainly would like to hear an evaluation of this proposal from those who look at it seriously. You talked about facing this in the past and asking some hard questions about what it meant and whether it saved as much money as proposed, and so forth. That is all reasonable, and I think we're dutybound to try to reach that.

Now, what about this idea—and I think Mr. Herr referred to it, about the quiet summer months—what about this idea of a pilot project on 5-day delivery. Can this be done? Does the Postal Regulatory Commission have to be part of that decision?

Ms. GOLDWAY. I would venture to say, if the pilot program is envisioned as something that would potentially be implemented nationwide, then it would be something that would have to come to us for prior approval, as well. If—

Senator DURBIN. Well, it's the nature of—

Ms. GOLDWAY [continuing]. It's just an experiment—

Senator DURBIN. It's the nature of a pilot—

Ms. GOLDWAY [continuing]. Under the law, there's a certain level of experiment that they can undertake without our direct review.

Senator DURBIN. That's the nature of a pilot program, or a demonstration project, is to see what the impact will be in the real world. I don't know if it's even realistic to decide that, you know, a few counties in the—

Ms. GOLDWAY. I'm reluctant—

Senator DURBIN [continuing]. United States will try this.

Ms. GOLDWAY. Yeah. I'm reluctant, without advice of counsel, to be specific, but it does seem, to me, smaller, discrete experiments with service certainly would be possible. After all, while the Postal Service does provide 6-day delivery pretty much uniformly across the country, there are areas where it does not now provide 6-day delivery—either it's a business area, or it's an extremely rural

area—so that its opportunity to provide 5-day delivery in some experimental fashion, I think, would be possible without the kind of comprehensive review that we require, or that you would require.

Senator DURBIN. Well, here's the way I'd see it, at this point. And I defer to my colleague to close here, as we hustle off to vote.

As I see it, there are two or three big questions out there about the current economic status of the Postal Service: the \$75 billion question, the \$2 billion question, which you've raised, questions about healthcare benefits that could have a direct impact on the immediacy of this decision.

Long term, I think Mr. Herr is right, we have to look at the Postal Service evolving into a different agency as it faces new challenges that cost money and create more competition.

I'd like to know what the Postal Regulatory Commission concludes, on the issue of 5-day service, before making a final decision. I am not against the idea of a pilot project, if that appears to be feasible or necessary, to see what the actual reaction of postal consumers would be if you tried it in a given area, and to try to measure from that whether this makes good public policy.

We're kind of stuck. It's kind of go or no-go, when it comes to the appropriation bill, in whether we include the language or we don't include it. And, thank goodness, I have the wise counsel of the Senator from Maine to help me reach that conclusion.

And I'll let her have the last word.

Senator COLLINS. Thank you, Mr. Chairman. Those are my last words.

SUBCOMMITTEE RECESS

Senator DURBIN. Thanks, everybody. Appreciate your attending this hearing.

[Whereupon, at 4:25 p.m., Thursday, March 18, the subcommittee was recessed, to reconvene subject to the call of the Chair.]

FINANCIAL SERVICES AND GENERAL GOVERNMENT APPROPRIATIONS FOR FISCAL YEAR 2011

WEDNESDAY, MARCH 24, 2010

U.S. SENATE,
SUBCOMMITTEE OF THE COMMITTEE ON APPROPRIATIONS,
Washington, DC.

The subcommittee met at 2:32 p.m., in room SD-192, Dirksen Senate Office Building, Hon. Richard J. Durbin (chairman) presiding.

Present: Senators Durbin and Collins.

OFFICE OF PERSONNEL MANAGEMENT

STATEMENT OF HON. JOHN BERRY, DIRECTOR

OPENING STATEMENT OF SENATOR RICHARD J. DURBIN

Senator DURBIN. Good afternoon. I am pleased to convene this hearing before the Senate Appropriations Subcommittee on Financial Services and General Government.

Our focus is on fiscal year 2011 budget request of the Office of Personnel Management (OPM). OPM has not appeared before our subcommittee since 1997. So we have been waiting a long time to see you.

I welcome my ranking member, Senator Susan Collins of Maine.

The Office of Personnel Management serves as the principal adviser to the President on personnel management issues for the country's 2 million Federal civilian employees. It designs, develops, and oversees compliance with workforce policies and sets the guidance in areas of recruiting, selection, development, and compensation. To facilitate the Federal employment application process at a single location, OPM manages the USAJOBS Web site, which posts 30,000 job vacancies a day; maintains 15.4 million résumés on file; and sends more than 500,000 e-mails daily to job seekers.

OPM manages the world's largest single employer-sponsored health insurance plan with 8 million insured individuals, which also insures Members of Congress. The agency also administers retirement benefits for the Federal Government with more than 2.5 million retirees.

In addition, OPM conducts 90 percent of Federal background investigations each year and provides observers to monitor the election process as assigned by the Attorney General.

OPM's newly unveiled strategic plan presents goals that will help prepare our Federal civil service for the 21st century.

OPM's priority, and one I hope is shared by every Federal agency, is to recruit and retain the best and the brightest. Our Nation's civil servants are called on to defend our Nation, restore confidence in our financial system, administer a historical economic recovery effort, ensure adequate healthcare for veterans and others, and search for cures to the most vexing diseases. So we depend on these men and women who are dedicating their lives to public service.

I am pleased to note that the 15.4 million résumés I mentioned OPM has on file are up from 1.9 million just a few years ago. With the surge of interest in public service, it is important that appropriate OPM policies and procedures be reformed to attract the best candidates.

For fiscal year 2011, OPM is requesting \$240 million in discretionary funds, the same as the enacted amount for fiscal year 2010, of which \$95.7 million is for basic operating expenses. They are requesting an additional 40 full-time equivalents (FTEs) in the area of retirement processing.

Mr. Berry, since you assumed the directorship last April, you have undertaken changes and improvements in hiring, including veterans hiring. And I know that disability hiring policy changes are a high priority for you.

In addition, you have overseen new efforts in the area of wellness with funding we provided last year, which we will talk to you about. I know you intend to recommend changes to the Federal pay system, increasing telework eligibility, improving the security clearance process, and getting the retirement system modernization project on track.

According to an article from a recent Government Executive magazine—whose cover you graced—with the title “High Hopes,” you have been referred to as a “change agent,” “the quintessential Energizer bunny,” and “shot out of a cannon.” Given what you hope to accomplish during your tenure, that is good because it looks like you have your work cut out for you.

I would like to turn now to Senator Susan Collins, the ranking member.

STATEMENT OF SENATOR SUSAN COLLINS

Senator COLLINS. Thank you, Mr. Chairman.

Director Berry, welcome. It is good to see you before us here today.

I appreciate your leadership at OPM and your efforts to fulfill the agency's mission to recruit, retain, and honor a world-class Federal workforce to serve the American people.

I have always been a strong advocate for our Federal workforce. Because of the good work of our Federal employees, the United States Government is able to protect our Nation and provide crucial services to our citizens each and every day. Without their dedication, this vital work could not be done, and their commitment to public service makes for a stronger America.

Many Federal employees place their very lives at risk on a daily basis. They knowingly put themselves in harm's way. The very nature of their work—whether it is military personnel, as Federal law enforcement or intelligence officers, or in other dangerous

callings—puts them on the front lines of an often challenging or even life-threatening missions. But as the recent attack on the building in Austin, Texas, and other past assaults directed at Federal buildings and personnel have demonstrated, Federal employees can become the target of terrorists and criminals.

Over the next decade, the Federal Government is facing a retirement wave, and with it, the loss of leadership and institutional knowledge at all levels. On average, retirements from the Federal workforce have exceeded 50,000 a year for a decade. Those numbers will certainly rise in the near future.

The Office of Personnel Management calculates that 60 percent of the current Federal workforce will be eligible to retire during the coming years. Federal agencies, which must already hire more than one-quarter of 1 million new employees each year, will need to work hard to replace these retirees, as the private sector and State and local governments will be competing for the same qualified applicants.

To meet this challenge, agencies must use the recruitment and retention tools they already have, such as student loan repayment, recruitment and retention bonuses, and the ability to rehire Federal annuitants to fill critical needs. That has been a particular concern of mine. Last year I authored a bill to allow just that.

OPM also needs to develop an effective and fair pay-for-performance system that rewards the very best Federal employees.

Director Berry, you have some very significant responsibilities that you work to accomplish those goals. And given fiscal constraints, I will be interested to hear how you will ensure that OPM will provide employees, agencies, and retirees with the important service they need but, most of all, ensure that the public has the qualified workforce we all need.

So, Mr. Chairman, I look forward to working with you on this issue.

Senator DURBIN. Thanks a lot.

Director Berry has quite a background, worked as legislative director for Congressman Steny Hoyer for 10 years, Assistant Secretary of Treasury, and the Interior Department's Director of both the National Fish and Wildlife Foundation and the National Zoo, which means he will be comfortable here in Congress.

We will ask questions about the panda later.

I now invite you to present your testimony, and your written testimony will be part of the record.

Director Berry.

SUMMARY STATEMENT OF HON. JOHN BERRY

Mr. BERRY. Chairman Durbin and Senator Collins, thank you so much for this opportunity to appear before you today.

I also want to personally thank both of you for your incredible leadership over so many years for our Federal employees and for retirees. On behalf of all of them, let me just say thank you. I know that if they could be here today, they would want to express thanks for your constant and stalwart leadership.

With your indulgence, I would also like to introduce my Deputy Director, Christine Griffin, who is with me today. Mr. Chairman, as you mentioned in your opening statement there are concerns

with both diversity and people with disabilities. Christine is one of the highest-ranking people in the Federal Government with a disability, and she is doing a phenomenal job. As I tell people, she is not really disabled, she is abled-squared. She is amazing and could do anything plus, and it is just an honor to be with her.

I appreciate the opportunity to appear before you to defend the President's budget request for the Office of Personnel Management for fiscal year 2011. I know that I am preaching to the choir, but I can't overstate the importance of our mission to recruit, retain, and honor a world-class workforce to serve America. We are developing plans to achieve these goals, and I look forward to sharing some of those details with you today.

For fiscal year 2011, OPM has requested \$240 million in discretionary resources. With this money, we will serve the taxpayers by establishing, implementing, and overseeing all Federal human resource policies, completing background security investigations for over 90 percent of the Federal agencies, ensuring compliance with merit system principles, and administering of benefits for over 2 million Federal employees, 2.5 million retirees, and their families, totaling over 8 million lives.

Even as we innovate and try to do more, this request stays level with the funds appropriated to OPM in fiscal year 2010.

The President has asked me to make Government "cool" again. And so, we have developed several initiatives to make the Federal Government the model employer for the 21st century. Both of you are supporting many of these initiatives, letting job seekers know that the Federal Government is already a great employer with the best workforce in the Nation.

In the past year, we have worked hard to expand the recruitment and hiring of veterans throughout the Government. Through an Executive order, the President established the Veterans Employment Initiative, creating a partnership between OPM, Departments of Labor, Veterans Affairs, and Defense.

OPM is requesting \$2.4 million, an increase of \$800,000 from fiscal year 2010, for this initiative in 2011. We plan to use those resources to increase our support and access for veterans seeking employment with the Federal Government. With your leadership, we have also provided benefits to support our soldiers and their families.

I am particularly proud of our efforts to create a new special hiring authority for agencies that allow them to hire the spouses of members of our armed forces, who, as you know, have to move on a regular basis burdening them with a unique disadvantage. Consequently, we are trying to help them gain access to Federal employment not in violation of our veterans hiring program, but rather in addition to it.

OPM also issued guidance in December to expand the paid leave benefits of members of the National Guard and reservists to help their families when they are called to active duty. Mr. Chairman, I want to specifically thank you for your leadership. This essentially enacts the legislation that you personally introduced, and for the first time ever, employees from the civil service sector who serve in the Reserve aren't disadvantaged by having their pay cut. This legislation has allowed us to restore their pay and maintain

that pay while they are serving in the military. So God bless you and thank you for your leadership. We have worked to implement this legislation so that these reservists are not penalized in any way with regard to their pay.

Another initiative is our effort to work with agencies to streamline the Federal hiring process. We are in the final clearance process with the Office of Management and Budget now and are ready, once we finish the agency clearance process, to send to the President a major hiring reform proposal that will essentially bring the Federal Government into the 21st century, or I should say the 20th century, where we will just start using résumés like everybody else.

I think that if we do nothing else, this will be a landmark shift that will allow us to greatly benefit from progress that has been made long ago in the private sector.

We requested \$4 million for the next year to build additional and improved assessments that will develop more shared, registered, and enhanced Government-wide recruitment, and we can talk about that more in the questions. We are reforming the Federal security clearance process and are seeking your authority to meet those demands by increasing our Investigative Services Division by an additional 160 employees.

In addition, we are taking a measured approach to updating our retirement systems and will be focused on improving overall electronic data collection. We must ensure that benefits are processed quickly and accurately and that our reform measures are deliberate and don't waste any more of the taxpayers' money.

I know you all have been very diligent in overseeing this throughout the years. There have been multiple failures. We want to make sure that we can guarantee success with regard to any steps we take on this issue.

In fiscal year 2011, OPM has requested \$1.5 million to develop a better calculator for our retirement processing. This will allow our caseworkers to process claims more expeditiously and to meet current needs. Basically, right now we don't have an automated system. As you know, RSM was disbanded and that effort closed down. We had started to actually decrease our staff under the expectation there was going to be a new system.

We are not going to have that system. Consequently, we do need to increase some staff. I am asking for 40 more employees so that we can just keep pace with the growth in demand that we are seeing. We are receiving, just this year, from the Postal Service alone an additional 18,000 retirements that we will have to process.

We are looking for additional resources to conduct the employee viewpoint survey on an annual basis rather than every other year. We believe that this can be a very effective management tool.

For the first time ever—and this really surprised me when I got there. We should have the best health database in the country. We have the largest single plan, covering 8 to 9 million lives and yet we have never collected any data from it. And so, we miss, quite frankly, enormous opportunities for improving cost efficiencies, evaluating which programs are working better, and determining what the needs of our current population are.

We want to make sure we can do that well. Thus, we are asking you for the necessary resources. It is a substantial investment, but it will allow us to begin collecting data for the first time ever about our employees' health benefit program, not at an individual level, but at the level where we can learn where our weaknesses are and where there are possible cost savings that could help us control costs in the future.

These priorities and the priorities in our budget reflect the strategic goals that you have discussed in our strategic plan: to hire the best, respect the workforce, expect the best of our workforce, and honor their service. If we want enhanced performance and superior results from our Federal Government, we must invest in our employees and attract, hire, and retain the best workforce.

To do this we must give our people the tools that they need to succeed and the incentive to perform at their maximum potential. We must assure employees that their services are and will continue to be respected and honored. I thank you on behalf of all Federal employees and retirees for both of your roles in doing that throughout your careers.

PREPARED STATEMENT

Thank you for this opportunity to be with you today, and I look forward to answering any questions that you might have.

[The statement follows:]

PREPARED STATEMENT OF JOHN BERRY

Chairman Durbin, Ranking Member Collins, and Members of the Subcommittee: As Director of the Office of Personnel Management, I appreciate the opportunity to testify before you today on the President's fiscal year 2011 budget request for the Office of Personnel Management (OPM). This budget will help us meet our responsibilities for establishing, implementing, and overseeing the Federal Government's human resources policies, background security investigations, merit system compliance, and administration of a broad range of benefits for the 2 million strong Federal civilian workforce, 2.5 million retirees, their families and survivors. I look forward to sharing with you the Administration's vision to recruit, retain, and honor a world-class workforce to serve America.

Included in the fiscal year 2011 budget request are my strategic goals for the agency: Hire the Best, Respect the Workforce, Expect the Best, and Honor Service. These guiding principles have framed my initiatives of the past year and will continue to guide our activities and priorities in the next fiscal year.

The President has asked me to make Government "cool" again, and to that end, we have several initiatives to reinforce the Federal Government to be the best workplace with the best workforce in the Nation. In the past year, with this subcommittee and Congress' support, we have worked hard to expand the recruitment and hiring of veterans throughout the Government; provide benefits to support the war fighter and his or her family; foster collaboration between labor and management in order to improve delivery of Government services; reform the Federal security clearance process, and propose initiatives to streamline the Federal hiring process. However, many challenges still remain. Nonetheless, OPM is well-prepared to meet these challenges, and the priorities outlined in this budget request are critical toward the success of these efforts.

HIGH PRIORITY PERFORMANCE GOALS

The following High Priority Performance goals are measurable commitments to the American people. They represent high priorities for both the Administration and the Office of Personnel Management and are expected to achieve significant results over the next 12 to 24 months. Each of the four goals is related to OPM's major performance improvement initiatives reflected in our budget. The High Priority Performance Goals include:

Hiring Reform.—80 percent of Departments and major agencies will meet agreed upon targeted improvements to: Improve hiring manager satisfaction with applicant quality, improve applicant satisfaction, and reduce the time it takes to hire.

Telework.—Increase by 50 percent the number of eligible Federal employees who telework by fiscal year 2011, increase by 50 percent the number of eligible Federal employees who telework over the fiscal year 2009 baseline of 102,900.

Security Clearance Reform.—Maintain or exceed OPM-related goals of the Intelligence Reform and Terrorism Prevention Act of 2004 and provide the OPM deliverables necessary to ensure that security clearance reforms are substantially operational across the Federal government by the end of CY 2010.

Retirement Claims Processing.—Reduce the number of retirement records OPM receives that are incomplete and require development to less than 38 percent by the end of fiscal year 2010, 35 percent by the end of fiscal year 2011, and 30 percent by the end of fiscal year 2012.

Wellness.—By the end of 2011, every agency has established and begun to implement a plan for a comprehensive health and wellness program which will achieve a 75 percent participation rate.

OPM REORGANIZATION

Shortly after becoming OPM Director in April 2009, I tasked the agency's senior leadership with developing a simplified model for restructuring the agency's executive offices and program divisions. The agency and its employee unions were partners throughout this process with a shared commitment to ensure employees are treated fairly, and to ultimately make OPM a better and more effective agency.

The foremost reason for reorganizing OPM was to enable our customers, as well as OPM employees, to see in clear, plain English, the functions that we perform and the organizations responsible for implementing them. The five main functional organizations within OPM now are:

- Employee Services, which provides policy direction and leadership in designing, developing and promulgating Government-wide human resources systems and programs;
- Retirement and Benefits, which administers retirement, health, and life insurance benefit programs for Federal employees, retirees, their families and survivors;
- Merit System Audit and Compliance, which ensures that Federal agency human resources programs are effective and meet merit system principles and related civil service requirements;
- Federal Investigative Services, which ensures the Federal Government has a suitable workforce that protects National Security and is worthy of Public Trust; and
- Human Resources Solutions, which provides effective human resources solutions to assist Federal agencies in achieving their missions.

There are three newly created offices that I believe will help improve the agency's operations. First, I created an independent Ombudsman that will address issues raised by OPM employees and some customers of OPM. I have also created an Internal Oversight and Compliance Office that will undertake reviews and assessments of OPM operations, as well as assist program offices with responses to and follow up on audits conducted by the OPM Inspector General and Government Accountability Office. Through these offices we will have an internal check on OPM's operations that will allow us to better identify and improve problem areas.

Also, I created an Office of Planning and Policy Analysis. Included in the OPM budget request is \$7 million to start a data warehouse to analyze the claims experience of participants in the Federal Employees Health Benefits Program (FEHBP). Through this effort we hope to identify trends in employee health issues and potentially drive down costs through a better understanding of the Federal employee and retiree population's most common healthcare needs.

Under this reorganization, OPM is more streamlined. Our customers—both internal and external—are better able to understand the services and products that we provide. The execution of the reorganization has also made OPM more effective in making the Federal Government the model employer for the 21st century through successful achievement of critical priorities.

FISCAL YEAR 2011 BUDGET REQUEST

The budget request presented to you today continues the path we began to chart last year in an effort to bring civil service into a new era. For fiscal year 2011, OPM is requesting \$240,071,000 in discretionary appropriations, the same as enacted for fiscal year 2010. The total includes appropriations from general funds as well as

limitations on transfers from the earned benefit Civil Service Retirement and Disability Fund, Federal Employees Health Benefits Fund, and the Federal Employees Group Life Insurance Fund, all of which are under OPM's management.

For basic operating expenses of the agency, our request includes \$95,770,000 in general funds for Office of Personnel Management Salaries and Expenses, \$22,564,000 of general funds and trust fund transfers for Office of the Inspector General Salaries and Expenses. Also, we are requesting a total of \$121,737,000 in transfers from the Trust Funds for the administration of the civil service retirement and insurance programs. This funding will provide the resources necessary to aid in carrying out several major initiatives.

Hiring Reform

The Administration believes that reforming the Federal hiring process is an urgent priority to attract the best and brightest talent into the workforce. The current hiring process is cumbersome and slow, frustrating managers and discouraging many talented individuals from considering Federal jobs and opportunities. In order to address this problem, OPM's fiscal year 2011 budget requests \$4,000,000 in order to promote innovative and coordinated approaches to help agencies streamline their end-to-end hiring process. This synchronization will better enable agencies to recruit and hire qualified students, mid-career professionals, and retirees. As part of the Administration's effort to create a more positive experience for Federal job applicants, OPM will continue efforts to overhaul the USAJOBS website. The effort will build on improvements that have already been made to make the site more user-friendly.

OPM is also committed to increasing employment outreach to veterans, in accordance with President Obama's Executive Order, "Employment of Veterans in the Federal Government" signed on November 9, 2009. This order established the Veterans Employment Initiative, with the goal of transforming the Federal Government into a model of veterans' employment. OPM, in collaboration with the Departments of Defense, Labor and Veterans Affairs, is leading the development and implementation of a Government-wide Veterans Recruitment and Employment Strategic Plan to address barriers to entry for Veterans and transitioning service members pursuing careers in the Federal civil service. We are requesting \$2,400,000 in fiscal year 2011 to advance this effort.

Finally, this year OPM launched a Federal Diversity Office to make creation of a diverse workforce a greater priority in the Government. The Diversity Office is looking at the development of a Government-wide diversity strategy to support Federal agencies in improving outreach to and hiring of diverse groups of candidates. In fiscal year 2011, budget resources will be used to fully staff the Diversity Office and deploy new policies, processes and procedures for improving diversity and promoting inclusion across the Federal Government.

Wellness and Work-Life

Availability of health, wellness, and work-life options for Federal employees is a critical tool for improving the ability of the Government to recruit and retain a high-performing workforce. In 2010, OPM received an appropriation of \$2,654,000 to develop and operate a comprehensive worksite wellness pilot program for the downtown Washington campus including GSA, Interior, and OPM. The development of Government-wide health and wellness policies and programs to provide employees with a meaningful balance of work and life will continue to be a top priority at OPM in fiscal year 2011.

Telework is another essential part of OPM's overall effort to improve work-life flexibilities for Federal employees. Increased use of telework in Federal offices across the country, particularly in major metropolitan areas with large concentrations of employees, would enable the uninterrupted delivery of Government services if employees were instructed to work from home due to extreme weather conditions, natural disasters, or other threats to health, including concerns regarding the spread of influenza. In fiscal year 2010 and 2011, OPM will continue its initiative on telework and provide support to agencies, managers, and employees about how to effectively implement telework programs.

Employee Viewpoint Survey

Since 2002, OPM has conducted a biennial survey of Federal employees to assist Congress and OPM in determining the overall direction and needed changes for future HR policy. The survey is also a valuable tool for agencies to improve employee engagement and satisfaction as well as to address areas in need of improvement identified in the survey. Beginning this year, OPM will be conducting surveys annually and our budget request includes \$2,500,000 for this effort in fiscal year 2011.

The improved annual surveys will provide the data necessary to chart the course for making the Federal workplace a model for the nation.

Security Clearance Reform

In 2004, Congress passed the Intelligence Reform and Terrorism Prevention Act of 2004 (IRPTA) which included provisions to address ongoing concerns regarding the timeliness and quality of personnel background investigations and employment suitability services. Since the enactment of IRPTA, OPM has significantly shortened the amount of time needed to complete initial clearance investigations and has eliminated the backlog of pending background investigation cases. In fiscal year 2011, continued efforts will ensure Federal customer agencies have the information they need to make timely decisions on the credibility and suitability of Federal employees, contractors, and military members.

OPM conducts investigations for Federal agencies on a reimbursable basis through the Revolving Fund. The fiscal year 2011 budget includes an estimated \$970,127,000 in new budget authority for Federal Investigative Services. This funding will be used to continue the transformation effort underway for the core FIS technology systems; to continue making improvements to security questionnaires used to collect investigative information; for implementation of a training program to standardize the investigative and suitability adjudicative process for all background investigations; and to cover fiscal year 2011 core FIS operational costs necessary to produce a quality and timely background investigation.

Retirement Systems Modernization

OPM has initiated the Retirement Systems Modernization (RSM) program to modernize and automate retirement processes to ensure Federal retirees and annuitants are paid accurately, timely, and receive high-quality customer service. The Federal Government's retirement systems face significant challenges and are at high risk of failure due to technology gaps. These challenges have been identified in numerous OPM and GAO reports, and congressional staff members have been briefed on the ongoing response to these challenges. Because of the strategic importance of this issue, I have asked OPM's Deputy Director, Christine Griffin, to take the lead on RSM and make this her top priority. Our budget requests \$1,500,000 to stabilize the retirement systems in fiscal year 2011.

During this fiscal year, our primary focus for modernization efforts is to lay the foundation for upgrading the retirement calculator, and to transition from a paper-based operation to an automated retirement process. OPM is also focused on implementation of an online retirement application tool that will utilize data gathered through the Enterprise Human Resources Integration (EHRI) program, allowing us to gather initial retirement information electronically for the first time. This capability will help improve the accuracy of retirement calculations by eliminating the potential for manual data entry errors and permitting real-time validation of the data provided. These initiatives will help to ensure that OPM and agency benefits officers have access to information necessary to perform their duties of processing claims and providing customer service to employees and annuitants. However, enhanced efficiencies will not happen overnight. The transition will require incremental and deliberate change in order to ensure that past mistakes do not occur again, and that taxpayer dollars are not wasted on an ineffective effort. In the interim, OPM must increase staffing levels in order to fulfill its responsibility to process its anticipated workload in a timely manner.

For fiscal year 2011, we are requesting 40 FTE and an additional \$2,800,000 to increase retirement claims processing staffing levels. The 40 FTE will permit OPM to process an additional 24,000 claims and reduce claims processing time from 45 days to 40 days in fiscal year 2011. In 2012, as staff is fully trained and seasoned, they will be able to process an additional 32,000 claims. The increase in FTE will assist in reducing the claims processing times to 38 days.

Acquisition Improvement

Finally, the Administration is seeking to strengthen the acquisition process Government-wide. As a result, they requested a general provision that provides for \$670,210 to increase OPM's acquisition workforce in order to improve contract oversight. OPM's Contracting Group has assumed a dramatic increase in contracting responsibilities over the past several years as a result of the increased scope of OPM's Government-wide support functions. OPM will use these requested funds to recruit, hire, and train five additional Contracting Officers, plus one additional Contracting Officer to increase staff devoted to small and disadvantaged business utilization.

The agenda I have presented to you reflects a commitment toward a new day for civil service. If superior results are what we want from our Federal Government, then we must attract, hire and retain a talented workforce. We must give them the

tools that they need to succeed, and the incentive to perform to their maximum potential, including our assurance that their services are and will continue to be respected and honored.

Mr. Chairman, this concludes my formal testimony on the Office of Personnel Management's fiscal year 2011 budget request. I look forward to addressing any questions or concerns that you and the Members of the Subcommittee may have.

Thank you.

NEW ADMINISTRATION WELLNESS INITIATIVES

Senator DURBIN. So, Director Berry, the President asked us to give you \$5 million for wellness, for pilot programs to deal with smoking cessation, disease management, and the like. Tell me how that is going.

Mr. BERRY. Mr. Chairman, the President's budget for fiscal year 2011 has actually consolidated these funds in the Health and Human Services (HHS) budget. And so, you will see a decreased request from that in the 2011 budget. You were very generous in allowing us to stand this up this year, and so the first, we are looking at creating demonstration projects where we can promote wellness in the workplace for Federal employees.

The first one that we are setting up is in our own headquarters, which will also serve our little campus. Right across the street from us is the General Services Administration (GSA) and the Department of the Interior. The three of us are going to share a new health unit.

Thanks to your support for this fiscal year, we have just issued a request for proposals from the health carriers that will come in and provide complete screening—free of charge—for employees at the workplace, during work hours on a comprehensive basis, so that people can get their blood sugar and their cholesterol levels checked and also receive pre-cancer screenings.

Our belief is that this program is going to produce enormous savings. Companies that have done this in the private sector have produced productivity increases of 40 to 50 percent in the first couple of years alone.

Senator DURBIN. Did you consult with those companies when you were thinking about how to approach this?

Mr. BERRY. Absolutely, and a number of our staff have been going around the country and meeting with some of the more innovative companies that do this in the workplace well. And so, I am very excited by this.

We just finished the renovation of our health unit. If you are ever down in our neighborhood, we welcome you to stop in and see it. It is now once again a place that you would not mind getting healthcare. I have to tell you that when I arrived at OPM, I would not have had a band-aid put on in our health unit. But we have made extreme advances in this.

We are going to be doing other demonstration projects. In addition to the one in the District of Columbia, there will be others conducted around the country. We are going to try to select units in the Midwest and on the west coast so that we can get a good sample and bring you back strong data as to the impact that this will make in the Federal employee community.

NURSING SHORTAGE AND INTERGOVERNMENTAL PERSONNEL MOBILITY PROGRAM

Senator DURBIN. I am going to give you a little bit of a challenge here on a different issue, and it relates to a national problem, which I think the Federal Government can help to address.

We anticipate a nursing shortage in America that will grow to 260,000 registered nurses, which we will need and not have, by the year 2025, twice as large as this country has seen since the 1960s, reflects the baby boomers and more healthcare and more primary care and the critical role that nurses play.

And so, when I looked at this nursing shortage in my State and across the country, it turned out that one of the major reasons was the lack of nursing faculty. In other words, registered nurses (RNs) or those with master's degrees or could obtain master's degrees coming in to teach.

Now it turns out the Federal Government currently employs about 53,000 nurses that have the educational background and expertise to teach the next generation of nurses. Now I appreciate that you are struggling to find the nurses we need in the Federal Government. I am hoping that I can talk to you about some possibilities here because if nurses out of the Federal workforce teach in nursing schools, they are, in fact, not only teaching, they are recruiting.

They are telling stories about their careers and why they chose the Federal Government, which I think may increase the likelihood that you will have an available nursing pool in the future. We talked to you—I know that you began to address the problem through the Intergovernmental Personnel Act Mobility Program, which allows temporary assignment of personnel between the Federal Government, State and local governments, colleges, and universities. But my staff feels there is some hesitation at your agency.

I would be interested in your perspectives on the potential benefit of rotating qualified federally employed nurses through nursing schools, what authorities the OPM has to improve recruitment of Government nurses in a future pipeline, and whether you have given any thought to the possibility of extending the Intergovernmental Personnel Mobility Program to retired Government nurses. Have you thought about this issue and how we might address it?

Mr. BERRY. Mr. Chairman, thank you, first, for your leadership in helping to create the opportunity for a program like this to exist. I think that the IPA Program, the Intergovernmental Personnel Act Program, that you were instrumental in creating, is a very powerful tool to achieve the objectives, just as you have identified. And I am in lock step with you on this.

You are right to identify that we have a huge nursing shortage in the Federal Government, especially with regard to staffing our veterans hospitals. And so, for example, to meet those needs, we have allowed direct hire authority to the Veterans Affairs Department, as well as throughout the Government in that regard.

At the same time, recognizing that shortage, it is a huge opportunity for us to have some of our more experienced registered nurses—and, I think yours and Senator Collins idea, to bring peo-

ple back and out of retirement who aren't ready to sit, or play golf full time, and to reengage them to allow us to outreach, be the recruiters and tell their story, not only passing on their knowledge to the shortage which exists throughout our State and local government operations, but in the Federal Government. I think it is a powerful thing.

The Federal Government should always be in a leadership role. I really believe we have that responsibility. And so, prior administrations had somewhat deemphasized this program. They had even stopped reporting on it to you. So, we didn't know for a while how many people were doing this, and whether this program was having an effect or whether agencies were stepping up to play this role.

We have reinstated reporting to you on this matter. Therefore, we are going to start tracking again how many people are doing this. So we will be able to tell you from year to year whether we are achieving the goal that you want, which is making sure that we are stepping up not only in the nursing program, but in many programs.

I think that you have identified and put your finger on a critical place that we have got to pay careful attention to, and that is the nursing shortage throughout the country. And the IPA Program can allow the Federal Government to play a leadership role.

If there is any back stepping or slow stepping on my staff's part, my commitment to you is that I will goose them along very aggressively. We would be very happy and honored to work with you and Senator Collins' staff to make sure that we are aggressively pursuing this program, and that you are proud of its results.

Senator DURBIN. If Senator Collins will spare me one little vignette here? About 4 or 5 weeks ago, I was in Africa with Senator Sherrod Brown, and we visited with the president of Ethiopia, and I discussed with him, among other things, the fact that so many Ethiopian medical professionals now practice in the United States. In the Washington, DC, area there are about 2,500 Ethiopian-trained doctors.

And I said I know your country desperately needs medical professionals, and we are stealing them away, and I would like to know your reaction to it. He said, well, we have a plan. And our plan is called flooding and retention. You want Ethiopian doctors? We are going to produce more than you could possibly dream of, and they are going to go to your country and work and send money back to Ethiopia, and we will keep enough here to meet our needs.

It is interesting that they have decided rather than to fight us, to basically say if you want our people, we will train more of them. And the United States seems to be slow to get to that point. We just don't seem to be ready to make a commitment. We know this is looming, and it is going to cause a lot of problems.

So I hope the Federal Government can inspire and lead in this area and show some innovation.

Mr. BERRY. Mr. Chairman, if I could? I would just like to give an extra shout out to the Department of Veterans Affairs. The leadership there, Secretary Shinseki and their Deputy Secretary Scott Gould, their human resources Assistant Secretary John Sepulveda, have been phenomenal to work with. On this issue, I

think they take the philosophy that the way to beat this is not to try to outcompete State and local government. It is to try to grow the pool together.

They are investing significant resources this year to help move up not only as we—to get LPNs move to the RN level. We have all of these pools that with the right accredited training, we can increase these pipelines. It is an advantage for us to retain. It is also an attraction for recruitment.

Through the multiple training we can jointly work with State and local governments so that both benefit from this program. They are putting real resources on this, millions of dollars. I think we are going to be able to move the needle on this this year for the first time in a long time.

Senator DURBIN. Well, let us try to work together.

Mr. BERRY. Absolutely. Be honored to, sir.

Senator DURBIN. Senator Collins.

Senator COLLINS. Thank you, Mr. Chairman.

POSTAL SERVICE OBLIGATION TO RETIREMENT TRUST FUND

Mr. Berry, we held a hearing last week about the Postal Service's financial crisis, and there are two major issues that have come up with which the Postal Service is working closely with OPM. And I want to ask your opinion on both.

First of all, we had testimony from the inspector general of the Postal Service, who discussed a report that his office issued, which concluded that the current system of funding the Postal Service's obligation to the Civil Service Retirement System has resulted in the Postal Service overpaying by \$75 billion, a truly astonishing find.

Now it is my understanding that the OPM determined this payment amount and explained its rationale in a 2004 letter to the Postmaster General, and I have read that letter that says the Board of Actuaries approved it and reviewed it. But this is a huge difference, and the reason this is important is if, in fact, there is an overpayment of \$75 billion, it would help solve a lot of the Postal Service's problems.

Getting a handle on this, however, has been extremely difficult.

Can you tell us whether OPM still stands by the analysis and payment levels that were established in 2004?

Mr. BERRY. Senator, this is a very tough issue, as you have identified it. I am keenly aware of the challenges the Postal Service is facing right now and have met with the Postmaster General as well as the Postal Service inspector general on this very issue.

Let me answer your question directly. Yes. For the time being, we do stand by the initial assessment. That assessment, as you mentioned, was upheld by the Board of Actuaries and the Government Accountability Office (GAO), not just the Board of Actuaries.

Now, the Postal Service inspector general has a new argument that they are advancing. I am very happy to go back and have that reconsidered. We will reevaluate our position, reconsidered with GAO and the Board of Actuaries to see if we are wrong. If so, we will adjust.

My responsibility to you as trustee of the retirement funds is to make sure that whatever we do, the fund is whole and that we can retain solvency and pay the claims as they come due.

That being said, I recognize the complexity and the challenges that are before us, and have made very clear that I am very willing to sit down with the Treasury Department, OMB, the Postal Service, and GAO and be a constructive partner in crafting a solution that guarantees that we can meet the Postal Service's concern and protect the solvency of the fund. I think I have made very clear that, in other words, we are very open minded to try to help however we can.

If, at the end of the day—because, like you, I am not an actuary, the lawyers and the actuaries say, John, your trustee responsibilities prohibit you from doing what these other folks want to do, I will be very happy to come back and tell you that this might require this change in legislation to do what you would like to do. This is how I could advise you on how best to move forward.

Right now, you are exactly right. We need to get everybody around one table and have people work together to try to crack this and resolve this once and for all.

Senator COLLINS. And while you are doing that, you also need to look at the payments to the retiree health benefits fund.

Mr. BERRY. Yes.

Senator COLLINS. It is a different issue, but another issue, and I know that you have been having some meetings on that as well, but that there is not yet a consensus.

We are just trying—well, let me speak for myself. I am just trying to get a handle on what is the appropriate payment. I just left a meeting where a person told me that the inspector general is wrong and is at one end of the spectrum, and OPM is wrong and at the other end of the spectrum, and the truth is somewhere in the middle. I don't know. I am not an actuary. There are obviously budget implications to shifting from the Postal Service the obligation to the Treasury, and I understand that. But it would be nice to know what the answer is in terms of just doing a factual analysis when we are hearing such diverse things.

DOMESTIC PARTNER BENEFITS

I will go back to that. I apologize for cutting you off, but just so in this first round, I could quickly get one more question in, and that is on the domestic partners benefit bill.

As you know, last October, our Homeland Security and Governmental Affairs Committee held a hearing on the domestic partners benefits and obligations bill, which I introduced with Senator Lieberman. This bill would provide the Federal workforce with the same kinds of benefits that are very prevalent in the Fortune 500 benefit structure, and those are the people we are competing with, by the way.

At the conclusion of the hearing—not to give you a hard time, but at the conclusion of the hearing, you did indicate to Senator Lieberman and me that “the cost of the bill is of such a level that I think we will be able to identify efficiencies to fully offset the cost over the term of the administration. If you need a commitment or a promise to that effect, I am happy to deliver it.”

It has been 5 months since that hearing, and we are still waiting for those offsets, which, you should understand as a strong supporter of the bill, is preventing the bill from being taken up on the Senate floor until we identify those offsets. And so, where are we on that issue?

Mr. BERRY. Senator, first, thank you again for your leadership on this issue. The administration strongly supports the legislation that you, Senator Lieberman, Senator Durbin and many others are supporting. I don't want this to be a catch 22. Let me make this ironclad promise to you.

Currently, we have an offset that is going through the clearance process with Office of Management and Budget. We are waiting for the committee to wrap up its report so that we can get Congressional Budget Office (CBO) scoring so we can guarantee that the offset we will give you equals the CBO cost estimate. Once we know that for sure, then I can meet our word to you. We have identified, I think, a very good offset.

Now, the chairman mentioned that my last job was Director of the National Zoo. As you know, especially in these times, offsets have become a very precious commodity. I feel like having a good offset is like going into the lion and tiger house with a plateful of meat. You get a lot of attention.

So, I am sort of loathe to reveal the offset for fear, quite frankly, that a larger tiger might take it away for another purpose.

My promise to you would be as soon as the subcommittee is ready to go to the floor and we have that CBO scoring, we will have an offset to cover the entire cost of the amendment for you so that you can move expeditiously to the floor without any delay.

I don't offer that as trying to be cute, but that is essentially where we are right now.

Senator COLLINS. Thank you.

GUARD AND RESERVIST DIFFERENTIAL PAYMENTS

Senator DURBIN. You talked a little bit in your opening about an effort I had underway for years to try to make sure that those Federal employees who were activated to serve, deployed as members of the Guard and Reserve would not suffer any pay loss. State, local governments, private companies have all stepped forward, and we used to honor them with a special Web site at the Pentagon, thanking them for their patriotism. And yet the largest employer of Guard and Reserve in America, the Federal Government, failed to do the same thing.

So I had one Senator who was an obstacle. I never convinced him, but I outlasted him and eventually passed in fiscal year 2009 the language necessary for this. Can you give me any idea—we talked at the time how it was important that those who qualified be paid on a timely basis. Give me an idea of the process that a Federal employee who is notified that his or her unit had been activated, about to be deployed, would follow to make sure that if they do qualify, they would receive these payments.

Mr. BERRY. Mr. Chairman, again, let me commend you on your leadership on this issue for so many years. Thank you on behalf of all of our reservists for delivering this great success.

I apologize for the delay in issuing guidance to the agencies about this. We got that guidance out in December. The reason, we found, wasn't that the civilian pay was complicated. It was the military pay side that was very complicated, trying to figure out do you include the housing payment? Do you include the hazard allocation? What is included in terms of military pay to define what the gap would be to ensure that we were treating them very fairly.

We finally reached a consensus with the Defense Department and the Office of Management and Budget on this and were able to issue that guidance.

The first thing I want to assure you about is the law you enacted took effect in 2009, March 11, 2009. We didn't get around to issuing the guidance until last December. Reservists are eligible for that pay back to the date of enactment. Even though we have made that clear in the guidance, and we will make sure that everyone is made whole back to the date of enactment. I want to promise you that we will ensure that no one is shortchanged because of our delay in getting that guidance out because of the complexity.

There are essentially four finance centers that pay employees on the civilian Department of Defense (DOD) side and throughout the Federal Government. The GSA runs one; the Department of Defense has the DFAS center; the Interior Department has what is called the National Business Center; and the U.S. Department of Agriculture (USDA) has the National Finance Center. We have been working with them to implement adjustments to their pay systems so that these calculations can now be made, and the reservists can be made whole.

And so, that is underway. I don't know if we have an exact date. If I could supply it to you for the record——

Senator DURBIN. Of course, you can.

Mr. BERRY [continuing]. The exact date we will be able to do that?

Senator DURBIN. And if you could, and if you don't know at this moment, the number of Federal employees who are in the Guard and Reserve. I don't know if you have that. If you don't, you can provide that to me as well.

Mr. BERRY. We estimate that the number could range, depending on the year, somewhere between 5,000 and 15,000 Federal employees at any one time that are on active military duty in the Reserve. That is the total number of the estimate that we gave this morning, 150,000?

We believe that several thousand or so will be eligible for direct payment under this proposal have been paid less than what they would have been paid in their civilian job and that this bill will allow us to make up for that. So it will be significant, and we will make sure it gets implemented quickly.

[The information follows:]

STATUS OF RESERVIST DIFFERENTIAL PAYMENTS

The status of making reservist differential payments varies among payroll providers. The most recent information we have from the four major providers is as follows:

General Services Administration (GSA)

On June 1, 2010, GSA reported that it had implemented automated capability for processing reservist differential during pay period ending May 8, 2010. GSA made its first reservist differential payments during pay period ending May 22, 2010.

National Business Center (NBC, Department of the Interior)

On June 2, 2010, NBC reported that since February 2010 it had manually processed several reservist differential payments. NBC reported that it continues to remain on schedule to automate the reservist differential in its Federal personnel/payroll system August 2010 release.

National Finance Center (NFC, Department of Agriculture)

On June 4, 2010, NFC reported that effective April 19, 2010, client agencies of NFC were able to enter reservist differential payments into its Special Payment Processing System (SPPS). NFC published processing instructions on its website via an NFC bulletin dated April 16, 2010. NFC reported that it had processed a total of 30 payments as of June 4 thru its SPPS system.

NFC also reported that effective May 9, 2010, the programming modifications for OPM's Update 52 to the Guide to Processing Personnel Actions (GPPA) related to reservist differential were completed and available for clients to begin their processing. NFC has published processing instructions related to these changes on its website via an NFC bulletin dated May 18, 2010.

NFC reported that it continues to perform the necessary analysis and research to address the system changes needed for the new Pay Status/USERRA codes related to the Nature of Action Code (NOAC) changes for reservist differential as per OPM's Update 61, Update 02, of the OPM Guide to Data Standards, issued April 1, 2010. Once this task has been completed, NFC will establish a target implementation date for this final phase of the project.

Defense Finance and Accounting Service (DFAS, Department of Defense)

On June 9, 2010, DFAS reported that it had a manual workaround in place to make reservist differential payments. As of pay period ending May 22, 2010, 331 payments have been made for a total of approximately \$800,000. All of these payments were made to DOD civilians.

On August 17, 2010, DOD reported it had identified approximately 5,558 appropriated-fund DOD employees so far as being eligible for reservist differential (i.e., had qualifying active duty service). Approximately 532 of these employees were due retroactive differential payments. For those 532 employees, the consolidated amount of reservist differential owed is approximately \$1.3 million. The total amounts covering anywhere from 1 pay period to 24 pay periods ranged from \$10.75 to \$26,665.02. The median total figure was \$1,518.71. The average amount (before taxes) is approximately \$2,500. DOD is in the final stages of analyzing a second group of employees that may be eligible for retroactive reservist differential payments. Payments will be effected starting September 17, 2010.

On June 24, 2010, DFAS provided non-DOD client agencies procedures to follow for authorizing reservist differential payments and followed up with a discussion during a quarterly customer meeting in July 2010. As of September 2010, DFAS has processed payments for the Departments of Veterans Affairs and Energy and the Environmental Protection Agency.

HIRING INDIVIDUALS WITH DISABILITIES

Senator DURBIN. If I could ask one other question, and it relates to disability policy in hiring. I talked to my staff because I think Congress is slow to meet the needs when it comes to the disability community. And I talked to my staff about our office and said, "What can we do here?"

I meet a lot of disabled veterans out at Walter Reed and a lot of folks who have served, come back needing a job, as an example, disabled veterans and others in the disability community. It has been hard. It has been more difficult than I thought it would be.

Sometimes it is matching up our job description with their talents, and our schedule, as crazy as it is from time to time, with their personal and family needs. And I am wondering what you are doing, as you look at the Federal Government, to address this,

whether our problem is unique or we just didn't go to the right place for information and guidance.

What can we do, should we do as Congress or as the Federal Government to give talented disabled people a chance to serve their Government?

Mr. BERRY. Mr. Chairman, thank you for your leadership on the Americans with Disabilities Act, with the amendments. You have been a stalwart leader over the decades on this issue. I know you and Tony Coelho and Mr. Hoyer have been partners in advancing this effort and this initiative, and your leadership is deeply appreciated.

When you look at the diversity equation in the Federal Government, the only group that has gone backward have been people with disabilities. We used to be over 1 percent. We are now under 1 percent, around 0.5 percent. It is embarrassing.

This is after the passage of the Americans with Disabilities Act, after the passage of the amendments that you all secured. We need to do better. And so, one of the reasons that I sought and recruited Christine Griffin from the Equal Employment Opportunity Commission (EEOC) is whenever you deal with diversity and Federal law, it is a very complicated area, as you all know, relative from Supreme Court cases on down.

Chris is both an attorney as well as someone who is skilled on this issue through her practice in the EEOC, where she was a Commissioner just before becoming Deputy Director of OPM. I have asked her to lead our effort on behalf of the President of an initiative that will focus not only on disability, but also on a diversity initiative that we could present to the President this summer that is going to try a new approach, within the scope of the law, that will allow us to better provide access to all communities in the country, including people with disabilities.

Now especially for people with disabilities, to focus specifically on your question, Chris has worked with agencies across the Government to organize the largest-ever hiring event, which we are holding at the Washington Convention Center in April.

What is the date, Chris?

Ms. GRIFFIN. April 26.

Mr. BERRY. April 26. And we welcome, if you have time to be able to join us at some point during that day.

What we have done is, rather than make this just another job fair, we have conducted outreach through the disability community and advocacy groups across the country, we have worked with Federal agencies to identify jobs that are currently available, and then we have had people apply in advance of this event so that we can try to do exactly what you said, Mr. Chairman, match their skills and ability with the positions that are now available and open in the Federal Government. And then, using Schedule A authority, what we are going to do at this hiring event is actually set up interviews between the agencies where we think those matches are in the ballpark so that they can interview those candidates at the Washington Convention Center and, if it works, hire them on the spot. So we will have OPM staff there to advise agencies and applicants, and get them started immediately.

We have very powerful tools that you and Congress have given us with Schedule A authority. They just haven't been used very effectively. And so, Chris and I are going to work very hard on this. The goal is to achieve forward momentum and progress on all fronts on the diversity level. But the place where we just have to move this needle, because it is the only one we have fallen backwards on, is with people with disabilities. They do deserve special attention, and we do have the ability to do it.

Last, but not least, if I could just thank you all for the appropriation that you give the Department of Defense to fund the Technology Support Center because what you have done through that is essentially take advantage of our market strength. Now the Federal Government can buy all of the technical equipment that is needed to accommodate people's disability in one place and get lower prices because they can buy them in bulk rather than an agency buying one specialized piece of equipment. You have centralized that in the Department of Defense, and then they do it on behalf of all Federal agencies. And so, for any Federal agency that wants to hire a person with a disability, if there is a special high-cost technology accommodation that needs to be made, it is covered thanks to the program.

The Department of Defense has been working in lock step with us on this program and they are going to be there with us on the 26th to help us in case anybody says, well, you know, "I have the skills to do this job, but I need a special computer," or "I need this special phone line."

So, Mr. Chairman, we are committed to this issue. I am with you 110 percent, and I hope to God by next year, we are going to be able to move the needle for you.

Senator DURBIN. I will ask you.

Senator COLLINS.

Senator COLLINS. Thank you, Mr. Chairman.

FEDERAL EMPLOYEE PAY

Mr. Berry, I want to ask you about an allegation that I am hearing with increasing frequency, and that is the average pay for a Federal employee is almost double the average pay overall. And because I am hearing this repeated by my colleagues, by my constituents, by commentators on television so often, I would like to ask you to address that issue in a factual way, to help us better understand this charge.

Mr. BERRY. Senator, I really appreciate that. There is a lot of misinformation out there right now.

Many of these jobs that you hear about compare Federal salaries, sort of the average Federal salary to the average private sector salary. However, they are not really comparing apples to apples.

The Federal Government 50 years ago used to be a largely blue collar operation. Today, it is a significantly white collar operation, with very high-skilled positions, including everything from financial regulation and derivative monitoring to National Institutes of Health (NIH) research, to law enforcement and cybersecurity. The skill sets that are required for the Federal Government to meet its responsibilities in the 21st century continue to increase in complexity. The average Federal salary includes those high-ranking po-

sitions. On the other hand the private sector includes a large number of service jobs that we do not have in the Federal Government—restaurant workers, kitchen staff, things like that for which there are very few counterparts left in the Federal Government in these areas. And yet that is a significant portion of the average private sector salary.

And so, you see how if you are going to put in a lot of lower-paid workers into the average private sector salary, it is going to be lower than the average Federal salary. However, you are not comparing like jobs with like jobs.

And so, whenever you do that, whenever you try to compare like jobs with like jobs and put the level of responsibility with it and the level of education that is required, Federal jobs are behind the private sector. So, and I don't want to say in each and every case because there will be outliers, and where there are outliers, quite frankly, we need to adjust the pay system to make sure we are not ahead of the private in those areas by any significant amount.

But a good case is nurses, Mr. Chairman, to go back to an earlier example. Only one-third of nurses in the private sector have a bachelor's degree. Over one-half of the nurses in the Federal sector have a bachelor's degree.

So, for example, in the USA Today story, they compared nurses in the private sector to nurses in the public sector, and the nurses in the public sector were paid, I think, something like \$5,000 more. Well, when you accounted for the bachelor's degree and the percentage increase, then immediately, that number evaporates.

Senator COLLINS. Let me just say that I think you need to respond to that because that is gaining currency, and it would be helpful to have in writing your analysis and response to that. You have raised a number of excellent points, but I don't think those points are getting out there, and I am starting to hear this more and more often.

What I hear is a comparison that the private sector, it is \$41,000, and for the average Federal employee, it is like \$70,000 something. And I think that needs to be addressed, and I would encourage you to do that.

Mr. BERRY. And quite frankly, one of the things we are looking at, Senator Collins, on this issue and what I found was interesting was that the formula we used was based on Bureau of Labor Statistics data. Well, over the years, they have stopped collecting the data at the level that we can really make careful analysis and comparisons. And so, there may be requirements needed to change this formula.

And so, I have appointed a task force to wrestle with this formula so that we can come forward and actually defend with iron-clad validity for you and for the American public exactly what the facts are based on the data. And so, we are working on that right now, and as soon as I get that, I will bring that up and make sure we carefully brief you and the chairman on this issue.

Senator COLLINS. That would be very helpful because, obviously, if there is an imbalance, that is a problem at this time of great budget strain. But if there isn't, we need to better make that case and explain why.

FEDERAL LONG-TERM CARE INSURANCE PROGRAM

Let me switch to another issue. You will recall that there have been a lot of problems in the Federal long-term care insurance program, and we have talked a lot today about making the Federal Government the model employer. And believe me, it has not been a model employer when it comes to that program.

So many people signed up for that program with these false assurances based on very misleading brochures from the provider, the insurance provider that indicated there would never be an increase in premiums if they paid this higher rate at a particular time. And I have those brochures. Literally, I personally have those brochures.

So I was so sympathetic to the witnesses who came before us and now were all faced with a 25 percent premium increase. Well, adding insult to injury, when the provider sent out the new forms for us to make our choices, they made further errors in describing it. That is just so unacceptable, and I think OPM needs to do a far better job of overseeing that program.

I have a point of personal pride here because I was a coauthor of the law that created this program because we wanted to encourage Federal employees to plan for long-term care and because so many people are under the misimpression that Medicare covers long-term care, which it doesn't. So—and this isn't an argument for the CLASS Act, in case my chairman is about to make that comment. He has a smile on his face. So I see that coming my way.

But the administration of this program has been far too lax, and it is not protecting retirees, participants, and future participants. So participants and beneficiaries are not getting the protection that they have a right to look to OPM to provide.

Mr. BERRY. Senator Collins, I want to apologize to our retirees who especially did not have full access to that information and who were essentially misled and are now put in this awkward position. This is obviously a program that I have inherited and am trying to do the best we can, and we will have recommendations for how we can hopefully prevent this from happening again.

What I have tried to do to, at least, to ease the blow, if you will, is to create alternatives so that not every employee or every member who is in that program would suffer that same increase. That would only be if they had the highest level of inflation protection over the long term.

And so, we have tried to create options for the employees so that they can understand the cost of that inflation protection in the long term, obviously, it is not the same level of protection. It is lower inflation protection, but it would—it lowers, obviously, the cost of the increase as you create these alternatives.

And so, we worked with the insurer to try to create as many of those alternatives as we could, and then allow the retirees who were in the program plenty of time to try to make their decision as to what level they wanted to pay for. And so, we have extended that through March to give them the time to wrestle with this. I know it is a tough decision, and I am very empathetic to the pain that this is causing them, and I hope we have given them sufficient choices that they can adjust to the budget that they find them-

selves in, as I appreciate many of these people are on fixed incomes now.

That being said, one of the biggest weaknesses, in my opinion, as the new person coming into this program here at the end here, is that when the law was created, because this was an emerging market, Congress told us that we needed to recompete this program entirely every 7 years. And so, there are no—there hasn't been an increase in rate in 7 years because we were able to enforce that.

But what happens is when you recompete to ensure that you have people applying and actually stepping up to offer the service, the market has matured. And so, every 7 years, we will find ourselves in this exact same position where whoever bids on the new contract 7 years from now could do the exact same thing and increase rates all over again.

And so, I think what I would like to—we have got a team working on this and to work with your staffs. Because the market has now matured in this program, we may want to look at a more longer-term contract that we could then enforce more stability in the program and prevent these spikes every 7 years.

And quite frankly, my biggest fear is, okay, what happens 14 or 21 years from now when some future OPM Director is going to have to recompete this program and now you have more retirees taking the benefits than might be joining the program, and all of the private sector saying, "I don't know if I want to join that program." And so, we may have no one bid. That would be a horrible situation.

So we need to, I think, take a longer view on this program and really design it for the longer term and not in these 7-year slices. And so, that is a long answer, but I appreciate the sensitivity of the issue.

Senator COLLINS. Thank you.

It is a difficult issue because if you lock one provider in for that many years, you may see a decline in service levels. That is not necessarily a—

Mr. BERRY. Right.

Senator COLLINS. It is a tradeoff, but I apologize for going over.

Senator DURBIN. No, that is fine.

LESSONS FROM THE 2010 SNOWSTORMS/TELEWORK

Director Berry, I just have one last question. When I was outside today and it was so sunny and beautiful, and I looked at the trees budding and blossoming, I thought 6 weeks ago, we were in the midst of a blizzard, the worst snowstorm in the history of Washington, which literally shut down the Capitol and shut down most agencies of the Federal Government for the better part of a week. What did you learn from that?

Mr. BERRY. Ah—

Senator DURBIN. Aside from the fact that we need better snow removal in a lot of places.

Mr. BERRY. We are working, Mr. Chairman, with the Council of Governments in the region. There is going to be on April 5 an after snow event to discuss lessons learned, and there are a lot of areas

we could do better in terms of coordination with the region with lanes and snow removal. We had it in both directions.

For example, Key Bridge was plowed—all the lanes on the bridge were plowed, but then when you got to Arlington, only two lanes of traffic were open. So that didn't work well. And vice versa, the same, 14th Street was plowed, but when you got into the city, only two lanes were open on 14th Street.

So we created these bottlenecks by just not coordinating and saying, okay, if we are going to open four lanes here, let us open it the whole way and not pieces. So there is a lot that we can learn.

I think the biggest thing we learned, and it is actually, I think, a good news story. The President called me on Wednesday during the second blizzard to check in and see how things were going. And I explained to him, I said, you know, Mr. President, in 1996, which was the last storm of similar import where the Government was closed for a period of time, less than 1 percent of the workforce could telework at that time because at that time, the two biggest obstacles to telework were security, protecting secure information, and second was technology. You just didn't have the memory capacity that, for example, this gentleman has right here on that portable computer.

Bring the clock forward to this past snowstorm a month ago. Over 35 percent of our workforce we know was online with our mainframes in many agencies across the Government. Some agencies, for example, the Patent and Trademark Office (PTO), had an 85 percent productivity level during the snowstorm while we were technically closed.

Well, they did that because they had a very aggressive telework program, the staff had the equipment and the security all tied up. The last major hurdle that we are trying to defeat right now is management intransigence. Managers just like—they think the person has to be at their desk, in that chair, or they are not doing the job. And we need to move our managers to be more results-focused. Because quite frankly, if they are doing a good job defining the result, then who cares where the work is getting done? Who cares when it is getting done?

Many women and men both with child-raising responsibilities, would love to do work at night between 9 and 11 p.m. once the kids have gone to bed. And should we, as a Government, care about that? Yes, we give them the tools to allow them to get the work done. Maybe they are not working from 3 to 6 p.m. because they pick the kids up from school and are helping with the homework but as long as the work gets done that's what matters.

And so, I think we can still get the 40 hours, but we can be more flexible in how we approach it. And where agencies that are doing that like the Patent and Trade Office, when we were closed, they weren't closed. They accomplished 85 percent productivity for the taxpayers.

At OPM, we accomplished only about 35 percent in that area, but we did 95 percent in our background investigations. You know why? All of our security background investigations, 90 percent of what is done throughout the Government are done out of people's homes. We have our caseworkers all across the country working

out of their homes. They do it securely, and they do it professionally. And we can do this.

So I told the President in 12 years, we have got it to a point where we went from 1 to 30 percent of the Government being able to operate. Shouldn't the goal really be 80 to 90 percent, where everybody would be like the PTO? So that may be within the next couple of years, if we really put our shoulders to this, and we get people the right equipment and we deal with this management problem of intransigence, we could have 85, 90 percent Government functionality during any event because we ought to be able to maintain continuity of operations.

And what I ought to be able to say is we're not closed today. We are on a mobile work day. And whether it is a snowstorm or whether, quite frankly, if a dirty bomb goes off somewhere in the city and we might have to evacuate a portion of the city for a long period of time, we still need to maintain those Government operations. And so, I think this is essential for continuity of service. We need to get there, and telework is the most powerful tool to do it.

And so, that would be my biggest lesson learned, Mr. Chairman, where I think there is a lot of hope, and we can do a lot better.

Senator DURBIN. Thank you.

Senator COLLINS.

Senator COLLINS. Thank you, Mr. Chairman.

ADDITIONAL COMMITTEE QUESTIONS

Senator DURBIN. Director Berry, thanks for coming. We are going to submit some questions to you. If you can get back to us in a timely fashion, we would appreciate it. Look forward to working with you. Thank your staff and all the committed people at OPM.

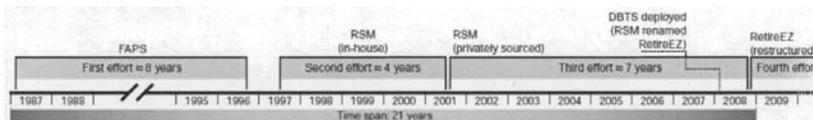
Mr. BERRY. Thank you, sir.

[The following questions were not asked at the hearing, but were submitted to the Office for response subsequent to the hearing:]

QUESTIONS SUBMITTED BY SENATOR RICHARD J. DURBIN

RETIREMENT SYSTEMS MODERNIZATION

Question. OPM's processing of Federal employee retirements has long been recognized as paper-intensive and reliant on antiquated systems while not providing prompt and complete benefit payments upon retirement. Since 1987, the agency has attempted to modernize its retirement process and systems through a series of four initiatives, none of which has been successfully completed. The following timeline shows the retirement modernization initiatives from 1987 to present.



In April 2009, GAO reported that OPM's latest retirement modernization effort (referred to as RetireEZ) remained far from achieving the modernized capabilities the agency intended. Also, OPM did not have a complete plan for proceeding with the modernization. What are OPM's specific plans for retirement modernization, including program scope, implementation strategy, lines of responsibility and authority, management processes, schedule, and expected results?

Answer. OPM is deeply committed to modernizing the Federal retirement system and addressing the issues identified in the Government Accountability Office's (GAO) April 2009 report regarding OPM's Retirement Systems Modernization (RSM) program. To ensure that work on RSM receives the highest level of attention,

Deputy Director Christine Griffin is leading our efforts on this program and she has made it her top priority. We have also realigned the program to the Chief Information Officer.

Consistent with Director Berry's "back-to-basics" strategy for the RSM program, priorities for fiscal year 2010 include modernizing the retirement calculators used to calculate the bulk of Civil Service Retirement System (CSRS) and Federal Employees Retirement System (FERS) retirements and establishing key "building blocks" to transition from a paper-based to an automated retirement process. Those "building blocks" include a data warehouse to store and allow access to retirement data and establishment of a method for agencies and Shared Service Centers (SSCs) to send electronic retirement information to OPM and across the government ("data feeds").

The data warehouse improvements will help OPM to process retirements faster by enabling collection of retirement data over the course of an employee's career rather than primarily at the time of retirement. Collection of this information through recurring data feeds, and an online retirement application will allow for validation of data prior to submission, thereby preventing incomplete or erroneous information from being submitted for retirement processing. Storage of this information will speed the adjudication process by making clear what information is available and what information may be outstanding. Given today's environment where over 30 percent of retirement cases are incomplete when submitted to OPM for processing, the possibilities exist to vastly reduce the amount of work required to "hunt down" missing information.

Improvements to the retirement calculator consolidate all calculations into a central rules engine that can be utilized across retirement processing systems as applicable; and will allow for integration with the data warehouse, thus eliminating time-consuming and error-prone manual data entry from today's paper files. This integration will reduce processing time and claim adjudication errors.

During fiscal year 2010, OPM improved the management of the program to address the concerns GAO identified in their April 2009 Report. Specifically, the RSM program was put under the Executive leadership of Deputy Director Griffin, with a clear strategy, lines of authority and management best practices implemented and identified in key program documents including a program Executive Charter. The RSM program generated cost estimates based on GAO's Cost Estimating and Assessment Guide and developed a comprehensive project plan, with a schedule and expected results (Integrated Master Schedule). OPM tracked the RSM program progress through OPM's Earned Value Management System, which measured RSM's performance based on adherence to scope, cost and schedule. We have and will continue to keep Congress and GAO apprised of our progress in addressing the recommendations made in GAO's 2009 Report.

For fiscal year 2011, the RSM program continues to focus on the "building blocks" needed to improve the retirement system and transition from a paper-based environment, including:

- Modernizing critical calculator and retirement systems;
- Automating manual paper-based retirement system through electronic data collection and applications;
- Implementing automated tools to improve retirement case processing; and
- Imaging incoming paper retirement records.

This approach differs from previous modernization attempts in several ways. First, each of the previous approaches were based on a complete overhaul and replacement of all retirement processing systems. The current approach takes a more measured approach in assessing which systems are operating effectively and targeting specific systems for replacement or upgrade. The second differentiator is the role of the government in integrating the various components. In all previous iterations, OPM relied primarily on vendors, either the prime vendor or a second vendor to integrate the systems components into a comprehensive retirement solution. OPM has realized that it was extremely difficult to identify a contractor with sufficient knowledge of OPM's current systems and proposed solution components to complete this task effectively. The current approach puts OPM Federal staff in this role, augmented by contractors for specific tasks, but with overall OPM staff leadership. The current approach differs from previous efforts by focusing on incremental improvements rather than a "big-bang" implementation with the completely revamped retirement system available on day one. This approach allows for much more efficient use of resources and decreased risk of system failure that would jeopardize retirement processing operations. The primary advantage to enabling the success of the current incremental approach is a Federal-wide standard, The Guide to Retirement Data Reporting, which defines the data and formats for agencies to send retirement data feeds to OPM.

Question. For more than two decades, the agency has attempted to modernize its retirement processes and systems, including in-house and privately sourced efforts, and none of these has been fully successful. Most recently, almost 2 years ago, OPM abandoned the latest effort. Where are you now in your decisionmaking process with regard to development of a new system?

Answer. OPM senior leadership and the leadership of OPM Retirement and Benefits have fully endorsed the RSM priorities identified for fiscal year 2010 and fiscal year 2011, which are consistent with the Director's "back to basics" approach for the program. These activities move the program in a methodical and deliberate fashion in order to ensure successful delivery of key "building blocks." These activities align to the capabilities GAO identified for a modernized retirement system including upgrading the aging OPM calculators and moving from a paper-based retirement process to an automated process. Delivering modern, improved retirement services, including web-enabled retirement applications, self-service tools, retirement estimators, and a comprehensive retirement case management system is dependent on first establishing the core "building blocks".

Funding has been approved by OPM's Capital Investment Committee and is being put in place for the retirement calculator improvements and development of a pilot online retirement application tool in fiscal year 2011.

Question. For fiscal year 2011, you are requesting an additional 40 FTE in order to speed the retirement claims processing time. This staffing is needed because over the past few years, staffing levels were reduced in anticipation of expected efficiencies which did not occur. Please elaborate on the nature of the staff to be hired—what will happen to staffing once the efficiencies occur?

Answer. Retirement processing staffing levels were reduced mainly through attrition over the past few years in anticipation of increased automation of retirement processing under prior RSM efforts. Since Director Berry's "back-to-basics" strategy for RSM will not deliver on significant efficiencies in the short-term, OPM must increase staffing levels in order to process its anticipated workload in a timely manner. Beginning in fiscal year 2011, the 40 FTE will permit OPM to process an additional 24,000 claims. The additional claim processing will reduce claims processing time by up to 5 days. Furthermore, the 40 FTE will have a greater impact when the Legal Administrative Specialists (LAS) have been fully trained and possess more experience. The LAS's will then be expected to process 32,000 more claims which will reduce claims processing times by an additional 2 to 4 days. As greater efficiencies are achieved, staffing needs going forward will be evaluated.

Question. OPM's February 2010 Retirement System Modernization Quarterly Report to the Appropriations Committee identified two main components of the retirement modernization program: (1) updating all computer systems that relate to the administration of retirement benefits; and (2) transitioning from a process that is heavily dependent upon the use of paper documents to one that utilizes electronic data. What has been OPM's specific progress toward developing these two components? Has OPM developed results-oriented (i.e., objective, quantifiable, and measurable) performance goals and measures to use in determining and reporting program progress?

Answer. In terms of updating the computer systems that support the administration of retirement benefits, OPM has focused on improving the retirement calculators that perform the bulk of Civil Service Retirement System and Federal Employee Retirement System retirement calculations. In fiscal year 2010, the RSM program:

- Completed standardizing 50 percent of rules and calculations. 100 percent will be completed in September 2010 and will be used to verify that all OPM calculators are using standard, current and correct calculations.

- Started to code the standard calculations into a new calculator platform (pilot). In fiscal year 2011, RSM will continue to code all calculations into a single calculator with a goal to consolidate OPM calculators in a modern, up-to-date system.

In terms of transitioning from a paper-based to an automated retirement system, in fiscal year 2010, the RSM program:

- Established a retirement data warehouse, which meets all security requirements.

- Transferred over 9 million imaged retirement records to the warehouse.

- Implemented data feeds to receive data electronically from the National Business Center and National Finance Center. Three other Shared Service Centers (SSCs) are providing timelines to send electronic retirement data via data feeds with OPM (GSA, DOD and U.S. Postal Service).

- Provided initial access to electronic and imaged retirement information.

—Completed the Guide to Retirement Data Reporting and publically posted the data standard, enabling agencies and SSCs to send retirement data in one format, and share that information across the Federal government.

The work supporting the transition to a paper-less retirement system will continue in fiscal year 2011.

In addition to measurement of RSM's performance against the program's Integrated Master Schedule and Earned Value Management reporting addressed above, the RSM program has provided results-oriented program goals in all budget submissions (i.e., Exhibit 300 Capital Asset Plans). To demonstrate this, one of the retirement program's priority goals is to reduce the percentage of incomplete retirement records OPM receives from agencies to less than 30 percent by the end of 2010 and, going forward, to reduce the percentage of incomplete records to 28 percent by the end of 2011 and 25 percent by the end of 2012. This is one of only five of the Director's near-term High Priority Performance Goals, on which OPM is reporting quarterly progress at Performance.gov.

Question. According to OPM's February 2010 Retirement System Modernization Quarterly Report to the Appropriations Committee, the agency has been coordinating with other Federal agencies regarding timing and application capabilities for its retirement system modernization. In addition, OPM's report stated that it plans to continue developing standardization rules through interagency coordination. To what extent is OPM dependent on other Federal agencies to modify or make changes to their system(s) in order for OPM to accomplish its goals for retirement system modernization?

Answer. The key to transitioning to a paperless retirement process is for OPM to receive electronic data from Shared Service Centers (SSCs). RSM continues to meet regularly with the SSCs to discuss retirement data requirements and the steps necessary to begin sending electronic data versus paper. The SSCs are providing schedules to send electronic retirement data to OPM. Two SSCs are already providing retirement data to OPM electronically, and the rest are planning to do so. Regular meetings and discussions with the SSCs also entail coordinating the validation checks that can be applied to information when it comes to OPM in order to verify it is complete and properly formatted. These requirements are documented in the Guide to Retirement Data Validations version 1.0. This guide will help OPM identify problems SSCs may have when sending information to OPM and also any problems with the data itself. OPM will be able to report these problems back to the SSCs so they can be corrected in advance of retirement processing.

Question. OPM's February 2010 Retirement System Modernization Quarterly Report to the Appropriations Committee included retirement call center goals for the agency. According to these measures, OPM has not been meeting agency established customer service standards. For example, OPM has not met its established goal for answering calls within an average of 1 minute since August 2009. What steps is OPM taking to improve the call center's service to Federal employees and retirees?

Answer. In our commitment to provide high quality customer service, OPM has taken several steps to improve the Call Center's service by promoting our Retirement Services Online webpage; focusing on resolving customer inquiries in the first call; adjusting work schedules; and employee training.

Many telephone inquiries that are received are transactions that can be performed by our customers online. Call Center agents are educating our customers about the online tools that are available 24 hours a day, 7 days a week. This will help customers get their annuity information faster, view and manage their annuity, and will help reduce call volume and customer hold times.

Stronger emphasis has also been placed on resolving customer telephone inquiries in the first call, which will significantly reduce the number of times a customer needs to contact the Call Center. Call Transfer Rates have decreased by 40 percent over past 2 years, and although Average Talk time increased by 18 percent over past year customers are more satisfied having their inquiries resolved in one call.

In an effort to adequately staff the Call Center, staffing schedules have been adjusted to better handle the hourly call volume during peak times. Higher skilled employees (Customer Service Specialists) will now handle calls, which will result in improved resolution rates and improved efficiencies.

Finally, of the current Call Center staff of 84, there are 18 newly hired customer service specialists. Talk time should come down as new employees become comfortable and familiar with their positions. We have already seen a 3 minute decrease in Average-Speed-of-Answer (ASA) in July 2010 over the previous month (from 15.8 minutes to 12.8 minutes). However, this may not be sustainable as we return to the busy times of the year.

Implementing the steps above will improve customer service at the Call Centers, but not be enough for us to reach the 1 minute goal for the average speed of answer.

This goal is a by-product of past priorities which was based on the provision that OPM would have a fully automated retirement system and substantially increased Call Center staff. Unfortunately, those provisions did not come to fruition. Nonetheless, customer service is a priority for OPM and we will analyze this in more detail to further improve our performance.

Question. GAO made recommendations that OPM correct significant weakness in five key management areas that are vital for effective development and implementation of a modernized system: cost estimating, project monitoring (using earned value management), requirements management, system testing, and project oversight. Specifically, GAO reported that OPM had not developed a cost estimating plan or established a performance measurement baseline—prerequisites for effective cost estimating and earned value management. In addition, the agency had not established processes and plans to guide system requirements development work or addressed test activities. Finally, although OPM's Executive Steering Committee and Investment Review Board were aware of retirement modernization activities, these bodies did not exercise effective oversight, which allowed the aforementioned management weaknesses to persist. Correcting these weaknesses is critical not only for the success of OPM's retirement modernization, but also for that of other modernization efforts within the agency. What is the status of OPM's efforts to address and overcome the program management weaknesses GAO identified? What steps is OPM taking to ensure that the program management weaknesses GAO identified are not adversely impacting the financial systems modernization program?

Answer. OPM has met with the GAO as a follow-up to their April 2009 Report on weaknesses with the technical implementation and management of the RSM program. RSM's continuous review process is central to fully adopting the recommendations of GAO to ensure the restructured program meets its objectives on time and within budget. To this end, RSM developed a reliable program cost estimate in 2009 in response to GAO findings and OMB guidance to rejustify further investment. Using GAO's Guide to Cost Estimation and Assessment the RSM Business Case Analysis (BCA) was developed and provided to OMB in September 2009 with the BY 2011 Exhibit 300. The BCA was recently updated for 2010 in support of the BY 2012 program budget and investment justification and provides more informed basis for acquisition and other planning. RSM established a new Program Management Baseline in June 2010 based on this information and updated and continues to develop several documents which are used in managing the program.

These key documents were specifically cited by the 2009 GAO Report as inadequate, and have subsequently been updated to correct those weaknesses, improve program oversight and reflect current program priorities. Status of these documents follows:

- RSM Executive Steering Committee (ESC) Charter.*—This charter was updated to improve program oversight. The Charter reflects OPM's reorganization, designating the Chief Information Officer as the ESC Chair and adding OPM's Deputy Director as an ESC member.
- RSM Change Control Board Charter.*—This Charter reflects OPM's reorganization and reestablishes standard processes to approve and manage program requirements.
- Program Management Plan.*—The update is currently under review. This document provides an overview of RSM's governance, describes program management roles and responsibilities, and identifies the automated tools used by the program for management and reporting purposes.
- Requirements Management Plan.*—Version 3.0 was approved by the RSM Change Control Board in March and is currently in use in every RSM effort to document requirements and calculations for retirement business processes.
- Test Management Plan.*—The plan is currently under review. This document outlines the testing approach that ensures the programs deliver the systems and services required by OPM and that those systems work efficiently to meet the requirements of the users.

OPM continues to engage with GAO as they follow up on OPM's progress in addressing the recommendations made in GAO's 2009 Report. OPM will continue to update our external stakeholders on the program as the execution progresses.

Question. OPM's February 2010 Retirement System Modernization Quarterly Report to the Committees on Appropriations discussed the development of a plan and timeline for the modernization of OPM's legacy retirement IT systems. What is the specific plan and timeline for modernizing OPM's legacy retirement IT systems?

Answer. OPM has developed a plan and timeline for modernizing the 32 aging OPM retirement systems, prioritizing modernization of the systems as follows:

- Fiscal year 2011–2012.*—OPM retirement calculators, employee data systems, Service Credit system and Case Control Systems.

- Fiscal year 2013–2014.*—OPM consolidated annuity payment systems and post-adjudication support systems.
 - Fiscal year 2015–2016.*—OPM consolidated data repository and retirement reporting systems.
- OPM will undertake modernizing these systems.

IMPLEMENTATION OF GUARD AND RESERVIST PAY

Question. Director Berry, at our hearing on March 24, 2010, you testified that between 5,000 and 15,000 Guard and Reservists employed in the Federal Government are eligible for the benefit in a given year, and that several thousand would require the pay differential. Following up on that, please answer for the record, how many Guard and Reservists there are overall in the Federal Government?

Answer. For the purposes of this response, the term “reservist” refers to members of the National Guard, as well as members of one of the Reserves. Based on a recent computer match between DOD records on reservists and OPM records on Federal civilians, there are (as of March 2010) at least 150,000 Federal civilian employees who are reservists. (The OPM database does not contain data on all Federal Government personnel. Among groups excluded from the OPM database are employees of the Postal Service, the Tennessee Valley Authority, the Federal Reserve, various intelligence agencies, DOD nonappropriated fund entities, the judicial branch, and much of the legislative branch).

DOD reports that the total number of reservists as of June 2010 was about 1,320,000 (including about 1,080,000 in the Ready Reserve). Thus, about 11.4 percent of all reservists are known to be Federal civilian employees. DOD reported to OPM that, as of June 2010, 102,644 DOD civilian employees were reservists (including 87,670 in the Ready Reserve). Thus, DOD employees make up about two-thirds of the known Federal civilian employee population of reservists.

As far as the number of reservists who are actually performing military service, OPM has made changes in its centralized employee data collection program, which should eventually result in readily available counts of the number of employees who are absent to perform service in the uniformed services in each quarter of the calendar year. Based on special analyses of existing Central Personnel Data File data, we estimate that 16,429 Federal employees were called to active duty during fiscal year 2009 and that 16,260 Federal employees were absent for military service as of the end of September 2009. (The corresponding estimates for fiscal year 2008 were 14,752 and 12,153.) Not all of these employees’ service is qualifying for a reservist differential. For example, some active duty service is voluntary—i.e., not under the involuntary call-up laws that trigger eligibility for a reservist differential. Also, about 10 percent of the service is less than 30 days, which indicates the service is probably annual training and not qualifying for reservist differential. We note, however, that agencies may not have been reporting all annual training service if employees covered the training with paid leave. Thus, the true percentage of active duty call-ups that are annual training is probably more than 10 percent. We have changed the reporting requirements so that agencies should use the Absence—Uniformed Services nature of action code even for short call-ups covered by paid leave.

Question. Can you provide a breakdown by Federal agency?

Answer. We are able to provide a report showing the result of a recent OPM–DOD computer match (as of March 2010), which shows counts of Federal civilian employee reservists by agency. (The OPM database does not contain data on all Federal Government personnel. Among groups excluded from the OPM database are employees of the Postal Service, the Tennessee Valley Authority, the Federal Reserve, various intelligence agencies, DOD nonappropriated fund entities, the judicial branch, and much of the legislative branch.)

Agency	Federal Civilian Reservists
Agency for International Development	55
American Battle Monuments Commission	3
Armed Forces Retirement Home	9
Broadcasting Board of Governors	6
Commodity Futures Trading Commission	3
Consumer Product Safety Commission	9
Corporation for National and Community Service	3
Court Services and Offender Supervision Agency	14
Defense Nuclear Facilities Safety Board	14
Department of Agriculture	1,366
Department of Commerce	682

Agency	Federal Civilian Reservists
Department of Defense (other)	4,623
Department of Education	40
Department of Energy	484
Department of Health and Human Services	821
Department of Homeland Security	8,950
Department of Housing and Urban Development	135
Department of Interior	1,027
Department of Justice	5,634
Department of Labor	334
Department of State	249
Department of the Air Force	44,803
Department of the Army	55,220
Department of the Navy	9,020
Department of Transportation	2,702
Department of Treasury	1,297
Department of Veterans Affairs	10,285
Election Assistance Commission	1
Environmental Protection Agency	190
Equal Employment Opportunity Commission	62
Export-Import Bank of the United States	5
Farm Credit Administration	3
Federal Communications Commission	15
Federal Deposit Insurance Corporation	73
Federal Election Commission	3
Federal Housing Finance Agency	2
Federal Labor Relations Authority	3
Federal Mediation and Conciliation Service	1
Federal Retirement Thrift Investment Board	3
Federal Trade Commission	7
General Services Administration	284
Government Printing Office	34
International Boundary and Water Commission	11
Merit Systems Protection Board	5
Millennium Challenge Corporation	3
National Aeronautics and Space Administration	341
National Archives and Records Administration	58
National Capital Planning Commission	1
National Credit Union Administration	21
National Foundation on Arts and Humanities	2
National Labor Relations Board	9
National Science Foundation	14
National Security Council	1
National Transportation Safety Board	18
Nuclear Regulatory Commission	168
Office of Administration	4
Office of Government Ethics	6
Office of Management and Budget	9
Office of National Drug Control Policy	2
Office of Personnel Management	142
Office of Special Counsel	4
Office of the U.S. Trade Representative	1
Overseas Private Investment Corporation	4
Peace Corps	4
Pension Benefit Guaranty Corporation	10
Presidio Trust	2
Railroad Retirement Board	14
Recovery Accountability and Transparency Board	1
Securities and Exchange Commission	25
Selective Service System	16
Small Business Administration	45
Smithsonian Institution	82
Social Security Administration	768
U.S. Holocaust Memorial Museum	2
U.S. International Trade Commission	2
U.S. Tax Court	2

Agency	Federal Civilian Reservists
U.S.-China Economic and Security Review Commission	3
Total	150,274

Question. Are you able to get more specific numbers from the Defense Department about how many eligible for the benefit and how many would require the pay differential?

Answer. OPM has made changes in employee data collection which should eventually provide more information on Federal employees absent for military service, including counts of those performing service that is qualifying under the reservist differential law.

OPM issued a memorandum to agencies on April 14, 2010, requesting the following:

“An estimate of the number of employees in your agency with active duty service between March 11, 2009, and the date of this memorandum that is qualifying under the reservist differential authority. This estimate should include all members of the Reserve or National Guard that have qualifying service, regardless of whether they are eligible for or are actually receiving reservist differential payments. The data should be consolidated so that one report is provided to OPM for each agency.”

Based on agency responses to the above request shown on the table below, 17,572 employees performed active duty between March 11, 2009, and April 14, 2010, that is qualifying under the reservist differential law. (This count does not reflect employees who received reservist differential payments—only those who had qualifying service.) This count included some agencies that do not participate in OPM’s centralized employee database, including the Postal Service, which reported 1,824 employees. DOD had the largest number of employees with 11,704, which represents about two-thirds of the total. These counts were for a 13-month period, thus including employees with any amount of qualifying service during that period. A count for employees performing qualifying service as of a single point in time would produce a smaller number.

	No. employees with qualifying service
DEPARTMENTS	
Agriculture	278
Commerce	37
Defense	11,704
Education	3
Energy	48
Health and Human Services	44
Homeland Security	810
Housing and Urban Development	10
Interior	200
Justice	1,329
Labor	18
State	20
Transportation	1 129
Treasury	111
Veterans Affairs	777
DEPARTMENTS TOTAL	15,513
INDEPENDENT AGENCIES	
BBG
Commission on Civil Rights
Corp National and Community Svc	3
DFNSB	2
Defense Intelligence Agency	20
Export-Import Bank
FERC
GPO	4
GSA	10

	No. employees with qualifying service
Missile Defense Agency	
Morris K. Udall Foundation	
NASA	18
National Gallery of Art	1
National Geospatial Intelligence Agency	22
Nuclear Regulatory Commission	4
National Security Agency (NSA)	23
OPIC	
OPM	13
RRB	2
SEC	2
Selective Service System	1
Small Business Admin (SBA)	5
Smithsonian	11
SSA	70
U.S. Access Board	
U.S. Senate	13
USAID	5
USPS	1,824
U.S. Trade Rep	1
INDEPENDENT AGENCIES TOTAL	2,059
GRAND TOTAL	17,572

¹ 109 of the 129 are FAA employees.

We asked DOD to provide us with more up-to-date data on DOD-employed employee-reservists. DOD reports that the 11,704 records are being analyzed in two parts. As a result of the first group analysis, approximately 5,558 appropriated-fund employees were identified as being eligible for reservist differential. Approximately 532 were due a differential payment. For those 532 employees, the consolidated amount of reservist differential owed is approximately \$1.3 million. The total amounts covered from 1 pay period to 24 pay periods and ranged from \$10.75 to \$26,665.02. The median total figure was \$1,518.71. The average amount (before taxes) is approximately \$2,500. The second group of retroactive records is now in its final review stage before distribution to DOD components to process payment actions. Payments will be effected starting September 17, 2010. DOD does not currently have data for service periods covering April 24, 2010, to the present, as those records are still being analyzed.

At any one point in time, about 13,600 DOD appropriated-fund employees are in an Absent-U.S. status. Of these, DOD estimates 5,400 are potentially eligible for reservist differential (i.e., called up under one of the qualifying legal authorities), and 540 are actually due a differential payment. However, some employees may only be due a payment for as little as a single pay period, often associated with first entering or leaving active duty when overseas allowances/payments are not being paid. Others are due a differential payment every pay period of absence.

NURSING SHORTAGE AND INTERGOVERNMENTAL PERSONNEL ACT MOBILITY PROGRAM

Question. Following up on the questions I asked at the hearing, I have an additional question on this topic. I understand that the Intergovernmental Personnel Mobility Program sets guidelines for the Departments interested in participating. It is also my understanding that in 2007, the Department of Defense, through the leadership of the U.S. Army, engaged in a similar project with the University of Maryland. OPM was not involved, but can you speak to the possibility of providing assistance to other agencies that may want to follow the example of the DOD's effort?

Answer. Even though we do not have the details of the 2007 project involving the U.S. Army, Department of Defense (DOD), and the University of Maryland, as the Federal agency responsible for establishing guidelines and regulations for the administration of the Intergovernmental Personnel Act Mobility Program (IPA), OPM remains interested in innovations that would expand the use of the IPA Program Governmentwide. That could include providing assistance to agencies that may want to duplicate other agencies' successful efforts.

For example, in March 2010 OPM sponsored a forum that included representatives from the Department of Defense, the Department of Health and Human Services, and the Department of Veterans Affairs. The purpose of the forum was to begin a dialogue with Federal agencies that have some involvement in the nursing profession to explore what role the IPA Program could play in addressing the nursing shortage, particularly the impact of the faculty shortage on the nursing shortage. Additionally, the Employment Services Division of OPM recently established a collaborative listserv for representatives of Federal agencies who administer the IPA program at the operational level for their agencies. It is our hope that the listserv will act as a valuable resource to Federal agencies by allowing them to share ideas, ask questions, and share best practices about the IPA Program across Government.

Finally, OPM plans to engage policy and programmatic stakeholders, both within and outside the Federal Government, in recommending initiatives to promote the IPA Program.

PROHIBITIONS ON THE HIRING OF IMMIGRANTS

Question. The Financial Services and General Government Appropriations bill carries a government-wide general provision (Section 704) relating to restrictions on the hiring of non-citizens in the Federal workforce. This provision has been a component of annual appropriations bills dating back to the Treasury and Post Office Departments Appropriations Act for Fiscal Year 1939. It has been modified at least 18 times in the past 70 years. As I developed the fiscal year 2010 bill last summer, I worked with the Chairman of the Homeland Security and Governmental Affairs Committee on revisions to the language to eliminate discrimination among immigrants based on their nation of origin. The changes were included as part of our enacted bill in December (Public Law 111–117, Division C, Section 704).

The modified provision permits the hiring of all legal permanent residents, refugees, and recipients of asylum, provided that they affirm that they are seeking citizenship. I note that the President's fiscal year 2011 budget request proposes to retain the fiscal year 2010 modifications. This provision applies to excepted service positions since a Ford-era executive order (1976) still prohibits non-citizens from being employed in the Federal competitive service. What actions has OPM taken to implement the changes in the law? Has OPM issued guidance to Federal agencies and updated the website? If not, when do you expect to do so? What assurances can you give the Committee that Federal agencies' human resources staff are aware of the changes and understand that the law no longer prevents them from considering and hiring immigrants in thousands of Federal positions?

Answer. OPM has provided information for agencies and job applicants on the USAJOBS website (<http://www.usajobs.gov/EI/noncitizensemployment.asp#icc>) regarding the changes to non-citizen hiring restrictions contained in Section 704. Also, OPM is discussing the statutory change with the Chief Human Capital Officers (CHCOs), and has asked CHCOs to inform OPM if agencies seek guidance on implementation of the new appropriations provision governing Federal hiring. We note that it is the obligation of each agency and its counsel to determine the scope of that agency's appropriation law restrictions in any given year and to ensure that hiring is done in accordance with such laws. OPM will work with OMB to issue guidance, if sought, on particular aspects of the new provision.

Question. Under Executive Order 11935, only United States citizens and nationals (residents of American Samoa and Swains Island) may compete for, and be appointed to, competitive service jobs. To what extent has OPM been engaged in discussions with the Administration and OMB officials to evaluate Federal immigrant hiring policies and possible revisions to E.O. 11935?

Answer. OPM has had general discussions with OMB regarding Federal immigrant hiring policies and options for revisions to E.O. 11935. However, no determination has been made regarding whether revisions are needed and what they might include.

TECHNOLOGY

Question. What percentage of OPM's budget request is allocated for technology?

Answer. The total for all Information Technology spending (for example, equipment, software renewals, and applications and systems development support) budgeted for fiscal year 2011 is \$242.85 million, which is 12 percent of OPM's total resources including appropriated funds, Common Services funds, and revolving fund activities.

Question. Please describe the programs that would receive major portions of technology funding for fiscal year 2011.

Answer. OPM's major IT investments in fiscal year 2011 include: \$77.531 million for Enterprise Human Resources Integration (EHRI), which streamlines and automates information exchanges in order to give the Federal HR community improved access to employee HR data to improve workforce planning for hiring, skills development, and retention strategies; \$39.759 million for EPIC Transformation and \$27.619 million for EPIC Operations and Maintenance, which will ensure agencies have information to make credentialing, suitability and/or security clearance decisions; \$33.484 million for operation and management of OPM's IT infrastructure, which provides the backbone for OPM's mission-critical systems; \$20.520 million for the Consolidated Business Information System (CBIS), OPM's core financial budget and procurement system; \$13.621 million for USAJOBS for technology and program operations to offer Federal agencies and job seekers a modern platform to support online recruitment and job application; \$5.105 million to develop a data warehouse for the Federal Employees Health Benefit Program; \$3.160 million for Human Resources Line of Business (HR LOB), which drives improved HR solutions and services through the establishment of Shared Service Centers service delivery models and strategies for agencies; and \$1.5 million for Retirement Systems Modernization, a multi-year transformation of the Federal civilian retirement system.

COMPREHENSIVE NATIONAL CYBERSECURITY INITIATIVE

Question. The White House recently released the unclassified version of its Comprehensive National Cybersecurity Initiative—the government's plan to secure public and private sector computer networks. To this end, the White House formed an interagency working group to examine the promotion of cybersecurity. Reportedly, the working group's efforts would include roles for OPM and the Department of Defense to create a high performing cybersecurity workforce. What is OPM doing to help achieve this goal?

Answer. OPM is leading Track 3, Federal Workforce Structure, of the National Initiative for Cybersecurity Education (NICE). Our primary objective is to implement strategies to ensure Federal agencies can attract, recruit, and retain skilled employees to accomplish cybersecurity missions today and in the future. We are implementing an incremental approach to understanding and defining cybersecurity work, developing competency models, analyzing workforce issues, and developing strategies that may be needed to address Federal workforce needs. We are working closely with agencies to meet current requirements, have granted Schedule A hiring authority to several agencies, and are encouraging the use of existing hiring flexibilities to meet agency needs.

Question. What are the costs associated with this initiative?

Answer. OPM did not receive any funding under the Comprehensive National Cybersecurity Initiative (CNCI). OPM is working with NICE leadership and National Security Staff to identify strategic priorities and match those to resource needs. OPM formed a NICE Track 3 workgroup, and personnel from OPM policy and program offices are accomplishing projects in support of the cybersecurity workforce. Approximately \$23,000 from other objects funding was applied toward facilitated workshops for Track 3 efforts.

Question. Please explain in detail the particular qualifications and skills required for positions in the cybersecurity workforce.

Answer. In general, qualification requirements for Federal positions are based on the occupational series to which each position is classified. However, defining those requirements for the cybersecurity workforce is not a simple matter. "Cybersecurity" is a term of art; it is not a specific Federal occupation. Working with agencies, we have identified at least 18 different occupations (including Computer Science, Computer Engineering, Information Technology, Intelligence and Investigations) that cover the different aspects of cybersecurity work, each having its own education and experience requirements.

Within its role in NICE, OPM is currently conducting a Governmentwide study to identify critical competencies needed across the Federal cybersecurity workforce. This information will help us correctly identify the occupations involved in cybersecurity work and the qualification requirements associated with those occupations. We have gathered initial information from agencies and stakeholders and will soon be surveying the workforce.

TELEWORK AND CONTINUITY OF OPERATIONS

Question. An oft-cited reason for the lack of progress on telework implementation in the Federal government is resistance by managers and supervisors. How many OPM managers and supervisors have or are teleworking either as an aspect of an ongoing program or in a pilot program?

Answer. We do not currently have the ability to track and report on telework instances/participation by individual supervisors. We are in the process of implementing a new database that will enable us to capture information regarding the number of supervisors who telework. In the recent Employee Viewpoint Survey, 56 percent of OPM managers and supervisors indicated that they telework (either regularly-scheduled, or on an ad-hoc basis) under the provisions of our ongoing Agency telework program. Assuming the survey respondents are representative of the general supervisory population, this equates to approximately 223 supervisors who may telework. Director Berry has been a strong proponent of telework governmentwide and as the leader of OPM.

Question. What feedback have these managers and supervisors provided to top OPM management on policy changes or approaches that could facilitate telework implementation government-wide?

Answer. We recently held managerial/supervisory focus groups on May 24 and 26, 2010, in the District of Columbia and on June 23 and 24, 2010, for supervisors in our field locations. Focus group comments reflected that supervisors and managers are supportive of telework flexibilities provided at OPM. They would like to see more consistency across organizations and expansion of the use of telework arrangements. In general, they favor encouraging flexibility without micromanaging.

Question. Of the Federal employees who are deemed essential government-wide, how many are able to telework in an emergency?

Answer. OPM does not have Governmentwide data on the number of employees deemed "essential".

Question. Do you have any government-wide data on how many essential Federal employees were able to perform mission critical functions during the 4 days of the snow blizzard in February 2010?

Answer. Based on information we obtained from a special request to agencies in the area most affected by the snow storms, we estimate the number of essential Federal employees who worked in the National Capital Region during the 4 days of the snow blizzard was 13,523.

Question. How many agencies have incorporated telework into their continuity of operations planning?

Answer. In response to OPM's annual call for 2008 telework data, 56.4 percent of the 78 responding agencies had incorporated telework into their continuity of operations planning. Based on a preliminary review of the 2009 data, this number is closer to 70 percent of responding agencies.

Question. How many essential OPM employees were able to continue their critical functions?

Answer. All 48 essential OPM employees were able to continue their critical functions.

Question. What are the savings—or cost avoidance—for each employee who is able to telework during continuity of operations situations?

Answer. We do not have per-employee savings data.

Question. What lessons were learned from the snow blizzard?

Answer. In view of the extreme circumstances of the snow events, we made a special request to the Chief Human Capital Officers (CHCO) Act agencies. We sought their voluntary responses to a number of questions in an attempt to identify some success stories emerging from the events. We received replies from 19 agencies. Following are some of the overall results.

—Thirteen of the respondents stated that telework was incorporated into their emergency response plans. Five agencies stated that telework was not incorporated into their emergency response plan.

—All agencies that said they had used telework considered it effective for those individuals who had power and who had their issued equipment available.

—Agencies that had employees who teleworked experienced little or no issues with telework.

—No agencies reported that they had incorporated transportation, sleeping, and food arrangements into plans for emergency personnel who were required to come into work during the closure event.

—Several agencies are conducting reviews of their related plans and policies after the snow closures of February 2010.

—Several agencies are planning on expanding existing telework opportunities.

Some agencies reported that not all of their employees eligible to telework had brought the necessary equipment and/or work material home with them prior to the snow event. Several agencies noted that some employees were not able to telework effectively through the event as they did not have necessary "hard" files/paperwork.

Clearly, some agencies need to do more to facilitate remote access by teleworking employees to files stored on their networks. Our query of the agencies also revealed

that there are still some agencies that have not yet incorporated telework into their emergency response plans, which all agencies need to do.

Question. Last year, OPM and other agencies (to varying degrees) established or refined emergency preparedness plans for the possibility that a pandemic flu might require social distancing and working off-site. Did these plans enhance agencies' continuity of operations during the snow blizzard? If so, please elaborate. If not, what emergency preparedness policies and procedures might be need for future events, whether they are caused by natural disasters or terrorist acts?

Answer. OPM provided guidance to agencies regarding planning for pandemic influenza in 2009 (see http://www.opm.gov/pandemic/OPM-Pandemic_AllIssuances.pdf) which emphasized, among other things, the importance of agencies and their employees being telework ready. The blizzard demonstrated that agencies still have work to do when it comes to having the necessary infrastructure to accommodate telework during emergencies.

Question. During the February snow blizzard, it was reported that the cost of closing the Federal government was an estimated \$100 million per day. In a radio interview during the blizzard, you indicated that the estimate was out of date and that a re-estimate was in order. What factors should be considered and what methodology would be used for estimating the cost of a 1-day government shutdown? Has OPM recalculated the cost of a 1-day government-wide closure? If so, what is the revised estimate? If not, when might a recalculation be available?

Answer. Factors considered in estimating the cost of closing the Federal Government include the estimated numbers and pay grades of employees in the National Capital Region (the area most affected by the storms), less the number of emergency personnel and estimated teleworkers who worked during the closure. Our revised estimate of the cost of a 1-day Governmentwide closure is approximately \$71 million.

FEDERAL EMPLOYEE RECRUITMENT AND RETENTION

Question. In January 2010, OPM released its report to Congress, Recruitment, Relocation and Retention Incentive—these incentives are often referred to as the “3Rs.” In calendar year 2008, 47 agencies spent a total of \$284 million on 39,512 recruitment, relocation, and retention incentives for Federal employees. Would you elaborate on the implementation of the 3R programs?

Answer. Agencies have used recruitment, relocation, and retention incentives (3Rs) to help recruit and retain Federal civilian employees since the authorities were originally enacted in the early 1990s. In May 2005, changes in law became effective that provided additional flexibility to grant 3Rs payments. Under OPM's regulations, agencies have discretionary authority to grant 3Rs payments to employees without OPM approval in most situations. Currently, OPM approval is required only for 3Rs payments in excess of the normal payment limitations (e.g., for retention incentive payments in excess of 25 percent for individual employees and 10 percent for a group of employees, up to a maximum payment of 50 percent) and to cover non-General Schedule categories of employees under the 3Rs authorities.

Question. Are there categories of occupations and positions that have received the major portion of these incentives?

Answer. In calendar year 2008, agencies typically paid 3Rs payments to employees in occupations critical to agency missions, such as healthcare, engineering, security, and information technology.

Of the top 30 occupations that received recruitment incentives, 7 occupations were in healthcare fields and 7 in engineering fields. The single occupation for which recruitment incentives were most used was patent examiners, who accounted for more than 11 percent of all recruitment incentives paid.

Relocation incentives were spread across a wide array of occupations. Of the top 10 occupations for which relocation incentives were used, the two fields in which they were most likely to be used were occupations in criminal investigating and contracting, accounting for 7.35 percent and 6.62 percent, respectively.

Retention incentives were primarily used to retain employees in healthcare occupations, accounting for 34 percent of all retention incentives paid. Security and engineering occupations each accounted for almost 8 percent of retention incentives issued. Information technology employees received 4 percent of retention incentives paid.

Question. How many employees have received more than one of these incentives—for example, how many, if any, employees received both a recruitment and relocation incentive?

Answer. OPM's regulations prohibit employees from receiving recruitment, relocation, and retention incentives concurrently in most situations. However, the regula-

tions do not limit how many non-concurrent incentives an employee may receive over the course of his or her career, provided all the regulatory criteria for these incentives are met. OPM is currently working with agencies to improve the quality and accuracy of 3Rs data submitted to OPM's Enterprise Human Resources Integration (EHRI) data system. Once EHRI data from agencies is certified to be accurate, OPM expects to be able to track trends such as how many employees received more than one incentive over the course of their career.

Question. What improvements, if any, may be considered?

Answer. Over the last year, OPM has led an initiative, in coordination with an interagency workgroup, to review existing policies and identify ways to improve the administration and oversight of the 3Rs authorities. In February 2009, OPM issued a memo to agencies explaining what we found in our review and, as a result, we plan to—

- Develop additional guidance and tools to help agencies write stronger justifications for 3Rs authorizations, improved 3Rs plans, and more explicit agency internal monitoring procedures, with greater emphasis on the consideration of the costs and benefits of the 3Rs;
- Issue proposed regulations to require agencies to review all retention incentives and group recruitment incentives at least annually to determine whether they should be revised or discontinued; and
- Review the 3Rs data submitted to EHRI for agencies that used the greatest number of 3Rs. OPM will ask agencies to validate or certify the data accuracy. Once the 3Rs data is validated, OPM and agencies will be better able to track 3Rs trends on an ongoing basis and, if necessary, investigate any 3Rs data anomaly and take corrective actions immediately.

Question. Are there any preliminary data on the use of the 3Rs in 2009?

Answer. We are currently compiling the calendar year 2009 report from the data submitted by agencies. We expect to release the report later this year.

Question. Please describe how OPM has used each of the 3Rs in your own organization.

Answer. During fiscal year 2010 OPM has granted 1 recruitment and 2 relocation incentives as a recruiting tool for some of our hard-to-fill positions, including a senior program director position in our USAJobs program office, a supervisory Criminal Investigator who was relocated between duty stations within OPM, and a senior Human Resources Specialist who was relocated between duty stations within OPM.

Question. The Chief Human Capital Officer at the Department of Homeland Security has testified before Congress on the use of “virtual job fairs” to recruit employees, particularly information technology staff. Please explain how a “virtual job fair” works.

Answer. OPM did not participate in DHS’s “virtual job fair,” however, on September 14, DHS will present a briefing to OPM on its use of a virtual job fair to recruit top talent.

Question. To what extent has OPM used this approach to hire employees?

Answer. OPM has not used this approach to hire employees because of the lack of 508 compliance (an accessibility issue for individuals with disabilities) of “virtual job fair” sites. We are currently pursuing a 508-compliant job fair site, and when funds become available, we plan to pursue the purchase of such a site.

Question. What safeguards are in place to ensure that the merit system principles codified in Title 5 are upheld?

Answer. As with any recruitment and hiring activity, agencies must ensure their practices are in conformance with the merit system principles, as well as with all other applicable provisions of title 5. In addition, OPM, in its oversight role, will hold agencies accountable for compliance with the laws and regulations governing recruitment and selection.

Question. Has the economic downturn slowed the rate of retiring Federal employees?

Answer. We are not able to determine the specific impact of the recession on the rate of retirement among Federal employees. However, we do have historical data as shown with regards to the number of employees added to the retirement roll each year since 2000 which may be useful to provide some perspective on the trends in retirement of Federal employees.

Fiscal year	Total retirements
2000	77,383
2001	77,330
2002	74,153
2003	81,128

Fiscal year	Total retirements
2004	90,441
2005	94,977
2006	103,292
2007	92,349
2008	86,615
2009	87,907

Question. What is the current projection for the retirement of baby boomers?

Answer. It is difficult to make projections regarding retirements due to the variety of factors that go into retirement decisions (i.e. the economy, retirement savings). Accordingly, OPM is not currently able to provide specific projections regarding the retirement of baby boomers in the Federal workforce.

Question. What guidance, if any, does OPM provide to departments and agencies to ease the expected retirements of baby boomers in the next 5 years?

Answer. To ease the expected effect of retirements, OPM supports knowledge transfer from one generation of leaders to the next generation of leaders. OPM has submitted a legislative proposal that would allow Federal employees covered by the Civil Service Retirement System or the Federal Employees Retirement System to enter a phased retirement status at the end of their careers, under certain circumstances. This would enable agencies to retain the services of highly valued and experienced employees for longer periods than they would otherwise be able to. This proposal would require that part of the individual's time be spent mentoring other employees.

To prepare for an increase in the number of retirements from the Federal Government, OPM works with agencies to assess leadership needs and use current leaders to prepare new and emerging leaders for future assignments and roles. The following are some examples of recent OPM programs and activities:

- OPM hosted a best practices forum on mentoring when our “Best Practices in Mentoring” booklet was made available to agencies through the OPM website. OPM participated in a mentoring forum conducted by and for the Intelligence Community.
- OPM is working with agencies to develop an executive on-boarding framework. A forum was held for agencies to investigate methods and techniques to better prepare new Federal executives for successful executive careers. For example, the National Science Foundation has initiated a pilot on-boarding program, which includes a letter from the outgoing executive to his or her successor, among other features.
- OPM is developing a wiki that will facilitate knowledge sharing for the training and development community. The wiki will debut with five initial topics later this summer.
- OPM facilitates knowledge management by hosting best practices forums or webcasts. Webcasts on leadership development programs have been offered, which are recorded for posting on OPM's YouTube channel.
- Best practices forums are hosted quarterly for performance management and executive resources practitioners. At these forums, OPM provides agencies with guidance and advice. Agencies, in turn, present information on their best practices on a wide variety of topics, including their Senior Executive Service (SES) career development programs, diversity, and leadership succession management.
- In the Guide to Strategic Leadership Succession Management Model, OPM provides recommendations for assessing executive workforce needs, projecting attrition, and designing strategies for meeting staffing needs. These guidelines are followed by agencies in the preparation of their Strategic Leadership Succession Plans and their Human Capital Management Reports.
- Through the Federal Executive Institute in Charlottesville, Virginia, OPM offers a course entitled “Leaders Growing Leaders; Building Your Organization by Developing Leaders at Every Level.” The course offers participating executives the opportunity to gain experience practicing informal roles as exemplar, mentor, coach, and teacher to help cultivate the next generation of leaders. Participants also learn how to frame their life and work experiences as stories to help others learn leadership lessons.

Question. The government-wide website, USAjobs.opm.gov, has been reconfigured. Please discuss the improvements, if any, to the website.

Answer. The refreshed USAJOBS site enhances the user experience by updating the look and feel, including introducing social media and increased personalization; improving site navigation, making it easier to move about the site; enhancing the

job search tool so applicants find the right job for them; streamlining employment information to ensure guidance is readily available; and providing targeted resources for those with special needs (students, executives, veterans, and individuals with disabilities). Also, applicants can now email their resumes that they created using the USAJOBS resume builder.

Question. Are there enhanced features to assist veterans and persons with disabilities in their job search?

Answer. All veterans' employment information has been consolidated onto one site (www.fedshirevets.gov). A résumé mining capability has been added for preference eligible veterans and 30 percent or more disabled veterans.

For persons with disabilities, a new page has been added to USAJOBS with information that includes tips for applying competitively or under the Schedule A appointing authority. Template letters have been created for download, to be used when applying under Schedule A.

Question. What partnerships have OPM formed to reach out to college campus to recruit the best talent to public service? Have these efforts been successful?

Answer. In January 2010, OPM created a Student Programs Office to promote innovative and coordinated approaches to recruiting and hiring students into the Federal Government. A significant part of this new office's role involves collaborating with academia and other organizations focused on the recruitment of students and recent graduates into the Federal service.

Through the Call to Serve initiative, OPM works in collaboration with the Partnership for Public Service to educate a new generation of leaders about the importance of a strong civil service, help re-establish links between Federal agencies and college campuses, and provide students with information about Federal jobs. Through this network, we are able to reach more than 700 schools and more than 75 Federal agencies. Throughout the year, we nurture these relationships by providing training workshops, a Federal Service Summit, best practices, and other key resources relating to Federal employment.

In addition to the Call to Serve initiative, OPM has worked with a variety of colleges and universities nationwide to promote the Federal Government as an ideal place to work. Earlier in fiscal year 2010, we sponsored five Federal Career Days—at Johns Hopkins University, City College of San Francisco, Massachusetts Institute of Technology, University of New Mexico, and Rutgers University—to showcase the Federal Government as the most dynamic and progressive employer in the country as well as a “cool” place to work. These schools offer strong curricula relating to Federal agency mission-critical occupations and demonstrate a willingness to promote Federal employment opportunities for their students. In addition to the Federal Career Days, we have partnered with, and participated in many events at, other colleges, universities and organizations that have key roles in attracting a diverse student population into the Federal workforce. Over the past fiscal year, these have included the American Society of Public Administration, National Association of Colleges and Employers, Government College Relations Council, Federal Employed Women, League of United Latin American Citizens, Southeast Federal Recruiting Council, Hispanic Association of Colleges and Universities (HACU), and Gallaudet University.

Finally, in 2010 the Presidential Management Fellows (PMF) Program expanded its outreach to over 30,000 graduate school contacts across the country. This outreach included e-mail blasts, campus visits, presentations, and partnering with associations. Recently, OPM Director John Berry approved a variety of reinvigoration efforts to enhance the PMF Program:

- Increasing investment in the assessment process to improve the quality of PMF finalists. For the upcoming PMF Class of 2011, we are enhancing the PMF assessment process to improve both the quality of finalists and the applicant experience.
- Improving the PMF Program experience. The Program is in the process of creating “PMF Power Packs,” consisting of current PMFs, to work on 5 program areas: (1) diversity outreach, (2) development of a new orientation program “for PMFs, by PMFs”, (3) assistance with the new assessment process, including logistics, event planning, and coordination of the in-person phase, (4) development of a job-matching process for PMF finalists, and (5) creation of an alumni program.
- Increasing outreach efforts through strategic partnerships. This includes work with organizations such as the National Association of Schools of Public Affairs and Administration (NASPAA), National Association for Equal Opportunity in Higher Education (NAFEO), HACU, etc., to create a marketing and outreach plan to reach all segments of society. Many Federal Executive Boards (FEBs)

also reach out to local colleges and universities to share information on Federal employment.

As a result of the aforementioned efforts, we have witnessed an increase in the number of students and recent graduates entering the Federal Government through Governmentwide student programs and the PMF Program. The PMF Program experienced a 70 percent increase in its number of applicants over the number of PMF applicants from 2009. In 2009, we had approximately 500 Fellows appointed in Federal agencies, representing the highest number of Fellows appointed in the history of the program. We are expecting even more in 2010.

WORK-LIFE PROGRAMS

Question. What amount and percentage of the OPM budget is allocated for administration of work/life programs? How many full-time equivalents (FTEs) are associated with this function? What are the two most important issues facing the Federal workforce in terms of work/life issues and what are OPM plans to address these concerns?

Answer. Of OPM's budget of \$905 million, 0.42 percent is allocated for the Governmentwide oversight of work/life programs. There are currently 6 FTEs allocated for this function.

The two highest priority issues are the Federal telework program and employee health and wellness. OPM Director John Berry has shown his commitment to these two areas by establishing a high priority performance goal for each.

The goal for telework is, by the end of fiscal year 2011, to increase by 50 percent the number of eligible Federal employees who telework over the 2009 baseline of 102,900.

Key components of OPM's strategy to meet this goal include: working with agencies to make sure they have effective telework policies that translate into successful programs; and developing high-quality and broadly accessible telework training.

The goal for health and wellness is, by the end of fiscal year 2011, for every agency to have established and begun to implement a plan for a comprehensive health and wellness program which will achieve a 75 percent participation rate. Key components of OPM's strategy to meet this goal include: providing guidance to Federal agencies on what constitutes a comprehensive health and wellness program and criteria for assessing the adequacy of agency plans; and producing a training package aimed at employees and managers that agencies can use to inform their employees of the value of health and wellness programs.

Another area that we believe to be an important issue facing Federal employees is dependent care. The range of dependents for which employees are expected to provide support, and the range of support necessary for those individuals, is broad. More than half of Federal employees fall into the age category of adult Americans who are caring for both elders and children. Providing support through workplace programs allows Federal employees convenient access to supports and resources, and facilitates productivity while at work.

OPM's plans to address the dependent care needs of Federal employees include providing: training and resources for Federal work/life staff; networking opportunities for agency work/life staff; and guidance documents and handbooks.

Question. Some versions of the healthcare reform legislation would assign a role to OPM regarding benefit negotiations and administration with health insurance providers for plans. How many FTEs and appropriated monies currently support Federal Employee Health Benefit Program (FEHBP) administration functions in OPM?

Answer. Currently, OPM is appropriated approximately \$11.7 million to administer the FEHBP, with approximately 90 FTEs. This does not include the support of the Office of Inspector General, which is responsible for auditing FEHBP health plans. It also does not include a proportionate share of accounting or legal services.

(Dollars in millions)

	Appropriated Money	FTE
Policy, including Office of the Actuary	\$5.5	22.1
Operations	6.2	68.0
Total	11.7	90.1

Question. What staff would need to be hired and what additional expertise would be needed if the OPM role were expanded in this area? How would this added role affect OPM's performance of its core mission?

Answer. The Patient Protection and Affordable Care Act (Public Law 111–148), enacted March 23, 2010, gives OPM additional health insurance plan oversight and administrative responsibilities. Under section 1334, OPM will contract with health insurance issuers to offer at least 2 multi-State health plans through each State Health Insurance Exchange. The Exchanges will make available qualified health plans, including multi-State plans, to the general public beginning in 2014.

This added role will not have any effect on OPM's performance of its current core mission. OPM will need to develop the capacity, including additional staff, to manage the Multi-State Plan option(s) that will be available via State exchanges in 2014. Development of such capacity includes examining the interaction between multi-State plan requirements and State insurance regulations, analyzing potential enrollee demographics and utilization patterns, and modeling potential premium costs. Work over the next several months will focus on shaping the OPM role with the Multi-State Plan option from the framework outlines presented in the new law and identifying the institutional support that OPM will require to develop and manage this program from 2010 to 2014.

Question. OPM has announced that it is revamping the human capital survey that is designed to gauge Federal employee views on a variety of key Federal workforce practices on an annual basis. What are the significant changes/enhancements in the survey methodology? Will the data be disaggregated to allow for a more in-depth look into the views of employees in various offices and units of a department rather than just the department as a whole?

Answer. Starting in 2010, OPM plans on administering the Federal Employee Viewpoint survey annually to fulfill the growing need for Governmentwide standardized data. While changes to the survey in regard to content, process, and depth of reporting are currently being planned for the future, some minor changes were made to the FedView survey for 2010 administration. The survey was revised to add items in the areas of employees' work experience, supervision, leadership, and work/life issues.

In addition, OPM decided to move questions on Governmentwide benefits, like life insurance, health insurance, and retirement, to a separate survey; most agencies supported these changes. OPM already provides data below department or agency-wide level to allow visibility into the perceptions of employees within major organizations and subdivisions, and OPM works with agencies to support their needs for specialized views or cuts of survey results. In all cases, OPM ensures the identity of individual respondents is protected.

FEDERAL EMPLOYEES AND GOVERNMENT PROCUREMENT

Question. Within the government procurement community, the state of the acquisition workforce is of great interest. Generally, it is understood that the acquisition workforce as a whole—which is dealing with complex acquisitions and increased government procurement spending, and learning new acquisition methods—is undermanned and undertrained. How is OPM assisting the Office of Federal Procurement Policy, and other Federal agencies, in bolstering the government's acquisition workforce?

Answer. OPM has designated the 1102 Series as a Governmentwide mission-critical occupation. OPM's shared registers include the contracting series. We also assist agencies with employees in the 1102 Series in providing fiscal year reporting for OFPP on the 1102 Series workforce strength and 5-year projections of attritions and accretions.

Agency reporting includes:

- Resource data for entry-, mid- and senior-level as part of the measures reported for each agency's annual Human Capital Management Report.
- Target acquisition workforce profile and actual attrition at the end of the reported measurement year.
- Comparison of current workforce targets with actual population to determine gaps or surpluses.
- Workforce targets and projected attrition for the next fiscal year (short-term goal).
- Workforce targets and projected attrition for an additional 4 fiscal years in the future (long-term goal).

Agencies this year were to establish targets and project attrition for fiscal year 2010 and fiscal year 2014. Agencies were also to report their current population and

certifications as of the end of fiscal year 2009. OPM will continue to work with agencies and assist them with efforts to provide accurate and complete reporting.

Question. What hiring authority flexibilities can agencies use to hire acquisition professionals in a timely fashion?

Answer. From September 30, 2007, through September 30, 2012, agencies have direct hire appointing authority for certain Federal acquisition-related positions, such as entry-level and senior contracting positions and all purchasing positions.

Through December 31, 2011, agencies are also authorized to reemploy annuitants in the acquisition-related positions mentioned above without offsetting their salaries, as is normally required when reemploying annuitants. Agencies' decisions to use this authority must be based on the unusually high or unique qualifications of an individual, exceptional difficulty in recruiting or retaining a qualified employee, or a temporary emergency hiring need, which makes the reemployment of the individual essential.

Question. What constraints exist, if any, that might impede agencies' efforts to hire and train individuals for their contracting offices?

Answer. One constraint is the challenge of accurately projecting future workforce needs. This depends, in part, on how many positions are defined as having "inherently governmental" functions. The definition of "inherently governmental" affects the workload of contract specialists and informs agencies' decisions regarding the number of positions they need to fill. A strong desire to avoid over-hiring can also complicate workforce planning efforts.

In addition, Federal contracting is quite technical and requires in-depth knowledge of Government policy and regulations, as well as substantial training and experience to be fully productive. Effective training programs that are adequately resourced are essential. Moreover, once their contract specialists are trained, Federal agencies face competition from non-Federal employers willing to pay more for employees with Federal work experience and training and credentials.

Question. As the Director of the Office of Management and Budget noted in a July 2009 memorandum, "[f]ederal agencies use both Federal employees and private sector contractors to deliver important services to citizens." His memorandum also stated that overreliance on contractors "can lead to the erosion of the in-house capacity that is essential to effective government performance," and counseled that achieving the best mix of Federal employees and contractor employees can be accomplished by identifying the proper role of each sector. What is the human resources perspective on the multisector workforce?

Answer. We believe an effective balance between Federal employees and contractors can be achieved by taking into account strategic human capital planning, the concept of "inherently governmental function" and "critical function" and effective talent management.

—Strategic human capital planning is essential to an understanding of the full picture of workforce requirements for mission accomplishment.

—The concept of "inherently governmental" function and "critical" function must be clearly understood and properly applied to ensure inherently governmental functions are performed only by Federal employees and critical functions are performed by Federal employees to the extent necessary to ensure the government maintains control of its mission and operations.

—Effective talent management strategies should be used (including effective recruiting and retention strategies) to ensure that agencies have adequate numbers, and the right skill mix, of employees to accomplish the mission.

Question. What are some of the issues that an agency might encounter when it has Federal employees and contractor employees working side-by-side?

Answer. Many of the issues that arise when Federal employees and contractors have been working side by side concern differences in systems for pay and reward, discipline, and termination, as well as general ethical considerations (including organizational and personal conflicts of interest). Some examples of these differences include:

—Contractor employees are not subject to the various laws governing Federal employment, which impose various protections and restrictions.

—There are generally no limits on the compensation that may be provided to contract employees, while Federal employees generally are subject to compensation limits. If contract employees are paid at higher rates than Federal employees providing similar services, this could create morale problems within the Federal workforce. It could also lead to Federal employees leaving Federal service to accept contract jobs.

—A retired Federal employee who works for the agency as a contractor will receive his or her full annuity whereas that same retired employee would be subject to the reemployed annuitant salary offset if working for the agency as a

rehired annuitant unless a waiver is granted. The difference in how retirement is treated in these scenarios could be viewed as inequitable.

Question. What steps can agencies take to maintain a clear distinction between the management of its own employees and the management of contractor employees? That is, how can agencies avoid the appearance of a supervisor-employee relationship between agency staff and contractor employees?

Answer. The agency should take appropriate steps to ensure its employees are made aware when contract employees are performing work onsite, such as to provide professional and technical services. Such steps might include requiring contractor employees to wear distinctive badges, work in clearly identified work areas, and use e-mail addresses that clearly identify their status as contractors. In addition, agencies should ensure their employees are not directing the work of contractor employees but instead that agency contracting officials are giving direction to the contract supervisor.

Question. Under Office of Management and Budget Circular A-76, agencies may conduct public-private competitions to determine who—Federal employees or contractor employees—will perform work that agency employees had been doing. When a competition results in the awarding of a contract to a company, the Federal employees are no longer needed in that function. While it is possible that at least some of the agency employees will be hired by the contractor, there is no guarantee that this will happen. What role, if any, has OPM played in public-private competitions conducted by other agencies?

Answer. There have been no recent public-private competitions, in part as a result of a statutory moratorium on public-private competition. However, in past years, when agencies conducted public private competitions under OMB Circular A-76, OPM worked with agencies to provide soft landings for affected employees both where work was converted to private sector performance as well as where work was retained in-house but involved a reduction in labor. These efforts included consideration of buyouts and early retirements under OPM's Voluntary Early Retirement Authority (VERA) and the Voluntary Separation Incentive Payments (VSIP) Program. OPM's regulations govern how the agency's workforce is reduced because of that decision. General and detailed restructuring guidance material is available on OPM's website, and we offer on-site assistance through our reimbursable services staff.

Question. Generally speaking, what options are available to Federal employees who have been displaced by the outcome of a public-private competition?

Answer. If a permanent Federal employee is separated because of the contracting decision, the employee may be eligible either for retirement benefits if the employee meets the age and service requirements, or for severance pay.

The employee is entitled, by regulation, to reemployment priority in his or her former agency for 2 years to positions at the same or lower grade and in the same commuting area. Qualified employees are offered reemployment based on their tenure and veterans' preference. A displaced employee is also entitled by regulation to selection priority for 1 year to positions in other agencies at the same or lower grade in the same commuting area. This program requires former employees to apply for positions matching their skills and to be well-qualified for the positions. Both of these programs provide selection priority over candidates from outside the agency's permanent workforce.

Question. How might OPM track Federal employees who have been displaced?

Answer. OPM can track, through the Central Personnel Data File, those employees who were separated because of a decision to contract the work under OMB Circular A-76.

FEDERAL PAY AND FURLoughs

Question. Discussions of Federal pay rates have been prominent in the news of late with the USA Today articles presenting Federal and private sector pay comparisons and CNBC commentary calling for salary rollback. What is OPM's response to these viewpoints?

Answer. We have been closely following stories of Federal pay during the last few months. However, we view reports published by USA Today, the Cato Institute, and the Heritage Foundation critical of Federal workers as simplistic and misleading. Average salary comparisons as published by the Cato Institute and others ignore the huge differences in the occupational makeup of the Federal and non-Federal workforces; they do not reflect the complexity of the work, level of skill and education required, scope of responsibility/impact, special requirements such as security clearances, or the location where the work must happen.

On average, positions in the Federal government generally have a higher level of education than the private sector positions. About 19 percent of Federal workers have a master's degree, professional degree, or doctorate versus only 11 percent in the private sector. A full 48 percent of Federal employees have at least a college degree compared to 32 percent in the private sector. For example, the two largest private-sector occupations today are retail salesperson and cashier, low-paid occupations not found in Federal service. In contrast, the vast majority of Federal workers are in professional, administrative, and technical occupations that are well-paid in the private sector. Job-by-job comparisons published by USA Today are based on data published by the Bureau of Labor Statistics (BLS), but the data are improperly used. The Federal Government uses recognized statistical methods and professionally conducted pay surveys. BLS economists, working with OPM, have thoughtfully and carefully compared occupations in the Federal and non-Federal sectors for more than 50 years to provide Government policymakers with factual information in making their decisions on Federal employee salary levels.

When taking into account factors such as differences in occupational mix, geographic distribution, and level of work, we believe reports finding that Federal workers are paid substantially more on average than similarly situated non-Federal workers are false comparisons.

Question. In early 2009, you discussed sending a legislative proposal to reform Federal pay setting to Congress. What is the status of this proposal and what are likely to be the key components of any pay reform?

Answer. We continue to believe that reform of Federal personnel systems is vital, but based on experience and research in this field, especially given the current fiscal situation, we feel it makes more sense to focus now on enhancing the quality of employee reviews and feedback so they are more helpful and fair.

Question. The Department of Transportation had to furlough some employees recently because of an interruption in its appropriated funds during debate of a bill that would have extended funds for the National Highway Trust Fund on a short-term basis. What have other departments and agencies been reporting to OPM about the possibility of furlough actions this fiscal year?

Answer. We do not have any information from agencies regarding possible furlough actions this year.

Question. What specific guidance has OPM provided proactively to the departments and agencies both in general and specifically with regard to mechanisms that might provide alternatives to furloughs?

Answer. OPM provides guidance to agencies for options on how to reduce budgetary outlays in order to avoid or minimize the likelihood of furloughs or other actions such as reduction in force.

OPM's guidance notes that furlough is not a viable option if the agency is faced with a continuing, rather than temporary, lack of work and/or funds. For example, an agency may furlough an employee under the reduction-in-force regulations only when the agency plans to recall the employee to duty within 1 year in the position the employee held when furloughed.

Also, the fiscal savings from a furlough are sharply reduced when a furloughed employee becomes eligible for unemployment compensation that must be paid by the agency. For example, an employee who is furloughed for 5 or more consecutive days is generally eligible for unemployment compensation.

Finally, because furlough is a temporary situation, voluntary early retirement authority (VERA) and voluntary separation incentive payments (VSIP) are not an option to lessen the impact of furlough on the agency and its employees. VERA and VSIP are available only when an agency is undertaking long-term restructuring actions.

Question. Which departments and agencies are in the forefront with effective workforce planning models and what specific features of such workforce planning could be applied across the Federal Government?

Answer. Several agencies, including the Departments of State, the Department of Transportation, and the Nuclear Regulatory Commission, have consistently demonstrated effective workforce planning. These agencies have a defined governance structure for the workforce planning function, a systematic process that is used for workforce analyses, and they use automated tools for analyses and staffing projections. All of these agencies have a seamless integration of the strategic human capital planning and workforce planning activities.

Question. As stated prominently on the OPM website, OPM's mission is Recruiting, Retaining and Honoring a World-Class Workforce to Serve the American People. What are the most pressing challenges for OPM in the next fiscal year?

Answer. As the Director stated in his testimony and as are reflected in OPM's High Priority Performance Goals, the agency's fiscal year 2011 budget request reflects the strategic goals for the agency: Hire the Best, Respect the Workforce, Expect the Best, and Honor Service. These guiding principles also represent the most pressing challenges for OPM in achieving the vision of making the Federal government a model employer for the 21st century.

The current Federal hiring process is cumbersome and slow, frustrating managers and discouraging many talented individuals, including veterans, from considering Federal jobs and opportunities. OPM is also challenged to promote greater diversity and inclusion in the Federal workforce. The development of Government-wide training, health and wellness policies and programs to provide employees with a meaningful balance of work and life is another challenge that must be faced to improve Federal government performance.

The Federal Government's retirement systems face significant challenges and are at high risk of failure due to technology gaps. These challenges have been identified in numerous OPM and GAO reports and improvements are needed to ensure that employees' claims are settled timely and accurately.

Question. What initiatives or improvements are needed to address these challenges? What are the costs of these initiatives?

Answer. As stated in the Director's testimony, the Administration believes that reforming the Federal hiring process is an urgent priority to attract the best and brightest talent into the workforce. OPM's fiscal year 2011 budget requests \$4,000,000 in order to promote innovative and coordinated approaches to help agencies streamline their end-to-end hiring process. OPM is also committed to increasing employment outreach to veterans. OPM has requested \$2,400,000 in fiscal year 2011 to advance efforts to reduce barriers to entry for Veterans and transitioning service members pursuing careers in the Federal civil service.

OPM has initiated the Retirement Systems Modernization (RSM) program to modernize and automate retirement processes to ensure Federal retirees and annuitants are paid accurately, timely, and receive high-quality customer service. OPM has requested \$1,500,000 to stabilize the retirement systems in fiscal year 2011, with a focus on upgrading the retirement calculator, transitioning from a paper-based operation to an automated retirement process, and implementing an online retirement application tool. OPM has also requested an additional \$2,800,000 to increase retirement claims processing staffing levels and assist in reducing the claims processing times.

Question. Would you describe the key components of OPM's recently released, A New Day for Federal Service, Strategic Plan 2010–2015?

Answer. The strategic plan positions the agency to make the Federal government America's model employer. The plan outlines four broad strategic goals that define OPM's direction for the next 6 years in order to achieve its mission to Recruit, Retain and Honor a World-Class Workforce to Serve the American People.

The key components of the plan are the strategic goals that have been designed to assist agencies in enhancing the experience as individuals moves from applicant to Federal employee to retiree. The "Hire the Best" strategic goal concentrates on improving the Federal hiring process. The focus of the "Respect the Workforce" strategic goal is on employee retention through training and work-life initiatives. OPM's "Expect the Best" strategic goal strives to provide the tools and resources necessary for employees to perform at the highest levels while stressing accountability. Finally, the "Honor Service" strategic goal seeks to recognize the service of Federal employees through well-designed and well-administered compensation and retirement benefits programs.

Question. How will the fiscal year 2011 budget request specifically address each of the strategic plan's goals?

Answer. Each of the strategic goals is related to OPM's major performance improvement initiatives reflected as in the budget request:

—*Hire the Best.*—Funding requested will be used to reform Federal government recruiting and hiring policies, programs and procedures. The initiative will better enable agencies to recruit and hire qualified students, mid-career professionals, and retirees. OPM will continue efforts to revamp the USAJOBS website, building on improvements that have already been made to make the site more user-friendly and aligned with the Hiring Reform initiative. The budget request supports ongoing Administration efforts to assist veterans to find op-

portunities in the Federal workplace, and to promote diversity in the Federal workforce. Finally, the request continues efforts to have the information they need to make timely decisions on the credibility and suitability of Federal employees, contractors, and military members.

—*Respect the Workforce.*—The budget request calls for the Federal government to invest in its employees in order to improve the results of Federal programs and services. The development of Government-wide health and wellness policies and programs to provide employees with a meaningful balance of work and life will continue to be a top priority in fiscal year 2011 in order to help continue to attract the best and the brightest for Federal employment. Focus will continue on the importance of training throughout an employee's career, as well on programs and initiatives such as alternative work schedules, telework, and employee assistance programs that benefit current employees and help us continue to attract the best and brightest for Federal service. Resources will also help continue efforts to encourage labor-management collaboration in the furtherance of agencies' goals.

—*Expect the Best.*—Funds requested in the fiscal year 2011 budget will support OPM's responsibilities to advise and assist agencies on strategic human resources management. This includes operational activities to monitor compliance with civil service laws and regulations, ensure appropriate use of flexibilities and authorities, and providing agencies with tools, resources, guidance, education, and evaluation to continuously improve their human resources operations.

—*Honor Service.*—The budget request addresses the strategic goal to honor the service of Federal employees by ensuring timely and accurate delivery of OPM-administered retirement and insurance benefits for 2 million Federal retirees. Continued funding for the Retirement Systems Modernization (RSM) program will go toward priorities like upgrading the retirement calculator, automating the manual paper-based retirement system, and imaging incoming paper retirement records. The implementation of an online retirement application tool for gathering initial retirement information electronically from service centers will help improve the accuracy of retirement calculations. Altogether, these initiatives will help to ensure that OPM and agency benefits officers have access to information necessary to perform their duties of processing claims and providing customer service to employees and annuitants.

NATIONAL COUNCIL ON FEDERAL LABOR-MANAGEMENT RELATIONS

Question. In December 2009, President Obama issued an Executive Order (EO), Creating Labor-Management Forums to Improve Delivery of Government Services, which created the National Council on Federal Labor-Management Relations. The Council will support the creation of labor management forums across the Federal government to allow agency managers, employees, and union representatives to discuss agency operations in a non-adversarial setting. How will the Council ensure that the forums result in the implementation of productive ideas and innovation among Federal agencies?

Answer. The Executive order required each agency to develop, and submit for certification, a written implementation plan which addressed, among other things (1) how the agency would conduct a baseline assessment of the current state of labor relations and (2) how the agency will develop metrics to monitor improvements in such areas as productivity gains and cost savings resulting from establishment of labor-management forums. The achievement of productivity gains and cost savings is clearly dependent on the adoption of productive ideas and innovation by agencies. The operation and effectiveness of these forums will be monitored both internally by agencies and externally by the Council. As discussed below, the Council has adopted general recommended metrics and has established a work group on metrics, which is developing more detailed and focused metrics for agencies to use.

Question. Did all Federal agencies meet the March 9 deadline to submit plans to create labor-management forums?

Answer. While not all Federal agencies met the March 9 deadline to submit plans, all but a handful of agencies did submit plans by early April, and plans were received from all agencies by early May.

Question. How many of the plans have been certified? What are the issues in certifying the plans?

Answer. Fifty of the 51 agency plans have been certified by the Council. At the request of the National Council, SSA submitted a revised implementation plan on July 23, 2010. The National Council is currently evaluating that plan, and working with the agency on certification.

Question. At this point, what measures has the Council developed to ensure that these labor-management forums will improve efficiency in government operations and improve services to clients?

Answer. At its initial meeting in February, the Council adopted recommended categories of metrics for agency use in establishing and implementing forums. Those metrics were organized under three broad goals, the first and most important one being improvement in the agency's ability to accomplish its mission and deliver high-quality products and services to the public. At its May meeting, the Council established a work group to develop more detailed metrics. That work group has held a number of meetings, will be collecting information from and drafting guidance for the forums, and expects to make recommendations for the full Council to adopt this fall.

Question. How can you ensure that these councils will improve government operations and services to clients?

Answer. The LMF metrics working group is currently exploring practical answers to this question—to figure out what and how to track and measure to learn from each LMF experience and apply those lessons to improving government operations and services. We recognize that the overriding reason for creating labor-management forums is “to improve the productivity and effectiveness of the Federal Government,” and we are confident this goal will be achieved.

FEDERAL LONG-TERM CARE INSURANCE PROGRAM

Question. The Federal Long-Term Care Insurance Program (LTC) insurance program has entered a new contract cycle and OPM has notified Federal workers enrolled in the Automatic Compound Inflation Option (ACIO) (about 60 percent of enrollees) that their premiums will increase 25 percent from current rates. At congressional hearings last fall, OPM acknowledged that the marketing materials used during the first contract cycle could have misled enrollees in assuming that premiums would not increase in the future if that option was chosen. What processes and procedures does OPM have in place to ensure that this does not happen again?

Answer. New educational and marketing materials, along with new applications, were introduced in October 2009. These materials more prominently and frequently describe the conditions under which premiums may increase and that premiums are not guaranteed, including in the sections that describe the different types of inflation protection. We are also planning new marketing materials and application forms for an open season which we expect to hold in the spring of 2011. We are committed to making any other changes needed to make the rate information clear to current and prospective enrollees.

As an example of what we have done, every enrollee not eligible for or receiving benefits (e.g., not in a nursing home) received a decision package in late 2009 outlining options for moving to the new plan design or avoiding the premium increase (for those facing an increase). The decision package included background material illustrating the difference over time between a 4 percent and a 5 percent compound benefit increase. Historical inflation increase data were also provided. Modeling tools were available online to allow enrollees to project the growth of their current daily benefit under each inflation rate. The decision packages also contained detailed comparisons of specific benefits and the differences between the original plan, FLTCIP 1.0, and the new plan, FLTCIP 2.0.

In addition, the materials for the new FLTCIP 2.0 benefits are currently online at www.ltcfed.com and available by request from LTC Partners. The new materials, both in hard copy and online, provide detailed information and graphs that illustrate the difference over time between 4 percent and 5 percent compounded benefits, as well as detailed information about other benefit decisions.

The new educational materials state prominently and frequently that premiums are not guaranteed, and they explain the conditions under which premiums may increase. In addition, the Agreement and Acknowledgement section of the application, which requires the applicant's signature, discloses that premiums are not guaranteed. The new Benefit Booklet (the contractual statement of benefits) contains on the second page a section titled, “When We May Increase Your Premium” and discloses in several other places that premiums are not guaranteed. All current and future enrollees will receive a copy of this new Benefit Booklet.

Finally, Long Term Care Partners conducts hundreds of educational seminars each year at Federal agencies and meetings of Federal employee groups like the National Active and Retired Federal Employees Association (NARFE). They keep in frequent contact with Agency Benefit Officers to make sure information about the FLTCIP is widely available. Enrollees and prospective applicants can call Long

Term Care Partners toll-free to speak with a Certified Long Term Care Consultant for expert assistance in learning about the Program.

Question. Since the stated purpose of the Federal LTC Insurance program was to encourage people to purchase long-term care insurance and serve as a model for other employer-sponsored programs across the Nation, how does OPM intend to restore confidence in the program among Federal workers and to promote future participation given this issue?

Answer. OPM conducts close contractual oversight of the carrier, which means we can shape the LTC policies and products. OPM includes the NAIC Shoppers Guide to Long Term Care Insurance in the Information Kit provided to all applicants who request a hard copy application. This Guide is also available online as part of the online application process. OPM also requires its insurer to price its premiums according to NAIC rate stability guidelines. It is important that standard rate stability guidelines be applied universally across the long term care industry. While we understand there have been concerns about the program, we take our responsibility very seriously to serve the interests of enrollees by doing all we can to improve and to promote the continued success of the Program.

OPEN GOVERNMENT

Question. In December 2009, the President issued an Open Government Directive to Federal agencies instructing them to launch open government web sites within 60 days, draft open government plans with long-term steps to improve transparency, and solicit public feedback on agencies' core mission activities. Please describe OPM's actions to fulfill the President's open government and transparency initiative.

Answer. In response to the President's Open Government Directive, OPM has established an Open OPM governance structure that comprises the Executive Board, their respective representatives on the Core Team and Component Teams. The Teams will develop and implement actions to ensure accountability and the sustainability of transparency, participation, and collaboration at OPM. All Component Teams include OPM employees as well as members from public/nonprofit groups, other agencies, academia and unions. The Component Teams will gather information from the individual team members, exchange ideas and generate innovative options for solving problems. Those ideas and options will be forwarded to the Core Team (OPM employees) for analysis and to make recommendations to OPM leadership on the Executive Board.

It is our policy to integrate Open Government into OPM's ongoing mission activities, including, but not limited to, partnering with stakeholders, advising and assisting agencies, working with Congress and other stakeholders on developing policies, promoting effective and efficient human resources policies and practices across government while leading by example. The Open Government ethos will be integrated into our programs and sustained throughout each of the aforementioned methods for improving Federal customer service life cycle, from hiring, employment, retirement to annuitant.

The agency has created an Open OPM web site at <http://www.opm.gov/open/> for providing information on OPM's Open Government activities, including high-value data sets, the agency's Open Government Plan, and an Open OPM blog to provide updates and receive feedback from the public.

Question. Have you received feedback from citizens? If so, can you summarize some of the responses OPM has received?

Answer. We used the Open OPM Web site to solicit and receive public suggestions for our Open Government Plan. We have received and processed more than 1,000 e-mails from the public via our Open Government e-mail address and have received 58 unique ideas to improve Open Government through an IdeaScale Web tool. Feedback from the public focused primarily on the Agency's operations in recruitment, staffing, retirement, and benefits. The Director's goal "Expect the Best" was echoed in these comments, as was the Vision that "The Federal Government will Become America's Model Employer for the 21st Century." The Open OPM team continues to receive and respond to feedback from citizens through the use of a new Searchable FAQs tool on OPM's website, the Open OPM email address, and the Open OPM Blog.

SUBCOMMITTEE RECESS

Senator DURBIN. The session stands recessed.

[Whereupon, at 3:33 p.m., Wednesday, March 24, the subcommittee was recessed, to reconvene subject to the call of the Chair.]

FINANCIAL SERVICES AND GENERAL GOVERNMENT APPROPRIATIONS FOR FISCAL YEAR 2011

WEDNESDAY, APRIL 14, 2010

U.S. SENATE,
SUBCOMMITTEE OF THE COMMITTEE ON APPROPRIATIONS,
Washington, DC.

The subcommittee met at 2:30 p.m., in room SD-138, Dirksen Senate Office Building, Hon. Richard J. Durbin (chairman) presiding.

Present: Senators Durbin and Collins.

CONSUMER PRODUCT SAFETY COMMISSION

STATEMENT OF HON. INEZ TENENBAUM, CHAIRMAN

OPENING STATEMENT OF SENATOR RICHARD J. DURBIN

Senator DURBIN. Good afternoon. This hearing of the Financial Services and General Government Appropriations Subcommittee will come to order.

And I've got to report that Senator Collins will arrive momentarily. She'll miss my opening remarks. It will be devastating, but she'll recover.

Today's hearing is on the President's fiscal year 2011 budget request for the Consumer Product Safety Commission (CPSC). And testifying is Chairman Inez Tenenbaum.

Thank you for being here.

The Consumer Product Safety Commission is the Federal regulatory body tasked to protect children and families from unsafe consumer products. Every day, infants sleep in cribs, children don bike helmets and ride bicycles, and adults purchase medicines. We rely on the Consumer Product Safety Commission to make sure that infants aren't strangled by the slats or sides of the cribs, that children don't sustain head injuries while biking, and that parents don't worry that their children will open the child-resistant packaging.

Two years ago, the Consumer Product Safety Improvement Act (CPSIA) was enacted, giving the CPSC new authorities and resources, and significantly strengthening its ability to protect Americans from defective and unsafe products. Many people deserve credit for that, and I want to single out Senator Mark Pryor of Arkansas. What a great job he did bringing us all together for a bipartisan bill to authorize and empower your Commission.

For example, lead content levels for cribs, bunk beds, infant rattles, and children's jewelry have been reduced. Levels must be certified, based on independent third-party testing by a CPSC-recognized laboratory. Tracking labels will soon be on children's products, accompanied by product registration cards. And a publicly available, searchable database with safety information on consumer products is being established and will be operational early next year, we hope.

While the new lead limits are among the most stringent in the world for some children's products, the Commission voted to defer enforcement of testing and third-party certification requirements until February 10, 2011, in order to increase the number of available testing and certification facilities.

What a difference a few years can make. The Consumer Product Safety Commission has been transformed from a quiet, modest little agency with mostly voluntary enforcement powers to a more robust and proactive agency with enhanced enforcement authority.

Staffing, at a low of 385 in January 2008, is now at 502 and will grow to more than 530 by the end of this year. The budget this year, 2010, is double what it was 6 years ago. The first foreign office in Beijing has been opened, after all of the publicity that came out about products that were being exported from China into the United States. The need—now, this is a significant—of all the statistics—the need for toy recalls has declined 75 percent from 2008 to 2009, including an 80-percent decline in toy recalls due to lead-content violations.

For fiscal year 2011, CPSC is requesting \$118.6 million—\$400,000 more than the fiscal year 2010 enacted amount of \$118.2 million, and a staffing level of 576, which is an increase of 46 FTEs.

I'm not going to go through all the details of the budget request. They're going to come up during the course of our questioning here.

I'm looking forward to the testimony of Chairman Tenenbaum, and I am going to introduce her after I defer to my colleague here, Senator Collins.

STATEMENT OF SENATOR SUSAN COLLINS

Senator COLLINS. Thank you, Mr. Chairman.
And thank you for calling this hearing.

While the Consumer Product Safety Commission is a relatively small agency, as your statements pointed out, it has a critical mission of keeping the public safe from dangerous products. We all remember the alarming and too frequent tragic stories of hazardous toys that demonstrate the need to strengthen protections for consumers, particularly for children, as the chairman has pointed out.

In 2008, we acted to strengthen the laws governing the safety of goods entering this country and to provide much-needed additional resources to intercept unsafe products by passing the Consumer Product Safety Improvement Act. This new law included provisions resulting from a 2007 product safety investigation that I conducted in my role as the ranking member of the Homeland Security and Governmental Affairs Committee. That investigation produced provisions that included better coordination and information sharing between the Commission and Customs and Border Protection

(CBP) so that inspectors at our Nation's ports can focus their resources on the most risky shipments, targeting products, manufacturers, and importers with poor consumer safety records. And I'll be interested today to hear more about this improved import surveillance plan and the efforts to improve coordination with CBP.

While it is crucial for the Consumer Product Safety Commission to implement regulations to protect children from lead and other hazardous materials, we do want to ensure that the regulations do not prove overly burdensome or costly to small businesses, such as thrift shops and those who produce handmade crafts, clothing, and toys. The Commission needs to consider these small, often home-based businesses when issuing its rules and guidance, particularly for third-party testing.

Again, I very much look forward to hearing from the Chairman today, and appreciate our chairman, as we consider the budget request for the Commission.

Senator DURBIN. Thanks, Senator Collins.

I'm pleased to welcome Chairman Inez Tenenbaum, the ninth Chairman of the Consumer Products Safety Commission, sworn into office on June 23, 2009. Previously, Ms. Tenenbaum was elected as South Carolina's State superintendent of education, where she served two terms. She has extensive experience in legal, legislative, administrative, and regulatory matters and served on numerous task forces that provide oversight on children and family services.

Thanks for being here. I look forward to your testimony.

Ms. TENENBAUM. Good afternoon, thank you—thank you. I'll start all over again.

Good afternoon, Chairman Durbin and Ranking Member Collins. Thank you so much for this opportunity to appear in front of you.

I am pleased to be here today to discuss the U.S. Consumer Product Safety Commission's fiscal year 2011 budget. During the past 9 months as Chairman of the CPSC, I have had the opportunity to see firsthand the great work that the Commission undertakes every day. From new regulations to ensure the safety of cribs, to enforcement action against children's jewelry with harmful levels of lead, cadmium, and other toxic metals, the CPSC is once again an agency that means business when it comes to protecting the safety of the American consumer.

Much of this progress would not have been possible without the reauthorization of the Commission through the Consumer Product Safety Improvement Act of 2008 and the additional funding received by the agency in fiscal years 2009 and 2010. I greatly appreciate the increased resources that members of this subcommittee have supported over the past 2 years, and can assure you that these resources have been put to good use through increased staffing and improved import surveillance and enforcement efforts. It has also provided the resources necessary for the Commission to develop robust responses to new and emerging hazards, such as contaminated drywall, that has caused serious problems for thousands of homeowners. The results of this new commitment to the CPSC are already very encouraging.

One concrete example of this increased staffing and resources at the agency: During 2008, the number of CPSC full-time employees,

FTEs, had dropped to only 385. This was the lowest level in the agency's history and down from a high of 978 in 1980. Section 202 of the CPSIA required the agency to increase the number of FTEs to at least 500 by the end of fiscal year 2013. And I'm very pleased to report that we've already reached that milestone and currently have 505, as of April 9, dedicated FTEs at the CPSC.

But, employee numbers are only one indicator of change. Another key metric is results. One concrete example of that is our ability to stop dangerous products before they enter the stream of commerce. In fiscal year 2007, the CPSC collected approximately 750 samples of suspect products entering our country. In 2009, that number rose to almost 1,600. At the same time, we started to see a commensurate decrease in the number of voluntary recalls, from 563 in fiscal year 2008 to 466 in fiscal year 2009. The Commission's proposed 2011 budget requests \$118.6 million—and it's designed to accelerate this forward momentum by continuing internal modernization and rebuilding efforts.

As noted in my written statement, the proposed 2011 budget is only \$400,000 over our current 2010 level, but it will allow the Commission to support the key areas of emphasis by reallocating \$13.9 million in funds used in 2010 nonrecurring activities. Specifically, the proposed budget will allow the Commission to pursue new and enhanced initiatives in four key areas:

The first is the Commission's compliance initiative. Since the passage of the CPSIA, the Commission's staff has worked diligently to promulgate and implement the numerous rules required by that law. In 2011, the CPSC's work will shift from developing rules mandated by the CPSIA to enforcing those rules, both within our borders and at ports of entry. To further facilitate those efforts, the CPSC's 2011 budget requests approximately \$4.6 million and an addition of 41 full-time employees to support additional responsibilities associated with three key elements of the compliance program: regulatory enforcement, import surveillance, and defect investigations.

The second area is information technology modernization and Commission implementation of a searchable public database of consumer product safety information. Section 212(b) of the CPSIA requires the Commission to upgrade its information technology systems and to develop a database that allows consumers to submit incident reports that can subsequently be reviewed by all members of the general public.

In response to this mandate, CPSC is developing a single, integrated, Web-based environment. The Consumer Product Safety Risk Management System, or RMS, will change the way the Commission receives and analyzes data. With the new RMS, the CPSC will be transformed. The Commission will have one powerful database for the input and analysis of multiple sources of data. Overall, this new capability has the potential to uncover more defect patterns for staff to examine and to triage. This, in turn, could lead to an increase in recalls of defective products and the prevention of injuries and deaths. The Commission has already allocated approximately \$20 million to fund many of the initial planning and design costs of the RMS and deeply appreciates this subcommittee's past support of the program.

In 2011, funding resources—requirements will largely shift from design-and-build costs to maintenance items. Therefore, the 2011 budget requests \$1.8 million for a staffing combination of eight FTEs and contract positions to maintain the system and comply with OMB's requirements for information technology governance, cybersecurity, and privacy.

The third area is consumer outreach and education. Providing consumers with recall and product hazard information that helps make families and communities safer is one of my top priorities. Over the past year, the Commission has made great strides in consumer outreach by reestablishing our presence on network television, in the national newspapers, and on the radio. The agency also launched CPSC 2.0, a social media initiative that is reaching out to tens of thousands of consumers via YouTube, Twitter, Flickr, the OnSafety blog, and our own recall widget. This year and in fiscal year 2011, the Commission plans to accelerate efforts to conduct grassroots education and advocacy in hard-to-reach and vulnerable populations. We will also continue to focus on public education and outreach efforts to prevent drownings and entrapment involving children in residential and public pools.

Fourth, the 2011 budget proposes an additional \$2 million for the CPSC to support the National Nanotechnology Initiative. In the last few years, there have been increasing public concerns over potential health impacts associated with this technology. Although nanomaterials may have the same chemical composition as non-nanomaterials, at the nano scales, they may demonstrate different physical and chemical properties and behave differently in the environment and the human body. The \$2 million proposal will allow the Commission to conduct exposure and risk assessments of nanotechnology materials, allow for database updates to properly flag reports of nanotechnology incident with consumer products, and conduct consumer outreach efforts, such as public meetings.

PREPARED STATEMENT

Mr. Chairman, thank you again for the opportunity to testify on the proposed 2011 budget for the U.S. Consumer Product Safety Commission, and I look forward to working with you and other members and Ranking Member Collins on this subcommittee, and will be happy to answer any of your questions.

[The statement follows:]

PREPARED STATEMENT OF INEZ TENENBAUM

Good afternoon, Chairman Durbin, Ranking Member Collins, and Members of the Subcommittee on Financial Services and General Government. I am pleased to be here today to discuss the U.S. Consumer Product Safety Commission's (CPSC) fiscal year 2011 budget request.

During the past 9 months as Chairman of the CPSC, I have had the opportunity to see first-hand the great work that the Commission undertakes every day. From new regulations to ensure the safety of cribs to enforcement action against children's jewelry with harmful levels of lead, cadmium and other toxic metals, the CPSC is once again an agency that means business when it comes to protecting the safety of American consumers.

Much of this progress would not have been possible without the reauthorization of the Commission through the Consumer Product Safety Improvement Act of 2008 (CPSIA), and the additional funding received by the agency in fiscal year 2009 and fiscal year 2010. I greatly appreciate the increased resources Members of this Subcommittee have supported over the past 2 years, and can assure all of you that

those resources have been put to good use through increased staffing, improved import surveillance, and increased compliance activities. It has also provided the resources necessary for the Commission to develop robust responses to new and emerging hazards such as contaminated drywall that has caused serious problems for thousands of homeowners.

The results of this new commitment to the CPSC are already very encouraging. One concrete example of this is increased staffing and resources at the agency. During fiscal year 2008, the number of CPSC full-time employees (FTEs) had dropped to only 385—the lowest in the agency’s history. Section 202 of the CPSIA required the agency to increase the number of FTEs to at least 500 by the end of fiscal year 2013. I am very pleased to report that we have already reached that milestone, and have 502 FTE positions filled at the CPSC as of April 1, 2010.

But employee numbers are only one indicator of change. Another key metric is results. One concrete example of that is our ability to stop dangerous products before they enter the stream of commerce. In fiscal year 2007, the CPSC collected approximately 750 samples of suspect products entering our country. In fiscal year 2009, that number more than doubled to almost 1,600. At the same time, we started to see a commensurate decrease in the number of voluntary recalls from 563 in fiscal year 2008 to 466 in fiscal year 2009.

The Commission’s proposed fiscal year 2011 budget request of \$118.6 million is designed to accelerate this forward momentum by focusing on modernization efforts that will flag emerging hazards and help us keep those products out of our country and the hands of children.

While this request is only \$400,000 over the fiscal year 2010 level, it will allow the Commission to increase the FTE level by 46 in fiscal year 2011 (for a total of 576 FTEs), fund a broad new compliance initiative, implement the second phase of the Commission’s continued Information Technology (IT) modernization, continue to improve consumer outreach, and direct \$2 million in support of the Federal National Nanotechnology Initiative by reallocating \$13.9 million in funds used for fiscal year 2010 nonrecurring activities.

THE COMMISSION’S COMPLIANCE INITIATIVE

Since passage of the CPSIA, Commission staff has worked diligently to promulgate and implement the numerous rules required by that law. In 2011, the CPSC’s work will shift from developing rules mandated by the CPSIA to enforcing those rules—both within our borders and at ports of entry.

To further facilitate those efforts, the CPSC’s fiscal year 2011 budget requests \$4,647,000 and the addition of 41 full-time employees (FTEs) to support additional responsibilities associated with three key elements of the compliance program: regulatory enforcement, import surveillance, and defect investigations.

Regulatory Enforcement

Experience shows that enforcing new rules takes considerably more resources than enforcing an existing rule that has been in place for a number of years. The number of new rules mandated by the CPSIA during fiscal year 2009 and fiscal year 2010 are more than double the number of rules promulgated by the Commission since 1990—and will result in a dramatic increase in enforcement responsibility.

The fiscal year 2011 budget, therefore, requests \$1,647,000 and 15 FTEs to enforce the new rules. This includes four new compliance officers, five field investigators, three lab testing and other technical specialists, two attorneys, and one FTE to coordinate with state and local authorities.

Import Surveillance

The Commission’s import enforcement workload will also increase as investigators ramp up efforts to verify testing certifications and collect increasing numbers of suspect product samples at our Nation’s ports. The need for more staff and better coordination with U.S. Customs and Border Protection (CBP) was specifically highlighted in an August 2009 Government Accountability Office (GAO) report. Mr. Chairman, I know this is an area of critical interest for both you and Ranking Member Collins, and the Commission is eager to fully address this issue.

Accordingly, the fiscal year 2011 budget requests \$1,965,000 to expand coverage at the ports, verify third-party testing certifications, collect samples of suspect products, and—most importantly—stop unsafe products from entering the country. This request will support an additional sixteen FTEs dedicated to import surveillance (five investigators and analysts that will be stationed at ports, two compliance officers to process additional import samples, and nine FTEs for lab testing and other specialties), as well as \$100,000 for the destruction of goods refused at the ports by CPSC.

Defect Investigations

The number of product incident reports the Commission receives almost doubled between fiscal year 2003 and now. With the rollout of the searchable public database by March 11, 2011, we expect that the number of incident reports will grow exponentially. These reports often provide critical information and data to the CPSC. However, with current resources, CPSC staff is only able to thoroughly investigate a very small number (approximately 10 percent) of the total reports received.

Increased resources are needed to enhance our defect investigation capability, and ensure that the Commission can adequately review and process the rapidly increasing number of product incident reports. Therefore, the fiscal year 2011 budget requests \$1,035,000 and ten additional FTEs (three compliance officers, five field investigators, one technical specialist, and one attorney) to support this critical effort.

INFORMATION TECHNOLOGY MODERNIZATION

Section 212(b) of the CPSIA requires the Commission to develop a database that allows consumers to submit incident reports that can subsequently be reviewed by all members of the general public and upgrade its information technology systems.

As noted above, the searchable public database will be launched in less than 1 year, and I look forward to working with Members of this Subcommittee to ensure that your constituents know how to access and use it. In the course of completing the database, we are also working to solicit extensive public input and establish clear rules for how the database will operate and how CPSC will interact with consumers and manufacturers.

In order to support the data that will be generated by the database and meet the information technology modernization mandate, CPSC is developing a single, integrated, web-based environment, the Consumer Product Safety Risk Management System (RMS), that will change the way the Commission receives and analyzes data. Current systems at the Commission are fragmented, and information flows often have to be manually sorted by staff to identify new and emerging hazard patterns.

CPSC will be transformed with the new RMS. The Commission will have one powerful database for the input and analysis of multiple sources of data. This capability will be absolutely critical as data streams from the new public database start flowing into the Commission. In addition, the system will have new predictive “data mining” tools that will allow the CPSC to compare new incidents electronically with all prior incidents. Overall, this new capability has the potential to uncover more defect patterns for staff to examine. This, in turn, could lead to an increase in recalls of defective products and the prevention of injuries and deaths.

The Commission has already allocated approximately \$20 million to fund many of the initial planning and design costs for the RMS, and deeply appreciates this Subcommittee’s past support of this program. In fiscal year 2011, funding requirements will largely shift from design and build costs to maintenance items. Therefore, the fiscal year 2011 budget requests \$1.880 million for a staffing combination of eight FTE and contract positions to maintain the system and comply with Congressional and Office of Management and Budget (OMB) requirements for information technology governance, cybersecurity and privacy.

CONSUMER EDUCATION AND OUTREACH

Providing consumers with recall and product hazard information that helps make families and communities safer is one of my top priorities. Over the past year, the Commission has made great strides in consumer outreach by re-establishing our presence on network television, in national newspapers, and on the radio. We have also re-established the trust of consumers that CPSC is putting their interests first.

The agency also launched “CPSC 2.0,” a social media initiative that is reaching tens of thousands of consumers via YouTube, Twitter, Flickr, the OnSafety blog, and our Recall Widget. This year the Commission plans to further accelerate this initiative by expanding the platforms we use to include cell phone text messages.

The Commission also plans to accelerate efforts to conduct grassroots education and advocacy in hard-to-reach and vulnerable populations. In August 2009, the GAO released a report recommending that the CPSC increase its focus on reaching minority populations. Since becoming Chairman of the CPSC, I have directed Commission staff to explore additional outreach efforts to underserved populations. In carrying out a special Minority Outreach initiative, we will increase our use of existing tools, such as the Neighborhood Safety Network (NSN) program—that provides vital information to more than 5,600 community organizations and leaders—as well as use new tools, such as targeted, grassroots programs for Hispanics, African-Ameri-

cans, American Indians, and other minority groups. This will also remain a key priority of the Commission in fiscal year 2011.

One of the most tragic subjects the Commission deals with are drownings and entrapments involving children in residential and public pools. I am pleased to note that the fiscal year 2011 budget contains \$1,000,000 specifically for continuing pool and spa safety education. This funding will build on the previous funding of \$8.1 million in fiscal year 2009 and fiscal year 2010, and continue to help the agency drive down the 300 child drownings each year and increase compliance with the Virginia Graeme Baker Pool and Spa Safety Act.

NANOTECHNOLOGY

The CPSC's fiscal year 2011 budget also proposes \$2 million to support the Federal National Nanotechnology Initiative, and seeks to collect additional data and explore environmental, health, and safety issues related to the increasing use of nanotechnology in consumer products.

In the last few years, there has been increasing public concern over potential health impacts associated with this technology. Although nanomaterials may have the same chemical composition as non-nanomaterials, at the nanoscale they may demonstrate different physical and chemical properties and behave differently in the environment and in the human body.

The \$2 million proposed will allow the Commission to conduct exposure and risk assessments of nanomaterials, allow for database updates to properly flag reports of nanotechnology incidents with consumer products, and conduct consumer outreach efforts such as public meetings. Perhaps even more importantly, it will also allow the Commission to take a very proactive approach to this emerging issue, rather than merely reacting to incident reports after they are received.

Mr. Chairman, thank you again for the opportunity to testify on the proposed fiscal year 2011 budget for the U.S. Consumer Product Safety Commission. It provides the funding necessary to continue the transformation of this agency from what some have described as a "teething tiger" into the world's leading lion of consumer protection.

I look forward to working with you and other members of the Subcommittee on the Budget Request, and would be happy to now answer any questions you may have.

STAFFING INCREASES

Senator DURBIN. Thanks, Chairman Tenenbaum.

And I might note that the increase—or, should I say—the restoration of employees at the Consumer Products Safety Commission, we thought, was warranted, because of the massive numbers of products that come your way, and particularly the increase in imports into the United States, which created a brand new challenge for us. And so, just for the record, that was our thinking behind the increase in full-time equivalent employees.

I want to discuss about five issues, and I'm sure I won't get into all of them.

LEAD STANDARDS

So, let me ask about lead, because we were concerned, when we wrote the bill, as to whether or not we came up with a reasonable standard for lead in toys. And before the bill was written, there was no lead limit at all for children's products. In February 2009, permissible lead levels in children's products were reduced to 600 parts per million. By August, the lead limit in children's products were to come down to 300 parts per million. In those coated with paint, the limit dropped to 90 parts per million.

A stay of enforcement on third-party testing requirements was granted by the Consumer Products Safety Commission in February 2009 for 1 year because there was "substantial confusion," in the industry, regarding specific requirements related to the applica-

bility, as well as testing and certification. An extension of that stay of enforcement was granted in December of last year on testing and certification for many children's products for 1 year, until February 2011, while the CPSC continues to accredit third-party-testing labs.

Now, I want to make sure I understand. If we have written this law in a fashion that makes it difficult for you to either understand or enforce—when I read the word “confusion,” I want to make sure I understand what's behind that—then it's our responsibility to step forward and correct any errors that we've made there. If, however, this is a question of just setting up the mechanism for enforcement, that, to me, is a different question, and I can understand it takes more time. So, could you address the lead issue in toys and children's products first?

Ms. TENENBAUM. Thank you, Mr. Chairman.

Yes, we did stay the enforcement on certain products while we put in place the specific testing requirements for those products, so that we could have laboratories who knew how to go about testing those products. But, third-party testing and certification was never stayed on lead in paint, which now is at 90 parts per million. We are also enforcing full- and nonfull-sized cribs; pacifiers; small parts; and lead content on metal children's jewelry. What we stayed was lead content in nonmetal, not in children's jewelry or in paint. So, it could be lead content in brass or something else, but not children's jewelry.

But, we've also realized that the strict levels under 101, which says that you can exempt articles where the lead is inaccessible to the child or if you can show that, through normal and foreseeable use and abuse, any lead is not absorbed into the body. So, it's that “any lead,” where you might have very small levels and contact with the children's product is very infrequent. For example, bicycles and all-terrain vehicles (ATVs).

Senator DURBIN. We heard about that.

Ms. TENENBAUM. So, we stayed the bicycles and the ATVs, in terms of testing, until we could work this out, and also certain books. The newly printed ordinary children's books do not contain lead, but, the children's books printed before 1985 do. We had a problem with exempting those. So, if we had more flexibility around section 101 for any lead, then we would be able to work with the products as they came up for our consideration.

We have proffered a discussion around functional purpose. It would require industry to come to us and say, “We need this lead in our product for the functional purpose. If it's an ATV, we need it to make the ATV stronger. The contact with lead components on the ATV will be infrequent. It will have no adverse health effect on the user.” And so, then, we could give the ATV or the bicycles an exemption.

So, it's a narrow class of products that, if we had a functional purpose amendment to the CPSIA, then we would be able to exempt those products, like ordinary children's books.

Senator DURBIN. But, do you think that's going to require an amendment to the law?

Ms. TENENBAUM. We do.

Senator DURBIN. Okay. So, we ought to look at that.

Now, let—and to make it clear, the stay does not apply to lead paints, small parts, or children’s jewelry. We are talking about functional products and ATVs and the like. If—

Ms. TENENBAUM. And we stayed enforcement of the lead in ATVs last year.

Senator DURBIN. Okay.

OTHER TOXIC SUBSTANCES

Now, I’m going to go 2 extra minutes and give Senator Collins the same time, because I wanted to ask, as a followup—and we’re finding that there were replacements by some who are sending products into the United States—replacing lead with cadmium and antimony. And are you regulating those, as well?

Ms. TENENBAUM. Well, I issued a stern warning to Chinese manufacturers, in a speech to the Chinese, back at the beginning of this year. I was unable to attend the conference in China, because I had a hearing in Congress. But, we gave a stern warning. And our counterpart in China, the AQSIQ, issued the same stern warning to manufacturers and said, “Do not substitute any of these metals for lead.” Now, we really don’t think that that is occurring, that they’re intentionally substituting. But, we think they’re being careless in not realizing that you cannot use these metals in children’s products.

Under the ASTM F963 standard, which is the toy standard, the surface coating on toys is regulated.

Senator DURBIN. But, I understood—

Ms. TENENBAUM. Also, children’s jewelry is regulated under the Federal Hazardous Substance Act. We could call a toxic metal a banned hazardous substance. And right now, we are doing our research to establish the level of what we will allow for cadmium and other metals in children’s jewelry.

Senator DURBIN. So, I understood that the children’s pets—Zhu Zhu pets out of China, there was—they found some evidence of antimony in those. Are you saying that—

Ms. TENENBAUM. Well, the company—

Senator DURBIN [continuing]. They did or didn’t?

Ms. TENENBAUM. The company who manufactures the Zhu Zhu pets came to the CPSC, just days after one nonprofit organization announced they had found the antimony, and showed us all of their laboratory tests. We did our own testing, and then we established that the antimony was not at harmful levels to children. And we put that press release out that there were no harmful levels of antimony in Zhu Zhu pets.

Senator DURBIN. Okay.

Senator Collins.

Senator COLLINS. Thank you, Mr. Chairman.

Obviously, our first priority is to make sure that all products, including toys for children, are safe. There has been an issue with small home-based businesses finding it very expensive to comply with the standards in the new law. They obviously do not want to be selling products that aren’t safe, that are not—that would in any way endanger our children. But, the cost of third-party testing can be prohibitive.

And I want to give you an example. Last year, I met with a woman who owned a business called The Little Hat Company in South Berwick, Maine. And she produced children's hats. And she had this network of women who made the hats out of their homes. It worked so well for them, because they all had young children and they could stay home with the children, yet be able to make some money. Well, the combination of the cost of third-party testing for the Consumer Product Safety Improvement Act plus the economic downturn has forced this business to close up altogether. And that affected not only the business owner, but all of these part-time sewers whom she employed who were producing these cute little caps out of their homes.

As a result of this concern, last year we included language in the report accompanying the omnibus bill noting the concerns of these very small manufacturers—seems even odd to call them “manufacturers”; they're really craftspeople—regarding the third-party testing requirements. And we urged you to consider these types of home-based businesses when you issue your rules and your guidance on third-party testing, because we really need to find a way that allows them to ensure their products are safe, but doesn't put them out of business when, in fact, their products are safe.

What efforts have you made to address the concerns of these small businesses?

Ms. TENENBAUM. Thank you, Senator.

We have been extremely sensitive to the concerns of small businesses and crafters throughout the implementation of the CPSIA. In fact, we wrote a guidance on the CPSIA for small businesses, resaler crafters, and manufacturers of children's products. And over the last 9 months, the Commission has had four actions which provided relief to small businesses and crafters. And here are the four rules that we promulgated to do this:

First of all, tracking labels. The CPSIA required that children's products have a tracking label. We decided that there was no “one size fits all” and for small crafters, that was very important to them.

Two, lead determinations proceeding. This was a rule that we wrote, and we said products made out of cotton, paper, untreated wood, to name a few, do not—will never have—contain lead. Therefore, businesses like The Little Hat Company, if it was a cotton hat, would not have to have third-party testing. And we put that out to tell people that you do not even have to have a certificate, which would save them a tremendous amount of resources.

The third thing was component-part testing. If the hat was made of cotton, the hat would not have been testing, but if they had buttons sewn on it to make it decorative, if they bought buttons from a company that could certify they were lead-free, then The Little Hat Company would not have had to do additional testing. And so, if you could just test the component, then you would not have to test the whole product.

And the fourth is, we continue to stay enforcement on testing and certification for many children's products, giving people time to understand this law, and also to let the component-part testing market develop. Groups like the Handmade Toy Alliance have recognized our work, and they continue to work with us. We, for ex-

ample, just last month, we had two Webinars with the ETS4 community, which is the handmade toy and handmade crafters, on eBay, and the Handmade Toy Alliance, so that we could talk to them about what the CPSIA requires and make sure they understood how to comply with the law.

We will continue to keep small manufacturers in mind as we go into our rulemaking. And we also want to make our small business ombudsman, which is a part-time job, a full-time job, and expand this into education and outreach, so that we can have regularly broadcast Webinars for small businesses and answer their questions individually to allay their concerns with compliance.

Senator COLLINS. Thank you. Those sound like very worthwhile and protective moves on the Commission's part.

This women's business was cotton hats. And she did ornament them, at times, with buttons, and was concerned about having to test the buttons. And I remember raising with her, "Well, wouldn't that be the button manufacturer's job?" So, I'm very happy that you've clarified that. And I will relay that information to her, in the hopes that, when the economy improves, she can get back in business and not have to worry about adding what really is a tremendous cost to a very small business.

I'd like to, in my remaining moment, just ask you a little more about the small business ombudsman, since I did note that you plan to establish a full-time position. How would you ensure that this position is truly going to be able to assist small businesses? How are you going to inform small businesses that it even exists?

Ms. TENENBAUM. Well, we've had a small business ombudsman for a number of years, and most recently the small business ombudsman was located in the Office of International Programs and Intergovernmental Affairs, and the duties were only part time.

We are working with Booz Allen Hamilton to write a new strategic and operational plan for the Commission. And we are already beginning to realize that one of our primary functions should be education and outreach. So, we could place this full-time small business ombudsman in a larger Office of Education Outreach, where we would work with colleges and universities. We could invite professors to participate. We could work with nonprofits. And also, we would have a regular curriculum, where we would regularly host workshops. Since I've been the Chairman, we've hosted two workshops. One was a workshop for the database and another one was for continued testing. And we reached out and reserved a block of seats just for the Handmade Toy Alliance and small businesses. And so, we will continue to be very sensitive to small businesses in that regard.

Senator COLLINS. Thank you.

Thank you, Mr. Chairman.

ADDRESSING HARMFUL CHEMICALS/ELEMENTS IN PRODUCTS

Senator DURBIN. I want to ask you about a couple of issues that raise a larger question: the relationship of the CPSC to some other agencies of the Federal Government, when it comes to particular hazards.

The first one is known as BPA—I'm going to mispronounce this—Bisphenol A, which is, as I understand it, a plastic coating that

may be in virtually every canned product we buy and shows up in other things—baby bottles and sippy cups, sometimes; maybe pacifiers. And it's been linked to heart disease and cancer in humans and abnormal development in animals.

The EPA, Environmental Protection Agency, listed BPA as a chemical of concern. Although some products are labeled BPA free, they're still found to contain this chemical. So, to what degree does the Consumer Product Safety Commission feel a responsibility, under the law, to verify labeled contents or claims, such as "BPA free" in consumer products?

Ms. TENENBAUM. We feel very responsible. In fact, we work regularly on interagency committees with the EPA, with the National Institute of Standards and Technology (NIST), with the National Science Foundation (NSF), and the National Institutes of Health (NIH). And the research that all of these agencies do, we read and take very seriously. So, we are tracking the research on BPA and other chemicals. We track all the nanotechnology research. And then, our scientists will make determinations and recommendations, and we will eventually go into rulemaking if we think that it's necessary.

We also can take the information and begin voluntary recalls or mandatory recalls.

Senator DURBIN. Have you done that in relation to BPA yet?

Ms. TENENBAUM. Let me get back with you. I know we have done extensive work on BPA. And before I misspeak today, let me get you a full report on what we've done on that.

[The information follows:]

U.S. CONSUMER PRODUCT SAFETY COMMISSION ACTIVITY ON BISPHENOL-A (BPA)

Overview

Bisphenol-A (BPA) is used in the manufacture of polycarbonate plastics and epoxy resins. Small amounts of BPA can migrate out of products made out of polycarbonate (such as reusable bottles and food containers) during their normal use. BPA is considered an endocrine disruptor. BPA has also been shown to cause reproductive and developmental effects in animals at high doses. However, there is a lack of scientific consensus over whether BPA causes these types of effects at low doses.

Regulatory Jurisdiction

Jurisdiction over BPA is split between two agencies: The Food and Drug Administration (FDA) and the CPSC.

- BPA used in food containers or surfaces that come in contact with food is considered an unintentional food additive and is subject to the jurisdiction of the FDA.
- Polycarbonate is also used in bicycle helmets and safety glasses, which is under CPSC jurisdiction. These products are made of polycarbonate because that material is very hard. The hardness of the polycarbonate in these products is beneficial in terms of the safety provided to the user, and CPSC Health Sciences staff does not believe the exposures from these products would be significant compared to products under FDA jurisdiction that come into contact with food or liquids.
- If BPA is used in children's products that are intended for children to mouth or which children could mouth, that would also fall under CPSC jurisdiction. In such products, staff would have to look at the hazard, the exposure and the subsequent risk posed by any BPA present.
- Several Federal agencies (the National Institute for Environmental Health Sciences (NIEHS), FDA, the National Toxicology Program, and the U.S. Environmental Protection Agency (EPA)) are currently conducting research on the safety of BPA, especially at low levels of exposure. CPSC staff is monitoring

these studies and are participating, as appropriate, to provide technical input and peer review.

Current Efforts Involving CPSC and Our Federal Partners to Further Study BPA

CPSC's Health Sciences staff recently participated in an Office of Management and Budget (OMB) coordinated Federal agency review of the EPA draft Notice of Proposed Rulemaking (NPRM) to establish the Concern List under section 5(b)(4) of the Toxic Substances Control Act (TSCA). This list included BPA.

Health Sciences staff are also currently participating in the activities of the revitalized President's Task Force on Environmental Health and Safety Risks to Children. One of the reasons for revitalization of this task force is to create a high-level group that can ensure coordination across agencies that are dealing with common chemical concerns. CPSC was specifically recognized as a key partner on this group.

Staff from EPA's Design for the Environment (DfE) project recently invited CPSC staff to participate in a group being organized to look at BPA alternatives in thermal paper. CPSC staff has participated in meetings with that working group.

Senator DURBIN. So, now let me raise another question, another issue, involving other Federal agencies, from a slightly different perspective. The first example was a claim that a product was BPA free. And, as I said, it could have contained a chemical of concern, and the manufacturer said, "No, it doesn't." And you're saying that you accept the responsibility to test to make sure that it doesn't.

Ms. TENENBAUM. We would.

If it's within our jurisdiction as a consumer product, we would follow the research and we would ask for copies of the reports. Our scientists also sit on numerous committees with the other Federal agencies.

Senator DURBIN. So, let me give you another example that comes at it from a different angle. Recent research has questioned whether Triclosan—I hope I'm pronouncing it correctly—an antibacterial chemical widely used in home products, such as liquid soaps, hand sanitizers—I probably put it on my hands 10 times a day—dish-washing liquid, shaving gels, toothpaste, some clothing and toys—may disrupt the body's endocrine system—so, that explains my problems—and whether it helps to create bacteria that are resistant to antibiotics. Now, the Centers for Disease Control has found that the chemical is so pervasive that it has been found in 75 percent of Americans.

This chemical is regulated by three agencies: Food and Drug Administration (FDA), Environmental Protection Agency, and the Consumer Product Safety Commission. The FDA now says that recent research raises valid concerns about the possible health effects of this chemical, and EPA is also reexamining it.

So, what—in light of that situation, where no claim is being made that it's free of Triclosan, but there have been questions raised by other Federal agencies about its safety and impact on humans—what is the CPSC's responsibility, and what have you done, related to this?

Ms. TENENBAUM. We saw the same article and were discussing it on the way over here. And again, we will receive the research, work with our colleagues in the other agencies, and if their concerns are such that we think consumers are endangered, then we will take action either to issue a safety warning, do a voluntary recall, or write regulations.

Senator DURBIN. So, here's what I'm getting at, Madam Chairman. Assume, hypothetically—I won't mention this particular chemical—but, assume the set of circumstances I just described for

chemical *x*. But, assume that the industry says, “Well, you’re just wrong. It doesn’t create these problems. And we have our scientists, who come to a different conclusion.” What is the threshold at which the CPSC says, “Here is what we’re looking for. We are looking for an assertion—a credible assertion by a certain Federal agency that puts us on notice that we have to be sensitive to and look for this certain chemical. It can be litigated in court, it can be disputed in laboratories, but we are looking for this threshold.” What is that threshold on a chemical, such as Triclosan, as to when the CPSC says, “We are sufficiently warned that it could be dangerous that we are going to step forward and try to protect Americans from exposure”?

Ms. TENENBAUM. The threshold would be whether or not it causes harm or the threat of harm to a consumer.

Senator DURBIN. Who makes that decision on—

Ms. TENENBAUM. We would on our products. For example, in this year’s—in the 2011 budget, we’re requesting \$2 million so that we can work with the National Nanotechnology Initiative to get the agencies who are doing the research on nanotechnology to test our consumer products so that we will know, firsthand, what we have to do with those products, regarding nanotechnology.

Senator DURBIN. So, you aren’t looking to the FDA or the EPA or the Centers for Disease Control. You’re basically establishing testing standards to establish whether there’s a danger to humans, and then regulating, based on your conclusions.

Ms. TENENBAUM. We have our own scientists who draw the threshold. In fact, they are working right now to come up with a threshold, in children’s jewelry, for cadmium and any other metals. So, we will look at what the research other agencies have done. We would not duplicate it. But, if we feel like—that the work is good science, good solid data, then we can act on it.

Senator DURBIN. Do you take into consideration if States have decided to regulate? For example, BPA, if I’m not mistaken, has been regulated—I think it’s in California, maybe even in Connecticut. Do you take that into consideration?

Ms. TENENBAUM. We do. And, in fact, when I became Chairman, I asked the Office of General Counsel to have quarterly meetings with all the States’ attorneys general. We wanted to not have an adversarial position with them. We felt like they were our partners, because we’re a small agency. We need our attorneys general in all 50 States—and I came out of State government—to work with us. And in the last meeting we had, nearly every one of them attended either in person or by conference call they or their representative. So, we feel like California, for example, is very aggressive when it comes to consumer products, and they give us information on what they find.

Senator DURBIN. Thank you.

Senator COLLINS.

Ms. TENENBAUM. Illinois’ attorney general is also very proactive.

Senator COLLINS. Madam Chairman, I want to go back to an issue I raised in my opening statement, and that is, I authored provisions of your new law that were intended to bring about better coordination and information sharing between the Commission and Customs and Border Protection. I was alarmed to learn that CBP

had so little authority, prior to this law, to actually seize and destroy dangerous consumer products. So, what was happening is, a lot of times, the products were turned back at one port and then would be shipped through another port.

So, we were trying to close that port-shopping hole, if you will. The bill authorized CBP to seize and destroy these products that are entering our ports, rather than just refusing them. But, the success of that depends on close coordination with the Commission, and the Commission was charged with developing a comprehensive risk assessment so that there would be better targeting of the incoming shipments for inspection. So, the idea was that the Consumer Product Safety Commission was supposed to target the shipment, and then CPB would go inspect that, and could actually destroy the products, rather than just refusing them.

That is why I was disappointed when the Government Accountability Office (GAO) reported, last August, that not as much progress been made in this area as I would have held—hoped. The Commission, for example, it says, does not have access to key CBP import data that it could use to target the incoming shipments. It said that it—the agreements hadn't been updated between the two agencies, that there still was not the kind of information sharing that's absolutely essential for this to be successful.

Why hasn't there been more progress made in this very important area? Because this is really critical to keeping dangerous products from ever coming into our country in the first place.

Ms. TENENBAUM. You are so right. And actually, the GAO report helped propel us to having even closer coordination and cooperation with the CBP.

On March 25 of this year, we submitted our concept of operation to define our plans for using the International Trade Data System to the CBP. And that will help us look at the types of products and the names of importers, to help us quickly and more proactively identify potential risk and provide more timely responses.

And we're also asking for resources, in the 2011 budget, so that we can have the capacity for our IT system and CPB's to talk to each other; we need to be able to data-mine between the two agencies.

We are working with the CBP and have piloted enforcement programs that are developing new and streamlined import procedures with them. So, we already have pilot projects going. We have placed a full-time employee at the Commercial Targeting and Analysis Center (CTAC), right here in Washington, which is CTAC, which allows us to look at pre-arrival manifest systems, so that our people know what is coming in on the shipments. We can target whether or not our products—consumer products—are on that shipment.

We also have developed a repeat-offender listing and work with the CBP to identify and stop potentially hazardous shipments. Also, we work with them to have specific targeting operations which have proven that, when we can target shipments, we're finding a very high percentage of products that are violative of the standards.

We have the Operation Guardian Program, which we use the CBP's resources, and they will go ahead and identify violative holi-

day lights, Christmas lights, children's upper- and outerwear with drawstrings, and seize those products.

Right now, we're waiting to have the memorandum of understanding (MOU) between the two agencies signed. Once that MOU is signed, then we hope that we will have access to their automated targeting system. And once we have access to their system, we will have greater knowledge and potential information on how to improve further targeting methodologies. In fact, we will have a risk assessment methodology, and we're asking for funding in the 2011 budget to help us with this project, because then we'll be able to have information to develop a full-risk assessment methodology so that CBP and the CPSC can share data and collectively target incoming ships.

Senator COLLINS. Well, I'm pleased to hear of that progress, a lot of which is quite recent. I think it might be helpful, after 6 months or so, if the Chairman and I ask the GAO for a new assessment on how that relationship is working.

I just have one final issue that I wanted to raise with you, and that's the Chinese-made drywall problem. Now, I feel fortunate, because my State, fortunately, did not, apparently, get a lot of the Chinese-made drywall that has produced such problems in 37 other States. What concerns me is, there were some 3,000 reports from residents of 37 States related to problems with this drywall, including health concerns, noxious fumes, metal pipe corrosion—significant problems. What can CPSC do to better anticipate and prevent problems like this? It seems like you shouldn't have to get to a point where you have 3,000 complaints before a problem is identified.

Ms. TENENBAUM. Well, let me start by saying that I understand the anxiety and stress that the families that have had the impacted drywall have gone through. I've visited homes in Florida and Virginia, and I saw, firsthand, the impact that they had on people's lives. Young families, where all their equity was tied up in this one home, had to move out and move in with relatives. Some of them had to file for bankruptcy. And it was a crisis that I walked into when I became the Chairman last year.

There have been more resources spent on this—over \$3.5 million—than any other investigation we've ever undertaken at the CPSC. It's taken longer than we had liked for it to, but, we were also pioneering protocols and testing to validate a new science.

We partnered, last year, with other Federal agencies to do a 51-home study. We were able to find out that certain gases were being off-gassed in the homes. With that information, we then went to Lawrence Berkeley Laboratories. We recently released the findings of those chamber tests, in which we found that the Chinese drywall was off-gassing hydrogen sulfide at 100 times greater limits than domestic drywall.

Now, not all Chinese drywall was off-gassing the hydrogen sulfide. In fact, there were over 6 million pieces of Chinese drywall imported into the country after Hurricane Katrina, and not all of it had the problem. What we are able to do working with the Department of Housing and Urban Development (HUD), is to develop an identification protocol to determine if you have the off-gassing in your home. We've just come out with our own protocol for reme-

diation, which basically is, remove all the Chinese drywall, rewire the house, and remove the pipes. This is the only way to make the homeowner able to move back into the home.

Now, we provided all of our research to the multidistrict litigation, which was a Federal lawsuit in Louisiana, and the judge in that case, last week, even went further. There was a company—a Chinese company, called Taishan, which did not respond to the complainant. It was a damages hearing tried in their absence, in which the judge awarded \$2.6 million to seven Virginia homeowners. In that case, he said, “Take out all the drywall, Chinese and non-Chinese. Take out all the wiring. Take out all the cabinets and appliances, carpet. And essentially take the home down to the studs, and rewire. So, it was more extensive than what we said was the remedy.

And now we are wrapping up studies. We have one study ongoing on long-term corrosion. How much would this corrosion result in any kind of fire hazard, for example? And that’s what the long-term corrosion is. But, this was an anomaly, the off-gassing of hydrogen sulfide, because it wasn’t found in all the Chinese drywall, just some out of parts of China.

So, the next step is, how can homeowners find resources to remediate? There are really four ways.

In some cases, the builder has gone back in—I’ve seen this in Florida and in Virginia—and torn out the drywall, torn out the wiring, rewired the house, put in new drywall, and moved the homeowners back in. And that has happened in both States.

In other cases, there have been civil suits. We have the multidistrict suit, down in Louisiana. There have been other civil suits where builders, retailers, manufacturers on up the chain of commerce are being sued.

A third way is to try to find some kind of public funding. I know that the Director of HUD has sent a letter saying States can use the community block grant funding. If that funding is available, that funding can be used.

And then, the fourth way is to try to get some participation from Chinese manufacturers. We have told the AQSIQ and the Chinese, from the Chinese Ambassador to all the people with whom we deal, that we are going to work with the Chinese companies to try to find a just and fair solution. We want them to participate in some way, financially. And so, we will begin those talks relatively soon.

Senator COLLINS. Thank you.

Senator DURBIN. I had the same issue on my list to bring up, and I’m glad Senator Collins did. And I think her question, though, is one that I still want to try to probe a little more.

After 3,000 complaints, we knew we had a problem. The question is, when it comes to children’s products and toys, we’re basically trying to reach a point where we have a certification of testing before they arrive in the United States. So, let me ask about a product like drywall, here. Is it your impression that there is any requirement for testing in China of such things before they are exported to the United States?

Ms. TENENBAUM. The regulations relating to drywall in the United States have to do with the strength, in terms of how much weight it can bear. We did not have regulations which said, “You

cannot off-gas hydrogen sulfide.” It was a novelty. And so, therefore, we had to build the protocols. We had to start from the ground up and work through getting the test designed to even figure out what was coming off the drywall.

Senator DURBIN. So, look at it prospectively. If there was another shipment of drywall being manufactured in China for export to the United States, would it be subject to testing for this hydrogen sulfide?

Ms. TENENBAUM. Not right now. And it was only after Katrina, when we needed more drywall than we could manufacture domestically, that we started importing the drywall. We were handling our own needs just in the United States, and we did not have the problem.

Senator DURBIN. Well, I would say—

Ms. TENENBAUM. But, the other thing is, we have started requiring labeling. We want tracking labels so that we know the company and the area of China in which the drywall was manufactured. And we also have worked with the CBP, where they have stopped shipments into the country. In fact, they found a shipment coming in from San Francisco, and they notified us. And then we went out to check on it, and it was not gypsum.

Senator DURBIN. Well, I can tell you that—whether it’s this situation with drywall or the melamine spiking into the pet food, which showed up as a higher level of protein, and therefore, was worth more—nominally worth more, until they discovered it was dangerous. It really might be beyond us to imagine how many possible things could happen from products coming in from a place where there are very few standards being applied at the source of manufacture.

I’d like to close by asking about one of your beloved retirees, whom we talked about over and over again in this subcommittee. And I don’t even remember his last name, but his name was Bob. And Bob was the toy-tester. And some of our staff went out with their cameras and took pictures of Bob’s workshop, which consisted of a table with toys stacked up on them. And Bob had made some marks on the wall at certain levels—4 foot and 6 foot—and then would drop the toys from those levels and see if they busted into little pieces that kids could swallow. And it didn’t strike most of us as the kind of sophisticated testing most Americans would expect from an agency with your reputation. Now, Bob has retired, God bless him. And I know he did a good job for us while he was there, with the resources available. But, please tell me what the world of toy testing looks like at CPSC after Bob.

Ms. TENENBAUM. Well, thank you. Bob the toy-tester has retired. And we do not have just one person testing toys. Our staff estimates, depending on the workload, that toy-testing involves up to 20 staff from the Office of Hazard Identification and Reduction at any given time, including the laboratory, the engineering, human factors, and health scientists.

In addition, our field and import surveillance staff tests or screen toys at the port and the field. For example, investigators at the port have XRF machines, and they can screen for lead and other metals. If the toy fails XRF screening, it’s sent to the laboratory for further analysis by our toxicologists and our chemicals. And if the

toy fails on the small-parts screening, then it's sent to human factors to conduct an age determination to identify the age of the child for whom the toy will be purchased and is most appropriate. And based on this age determination, the laboratory and health scientists test the toy for small parts and sharp edges.

For toy hazards that fall outside of a specific toy regulation, many other CPSC technical personnel conduct product safety assessments on the specific toy in support of compliance activities.

And if you give me a moment, I'd like to tell you about our new lab. We brought pictures of the new lab. After 35 years at our current antiquated lab space, the CPSC will open a new modern testing facility in Rockville, Maryland. We're leaving Gaithersburg. And we will open it in December 2010. And this facility has 63,000 square feet, and we will be able to hold 100 staff and guest researchers in our laboratory. And for the first time, we'll have all of our technical personnel involved in testing housed under one roof.

This building was built by a private company as a laboratory. And it's very impressive. And we invite you, when we open the lab later on this year—you might want to wait til January 2011—to go with us out to see our new lab.

Senator DURBIN. Only if you invite Bob.

Ms. TENENBAUM. All right. We'll bring Bob back.

But, we want to show you—this is our new lab, and this is the old lab. The old lab has 37,000 square feet, as compared to the 63,000 square feet. And these were nine buildings that were 1950s-era buildings, all over that campus. And it only was able to hold 42 people. And we would have to do one test and then take the equipment down to reassemble it to do another test. This new lab allows us to test multiple products at one time. It enhances our ability to look at the children's electrical, combustion, sports, recreational equipment. We will have a dedicated space for children's testing. So, we'd love to show it to you, when we're ready.

ADDITIONAL COMMITTEE QUESTIONS

Senator DURBIN. Chairman Tenenbaum, we're going to send you some more questions in writing—

Ms. TENENBAUM. Thank you.

Senator DURBIN [continuing]. And open it up to other members of the subcommittee who might like to do the same.

Keep the record open until Wednesday, April 21, at 12 noon for subcommittee members to submit statements or questions.

And I thank you very much for your testimony.

I thank Senator Collins for joining me today.

[The following questions were not asked at the hearing, but were submitted to the Commission for response subsequent to the hearing:]

QUESTIONS SUBMITTED BY SENATOR RICHARD J. DURBIN

CHINESE PRODUCTS

Question. How are things progressing with the safety of Chinese products?

Answer. Recalls of product manufactured in China have begun to decline. After increasing steadily for many years, from a low of 121 in fiscal year 2003 to a high of 346 in fiscal year 2008, the number of recalls of consumer products manufactured

in China dropped to 230 in fiscal year 2009. Through June of fiscal year 2010, we have recorded 80 recalls of these consumer products, indicating a rate that should put the China recalls well below 200 for fiscal year 2010.

In general, we find the Chinese government cooperative in pressing its industry to correct specific issues. However, while the government has publicly stated its policy that industry should comply with best manufacturing practices for making safe consumer products, it needs to put more resources behind that policy.

Question. Have the Chinese disseminated information on standards and manufacturing processes throughout China and are their toys being tested and certified? How does the process work?

Answer. The Chinese government has stated that its own laboratories that inspect toys for export under Chinese rules must adhere to the safety requirements of the export market. We have conducted training for these laboratories on numerous occasions. CPSC also has made a significant amount of information about toy safety requirements available in Chinese on our web site and Chinese toy industry publications have picked up our material and reprinted it for their readers on several occasions.

All toys imported from China (and elsewhere) are subject to the CPSIA mandate that they be certified compliant with U.S. regulations and tested for compliance by an independent third party conformity assessment body (lab) accepted by CPSC. Importers typically select a lab from CPSC's list and instruct their Chinese suppliers to have the product tested by the lab. Alternatively, they permit the Chinese suppliers to select the lab from our approved list.

Question. In October 2009, the Chinese CPSC (AQSIQ) agreed to take immediate action to eliminate the use of lead paint in toys. Have the Chinese banned products with lead paint? What about products with lead?

Answer. There is an AQSIQ directive in place prohibiting the practice. AQSIQ has been aggressive in taking corrective action with manufacturers who attempt to use lead paint on toys exported to the United States. Overall, we have seen a substantial decrease in cases of toys with lead paint level exceeding current limits.

Question. When is your next meeting with Chinese officials and what do you hope to accomplish?

Answer. I will participate in a trilateral U.S.-EU-China Product Safety Summit in October 2010. AQSIQ will participate at the ministerial level and the European Commission will send their Commissioner responsible for product safety. Both the CPSC and our European partners view the event as an important opportunity to impress upon AQSIQ the need to get Chinese manufacturers to rely on best manufacturing practices for producing safe consumer products.

Question. Have any other countries followed suit to make their products safer?

Answer. The European Commission is a close partner with CPSC in our work with China. We have conducted joint training for manufacturers and continue to coordinate our messaging on product safety to the Chinese government.

BEIJING OFFICE AND ACTIVITIES

Question. I understand that at the end of last year, you established CPSC's first overseas office at the U.S. Embassy in Beijing and hired a Product Safety Specialist to work there. What are the responsibilities of this individual?

Answer. The Product Safety Specialist—

- acts as a pro-active resource distribution point for Chinese suppliers and government officials who need U.S. consumer product safety compliance information;
- serves as a liaison with AQSIQ to ensure timely exchange of critical regulator-to-regulator information;
- reports regularly to CPSC, in writing, on China's regulatory implementation of product safety measures and the effectiveness of Chinese product safety reform efforts;
- works closely with the CPSC Office of International Programs and Intergovernmental Affairs' China Program Coordinators to facilitate implementation of the U.S.-China Product Safety Work Plan (i.e., personnel and information exchanges);
- proposes and coordinates monitoring and evaluation activities to determine the impact of CPSC product safety initiatives for Chinese suppliers;
- analyses data from Chinese government and industry sources regarding safety and quality of consumer products;
- provides information to CPSC and the Beijing Embassy Economic Section on changes in Chinese practice, regulations, laws, or structures associated with product safety;

- translates relevant product safety documents and verifies document translations;
- coordinates visits to China of CPSC officials and assists with visits to CPSC by Chinese officials;
- with approval from CPSC headquarters and using fully cleared materials, provides selected Chinese audiences with briefings on U.S. requirements for consumer products;
- upon specific request by CPSC headquarters, visits production facilities and test labs, by arrangement with, and at the invitation of Chinese government officials and facility managers, in order to observe specified operations and verify specific activities.

Question. What are your plans to hire a Regional Product Safety Officer? What will be the responsibilities of that individual and what countries will be overseen?

Answer. The recruiting announcement for the Regional Product Safety Officer was listed on USAJOBS.gov on August 6, 2010. The deadline for applications is September 6, 2010.

The Regional Product Safety Officer will have the following responsibilities in the Asia-Pacific region:

- act as a pro-active resource distribution point for Asia-Pacific regional regulators, suppliers, and other stakeholders, who should understand U.S. consumer product safety compliance information;
- serve as a liaison with regional regulators to ensure timely exchange of critical regulator-to-regulator information;
- report regularly to CPSC on important regulatory implementation of product safety measures in the region and the effectiveness of national product safety programs;
- speak at appropriate events in the region to brief key target audiences on U.S. requirements for consumer products.
- with CPSC headquarters approval, visit regional production facilities and test labs, by arrangement with, and at the invitation of local government officials and facility managers, in order to observe specified operations and verify specific activities; and
- supervise the local hire Product Safety Specialist working in Beijing.

STAFFING

Question. Your 2010 operating plan states that staffing will remain at 530 FTEs in 2010, however, our enacted fiscal year 2010 conference report language states that the increased funding we provided shall support new staff hires, including at key ports of entry. May I have your assurances that you intend to hire additional staff in 2010? What will your FTE goal be? How many part-time and full-time employees are currently employed at the Commission?

Answer. The Commission continues to aggressively hire key staff during the remainder of fiscal year 2010. As of July 28, we have made 96 new hires since the start of the fiscal year 2010, which represents a 21 percent increase in overall agency staffing. During the current fiscal year, we have hired four additional employees at ports of entry for our Import Surveillance Division, and currently have five additional hires pending in this Division.

To date in fiscal year 2010, the CPSC has had 38 resignations and retirements. As a result, we project that we will average about 490 “annualized” FTEs for the fiscal year. This is a 13 percent increase over the annualized FTE usage for fiscal year 2009. The current FTE ceiling target we have given managers for fiscal year 2011 is 576 FTEs. This is the FTE number funded in the fiscal year 2011 CPSC budget request.

As of August 7, 2010, CPSC employment stood at 520.4 FTEs. This number includes approximately 25 temporary student hires that count against our FTE limit. As of August 7, 2010, we also have 15 pending hires and over 69 active vacancy announcements.

Question. I am aware that a number of long-time, well-qualified and knowledgeable staff have left the Commission. What are you doing to fill the gaps left by these important staff members? Are you having difficulty recruiting the highly technical staff that you need?

Answer. Our attrition rate has remained steady and is 5.9 percent thus far in fiscal year 2010. We continue to hire in all of our technical areas to handle the workload, provide for expertise in each technical area and ensure the transfer of knowledge as staff leave.

We have had difficulty filling positions for a few technical areas such as Mathematical Statisticians, Engineering Psychologists, Fire Protection Engineers, Toxi-

cologists, and Chemists. To maximize hiring potential in these areas, we have utilized the full range of recruitment flexibilities and incentives available for these positions, including recruitment and relocation bonuses, annual leave service credit, superior qualifications appointments, and telework opportunities. We have also opened many of these positions at both the entry grade level and at the senior journeyman level to ensure opportunities for applicants with varying degrees of education and experience.

The CPSC has also sought to expand the pool of qualified applicants by attending targeted job fairs, posting ads in professional journals and engaging in outreach to colleges and universities with a concentration in the technical areas we are recruiting.

WORKLOAD

Question. The reauthorization placed many new requirements on CPSC along with deadlines for achieving those milestones. How is CPSC managing the balance of meeting its long-standing responsibilities with the new mandates placed on the agency by the Consumer Product Safety Improvement Act?

Answer. In the Consumer Product Safety Improvement Act (CPSIA), Congress set an aggressive regulatory agenda for the CPSC over the course of the first 2 to 3 years after enactment. While the CPSIA mandates 42 separate action items for the Commission to undertake, that number understates the agency workload that results from each of those mandates. For example, that count does not include any interpretative rules, such as the definition requirements for “child care article” and “toy” under section 108.

To put this in context, mandatory rulemaking activity averaged less than seven per year from fiscal year 2000 through fiscal year 2008, with the number of rulemaking projects per year ranging from a low of one in fiscal year 2005 to a high of 10 in both fiscal year 2007 and fiscal year 2008. With the passage of the CPSIA, rulemaking activity has increased significantly, averaging about 26 substantial rulemaking activities each year for fiscal year 2009, fiscal year 2010 and proposed fiscal year 2011. The Commission also conducted an additional 15 activities supporting rulemaking proceedings in fiscal year 2009 and 15 to date in fiscal year 2010.

The work required by the CPSIA is in addition to the Commission’s ongoing regulatory activity in a variety of areas, including upholstered furniture, portable generators and cigarette lighters, as well as our ongoing compliance work in evaluating and recalling products that present hazards to consumers.

Timely implementation of the CPSIA is the agency’s top priority, but we have also tried to prioritize our work in a way that maximizes effectiveness and provides flexibility if new hazards emerge. One example of this flexibility is the Commission’s ongoing investigation of contaminated drywall, which is now the largest investigation in the history of the CPSC.

Question. How is the Commission prioritizing work associated with new responsibilities as a result of the reauthorization act? What criteria are being used to prioritize this work?

Answer. The CPSIA established a schedule of mandatory rulemaking activities, and these requirements have been placed on the Commission’s rulemaking agenda.

In addition, the CPSC has a regulation entitled “Policy on Establishing Priorities for Commission Activities,” (16 CFR § 1009.8) that guides its efforts to prioritize the work of the agency. A description of the process for prioritizing Commission action can be found in our semi-annual regulatory agenda/plan submission that summarizes the regulation cited above and lists following general criteria: frequency and severity of injuries; causality of injuries; chronic illness and future illness; cost benefit of CPSC action; unforeseen nature of the risk; vulnerability of the population; probability of exposure to the hazard; and any additional criteria.

Completion of congressionally mandated tasks is a key agency priority and resources have been allocated accordingly. Other work, such as the investigation of contaminated drywall and other potential emerging hazards are also allocated priority resources as necessary.

Question. In what areas do you feel that CPSC has been slow to act due to the complexity of issues and why?

Answer. The development of a draft proposed rule addressing the third-party testing requirements under CPSA section 14(d)(2) has been extremely complex and involved thousands of hours of staff resources. This proposed rule has the potential to offer families a vital new layer of safety and reassure U.S. consumers that toys and other children’s products are free of many known hazards. On the other hand, the rule also impacts tens of thousands of manufacturers and importers across all

of the various industry sectors producing children's products, including small business entities.

Given the complexity of the global supply chain and the number of various industries affected by these requirements, CPSC staff has sought extensive public comment from all interested stakeholders to further inform development of the proposed rule. On December 10 and 11, 2009, the Commission held a Testing Policy Workshop and invited public comment on aspects of section 14 of the CPSA, as amended by the CPSIA. Staff presentations were given, and breakout sessions were held on the following topics: Sampling and Statistical Considerations; Verification of Third-Party Test Results; Reasonable Test Programs and Third-Party Testing; Challenges for Small Manufacturer/Low Volume Production; Component Testing and Material Changes; and Protection Against Undue Influence.

A draft Federal Register notice for the proposed rule was published April 1, 2010, and the comment period expired August 3, 2010. Work is progressing, with the final rule scheduled for completion this year.

PORT SURVEILLANCE

Question. How many full-time CPSC staff work at how many U.S. ports?

Answer. The Import Surveillance Division currently staffs 11 U.S. ports with 14 on-site compliance investigators. The 11 U.S. ports with current on-site CPSC staffing include: Buffalo, New York; Denver, Colorado; Houston, Texas; John F. Kennedy International Airport, New York City, New York; Los Angeles/Long Beach, California; Miami, Florida; Newark, New Jersey; Norfolk, Virginia; San Francisco, California; Savannah, Georgia; and Seattle, Washington. We are currently recruiting for four additional locations (Chicago, Illinois; Laredo, Texas; Detroit, Michigan; and Port Everglades, Florida) and expect to have staff in place in those locations by October 30, 2010.

CPSC has also co-located staff in the Commercial Targeting and Analysis Center (CTAC) located within the Office of International Trade at U.S. Customs and Border Protection in Washington, DC.

Question. How will your fiscal year 2011 budget request augment this?

Answer. The fiscal year 2011 budget request proposes to increase the number of personnel in the Import Surveillance Division to 23 FTEs. Of those 23 FTEs, 19 would be stationed in ports of entry.

Question. In what ways are you working with Customs and Border Patrol?

Answer. CPSC has partnered with U.S. Customs and Border Protection (CBP) on a series of efforts focused on increasing surveillance of imported consumer products.

In March 2010, CPSC submitted to CBP our revised Concept of Operations that defines CPSC's plans for using the International Trade Data System. This plan includes defined processes to create screening and targeting criteria and the overall automation of import enforcement mechanisms. By doing so, we have identified touch points between the agencies where cooperation and coordination can be developed.

On April 26, 2010, CPSC was the first agency to sign an interagency Memorandum of Understanding (MOU) with CBP allowing CPSC personnel to co-locate at the Commercial Targeting and Analysis Center (CTAC). This MOU will greatly improve upon our interagency communication and information sharing.

This month, CPSC also formally executed an MOU with CBP that will give CPSC access to information in the Treasury Enforcement Communication System (TECS). This will assist CPSC investigators in the ports by providing them access to information that will improve local targeting and product interdiction activities.

CPSC is also actively involved in supporting the Importer Self Assessment-Product Safety (ISA-PS) program that is currently being piloted by CBP. The ISA-PS is envisioned to be a partnership among CBP, CPSC and importers to maintain a high level of product safety compliance to prevent unsafe imports. The ISA-PS is a voluntary approach to product safety compliance and will allow the agency to direct our resources to those companies with higher risk.

Question. For the future, do you envision locating a testing laboratory on the west coast so that many of the nation's imports can be tested at, or near their point of entry?

Answer. It does not appear that funding will be available in the near future for an additional CPSC testing laboratory on the west coast. However, CPSC and CBP have been in discussions for several months on utilizing CBP laboratories to test samples collected by CPSC at import. Training of select CBP laboratory personnel has been completed and beginning September 20, 2010, targeting will begin for an operation at several ports of entry focusing on potentially violative imitation jewelry.

Products collected as part of this operation will be sent to both CPSC's lab and a CBP lab for analysis. This pilot analysis program will enable us to determine if the results obtained at a CBP lab are comparable to those obtained at the CPSC lab. If the pilot confirms that the results are comparable, the anticipated next step is to begin having CBP labs test CPSC samples independently, with Compliance relying on those results to make admissibility determinations. When implemented, the use of CBP labs will increase the number of import samples that can be collected and tested.

GAO REPORT ON CPSC'S OVERSIGHT OF IMPORTED PRODUCTS

Question. A GAO report from August 2009 found that CPSC didn't have access to key Customs and Border Patrol import data that could be used to target incoming shipments for inspection. Further, the report found that CPSC's activities at U.S. ports could be strengthened by better targeting incoming shipments for inspection and by improving CPSC's coordination with CBP. What is being done to address these issues? Are you revising your agreements with Customs and Border Patrol? Please address the additional key issues raised in the August 2009 GAO report (GAO-09-803) on CPSC's Oversight of Imported Products, and discuss steps taken to address these concerns.

Answer. As noted in a previous response, CPSC is now an active participant in the Commercial Targeting and Analysis Center (CTAC) that has been developed by U.S. Customs and Border Protection (CBP) to spearhead the coordination of the efforts of the various Government agencies responsible for import safety enforcement.

On April 26, 2010, CPSC and CBP signed a Memorandum of Understanding (MOU) for the exchange of information within the CTAC. This document gives both agencies authority to share information, combining for the first time CBP entry and advance cargo data with CPSC violator information. This partnership has enhanced information exchange, improved targeting decisions, and assisted in development of risk analysis capability.

In addition, CPSC and CBP just executed an MOU that gives CPSC access to information in the Treasury Enforcement Communication System (TECS). This will assist CPSC investigators at the ports by providing them access to information that will improve local targeting and product interdiction activities.

NANOTECHNOLOGY

Question. Your fiscal year 2011 request includes \$2 million to support the Federal National Nanotechnology Initiative data collection activities and environmental, health and safety research, related to consumer products. Why are nanomaterials of concern? What kinds of activities will CPSC undertake as part of the National Nanotechnology Initiative?

Answer. The National Nanotechnology Initiative (NNI) has developed a definition of nanomaterials that specifies that these materials have a specific size range in the nanoscale, 1–100 nm (a nanometer (nm) is one-billionth of a meter), and unique physical and chemical properties that differ from other materials not in that specific size range. Because of the small size and unique properties of nanomaterials, there is a concern that they may cause health effects in humans or organisms in the environment. In particular, there is concern about nanomaterials incorporated into consumer products, and the potential risk of nanomaterials entering the bodies of adults and young children who use products that contain these materials.

As part of the NNI activities, several Federal agencies, including the CPSC, have worked together to identify and prioritize the questions that should be addressed and the types of research to be conducted to ensure the responsible development of nanotechnology and the safe use of nanomaterials. These research priorities are listed in the Federal environmental, health, and safety research plan that is currently undergoing revision by several Federal agencies. (A copy of the plan is available online at http://www.nano.gov/NNI_EHS_Research_Strategy.pdf).

There are also international efforts, including the OECD Working Party on Manufactured Nanomaterials (WPMN), to prioritize the testing needed for nanomaterials, sponsor health effects studies, and share information on test results. The CPSC staff participates in the international efforts along with several Federal agencies.

CPSC staff is aware of its role in the national and international efforts to address nanomaterial health and safety concerns, and has proposed a number of projects for fiscal year 2011 that address the identified needs outlined in the Federal strategy. In fiscal year 2011, CPSC plans to establish agreements with a number of agencies including the Environmental Protection Agency (EPA), National Institute for Occupational Safety and Health (NIOSH), the National Institute for Standards and Technology (NIST), and the National Science Foundation (NSF) to develop testing meth-

ods and conduct studies to quantify the releases of a variety of nanomaterials from several classes of consumer products. The information derived from these studies will be used in evaluations to determine if there are any potential risks associated with identified releases of nanomaterials from tested products. The CPSC also intends to work with other Federal agencies to increase the availability of information about nanomaterials in publically available databases and literature.

CHINESE DRYWALL INVESTIGATION

Question. I understand that CPSC and HUD have now issued guidance to homeowners with problem drywall, instructing that all problem drywall and wiring be eliminated and replaced. Is your guidance the culmination of your work on this subject or what are the next steps with regard to Chinese drywall?

Answer. CPSC and HUD have provided the public an effective means of identifying homes with problem drywall and of remediating those homes through the issuance of our interim guidance. In our remediation guidance, we have recommended the replacement of all possible problem drywall, all fire safety alarm devices, all electrical components and wiring, and all gas service piping and fire suppression sprinkler systems. CPSC and HUD expect to fine-tune our guidance documents as we analyze the results of our scientific studies as those studies wrap up.

While our scientific investigation is wrapping up, the CPSC continues to vigorously pursue avenues for relief for consumers as we continue to monitor private litigation and remain engaged with AQSIIQ.

LABORATORY STATUS

Question. I believe you were scheduled to move into your new laboratory space this year but the contract award process took longer than expected and you now expect to move at the end of the year. What activities will occur at the new laboratory space?

Answer. The CPSC Laboratory supports the overall CPSC mission to reduce unreasonable risk of injury associated with consumer products. This function requires selecting, procuring, calibrating, operating, and maintaining sophisticated laboratory equipment by knowledgeable and skillful personnel. Work results must be competent in order to withstand the scrutiny of litigation.

The new laboratory will house facilities for the testing and evaluation of products for hazards under Sections 7, 8, 12, or 15 of the Consumer Product Safety Act. This includes facilities for testing of regulated products such as children's sleepwear, general wearing apparel, mattresses and futons, and carpeting.

The flammability test laboratory will include a 2-hour fire-rated burn room for large- and bench-scale ignition test, various hoods and test chambers for small-scale ignition tests, and a chemistry laboratory and chemical hood for fiber analysis and specialized (plastic film, chemicals and solids) flammability testing.

The chemistry laboratory will house all the analytical instrumentation used by the chemists to evaluate children's and consumer products and household chemicals. This laboratory will contain four separate laboratory testing cells used for sample preparation where solvents and acids are used, the analysis of total acids and bases, testing for flash point and viscosity analysis and extractions such as those used in the phthalate plasticizer project.

The Instrumentation Laboratories will house the inductively coupled plasma spectrometer, which is used for analysis of metals, two Gas Chromatograph Mass Spectrometers, a Fourier Transform Infra-red Spectrophotometer, and two small indoor air quality exposure chambers.

CPSC's combustion products and appliances laboratory will contain three specialized and highly sophisticated chambers and instrumentation for testing a range of residential appliances including furnaces, stoves, ovens, gas-fueled fireplace sets, unvented space heaters, and camp stoves and heaters. A temperature- and humidity-controlled carbon monoxide gas chamber used to test CO alarms will also be situated in that space. Adjacent to these chambers, we plan to install the apparatus of the mechanical test laboratory: a large fatigue cycle test frame, a 14-foot tall monorail head-form drop tester for helmet and playground surface testing, two tensile/compression strength testers for evaluating mechanical support structures (such as bicycle frames), and a hydraulic pressure test facility for evaluating fire suppression sprinklers.

The electrical and mechanical test laboratories will be used for testing various consumer products, such as ATVs, small electrical household appliances, cribs, baby walkers, and toys. We will also have fireworks laboratory space to test some of the characteristics of Class C pyrotechnic devices for compliance with Federal regulations.

Question. I understand that the new facility does not allow for fireworks testing? Are you not testing fireworks then?

Answer. CPSC is not able to conduct the full range of fireworks testing at our current laboratory and will not be able to conduct the full range of testing at our new facility. We conduct testing to evaluate fireworks fuse burn time, functionality and reliability of the fuse to ignite the device, launch tube integrity, functionality and location of the aerial effects, and other characteristics at the Blossom Point Research Facility in southern Charles County.

SEARCHABLE CONSUMER PRODUCT SAFETY INCIDENT DATABASE

Question. In less than a year, the public will be able to access a CPSC database that will allow an individual to report an incident or injury from a product and also allow an individual to research safety information about a product. Where is the Commission, at this point, in developing the system?

Answer. In September 2009, funds were apportioned by the Office of Management and Budget (OMB) for the development of the public database. Since that apportionment, CPSC staff has worked diligently to complete the tasks required to implement the database by the March 2011 deadline.

In January, public workshops were held with consumer groups and industry to solicit comments and suggestions about how to best meet the requirements of Section 212 of the CPSIA. In April, the Commission proposed a rule specific to the implementation of the database. Comments received through this implementation proceeding have been used to help develop the system.

With strong support from agency executives, much of the development work has been completed and internal and several external focus groups have reviewed specific parts of the application. CPSC has also taken advantage of opportunities for presentations at meetings held by the Consumer Federation of America, the International Consumer Product Health and Safety Organization, and with the National Association of Manufacturers. Comments have been positive.

Later this fall, CPSC plans to hold more workshops with industry and consumer groups to garner more feedback. CPSC's Office of Public Affairs is also coordinating the development of the public awareness campaign consistent with the release of the database in March 2011. Overall, development work for the public consumer product safety incident database is on target and we anticipate a successful release in March 2011.

Question. What types of issues are you grappling with as you envision the system's development?

Answer. CPSC has not run into significant issues with the development of the system. During the public workshops held on the database many useful comments and suggestions were provided by industry and consumer groups. The Commission also received close to 50 comments in response to the proposed rule. These comments are currently being analyzed in preparation of the final rule. Although some of the technical details of the database design may be affected by the adoption of the final rule, the possible changes are manageable within the implementation timeframes.

Question. What types of input or assistance are you receiving for this type of undertaking?

Answer. As noted above, CPSC held public workshops with industry and consumer groups to help provide input for the design and functionality of the system. Meetings with other stakeholders and external focus group testing in recent months have also proven useful. Additional workshops are planned, along with more extensive use of the Commission's saferproduct.gov website to provide more information to the public as updated information becomes available. CPSC will continue to work as closely with industry and consumer groups well in advance of the launch of the public database to ensure its success.

STATEMENT SUBMITTED SUBSEQUENT TO THE HEARING

Senator DURBIN. Subsequent to the hearing Senator Mary Landrieu has requested that a statement she has submitted be inserted into the record.

[The statement follows:]

PREPARED STATEMENT OF SENATOR MARY L. LANDRIEU

Thank you Chairman Durbin and Ranking Member Collins for calling this oversight hearing on the Consumer Product Safety Commission's (CPSC's) budget for fiscal year 2011. The Consumer Product Safety Commission continues to do great work

to ensure that consumers protected against hazardous products. Of particular interest to me and the state of Louisiana is the CPSC's ongoing investigation into defective drywall made in the People's Republic of China. As homeowners in my state, and nationwide face possible health and environmental risks from Chinese-made drywall products, it is my hope that the CPSC will be able to provide a definitive solution in the investigation into this issue facing impacted consumers in the near future.

According to published reports, since 2006 more than 550 million pounds of drywall have been imported to the United States from China. This is enough to make tens of thousands of homes. However, these products may have come into the country as far back as 2000 and could be in over 100,000 homes nationwide. This is because since 2004, builders have turned overseas for materials because our own U.S. suppliers could not keep up with demand created by the U.S. construction boom, as well as a series of hurricanes and other natural disasters. This would include the 2004 Florida hurricanes, Hurricanes Katrina and Rita of 2005, and other disasters. The drywall entered the United States through numerous ports, including the Port of New Orleans. As I understand it, Florida was the number one destination for these products with over 3 million drywall boards. Louisiana was next with almost 660,000 drywall boards. In Louisiana alone, this could be as many as 7,000 homes. Overall to date, the CPSC has received about 3,082 incident reports from 37 states, the District of Columbia, Puerto Rico, and American Samoa. This problem spans the country, from California in the West to right here in the District of Columbia and Virginia. It is not just an isolated issue for homeowners in the Gulf Coast—Chinese drywall is a nationwide problem.

It is my understanding that the CPSC received its first consumer incident report from Florida in December 2008. In Louisiana, we began to see reports from homeowners in southeast Louisiana in late February of 2009. These reports were similar to those seen in Florida homes: a "rotten egg" smell within homes; health issues such as skin irritation, persistent cough, bloody noses, hair loss, and asthma attacks; lastly homeowners noticed blackened and corroded metal components in their homes. According to the Louisiana Department of Health and Hospitals, 990 calls have been received regarding defective drywall, and 551 of those callers have completed the DHH survey. The majority of these reports were centered in New Orleans and surrounding parishes in southeast Louisiana. From Orleans Parish, 151 calls have been received, followed by St. Tammany Parish with 118 calls, and Jefferson Parish, St. Bernard Parish, and East Baton Rouge Parish follow close behind. Just to give you an example of how widespread this issue is in my state, we have seen hundreds of homeowners ranging from St. Bernard Parish Fire Chief Thomas Stone to New Orleans Saints Head Coach Sean Payton report this product in their homes. Many parents have been seeking answers on what might be making their kids sick or, now that more details are coming out, how they should safely remove this product from their homes. This defective Chinese drywall represents an attack on these families and presents another obstacle on our road to Gulf Coast recovery.

In response to these reports, my office has heard from countless constituents on the need for consistent, scientifically-based information on the product, as well clear guidance on the public safety, health, and environmental impact. Families have asked for information on which Federal or State agencies to contact, in addition to any updates we have on the health risks posed by this product. Many families also called concerned about the impact of defective drywall not just on their children but also on pets. To address these questions, on April 23rd, my office issued a fact sheet for homeowners updating them on the Federal/State response, providing key contact information, and answering frequently asked questions. My office updates this document regularly as new information becomes available.

On the state level, it is my understanding that the calls which the Louisiana Department of Health has received have ranged from homeowners requesting home inspections, advice on home evacuations, in addition to inquiries on specific health information to provide their primary care physicians and veterinarians. A key question is that of remediation or possible financial assistance in order to deal with this problem. Many of my constituents received either Federal Emergency Management Agency (FEMA) or Small Business Administration (SBA) disaster assistance to rebuild these homes following Hurricanes Katrina and Rita of 2005. These families spent months in FEMA trailers and rental units following these disasters, they paid out of pocket or took on debt to rebuild. Now they find their rebuilt homes in worse shape than these post-disaster temporary units. In this situation, families are looking for answers and a timeline for when more information will be known on the definitive health impacts of this product.

In response to these concerns from my constituents, I have been working closely with Senators whose states contain contaminated drywall. Along with my col-

leagues, I have sent letters to various agencies requesting appropriate assistance for homeowners and I have filed S. 2731, the "Small Business Administration Disaster Recovery and Reform Act of 2009." S. 2731 includes a provision, which with restrictions, would authorize SBA to make disaster home loans for the repair and replacement of Chinese drywall. Senator Nelson has co-signed, and I look forward to pushing for this bill to become law to provide relief to homeowners.

Earlier this year, CPSC and the U.S. Department of Housing and Urban Development (HUD) issued a protocol to help identify problem drywall in homes. Further, interim remediation guidance was released by these agencies on April 2 based on CPSC's ongoing scientific research. These guidelines are a positive step to relief for affected homeowners, and the coordination of the CPSC and HUD is to be commended. However, it is important for all Federal agencies to better coordinate with CPSC and HUD in an effort to better assist in the remediation and recovery efforts.

While I understand the need to be thorough and build a case that might stand up to future legal scrutiny, and I understand that accurate scientific testing takes time, my constituents need definitive answers now. Parents caring for sick children or pets need answers, workers removing these products from homes need to know potential health risks, and local health officials need to know what environmental impact may occur if this drywall is dumped into landfills. Though results which have been released and interim remediation protocol are great leaps, I must stress the importance of a final solution.

In closing, I believe that the scope of this problem is huge because it touches on so many different stakeholders. The first thought is on the impact to homeowners and renters, as it should be for a health risk of this nature. However, medical professionals and veterinarians are also dealing with this issue as families report health problems. The possible public safety impact also draws in fire marshals, construction workers, and environmental inspectors. So this defective product is not just a concern for homebuilders or homeowners, but is a concern for many other professions in both the public and private sectors. That is why the testing of this hazardous material is so important—we must ensure that there is a timely and effective Federal response in cooperation with local health authorities. I look forward to working closely with my colleagues to support additional efforts to address this critical matter facing our homeowners.

I thank the Chairman and ask that a full copy of my statement appear in the record.

SUBCOMMITTEE RECESS

Senator DURBIN. And this meeting of the subcommittee stands in recess.

[Whereupon, at 3:26 p.m., Wednesday, April 14, the subcommittee was recessed, to reconvene subject to the call of the Chair.]

FINANCIAL SERVICES AND GENERAL GOVERNMENT APPROPRIATIONS FOR FISCAL YEAR 2011

WEDNESDAY, APRIL 28, 2010

U.S. SENATE,
SUBCOMMITTEE OF THE COMMITTEE ON APPROPRIATIONS,
Washington, DC.

The subcommittee met at 2:36 p.m., in room SD-138, Dirksen Senate Office Building, Hon. Richard J. Durbin (chairman) presiding.

Present: Senator Durbin, Lautenberg, Collins, Bond, and Cochran.

COMMODITY FUTURES TRADING COMMISSION

STATEMENT OF HON. GARY GENSLER, CHAIRMAN

OPENING STATEMENT OF SENATOR RICHARD J. DURBIN

Senator DURBIN. Good afternoon. I am pleased to convene this hearing and apologize for being a few minutes late.

This is a hearing to consider the fiscal year 2011 funding request of two of our most important Federal regulatory agencies, the Commodity Futures Trading Commission (CFTC) and the Securities and Exchange Commission (SEC).

I am happy to welcome my colleague, a little tired I am sure from yesterday, Senator Susan Collins of Maine, who is my ranking Republican on this subcommittee, my friend. We have worked together on many aspects of many different laws over the years, and this is a very important one.

We will have other colleagues who will join us during the course of the hearing.

I want to welcome Gary Gensler, Chairman of the Commodity Futures Trading Commission, and after his testimony, Mary Schapiro, Chairman of the Securities and Exchange Commission.

Both Chairmen have invested countless hours in helping to craft a more reliable regulatory foundation to guide us in the future. These two agencies occupy pivotal positions at the forefront of stimulating and sustaining economic growth.

When this subcommittee was created and started, I insisted that it bring these two agencies together into one Appropriations subcommittee because they parallel one another in their regulatory responsibilities and I felt that the ancient separations no longer applied, that they really should be considered as a tandem operation to bring confidence to important marketplaces in America. And I

think the President has chosen well in the two people who guide these agencies today.

The SEC, of course, is responsible for maintaining orderly and efficient stock and securities markets and conducting day-to-day oversight of major market participants.

The Commodity Futures Trading Commission, well known to me, is an agency that also carries out market surveillance, compliance, and enforcement programs in the futures arena, very important to our Nation and certainly to the city of Chicago and the State of Illinois.

This subcommittee has an oversight responsibility over both of these agencies. We are now debating whether or not any committee like the Appropriations Committee should have oversight over these two agencies. I believe sincerely that we should. We have dramatically increased the resources and personnel at both of these agencies, and I hope we will continue that trend because their responsibilities are growing and we have to provide them the people and the technology to meet that challenge. But as we provide these resources, we also need to provide oversight. No agency that comes before this Government should be above oversight and review. That is why this subcommittee will continue to work diligently to exercise its oversight responsibility. There are some who question that, but I feel very strongly that not only will these agencies receive resources but they will be held accountable for the way they use these resources and spend them.

I will not go into detail here about the money that has been allocated so far to both of these agencies. We will get into that in the course of questioning.

I would like to, at this point, give my colleague, Senator Collins, an opportunity to make an opening statement before Mr. Gensler testifies.

STATEMENT OF SENATOR SUSAN COLLINS

Senator COLLINS. Thank you, Mr. Chairman.

Mr. Chairman, let me begin by associating myself with your comments, in fact, with all of your comments. I know that both of us share such a commitment to providing these two important consumer agencies with the resources that they need, but like you, I also believe in effective congressional oversight. And if we essentially put the budgets of these two agencies off budget, if we allow them to avoid the annual appropriations process, I believe congressional oversight and accountability will suffer.

Therefore, I am going to try to ensure that the financial reform bill that passes—and eventually a financial reform bill will pass—does not take these agencies—and particularly it has been proposed for the SEC—outside of the annual appropriations process. I think it is so important.

And I would note to the two Chairmen that we have before us today that this subcommittee has been extremely responsive to concerns for more resources. We want to reverse the years when you had insufficient staff to do effective enforcement. Indeed, as we begin to review your budget requests for this year, we should take note of the significant funding increases that our subcommittee provided for your agencies last year. In the case of the SEC, we

went above the President's budget request. We gave an increase of nearly \$159 million over the previous fiscal year; in the case of the CFTC, an increase of \$23 million over the previous year.

I have been pushing very hard to make sure that you not only have the levels of staffing that you need, but you have the skilled staff that you need. In fact, I have a feeling that the two chairs are competing for skilled staff in many ways, for the attorneys, the experts, the accountants that you need.

The roles that you are playing are so important.

I will say that I am very disturbed by the recent press reports that senior SEC staff were looking at pornography at work instead of focusing on securities fraud. That behavior is despicable at any time, but it appears to have occurred during the height of the financial crisis and that makes it even more inexplicable.

I look forward to discussing a lot of the important issues in financial reform with our witnesses today.

Again, thank you, Mr. Chairman, for your leadership in this area.

Senator DURBIN. Thank you, Senator Collins.

Senator Bond, unless you have an opening statement, I am going to recognize Chairman Gensler, but you are going to be recognized if you do.

STATEMENT OF SENATOR CHRISTOPHER S. BOND

Senator BOND. Let me state very briefly because I do have a question or two for the Chairman. We welcome him here.

Everybody is talking about the financial regulatory system and the changes. In the heartland I am from, we hear and understand that Wall Street provides critical financial support. We also understand that the changes to the system are necessary on Wall Street, but if they alter significantly the way people do business back home, we want to make sure reform is done right.

The derivatives, yes. Some of the derivatives really need to be regulated. But a lot of the small businesses back home are in commodities hedging where the contracts pose no systemic risk, and lumping these into risky derivatives trading, as far as I am concerned, makes no sense. These are not speculative contracts. They are contracts between parties who operate normally. And to be blunt, if that goes through, I am afraid that this will entail higher costs for energy production, for transportation, particularly for farmers.

So I would like to ask you about that and appreciate the chance to raise that, Mr. Chairman.

Senator DURBIN. Thank you very much, Senator Bond.

Let us let Mr. Gensler give his opening statement, and then we will pose some questions. Please proceed.

SUMMARY STATEMENT OF HON. GARY GENSLER

Mr. GENSLER. Thank you, Chairman Durbin, Ranking Member Collins, and Senator Bond. I thank you for inviting me here to testify on behalf of the Commodity Futures Trading Commission. I am also honored to be here with Chairman Schapiro. Mary and I work very closely on many things. I remember last year we were at the

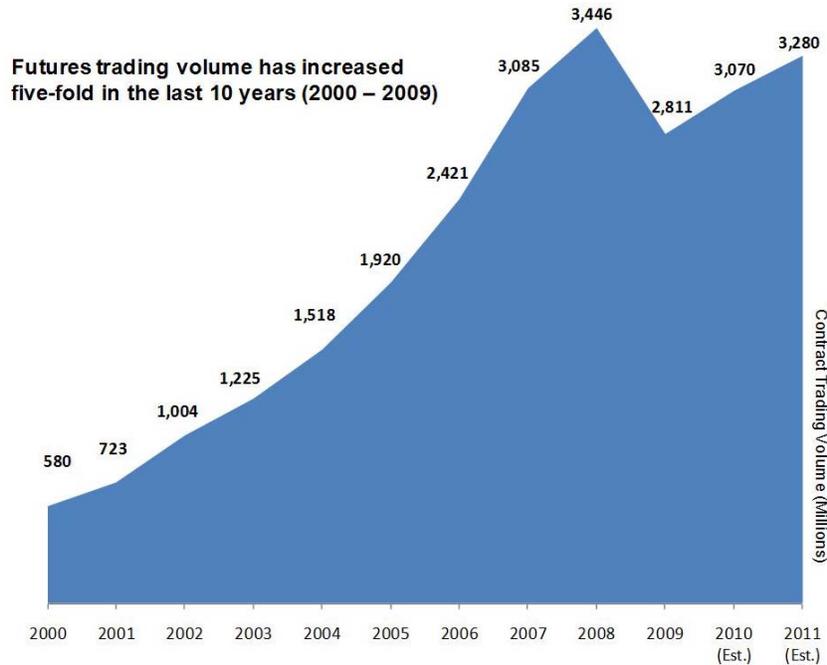
table together, and I appreciated that as well because she took more questions than me.

But I guess this year I'm at the table alone.

With the help of this subcommittee, the CFTC has risen to staffing levels of 600 people. This is roughly where we were in the 1990s, but it is with your help that we came back from about 440 people just 2½ or 3 years ago. We do believe, to fulfill our mission and protect the American public and promote transparency in markets, we need 745 people. We also need to get a bit more in our technology budget.

The CFTC, as you know, ensures that futures exchanges and the clearinghouses that we oversee work to lower risk to the public and increase transparency. We also oversee all of the intermediaries or the dealers in these markets as well.

Though our staffing level is only slightly higher than it was 10 years ago, futures trading volume—and I think I have a chart over here, if I might. The blue is the trading volume in this period of time in the 10 years since 1999. And as you can see, our staff actually shrunk and we are coming back.



Now, one might look at this and say that is productivity, but just imagine a city with police officers that has grown five-fold. You would not really want to have the police force shrink because you cannot investigate cases. You cannot protect the public. It is the same thing really in an agency like ours. We are like that police force that shrank while the city grew five-fold.

But with the help of this subcommittee, we have turned the corner. We have come back to, as I said, where we were in the 1990s.

And this increased funding, if I can just tell you what we have been able to do with it, but why we think we need some more.

First, we have been able to significantly increase our Enforcement Division. That Enforcement Division by the end of this year will be about 170 people. We think we need to get to 200 people however.

Second, we have embarked—we have just started—on a program to do automated surveillance. We have hundreds of thousands of trades that come in to us a day. We see all those trades. That is very good and the exchanges see them. But we want to automate the surveillance of those and bring 21st century computing power to the American public.

Third, we have also implemented the authorities that you and others in Congress granted us under the farm bill in 2008. That was to bring enhanced regulation to the markets and put out rules. We have proposed rules on position limits. We have proposed rules on foreign exchange. We are planning to put out rules on collocation in the near future.

But even with these recent increases, we need more. The market participants have technology now that we have to stay up with, and that is the thought.

So starting in 2010, we started a multiyear project to automate our surveillance. It is going to take us several years, and we have included that in the numbers.

Second, we do need staffing levels and resources to conduct annual reviews. When I got to the CFTC, I said are we like the bank examiners. Are we inside the banks every year? And I found out actually because we had shrunk, that we were not inside the exchanges and inside the clearinghouses every year just to do what is called a rule enforcement review. We think that we really need to be there every year and work with the exchanges, work with the clearinghouses to do that.

Third, our enforcement staff. We really do feel we need to get up to 200. Our financial crisis exposed more fraudulent schemes that require extensive staff resources. Manipulation cases particularly can take up to 2 to 3 years, and what Doug is putting up for me is just our overall funding request. And then I think my time will be up.

But our overall funding, which you helped us get to, is \$169 million, on the left. And what we are asking for in 2011 is \$216 million, or 745 full-time equivalents (FTEs). Much of that is to keep current services. We have taken out some more space because of the growth. Of course, there will be a cost-of-living increase and technology. But in addition to that, if Congress were to move forward, as I hope in the next few days that the Senate will—I was encouraged, Senator Collins, by what you said on that. But if the Senate takes up the full debate on derivatives reform, the SEC and CFTC will have a lot of additional responsibilities and authorities. The over-the-counter derivatives marketplace is 8 to 10 times the size of the on-exchange derivatives market measured in notional amount. I do not want to frighten you. It is a smaller number of transactions.

PREPARED STATEMENT

The President was good enough to include a \$45 million request that will get us part-way there. We think in 2011, we will need somewhere on the order of 240 more people and \$18 million more in technology to get started on the derivatives oversight. And I know that Chair Schapiro will have some of those numbers as well, but the thought is for 2011, it may be a conditional appropriation or if the derivatives reform were to go through, maybe you would include it in the whole appropriations package.

With that, I would be glad to take any questions.

[The statement follows:]

PREPARED STATEMENT OF GARY GENSLER

Good afternoon Chairman Durbin, Ranking Member Collins and members of the Subcommittee. I am pleased to testify on behalf of the Commodity Futures Trading Commission (CFTC), and I thank you for the opportunity to discuss issues related to the Commission's 2011 budget.

In the fall of 2008, the financial system and the financial regulatory system failed. While more than 1 year has passed and the system appears to have stabilized, we cannot relent in our mission to vigorously implement our mandate to protect the public from fraud, manipulation and other abuses in the commodity markets. I would like to express my gratitude to Congress for the recent increases in appropriations that now permit the Commission to address longstanding regulatory and oversight weaknesses. The CFTC, however, requires additional resources to hire staff with new competencies and skill sets and to ensure our technological infrastructure and systems keep pace with the industry we regulate. These improvements are essential to promoting transparency and integrity in the marketplace. Only through strong, intelligent regulation can we fully protect the American people and keep our economy strong.

CFTC REGULATORY REGIME

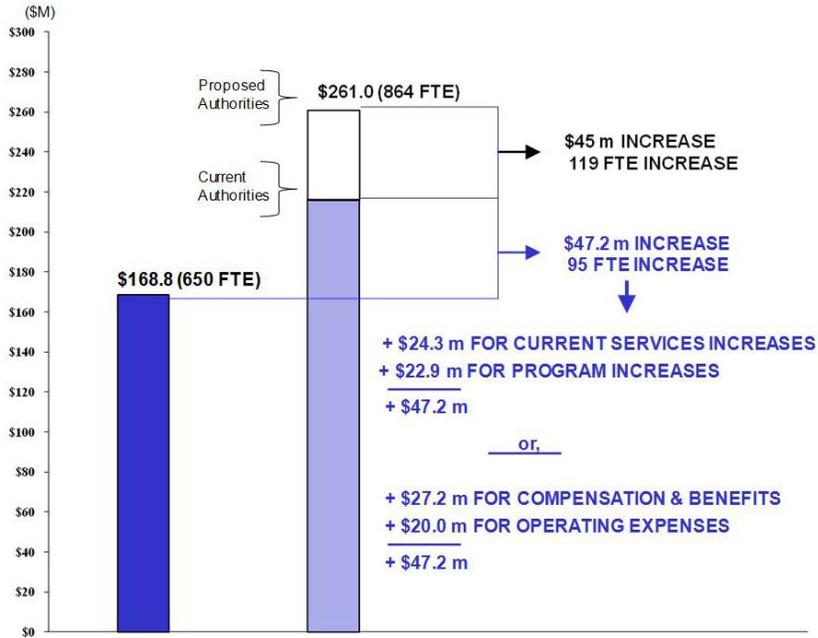
Before I discuss the President's budget request for the CFTC, I will take a moment to discuss the agency's oversight of the futures markets. Futures have traded since approximately the Civil War, when grain merchants came together and created the new marketplace. It took nearly 60 years and the Great Depression until President Franklin Roosevelt and the Congress regulated the futures markets.

The CFTC ensures that futures and commodity options exchanges have procedures to protect market participants and ensure fair and orderly trading, free from fraud, manipulation and other abuses. Exchanges are where buyers and sellers meet and enter into a transaction. The CFTC also oversees clearinghouses, which enter the picture only after two counterparties enter into the transaction. Clearinghouses act as middlemen between the two parties and take on the risk that one counterparty to the trade may fail to meet its obligations under the contract for the duration of the contract. Centralized clearing has helped lower risk to the markets for decades in both calm markets and in the stormiest of markets, such as during the 2008 financial crisis.

The CFTC has wide-ranging transparency efforts designed to provide as much information about commodity futures markets and trading to the American public as possible under current law. The agency also has broad surveillance powers to police the markets for fraud, manipulation and other abuses.

THE BUDGET

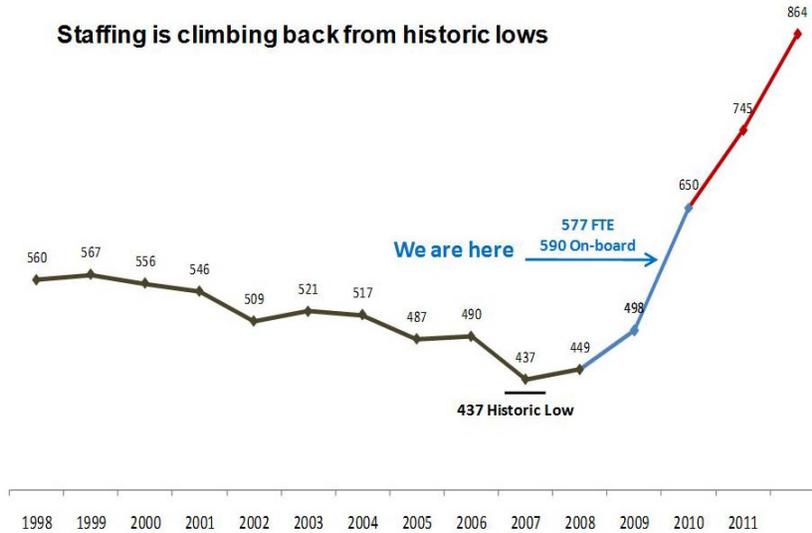
The President's budget proposes that \$216 million be appropriated for the Commission for fiscal year 2011 to remain available until expended through fiscal year 2012.



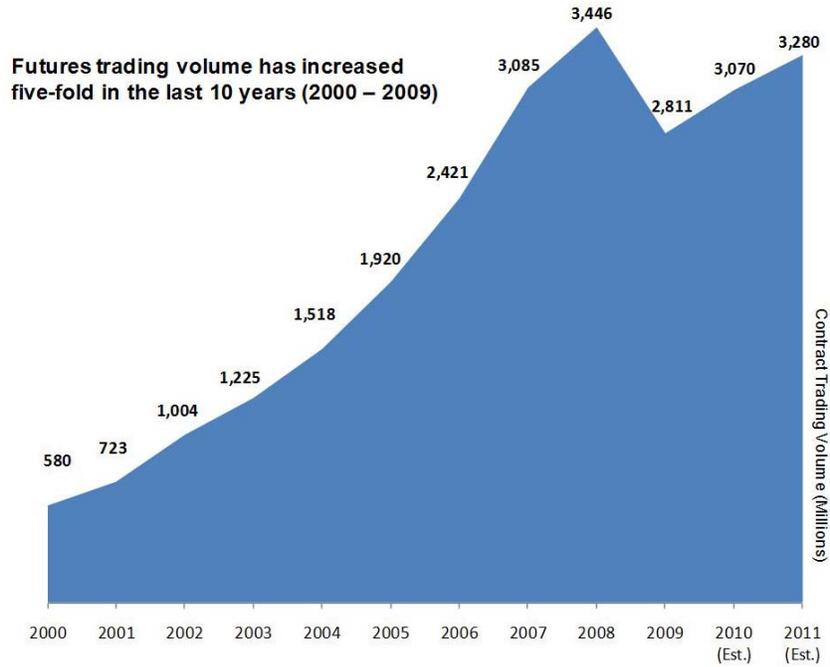
This amount would be for the agency to perform its duties under current statutory direction. In addition, the budget proposes that \$45 million be appropriated to be available through fiscal year 2012 contingent upon the enactment of authorizing legislation of new or enhanced financial regulation activities of the Commission.

Ten years ago, the CFTC was near its peak staffing level at 567 employees, but shrunk by 20 percent over the subsequent eight years before hitting a historic low of 437. Thanks to increased funding from Congress, the CFTC now has almost 600 staff on board, which is a net increase of 100 staff over were we stood a year ago.

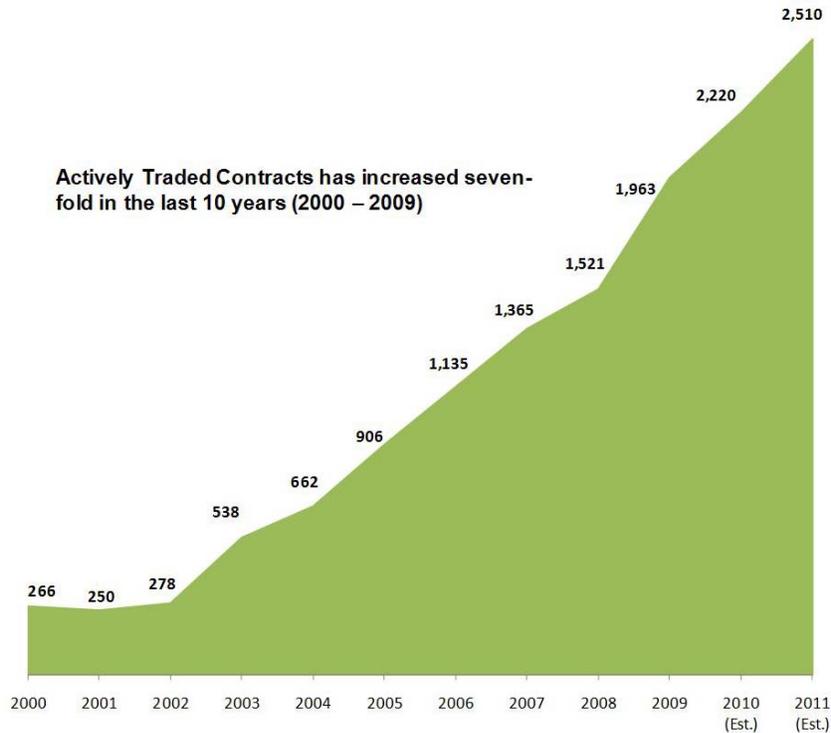
Staffing is climbing back from historic lows



All Commission programs: technology, market and intermediary oversight, enforcement, economic, legal and risk analysis have benefited from increased staff resources. Still, merely raising our staffing levels to the same as a decade ago will not be enough to adequately fulfill the agency's statutory mandate. In the last 10 years, futures trading volume increased almost five-fold.

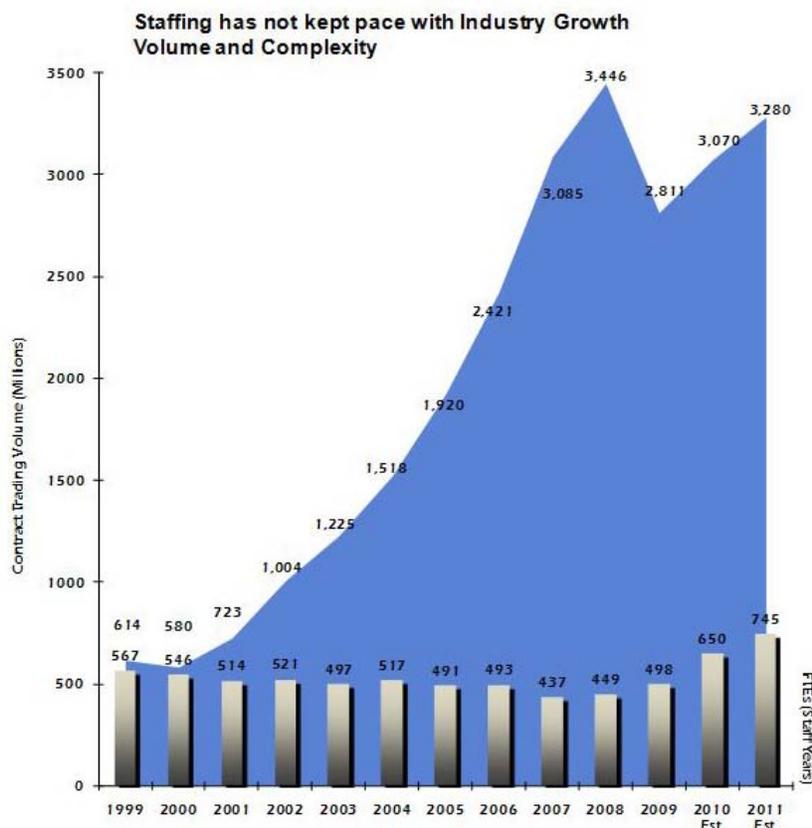


The number of actively traded futures and options contracts increased seven-fold, and many of these have become considerably more complex in nature.



We also moved from an environment with open-outcry pit trading to highly sophisticated electronic markets. What was once a group of regional domestic markets is now a global marketplace. What was once just a \$500 billion business has grown to a \$33 trillion industry. In short, the Commission requires funds to hire and retain highly trained professionals and equip them with information technologies that are as sophisticated as the expanding markets they we oversee.

Despite rapid advances in technology and the increased size and number of regulated futures markets, funding for the CFTC has lagged behind the growth of the markets.



While market participants have the technology to automate their trading, we do not yet have the resources to employ modern technology to automate our surveillance. Further, the CFTC still does not have the staffing levels or the resources to conduct regular examinations of market intermediaries, exchanges and clearinghouses. Until additional staff resources are acquired we can conduct those examinations only periodically and have no choice but to leave routine examinations of intermediaries to self-regulatory organizations. The CFTC needs additional staff, with new expertise to conduct yearly examinations of the registrants we regulate.

For these reasons, it is appropriate for our staffing levels and our technology to be bolstered to meet the new financial realities of the day. As such, the CFTC's Budget and Performance Estimate for fiscal year 2011, for existing statutory authorities, would increase the agency's funding by \$47.2 million to \$216 million and would augment agency staff by 95 FTE to a total of 745 FTE.

The requested funding increase to cover current statutory authorities includes resources to accomplish the following goals:

Updating the Commission's Surveillance and Technology Programs.—The Commission requires additional resources to replace legacy surveillance technology with 21st Century computers and software. Significant changes in the markets demand new systems capable of efficiently receiving and managing massive amounts of raw data and converting it to useful information for analysis by skilled market experts, economists and technologists. For example, existing Commission surveillance systems annually process more than one billion transactions to capture mission-critical data. Recent Commission initiatives to promote transparency of market data reveal the need for a substantial investment in systems development.

The timely reporting of quality and meaningful market information is not possible with current legacy systems. Integration of two legacy systems, one with position data and one with trade data, is vital to building necessary functionality to capture

more detailed data by trader, account ownership, inter-day transactions and intra-day transactions across all markets.

Upgraded systems and analytical tools, such as market compliance detection and alert software, together with new staff competencies and skill sets, will increase the staff's efficiency and ability to monitor the markets and provide better information about futures and options trading to the American public. Market transparency is crucial to public trust and confidence in the price discovery and risk management functions of the futures and option markets. In addition, increased transparency, sophisticated use of automation and a heightened level of oversight will foster market compliance and integrity and enable the CFTC to keep pace with a rapidly evolving industry.

Strengthening the Commission's Enforcement Program.—The CFTC should be adequately resourced to vigorously investigate and litigate complex market manipulation and trade-practice violations. Properly functioning markets must be free from fraud, manipulation and other abuses to ensure their integrity in setting prices and offsetting risk. A robust Enforcement program will foster regulatory compliance in the marketplace, protecting the American public and the marketplace. Adequate legal staff is necessary to act swiftly to investigate and prosecute fraudulent acts, such as the rash of Ponzi schemes uncovered during the recent market downturn.

Rigorously Exercising Existing Authorities to Ensure Market Integrity.—Additional economic and legal staff will enable the CFTC to conduct mandatory annual reviews of all contracts listed on exempt commercial markets (ECMs) to determine if they are significant price discovery contracts (SPDCs). Such contracts must be reviewed to determine whether the ECM should be subject to statutory Core Principles and Commission's regulations. These and other new and increasingly diverse products add to the scope and complexity of products staff must review and monitor to ensure the integrity of the marketplace.

Initiating Major Reviews of Existing Programs.—The Commission seeks additional resources to initiate major programmatic reviews of existing programs; expand development of the Commission's continuity of operations program (COOP); increase public and consumer education and outreach; implement the strategic plan; improve performance metrics; and enhance the Commission's equal employment opportunity program. The Commission is committed to creating a diverse pool of qualified candidates.

Continuing Current Service Level.—The CFTC requires additional resources to provide a continuation of the fiscal year 2010 current service level into fiscal year 2011. This includes annual merit based compensation adjustments for staff, lease of office space, utilities and communications, printing, supplies, capital equipment and fixed equipment.

Specifically, the funding will be allocated to increase staffing levels in the following divisions:

Division of Enforcement.—The Commission's Enforcement program is on track to reach a staff level of more than 170 by the end of this fiscal year. This is a significant program turnaround from an all-time low of 109 in fiscal year 2008. Nevertheless, a staff of 170 may be below what is needed to address the current challenges brought by the recent financial crisis. Our goal for fiscal year 2011 is to have an Enforcement staff of 200, including strategic plans to double the Enforcement staff in the Kansas City office. In addition, the Commission intends to augment the enforcement staff with improved litigation and forensics support technologies, such as the e-Law system. Use of the e-Law system improved productivity and has permitted the Commission to pursue resource-intensive investigations and litigation involving manipulation. It also has improved our ability to implement our new Farm Bill authorities in the over-the-counter forex futures market.

Division of Market Oversight.—The rapid changes occurring in the futures markets over the last decade have brought new challenges to the Commission's Division of Market Oversight (DMO). DMO now needs additional experienced professional staff to actively monitor exchanges to ensure compliance with CFTC regulations; keep a close eye for signs of manipulation or congestion in the marketplace and decide how to best address market threats; and ensure that traders do not exceed Federal position limits. Thus, the Commission seeks to increase DMO's staff from 139 in fiscal year 2010 to 168 in fiscal year 2011.

Specifically, DMO requires additional highly skilled economists, investigators, attorneys and statisticians so that: (1) position data may be analyzed quickly and thoroughly; (2) exchange applications and rule changes may be reviewed efficiently and comprehensively to ensure compliance with Core Principles and CFTC rules and policies; (3) exchange self-regulatory programs may be examined on an on-going annual basis with regard to trade practice oversight, market surveillance and compliance with disciplinary, audit trail and record-keeping regulations; (4) comments

related to a proposed energy position limits rulemaking, proposed significant price discovery contract determinations and other proposed rulemakings and industry filings can be comprehensively reviewed and summarized; and (5) proposed rulemakings and determinations can be effectively implemented should the Commission approve them.

Division of Clearing and Intermediary Oversight.—Additional resources would allow the Commission to perform regular and direct examinations of registrants and more frequently assess compliance with Commission regulations.

In the case of intermediaries, the Commission requires additional resources to directly assess compliance instead of relying on designated self-regulatory organizations (DSROs). The frequency of the reviews will increase to once a year from approximately once every 3 years. New staff will permit the review annually of all derivatives clearing organizations (DCOs) and the audit and financial surveillance programs of each DSRO ensuring ongoing rather than intermittent oversight. The Commission seeks to increase the Division of Clearing and Intermediary Oversight staff from 113 in fiscal year 2010 to 120 in fiscal year 2011.

Offices of the Chairman and the Commissioners.—The Offices of the Chairman and the Commissioners require professional, legal and economic expertise as they undertake a number of high priority programmatic initiatives, including: (1) subject to enactment of new authorities, regulation of derivatives markets and regulatory changes to protect the American public from systemic financial risks; (2) regulatory coordination with other agencies such as the Securities and Exchange Commission (SEC) and Federal Energy Regulatory Commission (FERC); (3) promoting market transparency; (4) promoting transparency on the Commission's website; (5) regulation of energy markets—especially with regard to position limits and the Commission's review of significant price discovery contracts; (6) increasing frequency of reviews and audits of Commission registrants; and (7) technology modernization, resource justification and program performance. The Commission proposes to bolster these offices from 35 staff in fiscal year 2010 to 47 staff in fiscal year 2011.

Office of the Chief Economist.—The CFTC's Office of the Chief Economist (OCE) conducts research on major economic issues related to the futures and options markets; participates in the development of Commission rulemakings; provides expert economic support and advice to other CFTC offices; conducts special studies and evaluations; and participates in the in-house training of staff on matters related to futures, options, swaps and risk management. OCE requires additional economists to review and analyze new market structures and off-exchange derivative instruments. OCE also needs additional resources to review and analyze risk management models supportive of the Commission's enforcement and surveillance programs. The Commission proposes to increase OCE staff from 13 in fiscal year 2010 to 17 in fiscal year 2011.

Enterprise Risk Management Office.—The budget proposes a new Enterprise Risk Management subprogram, consisting of three staff, to focus on proactively developing and employing methods and processes to manage risks that may be obstacles to the discharge of the Commission's responsibilities. The staff will identify plausible risks posed by current and future events or circumstances that may affect the Commission's ability to respond effectively. Risks will be assessed in terms of the likelihood and magnitude of impact. The program will determine an appropriate response strategy and monitor outcomes.

Office of the Executive Director.—The budget requests additional staff within the Office of the Executive Director to establish a Commission strategic and operational planning and evaluation function, the first such permanent resource. The additional two staff members will assist the Commission's programs in establishing metrics to track, monitor and evaluate program results, outcomes and goal achievement to ensure the effective and efficient allocation of resources. Adequate staff in the office is needed to ensure a sufficient level of human capital expertise focusing on employee development, recruitment and outreach, leadership, management training and employee relations. The Commission is mindful of the need to effectively manage staff resources to develop and sustain a professional workforce capable of keeping pace with our growing regulatory responsibilities.

Office of International Affairs.—The budget requests an additional staff member in the Office of International Affairs, which coordinates the Commission's non-enforcement related international activities, represents the Commission in international organizations such as the International Organization of Securities Commissions (IOSCO), coordinates Commission policy as it relates to U.S. Treasury global initiatives and provides technical assistance to foreign market authorities. The financial crisis has heightened the need for international cooperation among regulators, and an additional staff member is required to meet the mission critical responsibilities of the office.

Office of Proceedings.—The Office of Proceedings is responsible for providing an inexpensive, impartial and expeditious forum for handling customer complaints against persons or firms registered under the Commodity Exchange Act. The Commission requires one additional staff to ensure expeditious processing of complaints.

REGULATORY REFORM

In addition to implementing the authorities established in the Commodity Exchange Act, the CFTC also is working with Congress to bring comprehensive regulation to the over-the-counter derivatives marketplace. The Commission’s budget request includes an additional \$45,000,000 and 119 full-time equivalent employees for fiscal year 2011 to begin implementation of the Administration’s comprehensive proposal for financial regulatory reform. As proposed, the request is contingent on Congressional enactment of legislation giving the Commission new authorities. The Commission’s fiscal year 2012 total (current and proposed new authorities related to financial regulatory reform) staff requirement is estimated to be approximately 1,000 FTE. The requested funds will permit Commission implementation of new responsibilities under consideration by Congress, such as:

- Requiring swap dealers and major swap participants to register and come under comprehensive regulation, including capital standards, margin requirements, business conduct standards and recordkeeping and reporting requirements;
- Requiring dealers and major swap participants to use transparent trading venues for their standardized swaps;
- Ensuring that dealers and major swap participants bring their clearable swaps into central clearinghouses; and
- Providing the CFTC with authority to impose aggregate position limits including in the OTC derivatives markets.

Specifically, the Commission’s fiscal year 2011 budget request for regulatory reform would be allocated as follows: 41 additional staff for Market Oversight; 30 additional staff for Clearing and Intermediary Oversight and Risk Surveillance; 18 additional staff for Enforcement; 15 additional staff for Information Technology; eight additional staff for General Counsel; five additional staff for Human Resources and Management Operations; one additional staff for the Chief Economist; and one additional staff for International Affairs.

CLOSING

The staff of the CFTC is a talented and dedicated group of public servants. The financial crisis and the significant increase in trade volume, market complexity and globalization require that additional resources be committed to the protection of American taxpayers. For all of these reasons, it is necessary and appropriate that Commission staffing levels and technology be bolstered to address the new financial realities of the day.

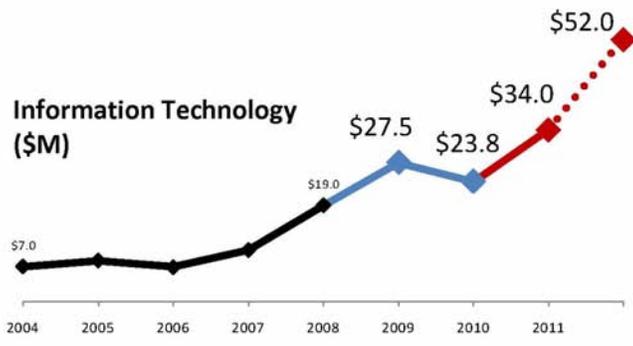
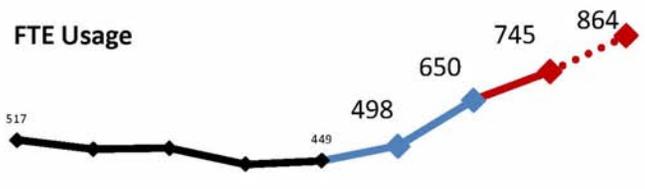
In short, despite the recent increase in funding, the Commission remains an underfunded agency. With additional resources, we will be more able to police the market, promote market integrity and protect the public from fraud, manipulation and other abuses.

I thank you for inviting me to testify today. I will be happy to answer any questions you may have.

Past 2004–2008	Present 2009–2010	Future
<p>AUTOMATING MARKET SURVEILLANCE</p> <p>Critical IT systems for the surveillance of positions and trading practices were not robust. They have not been upgraded to reflect the vast increase in volume and complexity of the markets.</p>	<p>Development of new staff skill sets with access data query, analysis, algorithmic models and reporting tools that alert staff to the conditions for potential abusive trading or misconduct.</p>	<p>Robust, linked and fully integrated IT surveillance systems that produce the surveillance reports needed to meet the analytical needs of our professional staff and the transparency needs of the public.</p>

Past 2004–2008	Present 2009–2010	Future
<p>IMPROVING MARKET TRANSPARENCY</p> <p>Lack of market transparency stemming from lack of reliable data about the size or effect of influential investor groups and potential harm posed by a commodity asset bubble.</p>	<p>New staff with new skill sets have improved data collection and reporting on the size of positions held by large traders.</p> <p>New public reports include: Disaggregated Commitment of Trader Reports. Supplemental Report on Commodity Index Traders. Swap Dealer Reports.</p>	<p>Collect and report data from swaps dealers and index investors. Release data on commodity index investment on a monthly basis rather than quarterly.</p>
<p>ENFORCEMENT</p> <p>The Commission's enforcement program reached an all-time low of 109 as recently as in fiscal year 2008. The financial crisis revealed fraudulent schemes that could only stay afloat during periods of rising asset values. The downturn exposed more leads than the Commission can thoroughly and effectively investigate. This is true both as it relates to fraud and Ponzi schemes as well as staff-intensive manipulation investigations.</p>	<p>Appropriations increases have permitted the Commission to enhance Enforcement staffing and resources committed.</p> <p>Staffing increased by more than 50 percent in 2 years.</p> <p>Leads and investigations increased by more than 100 percent over 2 years.</p> <p>New investigations will exceed 250, which is the highest level in 10 years.</p> <p>The Enforcement division filed 31 civil actions involving Ponzi type schemes in fiscal year 2009, which was more than twice the amount in fiscal year 2008.</p> <p>New tools and competencies are being developed to address and identify trends, analyze data and explore resources previously unavailable to the Commission.</p>	<p>Future initiatives include:</p> <ul style="list-style-type: none"> Pursuing all potential fraud cases reported to the Commission; Keeping pace with the proliferation in trading and the emergence of new electronic trading facilities. Effective enforcement requires looking beyond the exchanges to multi-level platforms and bilateral trading, which is very resource intensive; Enhancing the Commission's ability to respond efficiently to major market movement or major collapse of an entity without adversely affecting other on-going investigations and litigation; and Rebuilding bench strength and succession planning.
<p>INCREASED AUDIT OVERSIGHT</p> <p>The Commission does not conduct: annual compliance audits of every designated contract market (DCM). Audits occur every 3 years, on average; annual compliance audits of every derivatives clearing organization (DCO). Periodic reviews on selected core principles occur every 3 years; or routine examinations of CPOs, CTAs, & FCMs, which are currently performed by self regulatory organizations.</p>	<p>The Commission currently assesses or conducts: financial surveillance programs of SROs; certain regulatory functions performed by the NFA; other self-regulatory organizations such as DCM SRO functions; and examinations of FCMs for compliance with the CEA and Commission regulations.</p>	<p>Future initiatives include:</p> <ul style="list-style-type: none"> annual reviews of DCOs, which is critical as the volume of positions cleared by DCOs and the complexity of positions grow; annual compliance reviews of DCMs; examination of the books and records of additional FCMs on a "for-cause" basis and expand the reviews of certain compliance areas, such as sales practices and foreign currency trading; and additional examinations of CPOs and other registrants to ensure a better understanding of firms' operations, trading strategies, back office procedures and other factors integral to firms' compliance.

Commodity Futures Trading Commission Appropriation History and Budget Outlook



TECHNOLOGY

Senator DURBIN. Thanks a lot, Mr. Chairman. And there are so many questions to ask, and I know we will not likely have time to ask all of them today.

But I do want to reiterate what was said by Senator Collins. There are substantially greater investments in the resources that your agency and the SEC have to work with. I think it calls for substantially more oversight from our side of the table because there is a certain level of absorption which you can add to your staff in a professional manner and increase the workload. And then I have found, in the time that I have been around Congress, there reaches a tipping point where perhaps they cannot be absorbed effectively. There should be a committee of Congress watching this, following this, making certain that we are moving toward the same goal and that you are achieving that goal.

Let me ask you in a specific way about technology. My impression, having worked with Senator Collins on this issue since 9/11 when we were both on the Homeland Security Committee, is that the Federal Government is like the last to pick up on new technology. We create rules and obstacles for purchasing and acquisition and all sorts of security questions, and we fall far behind the private sector. Do you feel that your technology improvements parallel or are consistent with the technology available in the private sector for similar functions?

Mr. GENSLER. Well, first, let me say I welcome the oversight of this subcommittee and our authorizing committee as well and working with Marianne and Dale and all the staffs that are with you.

In terms of technology, we have had, with your help, an ability to get the data resources. We can actually take in all the transactions on the next day. We can take in all the positions at the end of the day. That is very helpful. We also rely on the exchanges because they have a lot of the technology as well.

But what we are trying to build is 21st century software to actually do automated surveillance—consider it sort of flags and alerts so that our staff can then see whether it is a wash sale, whether it is a position limit concern, and then go back to the exchanges, work to see if there is a violation, work with the Division of Enforcement if something has to be followed up on. With hundreds of thousands of trades a day, we need to do that.

I think, Senator, we are probably not there yet. I mean, think of algorithmic trading experts—we need to get some of that expertise into Government.

Senator DURBIN. What I am asking you, is there any built-in obstacles to your acquiring the technology that you believe is available and that you need?

Mr. GENSLER. The good news is we have the legal abilities. We do it through procurement laws and so forth, but we do have the legal ability to acquire it. It is usually just resources. In the past, we actually did not even have the hardware to store all the data. We have taken care of the storage side, but now we have to build some of that software.

Senator DURBIN. Is the answer no? I am asking if there are obstacles to your—

Mr. GENSLER. I am not aware of obstacles other than dollars and then the human time to actually do this.

TRANSPARENCY

Senator DURBIN. One other aspect of this is how much of this is being made available to the public to review your work and the activities that are not proprietary, obviously, of the exchanges which you monitor.

Mr. GENSLER. Well, there is a great deal of information that we make available in the aggregate data, and then Senator Bond asked about derivatives reform. If derivatives reform were to move forward, there would be a lot of information about that market as well on real-time reporting. I think that answers your question.

Senator DURBIN. I am just wondering if there is more and more of this information that is being made available to the public.

Mr. GENSLER. Well, we have had success in the last year. We have actually made more information available about index investments in the market. For years, we have put out reports on every Friday about the markets, and we have broken that down between commercial and noncommercial traders. Now people can see what swap dealers and money managers or hedge funds are doing in the market in aggregate. Again, we do not break out the individuals.

Senator DURBIN. I see.

I am going to yield now to Senator Collins.

Senator COLLINS. Thank you, Mr. Chairman.

ENERGY POSITION LIMITS

Chairman Gensler, as you know, I have had a great interest in seeing the Commission establish position limits to apply to the energy markets. Senator Lieberman and I held hearings looking at the price spikes in the energy markets a couple of years ago, and position limits can potentially help prevent those kinds of abrupt price movements or market disruptions. Could you update us on what is being done by the Commission to establish position limits for energy markets?

Mr. GENSLER. I thank you, Senator, for your leadership on this issue.

We published proposed rules in January and asked for public comment—that comment period actually closed yesterday—to reestablish position limits. There were position limits in the energy markets with the exchanges through 2001. So we were looking to possibly reestablish them. We have over 8,000 comments. So what we will do as an agency is review those—the staff is just embarking on that—and then bring those recommendations and review up to the five Commissioners and we will see how best to proceed based on those recommendations.

OVER THE COUNTER DERIVATIVES LEGISLATION

Senator COLLINS. The second issue that I want to talk to you about in this first round has to do with the regulation of derivatives. This is such a complex and important issue. We clearly need

more transparency. One of the debates, however, is the extent to which end-user manufacturers or grocery stores, like Hannaford's in my State, should face increased costs for investing in commodities essential to their products. And they will face increased costs if, in fact, they have to go through the clearinghouses.

Help us understand the debate on derivatives and whether there should be exemptions for end-users, whether you see the Agricultural Committee's bill providing exemptions. There is a dispute over whether or not they do. Educate us a bit on this issue.

Mr. GENSLER. Well, I thank you.

One of the key ways to lower risk in the derivatives marketplace is something called a clearinghouse. They have existed since the 1890s. They have been well regulated since the 1930s by us for exchange traded derivatives, and then there are other clearinghouses by the SEC. And they stand as middlemen or middlewomen, if I could say, between two parties. So if one of the parties fails, then they stand behind the contract. So that fundamentally lowers risk, and those clearinghouses have been very strong.

They, by the way, have not had access to the discount window. I think we probably should keep it that way. We should not expand the safety net to them. But they stand between the two parties.

So what we are recommending and what the bills do say is there would be clearing on those products that are standard enough to be brought into a clearinghouse. Some people think that may be three-quarters of the market.

But the Senate Agriculture bill, as merged into the Senate Banking bill, will have an exemption. The exemption would be for non-financial entities, if I might call them commercial entities, hedgers. It could be Hannaford Brothers in your State or it could be some of the commercial entities that Senator Bond referred to. They, if they are hedging whether it is for corn or wheat or it is an interest rate or a currency they are hedging, if they are not a financial entity—now, on the other hand, if it is an insurance company or a bank or a hedge fund, they would have to use the clearinghouse for their standard product. Their customized things they could still do.

Senator COLLINS. Thank you, Mr. Chairman.

Senator DURBIN. Senator Bond.

END USERS

Senator BOND. Thank you very much, Mr. Chairman.

Mr. Gensler, I am delighted you said they would not require an end-user to clear hedging.

If a community bank had a large portfolio of loans and wanted to offset part of that risk by going short or buying some form of put, who would be the appropriate person to regulate that? Would it be the bank regulator? Would it be the CFTC?

Mr. GENSLER. The bank regulator would regulate those banks.

Senator BOND. The CFTC would not be involved in it.

Mr. GENSLER. They would not regulate the bank. We would regulate the exchanges. If it was so standard that it was bought or sold on an exchange, we would regulate the exchange as we do now. That community bank might buy a future right now in the Chicago Mercantile Exchanges to hedge an interest rate. We do not regulate

the bank. We regulate just the exchanges in that example or the clearinghouse, of course.

Senator BOND. So they would not have to pay a separate fee if they were doing that. They would pay the fees that are already built in through the existing exchanges?

Mr. GENSLER. Well, I believe that is correct. That community bank could do a customized, tailored transaction. It might not even come to a clearinghouse. But if it is so standard that the clearinghouse is there, they would bring it there.

Senator BOND. Now, do I understand that you and the Secretary of the Treasury should say that where there are customized transactions, two parties that have worked together have adopted a customized derivative or hedging operation where it cannot be cleared—do you agree that there is no reason for two parties who have developed a complex contract be cleared or have margin?

Mr. GENSLER. Well, one, if it is customized, it would not be brought to a clearinghouse, and that is the recommendation. We are recommending that the swap dealers themselves, the dealers, the large banks be regulated, and that the banking regulators be able to lower risks to the American public by setting capital and margin requirements for those big financial houses that are the swap dealers themselves. But the customized transactions could occur and not be brought to the clearinghouses.

MARGIN

Senator BOND. Would they have to post margins on that?

Mr. GENSLER. What we have recommended is that the banking regulators, what is called prudential regulators, would have the authority to ask for those large swap dealers to either post or receive margin.

Margin also protects the other parties. What we need in our society, I believe, is that the large swap dealers should be able to fail. The terrible place that our Secretaries of the Treasury have been, Republicans and Democrats alike—they sit in the office, an ornate office. They get all the phone calls, and they say, can I let this company fail? And one of the problems is they are saying, well, if I let it fail, it is going to bring down the community banking system or it is going to bring down the farm credit system. So part is to have them post margin as well.

Senator BOND. But requiring margins, if a small bank hedges its risk, would it have to put up a margin or would that be up to the prudential regulator to determine whether it was appropriate to make that transaction?

Mr. GENSLER. If it is a custom-tailored product as you say, it would really be up to the banking regulators to say whether the big swap dealer—it is the regulator regulating the swap dealer would have that authority if the bill were to go through Congress.

SWAPS DEALERS

Senator BOND. If you are a major energy producer that has lots of contracts with a lot of—say, it is a coal or a natural gas company that has lots of contracts with lots of energy companies. Would these be major swap dealers who would be under the new regulations?

Mr. GENSLER. Senator, I think that the important thing is if they present themselves to the public dealing in swaps, they would be regulated.

Senator BOND. Not to the public but present themselves to their customers.

Mr. GENSLER. Well, what we want to guard against is the next AIG. We would not want to have an exemption or a loophole that the regulation is only regulating some swap dealers and not other swap dealers. Most energy companies are not swap dealers. Most energy companies are just hedging their own business.

Senator BOND. That was the question, whether by doing that, that would fall in a major swap dealer category.

Mr. GENSLER. I do not think most of them will. Some are swap dealers. Some do that. They actually have registered trading entities and so forth.

Senator BOND. Thank you, Mr. Chairman. Thank you, Mr. Gensler.

OTC MARKET SIZE

Senator DURBIN. Chairman Gensler, this whole conversation we are having about the future of derivatives, what will be regulated, what will not be regulated, what is standard, what will be custom—do you have any projection if we move into this new world of the volume that we would be talking about? You talked earlier about the number of contracts versus the size of the contracts. Could you give us some estimation of what we are looking at?

Mr. GENSLER. Mr. Chairman, I wish I had. This is such a dark market. It is hard to estimate. But the size of the market worldwide is about \$600 trillion, which is about 12 times the world economy. It is estimated about one-half of that is in the United States, which is about 20 times our economy. We Americans use them more than overseas.

But in terms of the numbers of transactions, we do not have an actual estimate. It is probably not a multiple. The market we oversee now is—I think the numbers were about \$34 trillion in futures. So you can see that is the 9 to 1 or something. But the numbers of transactions probably are less. The futures transactions are in the hundreds of thousands of trades a day. This new market is smaller than that in terms of numbers of trades a day, but we do not have an exact number. I wish I did.

Senator DURBIN. So if we embark on this brave new world, do you see a demand for more staffing and more activity at your agency?

ADDITIONAL RESOURCES NEEDED

Mr. GENSLER. I do. I mean, our best estimate—the Congressional Budget Office (CBO) asked us for 2011, and we forwarded these 238 people. What the President's budget did is said let us fund one-half of those people, or 119, in 2011 because we would be sort of growing during the course of the year. And I know the Securities and Exchange Commission has their numbers as well. We both do envision that this is a really important market to the American public, but it means little if Congress just authorizes it and we do not marry it with the appropriations.

Senator DURBIN. You talked about audits. What funding level would allow the CFTC to perform annual reviews of every DSRO and derivatives clearing organization, as well as annual examinations of commodity pool operators, trading advisors, and the futures commission merchants.

Mr. GENSLER. We believe, in the funding we have asked for this \$216 million, that we can do much of what you just said, the annual reviews of the clearing organizations, the trading organizations, and so forth. I may have not even listened closely. Some of those reviews that you mentioned are actually done by the self-regulatory organizations, but the ones we do we think that is the level.

STAFF EXPERTISE

Senator DURBIN. So my last question is kind of historic. When I first visited the Board of Trade and Mercantile Exchange over 25 years ago, they were still clinging to their early image as protectors of the agriculture sector in terms of the trading that was going on on the floor, and they were just starting to branch out into new worlds of futures.

And now I see, when I take a look at the activities that you are watching closely, that the financial commodity futures and option contracts make up approximately 79 percent of the trades that you regulate and other contracts like metals and energy products, about 13 percent. Only 8 percent can really be characterized as agricultural in nature.

What kind of challenges does this present to your agency to have this kind of mix which is moving toward much different objects that are at the soul and heart of the futures trading markets?

Mr. GENSLER. Well, I think you are right. It is actually a development that has happened over those 25 years. I think there is a uniformity and consistency of derivatives. They are all based upon some underlying commodity. We call a Euro dollar actually a commodity in the law.

But what we have to do as an agency is we have experts who have expertise in corn and wheat. We have some other experts in our Division of Market Oversight that have expertise in the financial products. So as these products continue, we try to build separate expertises that have a uniform expertise around derivatives but then have some product expertise. This is a little bit different. We have problems in the wheat market still about wheat convergence. That is very different than what goes on in the Euro dollar market, but we build the expertise across the product sets, as we will have to in the future as we take on more responsibilities possibly in what is now called the swaps market.

Senator DURBIN. Let me ask you about that. Are those going to be so unique by contract that they are going to put a special burden on your regulators to try to understand the real heart and nature of the transaction?

Mr. GENSLER. Well, I think humility suggests that there is going to be a lot we are going to learn along the way because we have not as a Nation regulated these products in the past. We do not have the authority. But I do think, for instance, interest rate derivatives where the CFTC will take the lead—we will share a lot

with the SEC—that that has a lot of similarities to what we do overseeing the Euro dollar contracts for now. Of course, the commodity derivatives have a lot of similarities, but there will be things that we are going to be learning along the way. We will be, hopefully, sharing that with you.

Senator DURBIN. Thank you.

Senator COLLINS.

Senator COLLINS. Thank you.

PROPOSED COUNCIL OF REGULATORS

Chairman Gensler, I think you said in response to Chairman Durbin's question that the futures market was something like \$34 trillion. That raises the question in my mind. Under Senator Dodd's bill, is the CFTC a member of the Systemic Risk Council of Regulators?

Mr. GENSLER. I believe the answer is yes.

Senator COLLINS. Let me ask the next question. Should you be a member?

Mr. GENSLER. I think so. I think so. Thank you.

Senator COLLINS. And if you are not a member of the council, I am going to offer an amendment to put the Commodity Futures Trading Commission Chairman on that council. I think it is really important that we try to be as inclusive—

Mr. GENSLER. The only reason I hesitated, I could not remember what it was called. I know there is a council. It may have different names in different bills.

Senator COLLINS. It does.

But they are in. Okay. The Chairman confirms it.

TOO INTERCONNECTED TO FAIL

Let me ask you a question then. How do you plan to help monitor and mitigate the potential for systemic risk arising from the concentrations or interconnectedness of risks that are related to derivative products?

Mr. GENSLER. Well, derivatives do weave sort of a spider's web between the financial system, and one of the reasons that we have been fighting to lower risk for the American public is to bring the derivatives into clearinghouses. Clearinghouses, again, stand between buyers and sellers, and that is one of the ways that we lower interconnectedness. Our system today does not just have "too big to fail." When Continental Illinois Bank—because I know it is in your State—that was thought years ago to be too big to fail in a sense, but now we have banks that are too interconnected to fail. If we let it go, it is going to pull down everything else. That was the central lesson of AIG. And tens of billions of dollars of our money, taxpayer—all of it went through AIG to other financial institutions.

So I believe we really need to, hopefully, stand—there will be some stress and pressures. There will be amendments probably offered to have another exemption here, another exemption there. And I hope—I would advocate we not have those exemptions for financial entities. We have an exemption for the commercial entities, but hopefully, we do not for the financial entities.

TRANSPARENCY

Senator COLLINS. Could you give us an example of the kind of transparency that would be helpful to you that would come about because of moving derivative trades to a clearinghouse? Let me ask this in a better way.

What would you know that you do not know now if more of the trades go through a clearinghouse?

Mr. GENSLER. There are two types of transparency, one to the regulators and one to the public. Clearinghouses and something called trade repositories will give transparency to the regulators and we will know a lot. We will be able to—and I know the SEC will be able to—better enforce and police the markets for manipulation and fraud because so much can be now just transferred. We can currently look at wheat futures. We can look at Euro dollar futures. Somebody can just move the same trade over into an over-the-counter interest rate or a complex credit default swap. So as enforcement agencies, we get to follow it across to those other markets.

But there is also public market transparency, and public market transparency only comes really from reporting the transactions on a real-time basis. And for that, every end-user, Hannaford Brothers and others alike, will actually benefit because transparency leads to lower cost, lower bid spreads. It does shift the information advantage away from Wall Street. Wall Street is not happy with the proposals the administration has made, but public market transparency does that.

It also lowers risk. Remember we were all debating about toxic assets. The more transparency we bring, it lowers risk as well to the public.

Senator COLLINS. That is very helpful.

END USER EXEMPTION

My final question to you is one that I raised with you in my office but I want to raise for the record as well, and that is, I have been hearing from some home heating oil companies in Maine that are worried that if they have to go through clearinghouses, that they will jeopardize their ability to enter into contracts with their customers that would be fixed price contracts for the upcoming winter. Do you see any problems created for them in this area?

Mr. GENSLER. I think you have heard from them because there have been a variety of bills, and even I as an advocate—I have advocated for no exceptions. But I think where Senator Lincoln and Senator Dodd and all the people that have worked on those two committee bills have come out, there would be an exception for commercial parties hedging as long as they were not financial. So the home heating oil companies would be exempted from having their transactions coming to a clearinghouse, as long as they were not speculating, which I do not think that is what they are doing.

Senator COLLINS. No, they are not.

Mr. GENSLER. So I think the bill accommodates that interest.

Commercial entities make up maybe, on worldwide statistics, about 9 or 10 percent of the market. We do not know precisely what it is in each and every market, but the exemption that is in

the Senate Agriculture and the Senate Banking bill is a balancing of interests, and it has exempted that 9 or 10 percent. But it is the commercial enterprises like the home heating oil companies in Maine.

Senator COLLINS. Thank you.

Senator DURBIN. Senator Cochran.

Senator COCHRAN. Mr. Chairman, thank you.

BUDGET IMPACT OF PENDING LEGISLATION

Chairman Gensler, I am curious to know about the new authorities which you are suggesting the CFTC should have. What is the status of the legislative authority that you are talking about? Has that been enacted into law, or is it just a proposal at this point?

Mr. GENSLER. It is a proposal. And the reason it came up here is, in terms of if it went through, the funding levels would be different. But right now the House of Representatives has passed a strong bill, but then the Senate hopefully in the next few days, you would tell me better.

Senator COCHRAN. I am not the chairman anymore. You forgot they had an election.

Mr. GENSLER. But I think that the Agricultural Committee and the Banking Committee have merged their product. They have a very strong derivatives portion that I believe is getting merged into the overall financial reform bill. I am hopeful, with Congress' deliberations, that we will get something to the President's desk.

Senator COCHRAN. This has a budgetary impact, does it not? Because it is going to cost more to enforce the new authorities. I assume there will be new hires required.

What are the other funds that you expect to be needed to be used for?

Mr. GENSLER. We have estimated to the Congressional Budget Office that in 2011 that we would need about 240 more people and about \$18 million more in technology budget. There is an awful lot of information that will be stored and will have to be assessed and so forth. That is included in the President's budget request in sort of a conditional way if Congress were to adopt financial reform.

Senator COCHRAN. Okay. Thank you very much.

Mr. GENSLER. Thank you.

Senator DURBIN. Chairman Gensler, thank you. There are plenty of other questions which we would like to share with you in writing and hope that you might be able to respond in a timely way. Other members of the subcommittee may have some questions. But we thank you for being here today and we will continue to work with your agency.

Mr. GENSLER. I thank the chairman and Senator Collins. Thank you.

Now you get Chairman Schapiro. Do I stay or do I leave? All right. Good luck, Mary.

SECURITIES AND EXCHANGE COMMISSION

STATEMENT OF HON. MARY SCHAPIRO, CHAIRMAN

Senator DURBIN. We now will hear from the Securities and Exchange Commission Chairman, Mary Schapiro, and following her presentation, we will proceed with question rounds of 5 minutes.

Chairman Schapiro, thank you for joining us today. We welcome your staff as well. Please proceed.

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

Chairman Durbin, Ranking Member Collins, Senator Cochran, thank you for the opportunity to describe how the President's fiscal year 2011 budget request would allow the SEC to better pursue our mission of protecting investors, regulating markets, and facilitating capital formation.

When I joined the Commission only last year, we were just emerging from an extraordinary economic crisis. The markets were still trying to regain a firm footing and confidence in the institutions of Government generally—and the SEC specifically—was badly shaken.

Thanks to the strong support that this subcommittee has provided, the SEC has begun to rebuild that confidence by making needed and significant changes to virtually every aspect of our operations. We brought in new leadership throughout the agency, streamlined procedures, and reformed operations. We began putting new technology in place, and we initiated one of the most significant investor-focused rulemaking agendas in decades. Our Enforcement Division undertook a top-to-bottom review, leading to a complete restructuring. Silos inhibiting internal communications were torn down. A layer of management was eliminated, freeing up professionals for front-line duty. And we created specialized units that will bring a deeper focus to critical areas such as market abuse and structured products.

These efforts are already paying dividends. Thanks to the support of this subcommittee, among the highlights of my first year we sought more than twice as many temporary restraining orders and asset freezes in 2009 as in 2008. We issued well over twice as many formal orders of investigation. We won \$540 million more in disgorgement orders. Penalty orders more than doubled. And we filed nearly 10 percent more actions overall, including nearly twice as many involving Ponzi schemes.

Our Office of Compliance, Inspections, and Examinations is undergoing a similar review which we expect to yield significant restructuring and improvements.

And to get ahead of the next financial challenge we may face, we created a new Division of Risk, Strategy, and Financial Innovation and are staffing it with people who bring us new and different perspectives and expertise.

We have made real progress, but restoring investor confidence and rebuilding the trustworthiness of financial institutions and markets will require a sustained regulatory commitment. Fiscal year 2011 will be a critical year in continuing our efforts to reinvigorate the Commission and its programs. The challenge we face grows every day. Since 2003, the number of registered investment advisors has increased by nearly 50 percent and their assets under management have grown by \$12 trillion. Today we rely on fewer than 4,000 individuals to monitor more than 35,000 regulated entities. And yet, it was only this year that the SEC staff members returned to the level last seen in 2005, and in the intervening years tight budgets forced us to cut investments in new information technology by more than one-half. This subcommittee's support has allowed us to reverse those harmful trends, and I thank you deeply for that.

And the President's fiscal year 2011 budget will allow us to continue on this new path. More staff will mean a deeper pool of institutional expertise, as we hire specialists with deep experience with today's markets and products. More staff will also mean more investigations and trials and a smaller gap between the number of examiners and the firms they examine and greater capacity to respond to emerging trends.

The President's budget will also provide a much-needed \$12 million increase in information technology (IT). Our top IT priority is completion of a new system for reviewing complaints, tips, and investigative leads provided by whistleblowers or other sources. The initial phase is done, creation of a single searchable database for existing tips and complaints. To this we will add risk analytics that help us quickly and efficiently identify high-value tips and search for trends and patterns across the data.

We are also enhancing collection, analysis, and distribution of the disclosure documents filed with the Commission. This will allow us to monitor macro trends, search for hidden risks, and track systemic changes.

We also plan to complete improvements to the case and exam management tools available to our enforcement and examination programs. While we will never match the technology available to the financial institutions we regulate and the big law firms we face, the ability to search and use the vast mountains of data we collect will make our team much more competitive. New technology will be accompanied by comprehensive training, allowing staff to navigate the constantly evolving financial environment they monitor.

And in the year ahead, we will also continue our pursuit of rule-making that looks after the interests of investors and responds to changes in the American financial marketplace. Key goals include a thorough review, already underway, of the rapidly evolving equity market structure, helping shareholders more effectively exercise their rights, and giving investors better information to make sound decisions regarding investments in municipal and other securities.

PREPARED STATEMENT

I am pleased with the progress we have made, but we recognize that much work remains to be done to continue to restore investor confidence in our markets. The funding level of the President's budget request is critical for us if we are to continue to improve our performance in an increasingly complex financial world.

Thank you and I would be happy to answer your questions.
[The statement follows:]

PREPARED STATEMENT OF MARY SCHAPIRO

Chairman Durbin, Ranking Member Collins, Members of the Subcommittee: Thank you for the opportunity to testify today in support of the President's fiscal year 2011 budget request for the Securities and Exchange Commission.¹ I am grateful for the support that you and this Subcommittee have provided to the Commission. I welcome this opportunity to answer your questions and provide you with additional information on how the SEC would make effective use of the \$1.258 billion that the President has requested for the coming fiscal year.

When I joined the Commission early last year, we were just emerging from an economic crisis that threatened our financial system and the entire American economy. The markets were still trying to regain a firm footing, and confidence in the institutions of government generally—and the SEC specifically—was badly shaken.

Since then, we have taken significant steps to make the SEC more vigilant, sharp, and responsive—and focus the agency squarely on its mission to protect investors, maintain orderly markets, and facilitate capital formation. We brought in new leaders across the agency. We streamlined our procedures. We worked to reform the ways we operate. We began modernizing our systems. We set out to regulate more effectively. We fully engaged in the debate on regulatory reform, and we initiated one of the most significant investor-focused rulemaking agendas in decades.

While we made real progress over the past year, restoring investor confidence and rebuilding the trustworthiness of financial institutions and markets will require a sustained regulatory commitment. Fiscal year 2011 will be a critical year in our continuing efforts to reinvigorate the Commission and its programs.

My testimony will provide an overview of the actions and initiatives that we began over the past year thanks to the support that this Subcommittee has provided. I will then discuss the President's fiscal year 2011 request and the important work which these resources would make possible.

NEW LEADERSHIP, ORGANIZATIONAL STRUCTURES, AND EXPERTISE

Without a doubt, the most critical element to success in improving the Commission's operations is the agency's talented and capable staff. During the past year, I am pleased to have been able to bring on board new senior managers who are playing a vital role in our efforts to transform the agency.

We brought in new leadership to run the agency's four largest operating units—the Division of Enforcement, the Office of Compliance Inspections and Examinations, the Division of Corporation Finance, and the Division of Trading and Markets. We also selected a new General Counsel, Chief Accountant, head of the Office of Investor Education and Advocacy, and directors for the New York, Miami, and Atlanta regional offices. The efforts of these new senior managers, together with the efforts of other leaders who are continuing their service, are already making the SEC a more agile, responsive and intelligent agency.

This new leadership team is committed to a culture of collaboration—sharing information and sharing ideas. To encourage that culture, I established several cross-functional teams to focus on issues such as life settlements and the development of a consolidated audit trail. We have begun integrating our broker-dealer and investment adviser examinations and are moving to consolidate our multi-office oversight of clearing agencies.

Significantly, we've created and staffed a new division—the Division of Risk, Strategy, and Financial Innovation—to bore through the silos that for too long have compartmentalized and limited the impact of our institutional expertise. A principal lesson learned from the financial crisis is that, because today's financial markets and their participants are dynamic, fast-moving, and innovative, the regulators who

¹The views expressed in this testimony are those of the Chairman of the Securities and Exchange Commission and do not necessarily represent the views of the President.

oversee them must continue to improve their knowledge and skills in order to regulate effectively. The Division of Risk, Strategy, and Financial Innovation will help to re-focus the agency's attention on and response to new products, trading practices, and risks. Already, this new Division has attracted renowned experts in the financial, economic, and legal implications of the financial innovations being crafted on Wall Street.

In addition, we are working to establish a deeper reservoir of experts throughout the agency to conduct risk analysis, spot emerging trends and practices, and reduce the likelihood that a problem might grow into a more potent risk.

We also are committed to improved training and education of agency staff in order to close competency gaps and expand knowledge of industry activities and trends. Training needs to be current, continuous, and mandatory—and it needs to equip the SEC's workforce with the tools they need to enforce the Federal securities laws and protect investors.

Last year, we launched an effort to ensure that employees throughout the agency receive timely and relevant training which will allow them to fulfill the agency's mission. This agency-wide initiative includes a new integrated structure to identify training needs and to approve professional education and leadership development programs. The new training initiative also seeks to improve collaboration with other regulators and has enabled hundreds of employees to take advantage of external professional certification programs. While it will take time to fully implement all the components of our new training initiative, we are already seeing good results from this increased focus on staff development.

REINVIGORATING THE ENFORCEMENT PROGRAM

Enforcement of the securities laws is the foundation of the SEC's mission. Swift and vigorous prosecution of those who have broken the law is at the heart of the agency's efforts to restore investor confidence. But in recent years, the SEC's enforcement program had suffered under a variety of procedural, structural, and budgetary constraints.

Over the past year, we have improved our law enforcement capabilities and sent a clear signal to our staff that we value toughness and speed by removing procedural roadblocks impeding their investigations. For example, we delegated to senior staff the authority to issue subpoenas, so investigations can be launched without the prior—and time-consuming—approval of the Commission. We also abolished the requirement that staff obtain Commission approval before entering into settlement talks involving civil monetary penalties against public issuers.

We added a host of measures to encourage corporate insiders and others to come forward with evidence of wrongdoing. These new cooperation initiatives establish incentives for individuals and companies to fully and truthfully cooperate and assist with SEC investigations and enforcement actions, and they provide new tools to help investigators develop first-hand evidence to build the strongest possible cases as quickly as possible.

Last year, I hired as the Director of the Enforcement Division, Robert Khuzami, a longtime Federal prosecutor who had served as Chief of the Securities and Commodities Fraud Task Force of the U.S. Attorney's Office for the Southern District of New York. Under his leadership, we are undertaking the most significant structural reforms of the enforcement program since 1972—reforms designed to maximize resources and enable us to move swiftly and vigorously against securities fraud. Highlights of the initiatives currently being implemented include:

—*Specialization.*—The Division has created five new national specialized investigative groups dedicated to high-priority areas of enforcement, including Asset Management (hedge funds and investment advisers), Market Abuse (large-scale insider trading and market manipulation), Structured and New Products (various derivative products), Foreign Corrupt Practices Act violations, and Municipal Securities and Public Pensions. The specialized units will utilize enhanced training, specialized industry experience and skills, and targeted investigative approaches to better detect links and patterns suggesting wrongdoing—and ultimately to conduct more efficient and effective investigations.

—*Management Restructuring.*—The Division has adopted a flatter, more streamlined organizational structure under which it has reallocated a number of staff who were first line managers to the mission-critical work of conducting front-line investigations. While a layer of management has been eliminated, the Division is maintaining staff-to-manager ratios that will allow for close substantive consultation and collaboration, resulting in a management structure that facilitates timeliness, quality, and staff development. The Division also has hired its first-ever Managing Executive, who is focusing on the Division's administrative,

operational, and infrastructure functions, thus freeing up valuable investigative resources for mission-critical work.

—*Office of Market Intelligence.*—The Enforcement Division has established an Office of Market Intelligence, which will serve as a central office for the handling of complaints, tips, and referrals that come to the attention of the Division; coordinate the Division’s risk assessment activities; and support the Division’s strategic planning activities. In short, this office will allow the Division to have a unified, coherent, coordinated response to the huge volume of complaints, tips, and referrals we receive every day, thereby enhancing the Division’s ability to open the right investigations, bring solid cases, and effectively protect investors.

In my first year, compared to the previous year, the SEC’s enforcement activity increased significantly. We sought more than twice as many temporary restraining orders and asset freezes; we issued well over twice as many formal orders of investigation; we won \$540 million more in disgorgement orders while penalty orders more than doubled; and we filed nearly 10 percent more actions overall, including nearly twice as many involving Ponzi schemes.

Of course, numbers alone don’t capture the complexity and range—or the importance—of the actions we brought. For example, we have brought a number of cases involving issues surrounding the financial crisis, including cases alleging accounting fraud at subprime lenders, misrepresentation of complex investments as appropriate for retail investors seeking safe financial products, fraud in connection with CDO marketing materials, and misleading investors about exposure to subprime investments. Our cases have included actions against Goldman Sachs and Co., American Home, Countrywide, New Century, Brookstreet Securities, and Morgan Keegan.

Examples of where the SEC’s actions have benefitted investors include:

—Charging Boston-based State Street Bank and Trust Company with misleading investors about their exposure to subprime investments while selectively disclosing more complete information only to certain favored investors. As a result of this one action, more than \$300 million will be distributed to investors who lost money during the subprime market meltdown.

—Charging the investment adviser for the Reserve Primary Fund with failing to properly disclose to investors and trustees material facts relating to the value of the fund’s investments in Lehman-backed paper. We also charged the adviser with misrepresenting that it would provide the credit support necessary to protect the \$1 net asset value of the Primary Fund when, according to our complaint, the adviser had no such intention. In bringing the enforcement action, the SEC also sought to expedite the distribution of the fund’s remaining assets to investors by proposing a pro-rata distribution plan, which the Court has approved. To date, investors have been provided with recovery of more than 98 cents on the dollar, with a Court-ordered distribution to be effected in the coming days that will bring their recovery to over 99 cents on the dollar.

In addition to the significant cases we have brought arising out of the financial crisis, we have continued to bring cases in many other important areas.

—In a pension fund pay-to-play case, we filed a settled action against a private investment firm, Quadrangle Group LLC, and one of its affiliated entities, charging them with participating in a widespread kickback scheme to obtain investments from New York’s largest pension fund.

—In the municipal securities arena, we settled fraud charges with J.P. Morgan Securities for its alleged role in an unlawful pay-to-play scheme in Jefferson County, Alabama. J.P. Morgan paid \$50 million directly to Jefferson County, forfeited more than \$647 million in claimed termination fees, and paid a penalty of \$25 million. At the same time, the SEC also charged two of J.P. Morgan’s former managing directors with fraud arising out of this scheme and had previously charged others, including the former Birmingham mayor—who last month was sentenced to 15 years in prison and fined \$360,000—a JP Morgan banker, and the local operative who served as go-between.

—In the area of accounting and financial fraud, auditor Ernst & Young LLP paid an \$8.5 million settlement—one of the largest ever paid by an accounting firm—and six current and former partners were sanctioned for their conduct in the audit of Bally Total Fitness Holding Corporation. We charged that they abdicated their responsibility to function as gatekeepers while their audit client engaged in fraudulent accounting.

—Finally, in the *Galleon* and *Cutillo* cases, we charged more than a dozen hedge fund managers, lawyers and investment professionals in two overlapping serial insider trading rings that collectively constitute one of the largest insider trading prosecutions in Commission history. In the parallel criminal prosecutions, ten individuals have already pled guilty and nine additional individuals have been indicted.

STRENGTHENING EXAMINATIONS AND OVERSIGHT

Strong regulation is essential to the fair, orderly, and efficient operation of markets. A vigorous examination program cannot only reduce the opportunities for wrongdoing and fraud, but also provide early warning about emerging trends and potential weaknesses in compliance programs. Over the past year, we have begun reforming the Office of Compliance Inspections and Examinations in response to ever-changing Wall Street practices and lessons learned from the Madoff fraud. Reforms include:

- Placing greater reliance on risk assessment procedures and techniques to better identify areas of risk to investors.
- Requiring examiners to routinely verify the existence of client assets with third party custodians, counterparties, and customers, and have developed procedures to ensure compliance with the Commission's new rules to strengthen custody controls of an investment adviser's client assets.
- More rigorously reviewing information about firms before sending examiners out to the field, so that we can use our limited resources more effectively and to target those firms with the greatest risks.
- Enhancing the training of examiners and re-focusing on basics such as exam planning, tracking, and accountability.

We also plan to make significantly greater progress during the current year under the leadership of our new OCIE director, Carlo di Florio, who came to the SEC from PricewaterhouseCoopers, where he was a national leader in corporate governance, enterprise risk management and regulatory compliance and ethics. He also has extensive experience investigating corporate fraud, corruption, conflicts of interest and money laundering. At my request, he is undertaking a top-to-bottom assessment of the Office's operations to determine where additional opportunities exist to strengthen our exam program. As I will discuss later, there is such a huge disparity between the number of examiners and the number of entities that we must examine that we must ensure that we are using our limited resources wisely.

IMPROVING AGENCY SYSTEMS AND MANAGEMENT

A key priority for me as Chairman is to ensure that our staff has the tools they need to conduct oversight of vast financial markets. Between fiscal year 2005 and fiscal year 2009, investments in new information technology systems dropped by more than half, resulting in a growing gap between our mission and the ability of our systems to help us accomplish it. Thanks to the resources provided by this Subcommittee, this fiscal year we have been able to begin investing in several new or improved IT projects and systems.

One of the first initiatives I launched was a strategic review of the agency's systems for reviewing complaints, tips, and investigative leads provided by whistleblowers or other sources. Having an effective process to identify the most important tips can give the agency an early jump on frauds and other violations of securities laws, help guide compliance exams, and provide important information across the agency to aid staff working to protect investors and maintain market integrity. The absence of such a system directly contributed to past failures by the agency.

We have completed the first phase of this effort, which was to centralize into a single, searchable database all our existing tips and complaints that were previously in multiple databases. This means that complaints we receive in Chicago are now downloaded into the same database as complaints received in Miami or any of our other offices, and the information investors share with our investor assistance hotline can be searched alongside complaints received by our markets hotline in our Division of Trading and Markets. Additionally, we released for the first time a set of agency-wide policies and procedures to govern how employees should handle the tips they receive.

Simultaneously, we have been working on a new intake system that will allow us to capture more information about tips and complaints. The new system will provide more robust search capabilities so that tips can be better assessed or triaged. In addition, this new system will add enhanced workflow abilities so we can track how tips and complaints are being used throughout the agency. We expect to deploy this system later this year. Meanwhile, we also are in the early stages of designing the third phase of this system, which will add risk analytics tools to help us quickly and efficiently identify high value tips and search for trends and patterns across the data.

In addition, we are enhancing the collection, internal analysis, and subsequent distribution of disclosures filed with the SEC, so that this unique set of data can be aggregated both across firms and over time—allowing us to monitor macro trends, search for hidden risks, and track systemic changes in filings.

During my first year, I also focused much attention on improving the agency's basic internal operations—the processes that guide our work, support the agency's infrastructure, and determine how we are organized. The public appropriately holds the SEC to a very high standard for integrity and professionalism, and we must hold ourselves to that very high standard as well. In the past year, we took major steps to implement a compliance program to guard against inappropriate securities trading by SEC staff. We have acquired and deployed a computer compliance system to track, audit, and oversee employee securities trading and financial disclosures in real time, and have hired a new Chief Compliance Officer to oversee these efforts. We also are strengthening internal rules governing employee securities trading and, in May 2009, we submitted proposed rules to the Office of Government Ethics ("OGE") that would prohibit staff from trading in the securities of companies under SEC investigation—regardless of whether an employee has personal knowledge of the investigation—and require the preclearance of all trades.

Also during the past year we hired a new Chief Freedom of Information Act (FOIA) Officer and have undertaken a comprehensive overhaul aimed at strengthening our FOIA program and our commitment to open government.

Within the next few weeks, we will also have on board a Chief Operating Officer. As I mentioned to the subcommittee last year, this is a new position that we are creating to help us manage our significant rebuilding projects. Our COO will provide executive leadership in the areas of information technology, financial management, and records management (including FOIA).

I have approved a new internal audit follow-up rule that sets forth roles, responsibilities, and procedures to ensure that SEC staff take timely and appropriate corrective action to address recommendations by the Government Accountability Office or the SEC's Office of Inspector General.

In addition, we are undertaking significant efforts to eliminate the material weakness in our internal controls over financial reporting, including automating the numerous processes that have been performed manually and strengthening our core financial system.

ENGAGING IN A SIGNIFICANT INVESTOR-FOCUSED RULEMAKING AGENDA

Of course, the changes we have initiated have not just been internal. The past year has witnessed one of the Commission's most significant rulemaking agendas in years. Here are some highlights:

Adopted:

- Custody controls*.—We adopted a rule in the wake of the Madoff fraud designed to provide greater protections to investors who entrust their assets to investment advisers. The rule leverages our own resources by relying on independent, third-party accountants serving as a "second set of eyes" to confirm client assets and review custody controls in situations where the possibility for misappropriation of client assets is most acute because of the adviser's possession of, or control over, client assets.
- Proxy enhancements*.—We adopted rules that require companies to provide investors with more meaningful information about the leadership structure of boards, the qualifications of board nominees and the relationship between a company's overall compensation policies and risk taking.
- Discretionary voting by brokers for directors*.—We approved a New York Stock Exchange rule to eliminate broker discretionary voting for all elections of directors, whether contested or not. This helps to ensure that director elections are determined by investors with an economic interest in the company.
- Short selling/Fails-to-deliver*.—We adopted a rule that will restrict short selling when a stock is experiencing significant downward price pressure. This rule will also enable long sellers to stand in the front of the line and sell their shares before any short sellers once a circuit breaker is triggered. In addition, we addressed the potentially harmful effects of abusive "naked" short selling, adopting rules that require that fails-to-deliver resulting from short sales be closed out immediately after they occur. Since this rule was adopted, the number of failures to deliver securities has dropped significantly.
- Money market funds*.—We adopted new rules that will help avoid a recurrence of the serious problems exposed in 2008, when the Reserve Primary Fund "broke the buck." The rules will strengthen the oversight and resiliency of these funds by, among other things, increasing credit quality, improving liquidity, shortening maturity limits, and requiring stress testing of money market fund portfolios and the disclosure of the funds' actual "mark-to-market" net asset value.

—*Central Clearing of Credit Default Swaps.*—We took action to address counterparty risk and improve transparency in the multi-trillion dollar credit default swap market by approving conditional exemptions that allowed certain clearinghouses to operate as a central counterparty for clearing credit default swaps.

—*Credit Rating Agencies.*—We adopted rules, and proposed others, to create a stronger, more robust regulatory framework for credit rating agencies—including measures designed to improve the quality of ratings by requiring greater disclosure, fostering competition, addressing conflicts of interest, shedding light on the practice of rating “shopping,” and promoting accountability.

Proposed:

—*Asset-backed securities.*—We proposed rules to fundamentally revise the regulatory regime for asset-backed securities. This comprehensive proposal would revise the disclosure, reporting, and offering process for asset-backed securities to better protect investors in the securitization market and promote efficient capital formation.

—*Proxy access.*—We proposed rules to facilitate the effective exercise of the rights of shareholders to nominate directors to the boards of the companies they own. If adopted, this rule would increase shareholders’ ability to hold boards accountable.

—*Large Trader Reporting.*—We proposed rules to create a large trader reporting system that, if adopted, would strengthen our oversight of the markets by enhancing our ability to identify large market participants and collect information on their trades so we can better analyze the data and investigate potentially illegal trading activity.

—*Flash orders.*—We proposed rules that would effectively prohibit all markets from displaying marketable flash orders.

—*Sponsored Access.*—We proposed a new rule that would effectively prohibit broker-dealers from providing customers with “unfiltered” or “naked” access to an exchange or ATS.

—*Dark pools.*—We proposed rules to generally require that information about an investor’s interest in buying or selling a stock be made publicly available, instead of available only to a select group operating within a dark pool.

—*Pay-to-Play.*—We proposed rules to address pay-to-play practices where investment advisers are managing or seeking to manage public monies that fund state and local pension plans and other important public programs.

—*Municipal Securities Disclosure.*—We proposed rules to improve the quality and timeliness of disclosure of material events related to municipal securities, such as payment defaults, rating changes and tender offers.

Our rulemaking agenda makes it clear that the Commission is now willing to address challenging issues and make tough choices.

SEC RESOURCES

The financial crisis reminded us just how large, complex, and critical to our economy the securities markets have become. Over the last 20 years, the dollar value of the average daily trading volume in stocks, exchange-traded options, and security futures has grown by over 25 times, reaching approximately \$245 billion a day. The number and size of market participants have grown as well. For example, since 2003, the number of registered investment advisers has increased by 49 percent, and their assets under management have jumped by over 57 percent, to \$33 trillion.

Yet, while the markets were growing exponentially in size and complexity, the SEC’s workforce was getting smaller and its technology was falling further behind. We are only just now returning to the staffing levels of 5 years ago. As you know, between fiscal year 2005 and fiscal year 2007, the agency experienced 3 years of flat or declining budgets, losing 10 percent of its employees, which severely hampered our enforcement and examination programs. In the context of rapidly expanding markets, limited SEC staffing levels hindered the agency’s ability to effectively oversee the markets and pursue violations of the securities laws.

Fortunately, thanks to support from the members of this Subcommittee, we have begun to rebuild our workforce and to invest in needed new technologies. Yet, the SEC is still responsible for overseeing more than 35,000 entities with just over 3,800 staff. Additional resources are essential if we hope to make the SEC a dynamic and effective regulator of our financial markets.

The President is requesting a total of \$1.258 billion for the agency in fiscal year 2011, a 12 percent increase over the fiscal year 2010 funding level. If enacted, this request would permit us to hire an additional 374 professionals, a 10 percent increase over fiscal year 2010. That would bring the total number of staff to about

4,200. The request also will permit us to continue expanding our investments in surveillance, risk analysis, and other technology, as well as in better training for SEC staff.

Of this total request, \$24 million would be contingent upon the enactment of financial reform—so that if reform is passed, we would have the resources to begin implementing our enhanced authorities.

It is important to note that the proposed increase in spending would be fully offset by the fees we collect on transactions and registrations. In fiscal year 2011, we estimate that we will collect \$1.7 billion—an increase of \$220 million over fiscal year 2010.

If we were to receive the proposed increase in spending, we anticipate it would be broken out as described below.

In the Enforcement Division, the budget request would enable us to add about 130 new full time employees so we can reinforce our investigations process, support more cases, and strengthen the intelligence analysis function. With these new staff resources—along with the Division restructuring and initiatives outlined above that will make the Division more efficient and effective—the Division projects that we will be able to open 75 more inquiries than the previous year, open 130 more formal investigations, and file charges in 70 more civil or administrative cases.

In addition to fully staffing the new Office of Market Intelligence and its critical risk assessment and strategic planning functions, we plan to use additional Enforcement Division resources in the following ways:

- Hire Individuals with Specialized Industry Experience.*—One of the SEC's priorities is to seek persons with specialized financial industry experience. We intend to hire enforcement staff with specialized expertise in financial products, including structured products and hedge funds, trading strategies, risk, and financial analysis. Building upon the existing strengths of the Division, specialists will increase the Division's depth of understanding of the patterns, links, trends, and motives of wrongdoers. Moreover, the specialists can utilize their unique experience to more quickly target, analyze, and bring to light unlawful activities.
- Hire Additional Trial Attorneys.*—It is essential that the SEC be able to act decisively on its growing caseload and that the Division has the resources to present effective cases at trial and to negotiate potential settlements from a position of strength. We intend to hire additional experienced trial counsel, not only to enable the Division to carry a caseload that includes increasingly complex cases, but also to allow the SEC and the Division to demand tough but appropriate sanctions with the confidence that we have the resources to litigate if necessary. It is critical that the Division convey to defendants that we are prepared to go to trial and to win. With our increased case load, our trial unit needs to expand to ensure that we are able to maintain a program of rigorous enforcement for the protection of investors.
- Increase Administrative Staff.*—Division lawyers spend too much time on tasks more efficiently handled by support and paraprofessional staff. We can leverage our resources by transferring document management, case filings, and other administrative tasks to support staff with the appropriate expertise, thereby freeing up our attorneys to tackle critical front-line work of investigating cases, bringing enforcement actions and allowing all levels of the staff to leverage their specialized knowledge.
- Train Strategically.*—It is critical that the Division invest in employee development to prepare its staff to respond to continuing changes in the securities industry, sophisticated new products and novel trading strategies. In addition, the Division needs to ensure that all staff has access to training to improve on the competencies and skills required for their jobs and to maximize individual potential.
- Information Technology.*—Information technology is also a priority for the Division. We are spending significant resources on a number of ongoing projects—improving the Division's case management system, managing ever-increasing amounts of electronic evidence with sophisticated new tools, and establishing a more centralized system for reviewing and analyzing tips, complaints, and referrals. We intend to commit whatever resources are necessary and available to ensure a timely conclusion to these upgrades. We also anticipate major future projects, including a new IT Forensics Lab, enhanced data and trading analytics, and improved document and knowledge management to further enhance efficiency and consistency across the Division.

In our Examinations unit, the budget request would allow us to add about 70 staff to help us begin closing the gap between the number of examiners and the growing number of registered firms we oversee. With these new resources, OCIE expects to be able to expand the scope and coverage of adviser and fund examinations and to

staff fully the oversight function for credit rating agencies, allowing us to examine half of the rating agencies in fiscal year 2011. If the financial regulatory reform legislation now under consideration requires hedge fund advisers to register, we will expand our inspection program to include these new registrants.

It is important to note, however, that even with an increase in the number of exams these additional resources will enable us to conduct, we anticipate examining only nine percent of SEC registered investment advisers and 17 percent of investment company complexes in fiscal year 2011.

In the newly created Division of Risk, Strategy, and Financial Innovation, the budget request would enable us to add about 20 new professionals. The new staff would allow the Division to establish a deeper reservoir of experts who can conduct risk and economic analysis and spot emerging trends and practices in support of rulemaking and enforcement activities. We anticipate hiring professionals with significant knowledge and expertise in financial markets and products, including economists, academics, lawyers, and financial market professionals.

Among the other divisions, the budget request would permit us to add almost 50 staff to the Divisions of Investment Management and Trading and Markets. These personnel will help us enhance oversight of money market funds, clearing agencies, broker-dealers, credit rating agencies, and, if brought under the agency's jurisdiction, hedge fund advisers and OTC derivatives. The Division of Corporation Finance would add about 25 professionals to allow it to focus more, and with greater frequency, on the financial statements and other disclosures of large and financially significant companies.

Finally, the fiscal year 2011 budget request proposes to spend an additional \$12 million on information technology investments, focused on several key projects. Our top priority, as I described earlier, will be the third phase of our new system for analyzing tips, complaints, and referrals.

We also intend to continue our efforts to build a suite of surveillance and risk analysis tools that will substantially improve the agency's ability to find connections, patterns, or trends in the data we collect. The agency has numerous internal information repositories which result from disclosure filings, examinations, investigations, economic research, and other ongoing activities. With better tools, we will be able to mine this data, link it together, and combine it with data sources from outside the Commission. This will enable staff to more effectively identify risks to investors, trends in the markets, and to identify patterns of activities meriting further examination or investigation.

We also plan to complete improvements to the case and exam management tools available to our enforcement and examination programs. We intend to modernize our financial systems and implement a new system to handle the significant increase in the volume and complexity of evidentiary material obtained during the course of investigations. We also need tools to significantly improve the efficiency of loading, storing, and archiving the roughly three terabytes of data received per month during the course of investigations in order to improve turnaround time to staff and to contain costs.

MANAGING AGENCY GROWTH

While the budget request anticipates significant growth in the size of the SEC, the agency is properly positioned to implement this spending plan. To accomplish the hiring of hundreds of new staff during the course of fiscal year 2011, the SEC is enhancing its human resources staff and, consistent with its current authorities, streamlining its hiring process. Improvements include simplifying the application process and maintaining a searchable database of applicants, so that it is possible to interview for a vacancy as soon as it appears rather than having to go through the lengthy posting process each time. Being able to better tailor, target and speed recruiting will enhance the quality of applicants and help the agency acquire the necessary talent to perform effectively in an increasingly complex financial environment.

CONCLUSION

Thank you, again, for your past support, and for allowing me to be here today to present the President's budget request.

While the SEC is a relatively small agency, we are charged with protecting millions of investors every day, including the nearly one-half of all households that own securities. I am pleased with the progress that we have made to date, but recognize that much work remains to be done to continue to reinvigorate the SEC and restore investor confidence in our securities markets. The funding level in the President's

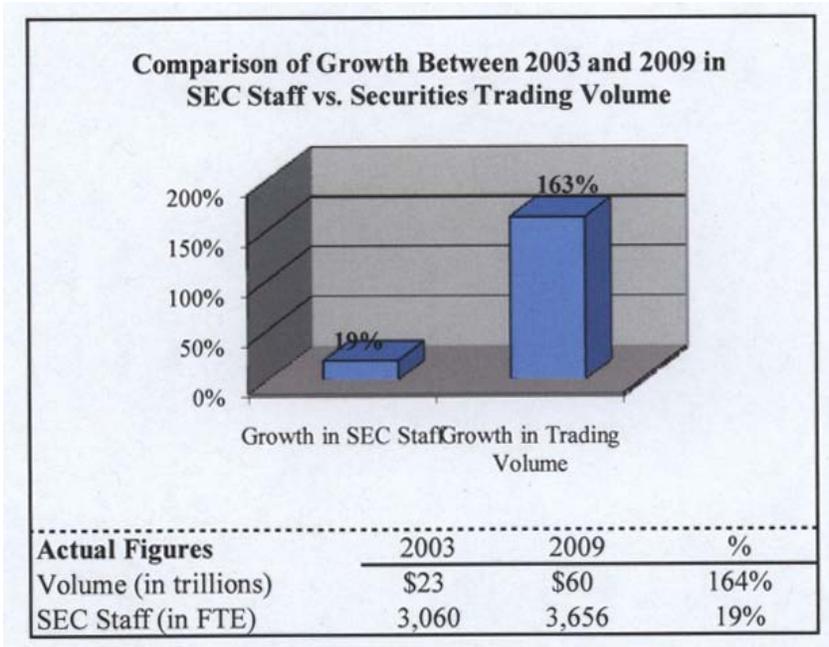
budget request is critical for us if we are to succeed in these efforts, and continue to improve our performance in an increasingly complex financial world.

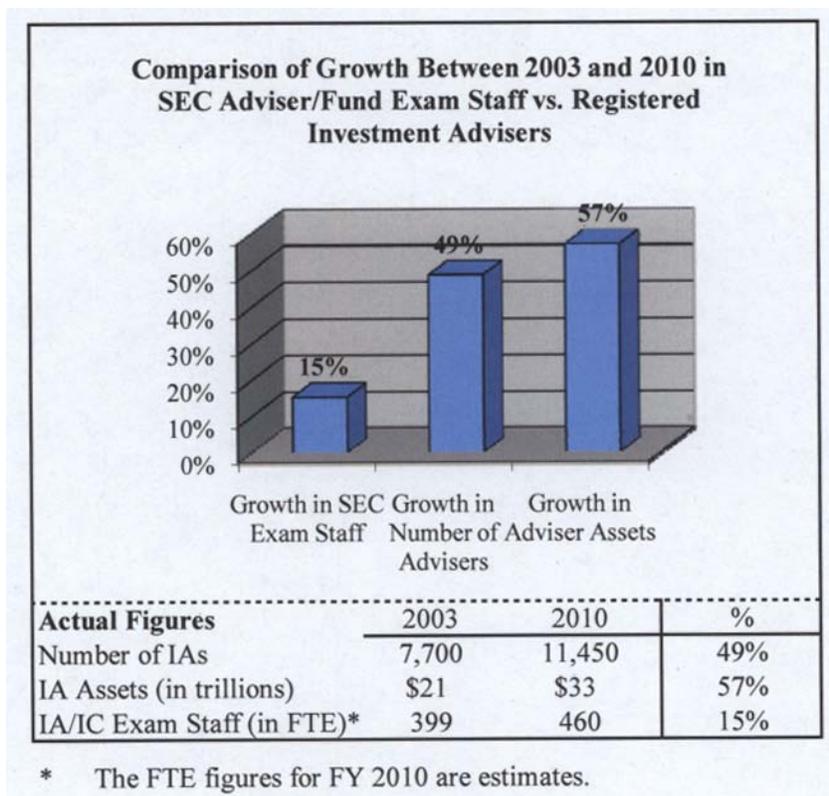
I am happy to answer any questions that you might have.

SEC STAFF LEVELS HAVE NOT KEPT PACE WITH INDUSTRY GROWTH

The SEC's staff of 3,816 FTE (estimate for fiscal year 2010) oversees more than 35,000 entities. These include: 11,500 investment advisers; 5,400 broker-dealers; 7,800 mutual funds; about 600 transfer agents; clearance and settlement systems; 12 securities exchanges; 10,000 public companies; 10 credit rating agencies; and FINRA, MSRB, & PCAOB.

The following charts provide examples of how various aspects of the markets have grown since 2003, relative to the SEC's staff:





OVERSIGHT OF CREDIT RATING AGENCIES

Senator DURBIN. Thank you, Chairman Schapiro.

I have joined a lot of other people in just finishing Michael Lewis' book, "The Big Short", and it is really an eye-opener of what was going on at the time that this real estate bubble was created. One of the areas that I had heard about many times that he made reference to was the work of credit rating agencies and the fact that some of the credit ratings that were given were misleading, to say the least.

Now, since the beginning of the credit crunch in early 2007, these agencies have come under fire for inflated ratings of mortgage-backed securities that did not reflect the financial stability of the borrowers. At our hearing last June, I asked you some questions about what the SEC was doing to restore confidence in these credit rating agencies, what improvements were needed.

In your budget justification materials submitted to the subcommittee in February, you indicate on page 4 that the fiscal year 2011 budget will enable the SEC to carry out a more robust oversight function for credit rating agencies and conduct examinations at one-half of the registered, nationally recognized statistical rating organizations next year. Underlined, "next year." You explained that in 2006, the SEC took on a major new responsibility with the

Credit Rating Agency Reform Act, which gave the agency authority to regulate internal processes of nationally recognized statistical rating organizations, such as recordkeeping and policies to guard against conflicts of interest. You contend “The SEC never received any increased or dedicated funding to carry out these new responsibilities, and it has been forced to divert positions from other programs in order to staff this vital function.”

I am puzzled by that statement. In fiscal year 2009, Congress provided the SEC with \$970 million in budget authority, \$57 million above the President’s request of \$913 million. And in fiscal year 2010, this current year, Congress provided \$1.1 billion, \$85 billion above the President’s request.

If the SEC regards its obligation to oversee credit rating agencies as a high priority, why were you not able to devote some of the increased funds we provided for this function in fiscal year 2009 and 2010?

Ms. SCHAPIRO. Senator, we have. I do not have the statement right in front of me. But let me assure you we are very committed to aggressive oversight of credit rating agencies. We have, in fact, created a new examination branch for credit rating agencies, and our goal would be to try to examine all the credit rating agencies on a regular basis. So we are quite committed to solving the problems that we have seen with respect to credit rating agencies.

In addition—

Senator DURBIN. Is this a typo where it says that you are going to start this work next year?

Ms. SCHAPIRO. We have already begun this work, and I will—

Senator DURBIN. This was in the budget justification materials given to this oversight committee.

Ms. SCHAPIRO. I can assure you this work has begun. We have a new head of our Office of Compliance, Inspections, and Examinations. Credit rating agencies are a focus of that office.

Senator DURBIN. We have the justification materials, and I would like to share them with you because what you have just said is not consistent with what was given to the subcommittee.

[The information follows:]

As a follow up to your question during the hearing, I wanted to offer clarification regarding the SEC’s examinations of credit rating agencies. As we discussed, page 4 of the SEC’s fiscal year 2011 Congressional Justification says: “. . . the SEC never received any increased or dedicated funding to carry out these new responsibilities, and it has been forced to divert positions from other programs in order to staff this vital function.” I understand that, in the months immediately following the passage of the Credit Rating Agency Reform Act of 2006, the SEC did not receive additional funds to handle these responsibilities, and the SEC during this period was in the middle of a 10 percent cutback in its overall staffing levels. However, this statement leaves the incorrect impression that the SEC has not received budget increases since that time. Accordingly, I have asked that this sentence be stricken from the version of the document that appears on the SEC website. As I mentioned in my testimony, your subcommittee’s support has in fact resulted in significant budget increases since I became Chairman and is allowing us to rebuild the agency’s workforce. In fiscal year 2009 the SEC was able to create a team of staff dedicated to examining credit rating agencies, and the fiscal year 2011 budget request asks for additional staff resources to expand the program.

I hope this information helps clarify the state of the SEC’s program to examine credit rating agencies.

WHISTLEBLOWER BOUNTY PROGRAM

Senator DURBIN. Let me ask about another issue. In the wake of the massive Ponzi scheme perpetrated by Bernie Madoff, the SEC has undertaken an array of reforms to reduce similar frauds and the fact that they would go undetected. Among the actions cited in SEC materials is, "advocating for a whistleblower program," as part of the financial reform legislation. The SEC has requested expanded authority from Congress to reward whistleblowers who bring forward substantial evidence about Federal securities violations. Current law permits the SEC to award a bounty to a person who provides such information, leading to the recovery of a civil penalty from an inside trader, from a person who tipped information to an inside trader, or from a person who directly or indirectly controlled an inside trader.

Now, a few weeks ago on March 29, the SEC's inspector general issued a report on how the bounty program is working at your agency. The SEC inspector general noted that while the SEC has had a bounty program in place for more than 20 years for rewarding whistleblowers for insider trading tips, there have been very few payments under the program. Likewise, the SEC has not received a large number of applications from individuals seeking a bounty over this 20-year period. The inspector general also found the program is not widely recognized either inside or outside your agency.

The inspector general indicated that although the SEC is seeking expanded authority to reward whistleblowers who bring forward substantial evidence about other significant Federal security law violation, the current SEC bounty program is not fundamentally well-designed to be successful.

They called for a long list of improvements by your inspector general. Make the application more user-friendly. Establish internal policies and procedures to assist staff in assessing contributions made by whistleblowers in making bounty award determinations. Routinely provide status reports to whistleblowers regarding their bounty applications. Track the applications to ensure timely and adequate review.

The inspector general acknowledged that the SEC has begun to take steps to correct the deficiencies identified in this whistleblower bounty program, including consultation with the Department of Justice, the Internal Revenue Service, and other agencies.

After the embarrassment of Bernie Madoff, this inspector general report about your whistleblower program is troubling to me. It indicates that the level of energy which we expected in response to Madoff and the embarrassment he brought to your agency and to our Government would create a whistleblower program to try to save some of those investors and savers who could be exploited by people like him.

Ms. SCHAPIRO. Senator, I would very much like to address that.

First of all, when I arrived, I asked that we build a more robust, effective whistleblower program simply because the insider trading program has not been effective. And that is in part because insider trading rarely is brought to the attention of the SEC by tips. It is generally discovered as a result of surveillance done by the ex-

changes or surveillance that is done by the SEC itself. So we needed a program that was far more effective and covered much more than insider trading, which is a small proportion of the cases that we bring every year.

So the SEC staff, in fact, crafted the whistleblower legislation that we believe would be far more effective, addresses the issues that are raised in the inspector general's report, and we think will allow us to really leverage the information that whistleblowers bring to the SEC on a broad range of potential violations.

Senator DURBIN. But you are asking for expanded authority to reward whistleblowers. If you were discounting what they could do, why would you ask for expanded authority in that program?

Ms. SCHAPIRO. But I am not discounting what they do. I believe we can make tremendous use of tips and complaints from whistleblowers.

In the narrow context of insider trading, which is the only place the existing program can be applied, it has not been an effective program. So we need legislative authority to craft a program that will allow us to give whistleblowers more meaningful recovery on their claims and that will cover more than simply insider trading which, as I said, frequently is not the result of a whistleblower coming to us because insider trading tends to be detected from abnormal trading activity in a stock prior to the announcement of a merger or an acquisition that is detected by exchange surveillance systems referred to the SEC and then prosecuted by us. So the program was flawed in many ways, which is why we asked to expand the program, make it more robust, and have the legislative authority to do that.

Senator DURBIN. So is the inspector general's report on the right track of what you need to do within your own agency about this program?

Ms. SCHAPIRO. I think the inspector general's report is on the right track, and in fact, many of the recommendations he made are really a result of talking extensively with our staff about how to make this program better.

Senator DURBIN. Senator Collins.

ENFORCEMENT ACTIONS

Senator COLLINS. Chairman Schapiro, there have been three issues in the press lately that affect the SEC that I particularly want to ask you about today to get your answers on the record and perhaps put an end to some of the speculation about one of these issues and that is the first one that I am going to begin with.

There has been speculation reported in the financial press that the SEC's case against Goldman Sachs was somehow motivated by the timing of the financial reform bill that the Senate will shortly consider. For the record, was the timing of the SEC's enforcement action against Goldman in any way connected to the Senate's actions on financial reform?

Ms. SCHAPIRO. Absolutely not, and I put out a statement to try and make that quite clear that we do not time our enforcement actions by the legislative calendar or by anybody else's wishes. We bring our cases when we have the law and the facts that we believe support bringing our cases, and that is exactly what happened

here, as has happened in the more than a dozen other financial crisis cases that we have brought in the past year.

Senator COLLINS. I share your view on that issue, but I think it is important for me to ask you for the record.

Ms. SCHAPIRO. I appreciate the opportunity to answer it.

EMPLOYEE MISUSE OF COMPUTERS

Senator COLLINS. The second question I want to ask you has to do with the disciplining of SEC employees who were involved in the porn case.

I really am so appalled at those findings by the inspector general because it was not just one or two people. According to the inspector general's report, 33 staffers at the agency were found to have looked at porn on their computers at work over the past 5 years, and 17 of them were highly paid employees that were earning between \$99,000 and \$222,000 a year.

An unrelated issue but another issue that causes me to ask what your process is and what are you doing to discipline employees has to do with the inspector general's criticisms of the SEC's failure to uncover the Madoff Ponzi scheme. Has the SEC taken any disciplinary actions against employees as a result of the inspector general's findings in the Madoff case?

Ms. SCHAPIRO. Senator, I am happy to respond to both of those.

In the first instance, let me say that it was the agency's own filters that detected the activity that was reported by us to the inspector general, and there were 33 persons, as you point out, cited in the inspector general's report over a 5-year period. And a number of those, in fact, were outside consultants.

That said, I completely share your disgust with this conduct. It is unacceptable at the Securities and Exchange Commission or anywhere else. We will deal very swiftly and very severely within the limits of the Federal employment rules and laws with anybody who abuses SEC resources. In fact, last week, I put out a message to all employees making it clear that anyone who abuses SEC resources in this manner or misuses them will be subject to termination. So we will deal with this very swiftly and severely, and all employees are clearly on notice with respect to that.

Many of these actions were a number of years ago, and disciplinary actions have already been taken at one level or another. We have significantly ramped up the potential penalties.

With respect to your last question regarding Madoff, as a result of the inspector general's investigation of the agency's failure to detect the Madoff fraud, there was a recommendation that we consider whether discipline is appropriate with respect to employees. I should say that, for example, in the Enforcement Division, of the 20 employees who were involved with Madoff investigations or examinations, 15 have already left the agency. With respect to those who are left, we have put in place a disciplinary process in accordance with the Federal rules that apply to all Federal workers in all situations like this. That process is intended to be fair and deliberative but appropriate, and we are going through that right now. It is well underway, and I cannot really comment on any specific actions, but I can assure you that a disciplinary process is underway.

Senator COLLINS. Thank you.
 Senator DURBIN. Senator Cochran.
 Senator COCHRAN. Mr. Chairman, thank you.

CORRECTIVE AND DISCIPLINARY ACTIONS

May I ask whether or not any of the findings and recommendations of the inspector general in the case that Senator Collins raised have been implemented, or have those who were found to have violated regulations or laws in this connection been punished? You mentioned that five are still working there, and there were others who resigned, as I understand it.

Ms. SCHAPIRO. The inspector general, Senator, issued his reports in August and October, and between them, they included about 69 different recommendations for the staff. As a result of that, very promptly, the offices that were involved, primarily our inspections group and our enforcement group, issued corrective action plans, which under Federal law generally require that corrective actions in response to an inspector general report be taken within 1 year. As of March 31—so between 4½ and 6 months after those reports were issued—the offices have completed corrective actions on 35 of the 69 recommendations. We are awaiting the inspector general's concurrence on 19 of those. The rest are substantially well underway and I think we are making very significant progress.

With respect to the employees, as I mentioned, a number of them have already left. We are looking at whether personnel action should be taken. There is, as I said, an established process that we are legally required to follow, as we would in any employment issue involving a Federal worker. And that process is well underway, and we will be happy, upon its completion, to report back to the subcommittee.

STANFORD PONZI SCHEME

Senator COCHRAN. I have several constituents from Mississippi who called and came up to Washington to visit with me and other Members of Congress and the Senate to tell us about their experiences in the really serious financial dislocations that have been caused by this scheme. It is really heartbreaking to realize that these people were really innocent victims of somebody's greed and corruption, and I want to be sure that whatever can be put in place to prevent this kind of thing from happening in the future is acted on and done quickly.

Can you assure the subcommittee that that is the step and that is the intent of the SEC in this case?

Ms. SCHAPIRO. Senator, absolutely. As soon as I arrived last January, I put into motion a number of things that we hope will reduce the chances of a tragedy like this ever happening again. So we changed leadership across the agency. We restructured our Enforcement Division. We are in the process of restructuring our examinations group. We are bringing in people who have new skills that are better able to understand some of the information that Mr. Madoff managed to so expertly fool the staff with. We are doing much better training. We have over 500 employees who have gone through either certified fraud examiner training or chartered financial analyst training.

We have put in place new rules that will allow us to leverage the work of accounting firms when an investment adviser custodies assets with an affiliate, which is what happened in this situation. They are now required to have a surprise audit by a PCAOB registered accounting firm and allow us to have access to that information immediately so we can look for suspicious activity.

And as I mentioned in my statement, we have put in place a system to try to better track tips and complaints and referrals so that the kind of information that the staff had about Madoff will have far less chance of slipping through the cracks.

We have worked day and night to do everything we can think of to try to minimize the chances of a horrific event like this ever happening again. I share your deep concern about it.

Senator COCHRAN. I appreciate your response and the obvious interest you have in helping to change things so that it will be less likely, we hope not likely at all, for something like this to happen in the future.

I wish there was some way that we could provide some kind of restitution, or through a request from the administration, Congress could provide you with some authorities to help do something to compensate these victims for this terrible scheme.

Ms. SCHAPIRO. Through the SIPC program, Madoff victims are entitled to recovery. It will not come anywhere close to replenishing the funds that many of them have lost or thought they had earned over many years of this Ponzi scheme. But I believe at this point, the SIPC trustee has paid out somewhere around \$680 million, and the trustee has gathered about \$1.5 billion for distribution to victims. It is a long and difficult process, but it is well underway.

Senator COCHRAN. Well, thank you very much.

Senator DURBIN. Senator Lautenberg.

Senator LAUTENBERG. Welcome, Ms. Schapiro.

Ms. SCHAPIRO. Nice to see you again.

Senator LAUTENBERG. Congratulations on the earnestness with which you have taken over this assignment. That was desperately needed because not only did people lose lots of money, but they lost faith in Government at the same time.

Ms. SCHAPIRO. Absolutely.

TIPS AND COMPLAINTS

Senator LAUTENBERG. It is a subject of interest of mine over some years. I still sit on the board of the Columbia Business School, my alma mater, and in 2001 I was able to establish a chair at Columbia that called for better business ethics in corporate governance in 2001. And while I claim some clairvoyance, the fact of the matter is that to me, having come from the corporate world, I saw a situation developing that I found very discouraging. And we have seen it in the last years when looking back at the testimony given the people who served earlier, without direct criticism, that there were responses to questions that said, well, we just did not know. We were not aware with whistleblowers presenting fairly significant evidence of failures on the part of the SEC.

Is that still a source of information? Do we still get that kind of information? What happens when you get something?

Ms. SCHAPIRO. Senator, we do in fact. We get hundreds of thousands of tips and complaints a year. One of the problems I discovered when I arrived last year was that they came in from many different sources, investors, other regulators, companies, other regulated entities, and they came in all over the SEC. And there was no mechanism to centralize this information, connect the dots that might provide useful information about a trend or a growing problem with a particular product or a trading strategy or a particular firm.

So we spent the money that this subcommittee very generously gave this agency last year in technology dollars to begin to build a centralized repository for all the tips and complaints and referrals that come into the agency. That phase one is completed. The next phase is to add risk analytics to that, and we have created an Office of Market Intelligence in our Enforcement Division that is charged with the responsibility for knowing the data that is in there, understanding what creates the highest level of risk for the investing public, following up on those leads, triaging them, following up on them, tracking them, and making sure that we act on them as responsibly as we can.

There are hundreds of thousands, and I would not sit here and tell you we will never miss another one. But we have done everything we can think to do.

Senator LAUTENBERG. That is important. Could it be considered a fairly reliable source of inquiry that the SEC will look to these things? Because there was a pathetic response to why action was not taken in one case.

Ms. SCHAPIRO. Absolutely.

Senator LAUTENBERG. I see that your budget request clearly identifies enforcement as SEC's top priority, and obviously, it is brought about by the years of neglect that preceded this.

How do you stimulate your people to go after these things when the culture before was so neglectful? Are you able to keep track of what is going on there?

IMPROVING SEC ENFORCEMENT

Ms. SCHAPIRO. It is a great question. And I will tell you that I think—and I do not mean to sound Pollyannaish about this, but that the culture of the agency was maybe submerged a little bit over the last several years, but there is tremendous enthusiasm again for our enforcement role. We took the handcuffs off our Enforcement Division within 1 week after I arrived at the end of January last year. We told the enforcement staff that they could issue subpoenas without waiting for the five Commissioners to sit in a meeting and vote on it. It took months off the investigative process.

We enabled our staff to go ahead and negotiate corporate penalties with public companies in enforcement cases instead of getting permission in advance from the Commission, again speeding up the process, empowering them to do their jobs.

We created five specialized units of people with deep expertise and we are having tremendous success in recruiting people that will focus on specific areas and get deep and knowledgeable about structured products, asset management, insider trading, and market abuse, Foreign Corrupt Practices Act, and so forth. So we have

these specialized units that are going to be far more efficient, I believe, in bringing cases.

We took a layer of management out of the Enforcement Division and put hundreds of really talented people back on the front lines of doing the investigations and bringing cases.

We have done the most significant restructuring of the enforcement program in 30 years, and I think we are already seeing it pay dividends in the level of complexity of cases that we are bringing. If you look at the major cases over the last year, they are quite extraordinary. And, also the number of cases. For example, in 2009 over 2008, we shut down twice as many Ponzi schemes far earlier than the Madoff scheme would ever have been shut down.

CORPORATE COMPENSATION PROGRAMS

Senator LAUTENBERG. I would just ask the chairman, if I might take a moment from using and say that as you look at executive compensation, which I know is one of the things that you see—I ran a pretty good-sized company before coming here and was very conscious of things that we did to stimulate attitudes within the working population of the company, and when we put any money into the outside world to try and help us, we have effectively.

To me, a year-end—a termination bonus, what not to be the mark—a mark based on the stock price, but based on what good the individual did for the company, and instead of paying a bonus immediately, trail it out over maybe a 5-year period and say if the company achieved certain marks after you have been here, that is when the big bonuses ought to come. And I do not know what right you have at the SEC to make the recommendations on that basis or even to think about it.

Ms. SCHAPIRO. Senator, while I do not think we can dictate the terms of compensation arrangements, we did approve new rules in January that are in effect for this current proxy season that require the board of directors to explain to shareholders how they compensate risk-taking within the corporation and whether their compensation programs broadly, for all employees, not just the top five, might incentivize short-term risk-taking, how the board handles risk within the organization more broadly, as well as some others that we call proxy enhancements.

It is disclosure based, as much of our rules are, but I think it is forcing boards to really think about what do they want to say about their compensation programs and how do they want to explain the linkage between compensation and risk which we have seen over the financial crisis to be a strong link and one that had very deleterious effects at the end of the day.

Senator LAUTENBERG. I am glad to see that there is some fire in the belly over there.

Ms. SCHAPIRO. There is much fire.

CHIEF COMPLIANCE OFFICER WITHIN SEC ORGANIZATION

Senator DURBIN. Chairman Schapiro, you announced the appointment of a new chief compliance officer to serve as the internal watch dog to monitor security holdings and transactions by your own employees and, in your own words, said that this had to be

a world-class compliance program just as we expect from those we regulate.

There was an article that followed that decision, once they found out where this compliance officer would be standing on the pecking order or the administrative stair steps of your agency. There was a concern that this person really did not report—was in a post buried within the Office of Ethics Council, did not have an independent status, and did not report to you or another high-ranking official. The question was raised as to whether or not this really was a world-class attempt to deal with a serious problem that might involve some conflict of interest within your own agency.

Ms. SCHAPIRO. Senator, let me address this because I think the article was actually quite off the mark.

When I arrived at the SEC, I was surprised, I will say, to learn that there was not a system for monitoring employees' stock transactions, and I had come from an organization where we had quite a rigorous one. So I immediately brought in a contractor to help us develop a system that requires every employee to enter all of their stock holdings and all of their securities accounts into a centralized system. It enables employees to pre-clear any trades and ultimately will receive directly from brokerage firms duplicate copies of employees' statements.

At the same time, we are working with the Office of Government Ethics to bolster the existing rules that apply across the Government and no employee will be permitted to trade in the stock of any company under investigation by the SEC, whether or not they have any knowledge of it at all. That will also require preclearance and certification that they have access to no nonpublic material information about those companies. We are negotiating those rules out with the Office of Government Ethics right now.

The person we hired is responsible for that system. We have an entire Office of Ethics within the SEC. I meet with them regularly. In fact, I met with the new compliance officer this morning. But her responsibility is with respect to that system. It is not a chief compliance officer in the sense of one in a brokerage firm, which I think that article was trying to equate.

Senator DURBIN. So can this person report directly to you?

Ms. SCHAPIRO. She could. In fact, I met with her yesterday, and she knows my door is open to her at any time.

Because she is responsible for managing the system within the context of the many other ethical reviews that go on within the agency, it made sense to put her in the Office of the General Counsel. I would have no problem changing the reporting line. I think she will actually get more attention, though, and more focus there, and she knows she can come to me anytime, frankly, as every employee does on any issue that is of concern to them.

STANFORD PONZI SCHEME

Senator DURBIN. Let me ask you about the report that was released on April 16 from the Inspector General's Office about the *Stanford* case and the fact that this case was—Allen Stanford was indicted last year by the SEC in a \$7 billion fraud case, accused of fleecing more than 21,000 people, primarily through the sale of

a prized investment, certification of deposits issued by his bank headquarters in Antigua, and then sold at a brokerage.

The SEC's Fort Worth office was aware since 1997 that Robert Allen Stanford was likely operating a Ponzi scheme. But as the inspector general report states, no meaningful effort was made by enforcement to investigate. SEC agents began looking at Stanford's companies in 1998, 2002, and 2004, but dropped their efforts. The inspector general report also said SEC supervisors were more interested in quicker turnaround cases at the time, not the kind of examinations needed to look into a complex entity like Stanford. And to make it worse, the former chief of enforcement at SEC's Fort Worth office who helped quash the inquiries later went to work for Stanford in 2006 before he was told by the SEC to stop because it "was improper to do so."

Like the case of Madoff, the scathing report offers another reminder of potential breakdowns in regulatory oversight. I recognize that these circumstances like the Madoff situation preceded your arrival. Yet, cases like this can fester and then bubble up to surface years later.

What controls does the SEC have in place now that would ensure that a disturbing mess like the *Madoff* and *Stanford* cases do not reoccur? What else should be done to make sure that they do not?

Ms. SCHAPIRO. Senator, let me speak specifically to Stanford because I have talked quite a bit about all the changes that we have put in place with respect to Madoff, although I am happy to discuss those in much more detail.

With respect to the conduct that was discussed by the inspector general in the *Stanford* case, there were many missed opportunities, without a doubt, in that 1997 to 2005 period before the agency took Stanford up seriously and earnestly to have done something. I was not there, so I do not truly understand what happened.

I will tell you that we have new leadership across the board in this agency, in the inspections program, as well as in the enforcement program. We have created escalation committees so that if an examiner believes that they have found something that is a real problem and they are not getting the response when they refer it over to the Enforcement Division that they want, they take it to an escalation committee and that will go all the way up into the senior ranks of the organization.

We have new management reporting metrics that have been put in place in the Enforcement Division and regular review of open matters in both the examinations group and the enforcement group so that we can be sure things are not sitting for a long time.

Decisions will be made sometimes to shut down a matter because there is not sufficient evidence, and we could miss something by doing that. But it has to be a conscious decision based on the evidence that is in front of people at the time. It cannot be because of neglect that something has not been pursued.

So I think between the leadership changes, the structural changes within enforcement, the structural changes that I anticipate we will be announcing in the inspections group before very long, the creation of the escalation committees, and the new reporting mechanisms within the divisions, I am hopeful that we will never have a repeat of that incident.

OVERSIGHT BY APPROPRIATIONS COMMITTEE

Senator DURBIN. Let me say in closing, before turning it over to Senator Collins, the questions I have asked you today have been pointed. They have involved issues that are important and controversial. It is part of our responsibility on this side of the table with the oversight of your agency to ask those questions. There are some in the Senate now who want us to be taken out of this process. They do not want these questions to be asked, and I think that is wrong. We have a responsibility to make sure that you do your job and do it well and provide you with the resources to accomplish your goals, and the notion that the oversight of the Appropriations Committee is unnecessary for an agency as important as the Securities and Exchange Commission is just plain wrong. And I hope that we can continue a positive, constructive relationship providing you the resources and support you need, but you can count on this. As long as this Appropriations Committee is involved, each year you will face questions that get to the heart of your activities and be held accountable as we are held accountable.

Ms. SCHAPIRO. Senator, I appreciate that. I always endeavor to be completely transparent about what is happening at the SEC, what I see that is wrong, and how I am trying to fix it. This is an institution that must always learn from its mistakes, and that is my commitment to you. I will answer your questions.

Senator DURBIN. Make no mistake. I still have confidence in your leadership, but we have a responsibility on our side of the table as well.

Ms. SCHAPIRO. I understand.

Senator DURBIN. Senator Collins.

Senator COLLINS. Mr. Chairman, let me first wholeheartedly agree with the statements that you just made. I am going to bring up one of those kinds of questions right now too.

GLOBAL SECURITY RISK MANAGEMENT

In 2004, at the direction of Congress, the SEC established the Office of Global Security Risk Management, and this was created—and probably the chairman was involved because I know this is an issue that has mattered to him for a long time. It was created to protect investors from the risk associated with investing in companies doing business in nations that are designated as state sponsors of terrorism by the Department of State.

But the office within the SEC has failed to vigorously carry out its mandate. Its most important mandate is to ensure that all companies that are sold on American exchanges that operate in those countries are disclosing their activities to investors. I know the chairman and I have supported legislation that has allowed State pension funds to divest their holdings in such cases.

Why has the SEC not been more aggressive in following through by issuing regulations to ensure that corporations do disclose the information about their activities in such countries to their investors?

Ms. SCHAPIRO. Senator, the Office of Global Security Risk, as you point out, was created in 2004. In that period between then and now, that office has reviewed about 800 corporate filings that dis-

close doing business on some level with Iran, Syria, Sudan, or Cuba that are on the State Department list.

The disclosure requirements are based on materiality, and that is something we could change. But there is not a separate line item disclosure for any level of business with one of those countries. So we look at materiality both quantitatively and qualitatively—the amount of the business that is done with one of those countries relative to the size of the company. Is it humanitarian or is it potentially business that could have a military application, for example? Is the business continuous or isolated? Is there just one instance and so forth? So we do this materiality analysis, and if the staff determines that the contact with one of these countries is material, then disclosure is required.

We could look at—in fact, I will tell you we are looking at whether this should be line item disclosure without regard to the materiality of the business conduct between the public company and one of these four nations that are currently on the list.

DISCLOSURE AND MATERIALITY TEST

Senator COLLINS. Well, let me follow up on that because I am told that in November 2007, the SEC issued a concept release seeking comment on whether to develop a better mechanism to allow investors to have better disclosures in this area and that the comment period ended in January 2008 and that the SEC has taken no action since that time.

Ms. SCHAPIRO. I have asked the staff to—

Senator COLLINS. Is that incorrect?

Ms. SCHAPIRO [continuing]. Go back to that. Again, as I said, we are looking at whether line item disclosure here as opposed to our normal you must disclose material risks to the business or material levels of business in this regard.

Senator COLLINS. But why has there been no action for 2 years since the comment period—more than 2 years?

Ms. SCHAPIRO. I think there has been a general view that our disclosure system is about disclosure that helps people make investment decisions and make the right decision about purchasing or selling a financial asset, and that if it is a de minimis amount of business that is being done with respect to one of these countries, does it meet either the qualitative materiality or the quantitative materiality standards, that it will not be useful disclosure. As I said, we are revisiting that issue now.

Senator COLLINS. Well, what I would say is I think you have a good point about de minimis business, but you ought to complete the work on it so that investors do have access to that information because there are many investors who will not want to do business with a company or will not want to buy shares in a company that is doing business with one of these countries.

Ms. SCHAPIRO. And if I could just add one thing because you mentioned the law with respect to divestiture. Our very recent filing reviews show that two mutual funds, CREF and Old Mutual, have actually relied on that safe harbor to divest themselves of stocks of companies doing business in the Sudan. So I think that is very good news.

Senator COLLINS. I do too.

FIDUCIARY DUTIES OF BROKER-DEALER

Yesterday, as you know, at the hearings on Goldman Sachs, I asked what I thought was a pretty straightforward question to several of the bankers. I asked them whether they considered themselves to have a duty to act in the best interests of their clients, the kind of fiduciary obligation that investment advisors have. And to say that they danced around and evaded answering my question would be an understatement. But the fact is that the law currently does not impose that kind of fiduciary obligation on broker-dealers.

In your judgment, should the law impose a fiduciary obligation on broker-dealers?

Ms. SCHAPIRO. It absolutely should, and we have been strongly advocating for the regulatory reform bill to require that both investment advisors—and we have discussed this in a retail context, I will say, not with respect to the discussions this week about large institutional investors. But at a minimum, when you are dealing with the retail public, they are entitled to know that the financial services professional sitting across the table from them puts their, the customer's, interest first ahead of their own in all circumstances. There are some conflicts that perhaps can be disclosed. There are some conflicts that cannot be disclosed away in my view.

The duty that exists on the investment advisory side does not exist clearly on the broker-dealer side, and we need the law to make this a uniform fiduciary duty, and I am very hopeful that the Senate bill which does not have that provision right now will emerge with that provision in place. Right now we are required under the Senate bill to do a study. We are happy to study the issue, although I will say the SEC contracted with the RAND Corporation several years ago to do a study of this issue. So there is lots of work out there.

We will look at it again, but we would hope that when a study is done, it would trigger our ability to write the rules that would create a fiduciary duty if the study suggested that that is what is necessary. My personal bias, I will tell you out of the box, is that that is necessary.

Senator COLLINS. In writing this new rule, if we did, should we distinguish between individual retail investors for whom having that obligation is perhaps even more important because they are less sophisticated arguably than most institutional investors, or should it apply across the board?

Ms. SCHAPIRO. I think in the first instance, we have got to take care of retail investors. This is really a disgraceful situation in many ways.

But I would also note that in the Senate Agriculture Committee bill, there is a fiduciary duty that swap dealers owe to pension plans and municipalities, and that seems to me to be a very good idea.

So I think we could step this up over time to be broader, but I would start very clearly with retail.

Senator COLLINS. Thank you.

If you would provide me with a copy or provide the subcommittee with a copy of the RAND study, that would be helpful to us.

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

[The information follows:]

The Rand Report on Investor and Industry Perspectives on Investment Advisers and Broker-Dealers can be found at the following website address: http://www.rand.org/pubs/technical_reports/TR556.html.

Senator COLLINS. Mr. Chairman, I apologize for exceeding my time.

I am going to submit a question on Allied Capital, that case which was also criticized by the inspector general, for the record and some other questions as well.

But thank you for the additional time.

Senator DURBIN. Senator Collins, thank you very much.

And let me just also say that I applaud your last line of questioning and believe that you have really touched on something that is absolutely essential. Maybe we can find some bipartisan ground to share here on this. I think I could support your effort, and I am glad to hear that the chairman believes it is a wise undertaking. So maybe we can build on that.

ADDITIONAL COMMITTEE QUESTIONS

The record of this subcommittee is going to be open until next Wednesday, so we may submit some written questions, and other members may join us.

In the meantime, thank you so much for being with us today.

Ms. SCHAPIRO. Thank you.

Senator DURBIN. Keep up your good work.

Ms. SCHAPIRO. Thank you.

[The following questions were not asked at the hearing, but were submitted to the Commission for response subsequent to the hearing:]

QUESTIONS SUBMITTED BY SENATOR THAD COCHRAN

Question. There is a proposal in the financial reform bill that would make the SEC self-funded through the fees that it recovers. This effectively would exempt the SEC from Congressional appropriations and budgetary oversight. Before Congress decides to give up its constitutional responsibilities for directing Federal spending and providing necessary oversight over the Executive branch, we ought to know exactly what circumstances justify such an exemption for the SEC. What do you think those circumstances are?

It seems to me that, now more than ever, Congressional oversight is needed to “regulate the regulators” and to hold accountable those regulators who fail to do their jobs correctly. The SEC made many mistakes during the financial crisis. Recent reports by the Inspector General and others show that these problems were caused by mismanagement at the SEC, and not by any funding shortages. Shouldn’t Congress demand even more accountability of the SEC, rather than allowing the SEC to freely spend a greatly expanded budget?

Answer. As you know, the final Dodd-Frank Act that became law on July 21, 2010 did not include the self funding provision. That said, the Dodd-Frank Act does contain several funding reforms that I believe are very positive for the SEC. These improvements to the funding process should ensure appropriate Congressional oversight while addressing important issues regarding the agency’s funding. In particular, I am pleased that the Act will permit the SEC to provide information directly to the Committee regarding our funding requirements. I believe this enhanced communication will complement the ongoing Congressional oversight. I fully support these funding reforms and ensuring full transparency by the agency.

Question. The Office of the Inspector General identified several problems at the SEC, following its investigation of Stanford Financial. None of these involved inadequate funding or inadequate staffing at the SEC. Other recent reports identified senior-level employees using SEC computers to view pornography for hours a day when they should be protecting investors, and enforcement officials refusing to pur-

sue novel or more complicated cases. None of this suggests that if we give the SEC more funding, or the ability to fund itself, that the SEC's competence would improve as a result. Can you explain why Congress should give so much deference to the SEC, when it is plagued by these failures and mismanagement?

I am very troubled by the Inspector General's report on Stanford Financial. Many Mississippians and other Americans lost their life savings by investing in what were freely marketed as safe, Certificate-of-Deposit investments. Dating back to 1997, the SEC's Fort Worth Examination Group repeatedly requested that an enforcement action be brought against Stanford Financial. That was over 12 years before the SEC actually brought an enforcement action. The Inspector General found serious managerial, cultural, and performance-based problems at the SEC, which led to this terrible failure. First, what are you doing to help compensate the victims of the Stanford Financial fraud? And second, what steps are you taking to ensure that the performance problems identified in the Inspector General's report are corrected at the SEC?

Answer. The SEC is taking the situation of Stanford victims very seriously. In addition to working aggressively to maximize recovery to investors harmed by the Stanford fraud, Commission staff is studying all the facts relating to the *Stanford* case with respect to whether a legal basis exists for a SIPA liquidation of the registered broker-dealer, the Stanford Group Company. As part of this review, I have met with representatives of the Stanford Victims Coalition, and Commission staff also has met with a number of Stanford victims to discuss this matter. We continue to review the facts of the case to determine whether there is a statutory basis for providing SIPC coverage to the victims, and will continue to work with Congress in this regard.

With respect to the conduct that was discussed by the inspector general in the *Stanford* case, there were clearly many missed opportunities in the 1997 to 2005 period covered by the report. Since that time, much has changed regarding the agency's leadership, its internal procedures and its culture of collaboration. Even before the IG's report, the agency had taken a number of steps which address the concerns raised in the report. These steps include:

- Establishing escalation procedures and revamping the process for handling tips, complaints and referrals.
- Changing performance metrics so that quantity does not trump quality.
- Streamlining approval procedures in enforcement investigations.
- Establishing and consistently applying factors for referring matters to others agencies.
- Making effective use of other resources within the agency, such as economic and international experts.
- Training Enforcement Division staff on potential remedies available under the laws applicable to both investment advisers and broker-dealers.
- Sensitizing employees who leave the organization to their ongoing restrictions.

QUESTIONS SUBMITTED BY SENATOR SUSAN COLLINS

Question. An Inspector General report found that the SEC did not properly pursue allegations made against Allied Capital, but instead went after the hedge fund manager who challenged the value of Allied Capital's investments. This allegedly occurred after heavy lobbying by Allied, who was represented by a former SEC official. These actions raise concerns about how decisions are made at the agency about bringing and conducting investigations.

What procedures and criteria does the Enforcement Division use to review and approve new investigations?

Answer. The Division pursues all information it receives concerning potential violations of the Federal securities laws and Commission rules. We generate and receive leads for new investigations through a variety of efforts, including research, market surveillance, examination referrals, and observation by Division staff. We also receive tips and other information from outside the Division and outside the agency.

Upon receipt of a Tip, Complaint or Referral ("TCR"), the Division's Office of Market Intelligence analyzes TCRs and triages the information provided, sometimes in consultation with other Divisions and Offices, to determine whether the information provided (along with any other similar information already available to the Commission) alleges a potential violation of the Federal securities laws or Commission Rules such that further review by an investigative group is warranted. If the information warrants further review, the Office of Market Intelligence assigns the TCR

to an investigative group that, among other things, analyzes the information to determine programmatic significance and resource availability.

When the investigative staff generates information or receives a TCR concerning potential violative conduct, the investigative staff determines whether to open a Matter Under Inquiry ("MUI") based on whether a sufficiently credible source or set of facts suggests that a MUI could lead to an enforcement action that would address a violation of the Federal securities laws. Basic considerations used when making this determination may include, but are not limited to:

- The statutes or rules potentially violated;
- The egregiousness of the potential violation;
- The potential magnitude of the violation;
- The potential losses involved or harm to an investor or investors;
- Whether the potentially harmed group is particularly vulnerable or at risk;
- Whether the conduct is ongoing;
- Whether the conduct can be investigated efficiently and within the statute of limitations period; and
- Whether other authorities, including Federal or State agencies or regulators, might be better suited to investigate the conduct.

While the threshold analysis for opening a MUI is relatively low, determining whether the MUI should be converted to an investigation or whether to open an investigation, is typically a more detailed evaluation that is based on additional information. The evaluation for whether to convert a MUI to an investigation (or open an investigation) turns on whether, and to what extent, the investigation has the potential to address violative conduct. Threshold issues for the investigative staff to consider when evaluating the facts include: (1) Do the facts suggest a possible violation of the Federal securities laws involving fraud or other serious misconduct? (2) If yes, is an investment of resources by the staff merited by: (a) the magnitude or nature of the violation, (b) the size of the victim group, (c) the amount of potential or actual losses to investors, (d) for potential insider trading, the amount of profits or losses avoided, or (e) for potential financial reporting violations, materiality? (3) If yes, is the conduct: (a) ongoing, or (b) within the statute of limitations period?

In addition to the threshold issues above, one way to determine whether the conduct is serious is to consider the following supplemental factors:

- Is there a need for immediate action to protect investors?
- Does the conduct undermine the fairness or liquidity? of the U.S. securities markets?
- Does the case involve a recidivist?
- Has the SEC or Division designated the subject matter to be a priority?
- Does the case fulfill a programmatic goal of the SEC and the Division?
- Does the case involve a possibly widespread industry practice that should be addressed?
- Does the matter give the SEC an opportunity to be visible in a community that might not otherwise be familiar with the SEC or the protections afforded by the securities laws?
- Does the case present a good opportunity to cooperate with other civil and criminal agencies?

Both senior management and frontline staff participate in the analysis to determine whether to open a MUI, to convert a MUI into an investigation, or to open an investigation. Leveraging the skill sets and experience of staff and management ensures that Division resources are efficiently utilized in the investigation of enforcement matters. This process gives the Division the ability to have a unified, coherent, coordinated response to the huge volume of information we generate or receive every day, thereby enhancing the Division's ability to open the right investigations, bring solid cases, and more effectively protect investors.

Question. How does the Commission evaluate the implementation of these procedures to ensure that the division is managing its operations efficiently?

Answer. Managing the flow of information into and throughout the Division is critical to effective operations within the Division. We have established systems and procedures that enable senior management to track a host of critical elements including the flow of information and the progress of investigations. For example, TCRs are now logged into a single, searchable database system. This allows management to track TCRs to ensure that each TCR is appropriately referred to the investigative staff, or otherwise resolved. The staff has been instructed as to procedures for memorializing their resolution decisions, which ensures that there is a record that can be audited.

Simultaneously, we have been working on a new intake and resolution system that will allow us to capture even more information about TCRs. The new system will provide more robust search capabilities so that TCRs can be better assessed or

triaged. In addition, this new system will add enhanced workflow abilities so we can track how TCRs are being used throughout the agency. We expect to deploy this system later this year. Meanwhile, we also are in the early stages of designing the third phase of this system, which will add risk analytics tools to help us quickly and efficiently identify high value tips and search for trends and patterns across the data.

We have also enhanced our ability to manage workflow to improve the oversight of our investigations. Senior management tracks all MUIs and investigations within the Division to ensure that resources are allocated appropriately, MUIs and investigations are conducted efficiently, and enforcement recommendations, or other resolutions, are completed timely. A bi-weekly report on MUI openings allows senior management to closely track new matters. Investigations are reviewed on a quarterly basis by senior management and the investigative staff. This review process ensures that robust investigative theories are developed, potential obstacles are identified early, and investigations advance appropriately. The quarterly review process also increases the Division's opportunities to coordinate enforcement efforts with other agencies.

Additionally, senior management designates certain investigations as National Priority investigations; these include, among others, cases of potential programmatic significance, where the alleged misconduct occurred in connection with products, markets, transactions or practices that pose particularly significant risks for investors or a systemically important sector of the market. The Office of the Director tracks National Priority investigations on a monthly basis to ensure swift and efficient resolution of these matters. The Director routinely meets with investigative staff and management assigned to each matter designated as a National Priority investigation.

In addition to the systems and procedures to manage TCRs and the progression of MUIs and investigations, the Division has implemented several methods to track routine investigative benchmarks such as issuing subpoenas, taking testimony, and making recommendations to the Commission. We implemented a practice whereby the staff must obtain the Director's approval before requesting an extension of a tolling agreement. Division management uses a Dashboard metric to continually measure the progress of the Division and we compare our progress to both our internal goals and past results.

SUBCOMMITTEE RECESS

Senator DURBIN. The subcommittee stands in recess.

[Whereupon, at 4:08 p.m., Wednesday, April 28, the subcommittee was recessed, to reconvene subject to the call of the Chair.]

FINANCIAL SERVICES AND GENERAL GOVERNMENT APPROPRIATIONS FOR FISCAL YEAR 2011

THURSDAY, MAY 20, 2010

U.S. SENATE,
SUBCOMMITTEE OF THE COMMITTEE ON APPROPRIATIONS,
Washington, DC.

The subcommittee met at 3:03 p.m., in room SD-192, Dirksen Senate Office Building, Hon. Richard J. Durbin (chairman) presiding.

Present: Senators Durbin and Collins.

FEDERAL TRADE COMMISSION

STATEMENT OF HON. JON LEIBOWITZ, CHAIRMAN

OPENING STATEMENT OF SENATOR RICHARD J. DURBIN

Senator DURBIN. Good afternoon.

I am pleased to welcome you to this hearing before the Financial Services and General Government Appropriations Subcommittee.

And my apologies for running a few minutes late. We had a vote at 2:30 and had to wait until the end to make sure that everything turned out just right.

Today's hearing focuses on the Federal Trade Commission (FTC), both in the agency's budget request for fiscal year 2011 and on oversight.

Testifying before us this afternoon is the Chairman of the FTC, Jon Leibowitz.

Thank you for being here.

Mr. LEIBOWITZ. Thank you.

Senator DURBIN. I welcome my distinguished ranking member, Senator Susan Collins of Maine.

Consumers are affected every day by the Federal Trade Commission's work. Thanks to the Federal Trade Commission, consumers receive fewer telemarketing calls and e-mail spam, obtain free credit reports, receive identity theft victim assistance, can rely on truthful information on products and services, and benefit from competition in the marketplace through lower prices, more choice, and higher-quality products and services.

Funding provided to the FTC supports these successful outcomes. Over the past 3 years, the Federal Trade Commission saved consumers more than \$1.4 billion in economic injury by stopping illegal practices in the marketplace. Last year alone, the FTC took action against mergers likely to harm competition in markets, with

a total of \$22.3 billion in sales. Since 2006, the FTC's budget has grown to support a staff of 1,170, a cumulative 4-year staffing increase of 16 percent. New staff have enhanced the agency's ability to protect consumers and preserve competition. The growth of the staff and budget reflect a rapidly evolving and sophisticated marketplace. As technology continues to transform, consumers are enjoying revolutionary services and information unimaginable just a short time ago.

But, unfortunately, the risk from new technology has also increased, such as identity theft, privacy violation, and data security concerns. Newly hired FTC staff have been assigned to respond to these increased risks, not just through enforcement, but also through education of consumers and industry.

Funds provided to the FTC have also allowed the Commission to focus on risks from the current economic downturn. Unemployment and the foreclosure crisis have created prime opportunities for fraudsters to prey on financially vulnerable Americans. Since 2009, the FTC, working with States and other agencies, has been involved in bringing more than 200 cases against firms deceiving homeowners into paying for bogus mortgage modifications and foreclosure-avoidance schemes.

PREPARED STATEMENT

I am not going to go through the rest of my statement here, but make it part of the record, because I'm anxious to give my colleague a chance and then to open it up to questions.

[The statement follows:]

PREPARED STATEMENT OF SENATOR RICHARD J. DURBIN

Good afternoon. I am pleased to welcome you to this hearing today before the Financial Services and General Government Appropriations Subcommittee.

Today's hearing focuses on the Federal Trade Commission, both on the agency's budget request for fiscal year 2011 and on oversight of previously appropriated funds.

Testifying before us this afternoon is the Chairman of the FTC, Jon Leibowitz.

I welcome my distinguished Ranking Member Susan Collins, others who join me on the dais today and others who may arrive.

Consumers are affected every day by the FTC's work. Thanks to the FTC, consumers: receive fewer telemarketing calls and e-mail spam; obtain free credit reports; receive identity theft victim assistance; can rely on truthful information about products and services; and benefit from competition in the market through lower prices: more choice, and higher quality products and services.

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New staff have enhanced the agency's ability to protect consumers and preserve competition in the marketplace.

NEW TECHNOLOGIES, FINANCIAL FRAUD SPUR FTC GROWTH

The growth of FTC's staff and budget reflects a rapidly evolving and sophisticated marketplace. As technology continues to transform, consumers are enjoying revolutionary services and information unimaginable just a decade ago.

But unfortunately, the risks from new technology and capabilities have also increased, such as identity theft, privacy violations, and data security concerns. Newly-hired FTC staff have been assigned to respond to these increasing risks, not just through enforcement but also through education of consumers and industry.

Funds provided to the FTC have also allowed the FTC to focus on risks resulting from the current economic downturn.

Unemployment and the foreclosure crisis have created prime opportunities for fraudsters to prey on financially vulnerable Americans.

Since 2009, the FTC, working with states and other agencies, has been involved in bringing more than 200 cases against firms deceiving homeowners into paying for bogus mortgage modifications and foreclosure avoidance schemes.

To reduce mortgage-related scams in the long term, the FTC has initiated a rule-making proposing to prohibit companies from charging fees in advance of any loan modification services and to require specific disclosures so that consumers can make informed decisions.

MARKET MONITORING AND ANALYSIS PROMPTS FTC GROWTH

Staffing increases over the last several years have also enhanced the FTC's ability to monitor and review the competitiveness of increasingly complex industries. One of these is the petroleum market. Americans rely on this market for transportation and to heat and light our homes and businesses.

The FTC continuously monitors gas and diesel prices to track trends and potential market distortions. Just last year, the FTC created a new rule to prohibit fraud and deceit in wholesale petroleum markets. The FTC also educated businesses on compliance with the specific directives included in the new rules. Together these steps will enhance the competitiveness of the petroleum market.

FUTURE FUNDING

For fiscal year 2011, the FTC requests \$314 million. This is an increase of 7.6 percent over the fiscal year 2010 enacted level and would allow the FTC to hire 40 new staffers in similar growth areas from previous years. In particular, the FTC requests to add staff to handle the increasing workload related to financial practices, privacy and data security, and complex merger transactions.

I look forward to discussing these and other issues with you.

Senator DURBIN. But, Mr. Chairman, thank you for being here. My apologies, again, for running late.

Mr. LEIBOWITZ. No problem.

Senator DURBIN. Senator Collins.

STATEMENT OF SENATOR SUSAN COLLINS

Senator COLLINS. Thank you, Mr. Chairman.

I appreciate your holding this hearing on the budget request of the Federal Trade Commission.

As you pointed out, the FTC deals with issues that affect the economic life of all Americans. Through its administration of a wide variety of consumer protection laws, the FTC protects consumers from deceptive practices, such as fraudulent and predatory scams, identity theft, and credit fraud. The FTC also works to help American consumers by preventing unfair methods of competition in the marketplace.

I've long had an interest in combating consumer fraud. As the chairman may recall, when he was a member of what was then the Governmental Affairs Committee, we worked together on a lot of consumer fraud hearings.

Unfortunately, today we see that the incidence of fraud and predatory scams appears to be on the rise as con artists prey on citizens, particularly the elderly, who are facing financial hardship. And, unfortunately, in tough economic times, people seem to be more vulnerable to scams and schemes because, in many cases, they are in desperate financial straits. These con artists exploit these tough economic times to lure Americans into scams that look and sound legitimate.

At the Homeland Security Committee, we held hearings at which the FTC Chairman testified, looking at the scams associated with the stimulus bill last year. These con artists not only rob their victims of money, but also of their dignity. And that, in many cases, can make senior citizens reluctant to come forward and seek the help that they deserve.

I look forward to hearing from Chairman Leibowitz on the FTC's most recent efforts to identify and publicize these types of scams and other financial frauds.

I'm also very interested to learn more about the FTC's efforts to address anticompetitive pay-for-delay patent settlements, which keep lower-cost generic drugs off the market and cost consumers and taxpayers billions of dollars. And, judging from the charts before us, I think that the Chairman is going to address that issue, and I'm very glad that he is.

Finally, as I represent a State that borders Canada, I'm also interested to hear more about the Commission's effort to combat cross-border fraud, which periodically rears its ugly head in my State.

I also look forward to getting into a discussion about certain privacy issues, such as whether the FTC is investigating allegations against Google violating the privacy rights of our citizens as through its street view mapping activities. That's the allegation, and I look forward to discussing that, as well.

Thank you, Mr. Chairman.

Senator DURBIN. Thank you, Senator Collins.

Chairman Leibowitz.

SUMMARY STATEMENT OF HON. JON LEIBOWITZ

Mr. LEIBOWITZ. Thank you so much, Chairman Durbin, Ranking Member Collins, for inviting me to testify today, and for those very kind words about our agency.

As you know, the mission of the Federal Trade Commission is extraordinarily broad. And we pursue it vigorously, but with a very limited number of people.

For fiscal year 2011, we're requesting \$314 million and 1,207 FTEs. But, to put that into perspective, in 1979, when the population of the United States was only 225 million, before the Do Not Call list, before Internet scams, actually before the Internet, and a host of new statutory responsibilities, the FTC had nearly 1,800 FTEs.

With the active support of this subcommittee, we have been aggressive in our efforts to protect consumers from unfair and deceptive acts and unfair methods of competition. We look forward to doing even more in 2011. And we're going to have to do more, because, unfortunately, the recession has meant that American consumers are at an even greater risk than usual for financial frauds.

As scams have proliferated, we have tried to step up our efforts to stop them. Since the beginning of last year, the FTC has brought more than 40 cases against fraud targeting financially distressed consumers—and we're partnering more with the State attorneys general these days, although we always have—we've brought more than 300 cases to shut down foreclosure rescue scams, fake job of-

fers, and, as you mentioned, Senator Collins, phony access to Federal stimulus money.

These sorts of scams are not new. In the last decade, sadly, we've recovered nearly \$500 million for consumers who lost their money in the financial frauds area alone, which is a strikingly large amount of money.

The Commission has also used the rulemaking authority that you provided for us. In February, we proposed the rule that would ban advance fees by mortgage modification companies. And we expect to complete that rulemaking this summer. As we've seen in our law enforcement actions, far too often, consumers pay thousands of dollars in advance for these services, but they receive nothing in return. And that's often because these scams have 95 percent of their employees in sales and 3 percent of their employees doing modifications. The Commission has also proposed rules in the debt settlement and mortgage servicing and advertising areas.

We continue to prioritize consumer privacy and data security. We bring actions against companies that don't adequately protect consumers' personal information; we've brought 29 cases, to date. And we provide information to 15,000 consumers a week who call about identity theft.

Emerging technologies and business models, including social networking behavioral advertising, hold significant promise for consumer benefits, but also, as you mentioned, risks to privacy. So we are examining them closely. We've held a series of roundtables. We plan to share what we've learned and make recommendations later this year.

Do Not Call continues to be a success. I was almost going to say "ringing success," but I thought that would be a bad pun. But, I guess I did, and I guess it was. We anticipate that, by the end of June, 200 million numbers will be registered. The FTC took action in the past year against eight companies making robocalls. We've recovered \$40 million in fines over the past 5 years for Do Not Call violations. Just recently, we shut down one company—and the investigation was done out of our Chicago regional office—that alone placed more than 1 billion calls offering auto warranties.

Today, we're announcing a major case against AMS Financial for falsely representing that they could lower consumers' credit card interest rates and making illegal robocalls. We obtained a temporary injunction—or a restraining order in this case, freezing the defendant's assets. And we worked with several State attorneys general, including the wonderful Lisa Madigan, to do it.

We've also challenged hidden fees in prepaid telephone cards. And today we're announcing a \$500,000 settlement with Diamond Phone Card, which targeted the immigrant community. And you can see, this is their "Hasta la vista" card. It purports to give you a certain number of minutes for \$2, but, in fact, it gave consumers far less than that.

Protecting non-English speakers is a task we take very, very seriously. We produce most of our consumer educational material in both English and Spanish.

And we make extensive efforts to protect other vulnerable populations, including outreach activities to alert senior citizens to

fraud and reverse mortgages. We've brought multiple cases involving senior citizens in the last 1½ years.

And we have various initiatives underway to protect children. In the last year, we've distributed an online Internet safety guide called "Netcetera" to school districts—you may have copies on your desk; launched a kid-friendly campaign to teach kids how to evaluate advertising; and released our seventh entertainment-industry marketing report. And just as critically, pursuant to this subcommittee's direction, we are leading a multiagency task force on marketing food to children.

And, as you know, we also enforce the Federal antitrust laws in a wide range of areas, including healthcare, technology, energy, consumer goods and services, and the top priority, as you mentioned, Senator Collins, of the Commission's competition agenda—and we take a greatest-good-for-the-greatest-number-of-people approach—is stopping pay-for-delay settlements between brand name and generic drug makers. To be blunt, these are really sweetheart deals, and we estimate that it costs consumers about \$3.5 billion a year.

And here's what really is going on: A brand name drug company will sue a generic company. And they claim that the generic has violated their patent. And then they turn right around and they settle the case, literally by paying off the generic not to compete. So, the brand continues to charge monopoly prices. The generic companies collect a big fat paycheck. And consumers keep paying higher prices for much-needed medicines.

And so, it's win-win for the companies, but it is absolutely lose-lose for consumers. And because of a few misguided court decisions in 2005, as you can see, the problem has only gotten worse. There wasn't a single pay-for-delay deal in 2004. The two adverse decisions, which, of course, we disagreed with, came down at the end of 2005. And you can see, as our chart shows, there were a record 19 deals like this last year.

Every single Commissioner at the Federal Trade Commission supports ending these deals. And we're currently litigating two cases, with the hope of getting one to the Supreme Court. Today, we filed an amicus brief in the second circuit on a pay-for-delay case, along with 34 State attorneys general, including the State attorneys general of Maine and Illinois; they filed a companion brief.

A much quicker solution, however, would be legislation that ends this unconscionable practice. And so, we greatly appreciate the co-sponsorship of both you, Mr. Chairman, and you, Ranking Member Collins, of precisely that legislation. And we're hopeful, because the bill passed the Senate Judiciary Committee, the full House, and we have the endorsement of the President to abolish this practice, that it's possible we can get it done this year.

And I'd like—in my last 4 seconds, I ask unanimous consent for 15 additional seconds, just to mention one more—

Thank you so much, Mr. Chairman.

I'd like to talk about just one other area of particular focus for the Commission, and that's gasoline prices. When the price of gasoline hit \$4 a gallon in mid-2008, every household in the country felt the impact. Everyone in this room did. And we realize how important it is that petroleum markets remain competitive. So, in the

past year, we've added to our arsenal by adopting a rule prohibiting manipulation of wholesale petroleum markets and allowing us to fine violators.

PREPARED STATEMENT

We're doing a lot of other important work. I would be glad to talk about it, but I know I've exceeded my time, so I'm happy to answer questions.

[The statement follows:]

PREPARED STATEMENT OF JON LEIBOWITZ

INTRODUCTION

Chairman Durbin, Ranking Member Collins, 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 testify in support of the Federal Trade Commission's fiscal year 2011 appropriation request and to share with you some of the work the agency has done and plans to do over the next year. The Commission thanks you for this opportunity and looks forward to working with you to protect American consumers and promote competition.

The FTC is the only Federal agency with both consumer protection and competition jurisdiction across broad sectors of the economy. It enforces the Federal Trade Commission Act, which prohibits anticompetitive, deceptive, or unfair business practices, as well as a broad range of other laws.² The FTC's Annual Report, released last month, is attached to this testimony. The report highlights the agency's efforts to protect consumers and promote competition, including initiatives to stop fraud targeting financially distressed consumers, protect privacy, and prevent anticompetitive practices such as "pay-for-delay" in the pharmaceutical industry, which costs consumers \$3.5 billion a year in higher drug costs.

This past year, the staff of the FTC has handled a growing workload, which includes its strong and effective law enforcement program. The additional funding that Congress provided over the past fiscal year, for which we are grateful, has enabled us to increase the staff who are working to protect consumers from deceptive practices, particularly fraudulent schemes that have proliferated during these challenging economic times.

This testimony first describes some of our work under both our consumer protection mission and our competition mission and then summarizes the FTC's budget request for fiscal year 2011. To meet the challenges of the next fiscal year, the FTC requests \$314 million which will support 1,207 FTE. This request represents an increase of \$22.3 million and 40 FTE over the fiscal year 2010 enacted levels.

CONSUMER PROTECTION MISSION

The FTC Is Protecting Consumers During the Economic Downturn

With the economic downturn, the Commission has increased its emphasis on protecting consumers in financial distress. In the past year, the FTC has brought almost 40 law enforcement actions to stop scams that prey on consumers suffering from the financial downturn, and the agency is also engaged in rulemaking and consumer education efforts related to financial services. In the financial services area alone, the FTC has filed more than 100 actions against providers of financial services over the past 5 years, and obtained nearly \$500 million in redress for consumers of financial services in the past 10 years. By working closely with state attorneys general, we have expanded the reach of law enforcement efforts to help consumers in economic distress through hundreds of additional cases.

Helping Distressed Homeowners: Challenging Mortgage Modification and Foreclosure Relief Scams and Writing New Mortgage Rules

Since 2008, the Commission has filed 28 law enforcement actions focused on stopping mortgage loan modification and foreclosure relief scams. Companies operating these scams make deceptive claims about their abilities to modify the terms of consumers' loans and prevent foreclosure. During 2009, as these scams proliferated, we

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

² The Commission currently enforces or otherwise implements more than 60 laws.

partnered in sweeps with Federal and state law enforcement agencies to collectively file more than 200 lawsuits to combat these scams.³ For example, in one case, the FTC obtained a preliminary injunction that prevented defendants from falsely representing in Spanish-language radio and magazine ads that they would obtain mortgage loan modifications or stop foreclosure in all or virtually all instances.⁴ Consumers paid more than \$3.3 million to these defendants, and the FTC is seeking consumer redress.

To curb deceptive and unfair practices in the mortgage industry, the FTC is also considering rules on three mortgage-related topics:

—*Mortgage Assistance Relief Services.*—In March 2010, the Commission published a notice of proposed rulemaking covering loan modification, foreclosure relief, and other mortgage assistance relief services.⁵ If adopted, the proposed rule would ban providers from collecting fees prior to delivering promised results, prohibit misrepresentations in marketing, and require affirmative disclosures. The FTC expects to complete this rulemaking proceeding within the next 90 days.

—*Mortgage Servicing Practices.*—The Commission published an advance notice of proposed rulemaking addressing mortgage servicing practices and plans to determine in the near future whether to propose such a rule.⁶ Commission cases in this area have targeted core servicing issues such as failing to post payments upon receipt, charging unauthorized fees, and engaging in deceptive or unfair 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 Fair Debt Collection Practices Act in servicing mortgage loans, including debts that were in default when EMC obtained them.⁷ The EMC settlement required the defendants to pay \$28 million in consumer redress, and the Commission has sent checks to more than 86,000 consumer victims.

—*Mortgage Advertising Practices.*—The Commission published an advance notice of proposed rulemaking addressing mortgage advertising practices and plans to determine in the near future whether to propose such a rule.⁸ FTC cases in this area have targeted mortgage lenders and brokers for deceptive marketing of loan costs or other key loan terms, such as the existence of a prepayment penalty or a large balloon payment due at the end of the loan. For example, 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.⁹

Helping American Workers: Stopping Employment Opportunity Scams, Bogus Government Grants, and Get-Rich-Quick Schemes

In February 2010, along with state and Federal partners, the Commission announced Operation Bottom Dollar, a sweep that involved 69 civil and criminal actions against organizations making false promises of employment or employment placement opportunities.¹⁰ Last July, the FTC announced Operation Short Change, another Federal-state crackdown that challenged 120 schemes selling bogus government grant opportunities, illusory get-rich-quick plans, job opportunity scams, and phony debt-reduction services.¹¹

In addition, in October 2009, MoneyGram paid \$18 million to settle FTC charges that its money transfer system helped con artists trick U.S. consumers into wiring

³See FTC Press Release, Federal and State Agencies Target Mortgage Relief Scams (Nov. 24, 2009), www.ftc.gov/opa/2009/11/stolenhope.shtm; FTC Press Release, Federal and State Agencies Target Mortgage Foreclosure Rescue and Loan Modification Scams (July 15, 2009), www.ftc.gov/opa/2009/07/loanlies.shtm.

⁴See *FTC v. Dinamica Financiera LLC*, No. 09–CV–03554 (C.D. Cal. preliminary injunction issued June 3, 2009).

⁵Mortgage Assistance Relief Services Notice of Proposed Rulemaking, 75 Fed. Reg. 10,707 (Mar. 9, 2010).

⁶Mortgage Acts and Practices Advance Notice of Proposed Rulemaking, 74 Fed. Reg. 26,118 (June 1, 2009).

⁷*FTC v. EMC Mortgage Corp.*, No. 4:08–CV–338 (E.D. Tex. final order Sept. 9, 2008).

⁸Mortgage Acts and Practices Advance Notice of Proposed Rulemaking, 74 Fed. Reg. 26,118 (June 1, 2009).

⁹See FTC Press Release, Three Home Loan Advertisers Settle FTC Charges; Failed to Disclose Key Loan Terms in Ads (Jan. 8, 2009), www.ftc.gov/opa/2009/01/anm.shtm.

¹⁰See FTC Press Release, FTC Cracks Down on Con Artists Who Target Jobless Americans (Feb. 17, 2010), www.ftc.gov/opa/2010/02/bottomdollar.shtm.

¹¹See FTC Press Release, FTC Cracks Down on Scammers Trying to Take Advantage of the Economic Downturn (July 1, 2009), www.ftc.gov/opa/2009/07/shortchange.shtm.

them money in connection with fake lottery schemes, secret shopper scams, and bogus guaranteed loans. In April the FTC sent more than 34,000 checks to consumers identified as victims in these schemes.¹²

Halting Scams Promising to Relieve Consumers of Debt or Repair Their Credit Histories

Many consumers faced with mounting debt have turned unwittingly to scam artists for help. Since 2008, the Commission has brought ten lawsuits challenging sham nonprofit credit counseling firms, debt settlement services, and debt negotiators. During the same period, the FTC filed a dozen lawsuits against credit repair organizations that falsely misrepresented their ability to remove negative but accurate information from credit reports.¹³

To curb ongoing abuses in the debt relief industry, in August 2009 the Commission proposed a rule to, among other things, prohibit debt relief service providers from charging consumers a fee until they have delivered the promised results.¹⁴ The FTC expects to complete this rulemaking proceeding within the next 60 days.

Protecting Consumers in the Online World

The Commission devotes significant resources to protecting consumers in a high-tech world by promoting data security, preventing identity theft, and protecting online privacy.

To date, the FTC has brought 29 enforcement actions against businesses for failing to protect consumers' personal information. For example, in the past 7 months, the Commission has (1) announced a settlement with restaurant chain Dave & Buster's arising from a data breach that allegedly compromised the credit card numbers and expiration dates of approximately 130,000 customers;¹⁵ (2) in a case where a mortgage broker threw out consumer credit reports in a dumpster, obtained the first civil penalty for violation of a new Commission rule that requires companies to adequately dispose of sensitive credit report information;¹⁶ and (3) obtained a stipulated modified order against ChoicePoint after charging that the company failed to implement a comprehensive information security program, as required by a 2006 Federal court order.¹⁷

The FTC also helps consumers avoid identity theft and responds to 15,000 consumers each week who call the FTC identity theft hotline. Under Federal law, consumers have a right to a free credit report to help them detect identity theft and errors in their credit reports, which are used not only to obtain credit but also for employment, housing, and insurance. In recent years, however, companies have offered so-called "free" credit reports that are conditioned on enrollment in a costly plan, often an identity theft protection plan. To protect consumers from this confusing and deceptive marketing, the FTC amended the Free Credit Report Rule to require prominent disclosures for advertising of these supposedly "free" credit reports.¹⁸ Now, consumers will be better able to avoid supposedly "free" offers that actually cost money. In addition, in one of the largest FTC-state coordinated actions, the FTC and Illinois Attorney General Lisa Madigan jointly announced a settlement with LifeLock, Inc., which advertised its identity theft prevention service, claiming that it was "the first company to prevent identity theft from occurring."¹⁹ The order

¹² See FTC Press Release, MoneyGram to Pay \$18 Million to Settle FTC Charges That it Allowed its Money Transfer System To Be Used for Fraud (Oct. 20, 2009), www.ftc.gov/opa/2009/10/moneygram.shtm; FTC Press Release, FTC Mails Redress Checks to Fraud Victims Who Lost Money Through MoneyGram's Money Transfer System (Apr. 28, 2010), www.ftc.gov/opa/2010/04/moneygram.shtm.

¹³ See prepared statement of the Federal Trade Commission on The Debt Settlement Industry: The Consumer's Experience, before the Senate Committee on Commerce, Science, and Transportation (Apr. 22, 2010), www.ftc.gov/os/testimony/100422debtsettlement.pdf; prepared statement of the Federal Trade Commission on Financial Services and Products: The Role of the Federal Trade Commission in Protecting Consumers, before the Senate Committee on Commerce, Science, and Transportation (Feb. 4, 2010), www.ftc.gov/os/testimony/P064814financial-services.pdf.

¹⁴ Telemarketing Sales Rule Proposed Rule, 74 Fed. Reg. 41,988 (Aug. 19, 2009).

¹⁵ *Dave & Busters, Inc.*, FTC File No. 082-3153 (proposed consent order Mar. 25, 2010).

¹⁶ *FTC v. Navone*, No. 2:08-CV-01842 (D. Nev. final order Dec. 29, 2009).

¹⁷ *U.S. v. ChoicePoint, Inc.*, No. 1:06-CV-0198-JTC (N.D. Ga. final order Oct. 14, 2009).

¹⁸ The Credit Card Accountability Responsibility and Disclosure Act of 2009 required the Commission to issue a rule to prevent deceptive marketing of "free credit reports." The amended rule went into effect on April 2, 2010. See Free Annual File Disclosures Final Rule, 75 Fed. Reg. 9,726 (Mar. 3, 2010).

¹⁹ *FTC v. LifeLock, Inc.*, No. 2:10-cv-00530-NVW (D. Ariz. final order Mar. 15, 2010). See also State of Illinois Press Release, FTC, 35 States Reach Agreement with LifeLock for Misleading Advertising (Mar. 9, 2010), www.illinoisattorneygeneral.gov/pressroom/2010_03/20100309.html.

requires LifeLock to pay \$11 million to the FTC for consumer redress and \$1 million to 35 state attorneys general co-plaintiffs. The order also bars the company from making deceptive claims that its services offer absolute prevention against identity theft and requires it to take more stringent measures to safeguard the personal information it collects from customers.

The FTC also has brought numerous cases to meet the challenges of protecting consumers and their privacy while they are using the Internet. For example, in June 2009, the FTC moved quickly to shut down a rogue Internet Service Provider that knowingly hosted and actively participated in the distribution of illegal spam, child pornography, and other harmful electronic content.²⁰ The FTC complaint alleged that the defendant actively recruited and colluded with criminals seeking to distribute illegal, malicious, and harmful electronic content. After the Commission shut down this ISP, there was a temporary 30 percent drop in spam worldwide.²¹ Just last month, the court ordered the operation to turn over \$1.08 million in ill-gotten gains to the Commission.

Also last summer, the Commission settled allegations that Sears failed to disclose adequately the scope of consumers' personal information collected via software that Sears represented would merely track their "online browsing."²² The FTC charged that the software, in fact, monitored consumers' online secure sessions as well—including those on third-party websites—and collected information such as the contents of shopping carts, online bank statements, e-mail headers and subject lines, and other sensitive data. Only deep in a lengthy end user license agreement did Sears disclose the extent of the tracking.

In an effort to examine privacy issues more broadly, FTC staff convened three public roundtables to explore concerns about consumer privacy and ensure that the Commission's approach to privacy keeps pace with the latest technologies and emerging business models.²³ Participants discussed developments in areas such as social networking, cloud computing, online behavioral advertising, mobile marketing, health privacy, and the collection and use of information by data brokers and other businesses. The Commission plans to release recommendations for public comment later this year.

Enforcement of the National Do Not Call Registry

The National Do Not Call Registry is an unqualified success. So far, there are more than 198 million unique numbers on the Registry. By the end of June 2010, the Commission anticipates we will reach 200 million telephone numbers. To protect these consumers' privacy, the Commission strictly enforces the Do Not Call list and fights other abusive telemarketing practices.

During the past year, the Commission filed eight new actions that attack the use of harassing "robocalls"—the automated delivery of prerecorded messages—to deliver deceptive telemarketing pitches that promised consumers extended auto warranties and credit card interest rate reduction services.²⁴ In addition, DIRECTV paid a \$2.3 million civil penalty to settle charges that it placed prerecorded calls to consumers who previously had told the company not to call them, and Comcast paid \$900,000 to settle charges that it called consumers who had specifically asked not to be called.²⁵

Stopping Deceptive Advertising of Prepaid Phone Cards

The Commission continues to protect consumers from hidden fees and false claims about how many minutes prepaid phone cards deliver. This type of deception often targets recent immigrants from Latin America, Africa, Asia, and elsewhere around the world. This week, the Commission announced a settlement with Diamond Phone Card, Inc., which agreed to pay \$500,000 to settle FTC allegations that it charged hidden fees and misrepresented the number of calling minutes delivered by its pre-

²⁰ *FTC v. Pricewert, LLC*, No. 09–CV–2407 (N.D. Cal. final order issued Apr. 4, 2010).

²¹ See Official Google Enterprise Blog, Q2 2009 Spam Trends, <http://googleenterprise.blogspot.com/2009/07/q2-2009-spam-trends.html>.

²² *Sears Holdings Mgmt. Corp.*, FTC File No. 082–3099 (final order Aug. 31, 2009).

²³ See generally FTC Exploring Privacy web page, www.ftc.gov/bcp/workshops/privacyroundtables/index.shtml.

²⁴ See, e.g., FTC Press Release *FTC Sues to Stop Robocalls With Deceptive Credit Card Interest-Rate Reduction Claims* (Dec. 8, 2009), www.ftc.gov/opa/2009/12/robocall.shtm.

²⁵ *U.S. v. DIRECTV, Inc.*, No. 09 2605 MRP FMOx (C.D. Cal. final order May 14, 2009); *U.S. v. Comcast Corp.*, No. 2:09–cv–01589–HB (E.D. Pa. final order Apr. 16, 2009). Last year, the FTC also charged satellite television provider Dish Network with causing telemarketing calls—including robocalls—to be made to numerous consumers whose numbers are on the National Do Not Call Registry. See *U.S. v. Dish Network, LLC*, No. 3:09–cv–03–73–JES–CHE (C.D. Ill. filed Mar. 25, 2009) (action brought jointly with the Attorneys General of California, Illinois, Ohio, and North Carolina).

paid cards.²⁶ In total, the FTC has obtained more than \$4 million from companies charged with deceptive marketing of prepaid calling cards.

Protecting and Educating Children Through New and Innovative Initiatives

Promoting the Marketing of Healthier Foods to Children

The Commission continues its efforts to combat childhood obesity. Since 2005, the FTC has hosted three public forums on food marketing to children and childhood obesity. At an event in December 2009, the Interagency Working Group on Food Marketed to Children²⁷ suggested possible voluntary nutrition standards. Experts also presented new research on the impact of food advertising on children's food choices, discussed the legal ramifications of possible restrictions on food advertising to children, and assessed food industry self-regulatory efforts to impose nutritional standards on their advertising to children.²⁸

FTC staff is working on a follow-up report to the FTC 2008 Report on Marketing Food to Children and Adolescents. The 2008 report reviewed industry expenditures and activities in marketing foods and beverages, including integrated advertising campaigns that combine traditional media, such as television, with previously unmeasured forms of marketing, including packaging, in-store advertising, sweepstakes, Internet, and cross-promotion with movies.²⁹ The follow-up report, expected in 2011, will analyze marketing activities and expenditures in 2009 by dozens of food and beverage companies in promoting their products to children and teenagers. It will be an important tool to track the marketplace's response to childhood obesity and identify areas where more action is needed. The report also will examine the nutritional quality of those products and compare them to the nutritional quality of products marketed to children and teenagers in 2006.

Promoting Children's Internet Safety and Advertising Literacy

During the past year, the FTC developed additional resources for use by children, parents and teachers to stay safe online and learn about how advertising works. In response to the Broadband Data Improvement Act of 2008, the FTC produced the brochure *Net Cetera: Chatting With Kids About Being Online* to give adults practical tips to help children navigate the online world.³⁰ Since its release in late 2009, more than two million copies of *Net Cetera* in English and Spanish have been distributed nationwide.

At the end of April 2010, the FTC launched *Admongo.gov*, a campaign designed to help children think critically about online and offline advertising, and better understand the ads they see.³¹ Through this campaign, children learn to ask: Who is responsible for the ad? What is it actually saying? What does it want me to do? The FTC is working with schools, libraries, and other organizations to get this important education to kids, as well as their parents and teachers.

Protecting Children's Online Privacy

The Commission protects the safety and privacy of children online through enforcement and administration of the Children's Online Privacy Protection Act of 1998 ("COPPA") and its implementing rule.³² COPPA requires operators of websites and online services that target children under age 13 to obtain verifiable parental consent before they collect, use, or disclose personal information from children. The FTC engages in broad business and consumer education to ensure widespread knowledge of and adherence to COPPA. In the past 10 years, the Commission has brought 14 law enforcement actions alleging COPPA violations and has collected more than \$3.2 million in civil penalties. In light of significant changes to the online

²⁶ *FTC v. Diamond Phone Card, Inc.*, No. 09-CV-03257-NGG-VVP (E.D.N.Y. final order May 14, 2010). In 2009, the FTC resolved similar charges in two cases against prepaid phone card companies. See *FTC v. Clifton Telecard Alliance One LLC*, No. 2:08-CV-01480-PGS-ES (D.N.J. final order June 12, 2009) (imposing \$1.3 million judgment); *FTC v. Alternatel, Inc.*, No. 1:08-cv-21433-AJ (S.D. Fla. final order Apr. 1, 2009) (imposing \$2.25 million judgment).

²⁷ The Working Group is comprised of the FTC, the U.S. Department of Agriculture, the U.S. Food and Drug Administration and the Centers for Disease Control, and was established pursuant to Congress' (and this Subcommittee's) direction in the 2009 Omnibus Appropriations report.

²⁸ See generally *Sizing Up Food Marketing and Childhood Obesity* web page, www.ftc.gov/bcp/workshops/sizingup/index.shtml.

²⁹ *Marketing Food to Children and Adolescents: A Review of Industry Expenditures, Activities, and Self-Regulation* (2008), www.ftc.gov/os/2008/07/P064504foodmktgreport.pdf.

³⁰ See FTC Press Release, *OnGuardOnline.gov* Off to a Fast Start with Online Child Safety Campaign (Mar. 31, 2010), www.ftc.gov/opa/2010/03/netcetera.shtml.

³¹ See FTC Press Release, *FTC Helps Prepare Kids for a World Where Advertising Is Everywhere* (Apr. 28, 2010), www.ftc.gov/opa/2010/04/admongo1.shtml.

³² See Children's Online Privacy Protection Act of 1998, 15 U.S.C. §§ 6501-6508 (2009). The FTC's implementing regulations (the "COPPA Rule") are found at 16 C.F.R. Part 312 (2009).

environment, including the explosion of social networking and the proliferation of mobile web technologies and interactive gaming, the Commission recently initiated an accelerated review of COPPA's effectiveness.³³

Using Aggressive Law Enforcement to Combat Health Fraud

The FTC continues to protect consumers from false and misleading health claims involving products as diverse as cereals and cold remedies and claims as significant as cancer cures.

Last year, the Commission settled a case with Kellogg Company over charges that its advertising falsely claimed that Frosted Mini Wheats was clinically shown to improve children's attentiveness by nearly 20 percent.³⁴ The Commission also responded to the burgeoning area of immunity-boosting and cold and flu prevention and treatment claims when it investigated and reached a settlement with Airborne, Inc., the leading seller of effervescent tablets that purported to protect against exposure to germs in crowded environments. The Commission then settled similar charges against three major pharmacy retail chains that marketed their own store-brand "copycat" cold and flu products, and the manufacturer of these copycat products, requiring the companies to pay a total of \$9.8 million.³⁵

Importantly, the FTC also challenges claims that dietary supplements and devices treat, cure, or prevent cancer and other serious diseases. Last summer, a Federal district court ordered Direct Marketing Concepts to pay nearly \$70 million for consumer refunds for dietary supplements it claimed would treat, cure, or prevent cancer and other serious diseases.³⁶ In *FTC v. Roex, Inc.*, the FTC alleged that the defendants' nationally broadcast, live, call-in radio show made claims that an infrared sauna device could treat cancer and that various dietary supplements would treat, reduce the risk of, or prevent diseases such as cancer, HIV/AIDS, diabetes, strokes and heart attacks, Alzheimer's disease, and Parkinson's disease.³⁷ The defendants agreed to pay more than \$3 million for consumer redress and are prohibited from making such claims in the future.

Protecting Consumers from Cross-Border Fraud and Promoting International Consumer Protection

The FTC plays a leadership role in international consumer protection and privacy matters to better protect American consumers in a globalized world. The Commission's use of the U.S. SAFE WEB Act—which allows the sharing of information with our foreign sister agencies when working together to stop global scams—has directly benefitted American consumers because many of the foreign agency requests involved schemes directed at American victims. In December, the FTC submitted a 3-year report to Congress detailing its use of the powers Congress gave it to fight cross-border fraud. As explained in the report, the FTC has shared information in response to 38 requests from 14 foreign law enforcement agencies, resulting in more than 17 enforcement actions by U.S. and foreign authorities, and issued 26 civil investigative demands on behalf of 6 foreign agencies in 12 investigations.³⁸ The vast majority of these SAFE WEB information sharing requests resulted in actions against companies harming American consumers.

On the policy front, the FTC continues to shape international policies on issues such as electronic commerce, green marketing claims, and consumer economics to provide sound protection for American consumers in the global marketplace. This month, the Commission hosted a 2-day forum and "best practices" training session

³³ Although the Commission generally reviews its rules approximately every 10 years, the continued rapid-fire pace of technological change led the agency to accelerate its COPPA review by 5 years, to this year. See FTC Press Release, FTC to Host Public Roundtable to Review Whether Technology Changes Warrant Changes to the Children's Online Privacy Protection Rule (Apr. 19, 2010), www.ftc.gov/opa/2010/04/coppa.shtm.

³⁴ Kellogg Co., FTC File No. 082-3245 (final order July 27, 2009).

³⁵ Walgreens agreed to pay \$5,970,000 in consumer redress, CVS Pharmacy, Inc. agreed to pay \$2,783,047, Rite Aid Corp. agreed to pay \$500,000, and Improvita Health Products, Inc.'s principals agreed to pay \$565,000 to settle these matters. See FTC Press Releases, Walgreens Will Pay Nearly \$6 Million to Settle FTC Deceptive Advertising Charges, Suppliers of Airborne-like Cold-and-Flu Supplements Reach Separate \$565,000 Settlement (Mar. 23, 2010), www.ftc.gov/opa/2010/03/walgreens.shtm; CVS to Pay Nearly \$2.8 Million in Consumer Refunds to Settle FTC Charges of Unsubstantiated Advertising of AirShield "Immune Boosting" Supplement (Sept. 8, 2009), www.ftc.gov/opa/2009/09/cvs.shtm; Rite Aid to Pay \$500,000 in Consumer Refunds to Settle FTC Charges of False and Deceptive Advertising (July 13, 2009), www.ftc.gov/opa/2009/07/riteaide.shtm.

³⁶ *FTC v. Direct Marketing Concepts*, No. 04-CV-11136-GAO (D. Mass. final order Aug. 13, 2009).

³⁷ *FTC v. Roex, Inc.*, No. SACV 09-0266 (C.D. Cal. final order Mar. 4, 2009).

³⁸ See FTC Press Release, FTC Issues Report to Congress on Use of Its Enhanced Authority Under the U.S. SAFE WEB Act (Dec. 15, 2009), www.ftc.gov/opa/2009/12/safeweb.shtm.

of the International Consumer Protection and Enforcement Network for consumer protection officials from over 40 countries. Participants discussed global scams, electronic transactions, emerging trends and risks associated with social networking sites, and advance-fee fraud.

COMPETITION MISSION

Anticompetitive mergers, collusive behavior, and exclusionary conduct by monopolists can harm American consumers in dramatic, if sometimes less visible, ways. As our recent enforcement activity emphasizes, anticompetitive activity can raise the cost of prescription drugs, real estate services, and other consumer products and services, and can impede innovation that would bring better and more cost-effective products and services to American consumers. During fiscal year 2009, the Commission brought 25 competition enforcement actions, including filing a record seven merger challenges in Federal district court or in an administrative proceeding, and through the first half of fiscal year 2010, the Commission has already brought 16 competition enforcement actions.³⁹

Ending Pay-for-Delay Patent Settlements.

One of the Commission's highest antitrust priorities is stopping pay-for-delay patent settlements in the pharmaceutical industry, a practice that costs consumers \$3.5 billion each year.⁴⁰ In these deals (also known as exclusion- or reverse-payment settlements), the brand-name drug firm pays its potential generic competitor to abandon a patent challenge and delay entering the market with a lower-cost generic product. Such settlements limit competition at the expense of consumers, whose access to lower-priced, generic drugs is delayed—sometimes for many years—and raise the costs of prescription drugs for businesses and the government.⁴¹ We thank you, Mr. Chairman and Ranking Member Collins, for co-sponsoring a bill in the Senate to end these deals.

Since 2005, some court decisions have taken a lenient approach to such agreements in drug patent settlements. As a result, it has become increasingly difficult to halt pay-for-delay settlements through litigation, and such settlements have become a common industry strategy.

Because these settlements cause enormous consumer harm, the Commission devotes substantial resources to this problem. For example, we are appealing the U.S. District Court for the Northern District of Georgia's dismissal of our complaint in a pay-for-delay case against Solvay Pharmaceuticals regarding the drug Androgel, a testosterone replacement medication.⁴² We continue to conduct new investigations into pay-for-delay agreements.

Importantly, we have reason to believe that the tide may be turning. Just last month, an appellate panel in the Second Circuit, which had previously adopted a permissive legal standard on pay-for-delay settlements, took the extraordinary step of questioning its own standard and explicitly encouraging consumer plaintiffs to request the full court's consideration of the pay-for-delay issue.⁴³ And just 2 months ago, in March 2010, a Federal district court judge in Philadelphia denied a defense motion to dismiss the FTC's currently pending pay-for-delay case against Cephalon, the manufacturer of the drug Provigil, a sleep disorder medication with nearly \$1 billion in annual U.S. sales.⁴⁴

Beyond individual cases, we have employed our full expertise to attack pay-for-delay settlements. In the past year, we have issued studies measuring the scope of this problem, which found:

- The number of these agreements is increasing, from zero in fiscal year 2004 to 19 in fiscal year 2009;
- On average, the deals delay the availability of cost-saving generics by 17 months; and

³⁹ See FTC Competition Enforcement Database, www.ftc.gov/bc/caselist/index.shtml.

⁴⁰ See Pay-for-Delay: How Drug Company Pay-Offs Cost Consumers Billions, FTC Staff Study (Jan. 2010), www.ftc.gov/os/2010/01/100112payfordelayrpt.pdf.

⁴¹ In a mature market, generic drugs are 15 percent of their brand name equivalent. See id.
⁴² In re *Androgel Antitrust Litig.* (No. 11), 1:09-MD-2084-TWT (N.D. Ga. Feb. 22, 2010) (granting defendants' motion to dismiss).

⁴³ See *Ark. Carpenters Health & Welfare Fund v. Bayer AG*, Nos. 05-2851-cv(L), 05-2852-cv(CON) (2d Cir. Apr. 29, 2010) (affirming summary judgment for defendants but inviting plaintiffs to petition for rehearing en banc).

⁴⁴ *FTC v. Cephalon, Inc.*, No. 2:08-cv-2141 (E.D. Pa. Mar. 29, 2010) (denying motion to dismiss), www.ftc.gov/os/caselist/0610182/index.shtml.

—If not stopped, pay-for-delay deals will, conservatively, cost consumers \$3.5 billion a year.⁴⁵

Finally, we are continuing our efforts to encourage legislation that would more rapidly fix this enormous problem, working closely with Congress and the Administration.

Health Care

The healthcare system plays an important role in the lives and economic security of all Americans and has a significant impact on Federal, state, and local government budgets. Accordingly, it is one of the Commission's top priorities. Our efforts to protect and promote competition in the healthcare system are critical to reduce costs, improve quality, and encourage innovation.

The Commission has acted aggressively to stop anticompetitive healthcare mergers. In December 2009, the FTC trial team challenged, in Federal court, Ovation's acquisition of a drug for premature infants with congenital heart defects, introducing evidence showing that Ovation acquired its only competitor and took advantage of its monopoly to raise prices by 1,300 percent. The Commission is seeking a divestiture to restore competition and consumer recovery of Ovation's illegally obtained profits.⁴⁶ The FTC also reviewed several pharmaceutical mergers and required divestitures in Watson/Arrow, Merck/Schering Plough, and Pfizer/Wyeth to preserve competition that otherwise would have been lost.⁴⁷ In the past year, the Commission also has sued to block Talecris' acquisition of CSL, which the Commission alleged would have raised prices for plasma derivative protein therapies used to treat a variety of illnesses, including immunodeficiency diseases.⁴⁸ The parties abandoned the deal in the face of the FTC's challenge.

Merger enforcement also promotes innovation. In medical device markets, the Commission blocked Thoratec's proposed acquisition of Heartware, its only potential competitor for left ventricular assist devices. These devices are surgically implantable blood pumps that provide a life-sustaining treatment for patients with advanced heart failure.⁴⁹ Blocking the transaction ensures that the two companies will continue to compete to develop better devices, which will benefit consumers.

Pharmacy Benefit Management (PBM) services are a critical part of the healthcare industry, and the Commission has allocated substantial resources to enforcement, advocacy, and policy development in this area. PBMs can help healthcare plans manage the cost and quality of the prescription drug benefits they provide to their enrollees, but many have criticized PBMs for a lack of transparency in their operations, for improper use and inadequate protection of consumer information, and for utilizing their position in the market to undermine competition.

Last year, the Commission took action against CVS/Caremark, a leading PBM, in order to protect the personal information of consumers.⁵⁰ As CVS/Caremark has acknowledged, the Commission is currently investigating whether certain CVS/Caremark business practices may violate the FTC Act. This investigation is ongoing and has been structured as a joint effort of the Bureau of Consumer Protection and the Bureau of Competition so that the investigation can efficiently and effectively address both antitrust and consumer protection issues.

Energy

The petroleum industry plays a crucial role in our economy, and few issues are more important to consumers and businesses than the prices they pay for gasoline and energy to heat and light their homes and businesses. Accordingly, the Commission carefully monitors energy markets and devotes significant resources to maintain and protect competition across a wide range of industry activities. This work is undertaken by a large number of expert economists and attorneys who specialize in the energy sector.

Merger reviews are an essential part of this effort. In 2009, the Commission reviewed proposed acquisitions involving energy products under the Hart-Scott-Rodino ("HSR") Act and also monitored the industry for transactions that were not filed

⁴⁵ Pay-for-Delay: How Drug Company Pay-Offs Cost Consumers Billions, *supra* note 40.

⁴⁶ *FTC v. Ovation Pharm., Inc.*, No. 08-cv-06379 (D. Minn. complaint filed Dec. 16, 2008).

⁴⁷ *Watson Pharm., Inc.*, FTC File No. 091 0116 (final order Jan. 7, 2010); *Schering Plough Corp.*, FTC File No. 091-0075 (proposed order accepted for public comment Oct. 29, 2009); *Pfizer Inc.*, FTC File No. 091-0053 (final order Jan. 25, 2010).

⁴⁸ *FTC v. CSL Ltd.*, No. 09-cv-1000 (D.D.C. complaint filed May 28, 2009).

⁴⁹ *Thoratec Corp.*, FTC File No. 091-0064 (administrative complaint dismissed Aug. 11, 2009).

⁵⁰ *CVS Caremark Corp.*, FTC File No. 072-3119 (final order Jun. 18, 2009). Respondent independently agreed to pay \$2.25 million to resolve Department of Health and Human Services allegations that it violated HIPAA, the Health Insurance Portability and Accountability Act of 1996.

under HSR. In particular, the Commission investigated acquisitions involving refined petroleum products pipelines and terminals, liquefied petroleum gas (propane), lubricant oils, natural gas, and natural gas liquids storage and transportation.

In addition, the Commission continues the “Gas Price Monitoring Project” that began in 2002. The monitoring project is a daily, in-depth review of retail and wholesale prices of gasoline and diesel fuel in 20 wholesale regions and approximately 360 retail areas across the United States. The project provides information that allows the Commission to investigate potentially anticompetitive conduct in fuel markets and serves as an early-warning system to alert our experts to unusual pricing activity.⁵¹

Last November, the Commission added another tool to its arsenal. Pursuant to authority granted by Congress under the Energy Independence and Security Act of 2007, the Commission issued the Petroleum Market Manipulation Rule, which prohibits fraud or deceit in wholesale petroleum markets.⁵² The agency conducted an extensive rulemaking proceeding to decide whether and how to craft such a rule, holding a public workshop with participants representing industry, government agencies, academics, and consumers; conducting numerous meetings with consumer groups, trade associations, and businesses; and considering over 150 written comments from consumers and businesses. The Commission worked diligently on this issue for 16 months and now has instituted a rule that meets the goal of Congress. Importantly, the rule specifies that statements that intentionally omit material information and are likely to distort petroleum markets are violations of the rule. Commission staff has prepared and made available a compliance guide for businesses, which explains the Rule in depth and provides examples of the type of actions that would violate it.⁵³ These examples include descriptions of potential violations, such as false public announcements of planned pricing or output decisions, false statistical or data reporting, and wash sales intended to disguise the actual liquidity of a market or the price of a particular product. The Market Manipulation Rule has only been in effect for a short time, and the agency plans to aggressively enforce the rule as needed.

In addition to these actions, Commission economists and attorneys utilize their expertise to provide reports on energy matters, including market statistics and trends for use by Congress and other policymakers. For example, the Commission issues semi-annual reports on oil and gas activities and an annual report on ethanol. The Commission also has submitted multiple comments to the Federal Energy Regulatory Commission (FERC) on a broad range of competition-related issues, including, among others, ways to assess the competitive effects of partial acquisition of electric power providers, efforts to encourage consumer price responsiveness, and appropriate metrics to measure the performance of electric regional transmission organizations.⁵⁴

Technology Markets

Technological advances are critically important to growing our economy, creating jobs, and introducing more efficient products and processes into the marketplace, and the Commission focuses significant resources on promoting competition in technology sectors. In December 2009, the Commission charged chip manufacturer Intel Corporation with illegally using its position to stifle competition, strengthen its monopoly, and raise prices to consumers in violation of the FTC Act.⁵⁵ Trial is expected to start in September.

The Commission also monitors business relationships between firms with competing technology products. Section 8 of the Clayton Act prohibits, with certain exceptions, the same person from serving as a director or officer of two competing corporations. After an FTC investigation raised concerns about two individuals serving

⁵¹ See Gasoline and Diesel Price Monitoring, www.ftc.gov/ftc/oilgas/gas_price.htm.

⁵² See FTC Press Release, New FTC Rule Prohibits Petroleum Market Manipulation (Aug. 6, 2009), www.ftc.gov/opa/2009/08/mmr.shtm; 74 Fed. Reg. 40686 (Aug. 12, 2009).

⁵³ Guide to Complying with Petroleum Market Manipulation Regulations, www.ftc.gov/os/2009/11/091113mmrguide.pdf.

⁵⁴ See Comment of the Federal Trade Commission on Control and Affiliation for Purposes of the Commission’s Market-Based Rate Requirements Under Section 205 of the Federal Power Act and the Requirements of Section 203 of the Federal Power Act, FERC Docket No. RM09–16–000 (Mar. 29, 2010); Comment of the Federal Trade Commission on Control and Affiliation for Purposes of the Commission’s Market-Based Rate Requirements Under Section 205 of the Federal Power Act and the Requirements of Section 203 of the Federal Power Act, FERC Docket No. PL09–3–000 (Apr. 28, 2009); Reply Comment of the Federal Trade Commission on Transmission Planning Processes Under Order No. 890, FERC Docket No. AD09–8–000 (Dec. 3, 2009).

⁵⁵ Intel, FTC File No. 061–0247 (administrative complaint Dec. 16, 2009).

on the boards of both Apple and Google, these individuals each stepped down from the boards of one of the companies.

In addition to its enforcement role, the Commission also has been empowered by Congress to provide substantive policy analysis and guidance. During 2009, the FTC completed a series of eight hearings to explore the competitive dynamics of evolving markets for intellectual property, and FTC staff is drafting a report analyzing the competitive implications of information gathered at the hearings.

Consumer Goods and Services

The Commission works to protect competition in markets for consumer goods and services and has taken actions involving a variety of products, including recent cases involving real estate services, funeral and cemetery services, and soft drinks.

A home is one of the most important purchases, and usually the most expensive purchase, that Americans make. The Commission therefore has devoted substantial resources to ensure that home buyers benefit from competition. In November 2009, the Commission ruled that Realcomp II, Ltd., a real estate Multiple Listing Service (MLS) in Michigan, could not impede competition from non-traditional and discount brokers by prohibiting them from listing on popular real estate websites.⁵⁶ Such hurdles can raise the costs that home buyers pay for real estate services. The Commission has been particularly active in this market and has obtained consent orders with several other Multiple Listing Services throughout the United States (Texas, Pennsylvania, New Jersey, Colorado, Wisconsin, and New Hampshire) to protect the competition that discount brokers provide.⁵⁷

The funeral industry is also important to consumers and a focus of the Commission. In the past year, the Commission has taken action in two matters to preserve competition in cemetery and funeral services. When Service Corporation International (SCI) proposed to acquire Palm Mortuary, the third-largest provider of cemetery services in Las Vegas, Nevada, the Commission required SCI to first divest its existing cemetery and funeral home in Las Vegas.⁵⁸ When SCI proposed to acquire Keystone North America, the Commission ordered SCI to divest 22 funeral homes and four cemeteries in 19 areas throughout the country to preserve competition that otherwise would have been lost.⁵⁹

In another consumer sector, the Commission required PepsiCo, Inc. to restrict its access to the confidential business information of rival Dr Pepper Snapple Group, as a condition for proceeding with a proposed \$7.8 billion acquisition of Pepsi's two largest bottlers and distributors. Those bottlers also distribute Dr Pepper and Snapple Group soft drinks, and, without the restrictions, Pepsi would have had opportunities to obtain and use that information to reduce competition and harm consumers.⁶⁰

Industrial and Chemical Sectors

The Commission took action this year in several mergers between chemical companies that threatened to increase costs to manufacturers, state and local governments, and farmers, which might ultimately increase costs to end users. Commission staff successfully litigated a challenge against Polypore International Inc.'s acquisition of Microporous Products, securing an administrative order requiring complete divestiture of the acquired assets in order to restore competition in the manufacture of battery separators, a key component in car batteries, batteries for uninterruptible power supplies, and other flooded lead-acid batteries.⁶¹ The Commission also investigated mergers in other chemical markets and required

⁵⁶ Realcomp II, Ltd., FTC Dkt. No. 9320 (Opinion of the Commission Oct. 30, 2009).

⁵⁷ See West Penn MLS, FTC File No. 081-0167 (final order Feb. 13, 2009); Multiple Listing Serv., Inc., FTC File No. 061-0090 (final order Mar. 13, 2008); MiRealSource, Inc., FTC File No. 061-0266 (final order Mar. 20, 2007); Info. and Real Estate Servs, LLC., FTC File No. 061-0087 (final order Nov. 22, 2006); N. New England Real Estate Network, Inc., FTC File No. 051-0065 (final order Nov. 22, 2006); Williamsburg Area Ass'n of Realtors, Inc., FTC File No. 061-0268 (final order Nov. 22, 2006); Realtors Ass'n of N. Wisconsin, Inc., FTC File No. 061-0267 (final order Nov. 22, 2006); Monmouth County Ass'n of Realtors, FTC File No. 051-0217 (final order Nov. 22, 2006); Austin Bd. of Realtors, FTC File No. 051-0219 (final order Aug. 29, 2006). Indeed, due to pressure from the Commission and DOJ, the National Association of Realtors dropped its optional rule that prohibited affiliated Multiple Listing Services from transmitting prohibiting discount broker listings to public web sites on its web site.

⁵⁸ Serv. Corp. Int'l, FTC File No. 091-0138 (final order Jan. 6, 2010).

⁵⁹ Serv. Corp. Int'l and Keystone N. Am., Inc., FTC File No. 101-0013 (final order Apr. 30, 2010).

⁶⁰ PepsiCo, Inc. FTC File No. 091-0133 (proposed order accepted for public comment Feb. 26, 2010).

⁶¹ Polypore Int'l, Inc., FTC Dkt. No. 9237 (initial decision Mar. 1, 2010).

divestitures for high-performance chemical pigments, bulk de-icing salt sold to state and local governments, and anhydrous ammonia fertilizer used by farmers.⁶²

Promoting Transparency and Process Improvements

The Commission uses its resources to provide better guidance to companies and courts about when mergers are likely to run afoul of the antitrust laws and harm consumers. This provides businesses and their counsel a clearer understanding of the “rules of the road” and helps them to avoid anticompetitive conduct without the need for government intervention. It also helps judges to develop an appropriate framework to interpret and apply the antitrust laws. To this end, senior staff have been working with the Antitrust Division of the Department of Justice to jointly review, revise, and update the agencies’ Horizontal Merger Guidelines, which were released for public comment last month.⁶³ The Guidelines explain, in clear, plain language, how the Federal antitrust agencies evaluate the likely competitive impact of mergers and when the agencies are likely to challenge proposed mergers. The Guidelines were last updated in 1992, and since then advances in economic understanding and additional enforcement experience have gradually modified the way that the agencies evaluate and investigate mergers. The new version is intended to more accurately reflect current agency practice.

Policy and Research

The Commission promotes competition through research, reports, and workshops. A recent example is a series of workshops entitled “How Will Journalism Survive the Internet Age?”⁶⁴ The expansion of electronic commerce and media is challenging traditional news organizations, and many might not survive. This sea change may have implications for competition among media outlets and our democratic society. Our workshops have focused attention on this emerging concern, assessed the range of economic and policy issues raised by the changes in the market, and explored how competition can be used to enhance consumer welfare.

The workshops began in December 2009, and the opening session featured contributions from a diverse group of well-informed participants. Owners of news organizations, journalists, bloggers, technologists, members of Congress, economists, and other academics discussed the changing dynamics of the news business and considered what new journalism business models might evolve in the future. The workshops continued in March 2010, when experts in a variety of fields discussed certain proposals to reduce the costs of and increase the profitability of journalism. Next month, the Commission will hold a final public workshop to compare, contrast, and seek consensus about the policy options that have been proposed over the last 6 months. After evaluating the various issues raised, the Commission plans to issue a report in the fall.

The Commission also has issued reports studying the pharmaceutical industry. Last summer, the Commission released a report entitled “Follow-on Biologic Drug Competition,” which concluded that providing the U.S. Food and Drug Administration (FDA) with the authority to approve follow-on biologics would be an efficient way to bring lower-priced drugs to market.⁶⁵ Biologics—products manufactured using living tissues and microorganisms—are increasingly used to treat arthritis, cancer, diabetes, and other diseases.⁶⁶ The Commission also released a report analyzing the competitive impact of authorized generics, which are drugs approved by the FDA as brand-name drugs but that the brand subsequently chooses to market (or have marketed) as generic.⁶⁷

International Competition Activities

The Commission actively develops strong working relationships with foreign antitrust agencies, helping to ensure that markets around the world, in which U.S. com-

⁶² K+S Aktiengesellschaft, FTC File No. 091-0086 (final order Nov. 9, 2009).

⁶³ Horizontal Merger Guidelines For Public Comment (Apr. 20, 2010), www.ftc.gov/opa/2010/04/hmg.shtm. The proposed revisions are the result of a very open and public process, including public comments and input received during a series of five joint FTC/DOJ public workshops held over the past 6 months. The five workshops were open to the public and attended by attorneys, academics, economists, consumer groups, and businesses.

⁶⁴ Workshop information is available at www.ftc.gov/opp/workshops/news/index.shtml.

⁶⁵ Emerging Health Care Issues: Follow-on Biologic Drug Competition (June 2009), www.ftc.gov/os/2009/06/P083901biologicsreport.pdf.

⁶⁶ A follow-on biologic (FOB) is a drug that can be prescribed to treat the same condition as the branded product. To obtain FDA marketing approval the FOB applicant does not have to duplicate the safety and efficacy findings of the branded product; rather, it must show that it is biosimilar to the branded product.

⁶⁷ Authorized Generics: An Interim Report (June 2009), www.ftc.gov/os/2009/06/P062105authorizedgenericsreport.pdf.

panies compete, are fair and transparent. Now that over 100 jurisdictions have competition laws, it is more critical than ever that the Commission continue to promote sound antitrust policies and practices abroad. The agency uses a wide range of tools to accomplish these goals. The FTC promotes coordination and cooperation with foreign antitrust agencies to obtain necessary information and assistance for our investigations and to avoid divergent outcomes on cases that are reviewed in multiple jurisdictions. Over the past year, the FTC worked on almost 40 international antitrust investigations, including significant mergers such as Pfizer/Wyeth—a case in which agency staff worked with staff in the Australian, Canadian and EU competition agencies.

The FTC continues to build a strong network of cooperative relationships with our counterparts abroad, ranging from the EU and Canada to China and India. For example, the FTC recently signed a Memorandum of Understanding with the Russian Federal Antimonopoly Service. In addition, with congressional support, the Commission expanded its longstanding technical assistance program to help competition agencies in new market-based economies. More broadly, the Commission is a recognized leader in key multilateral competition fora, such as the International Competition Network (ICN), the competition committee of the Organisation for Economic Co-operation and Development, the experts committee of the United Nations conference on Trade, and the Development and Asia-Pacific Economic Cooperation.

NEEDED RESOURCES FOR FISCAL YEAR 2011

The FTC has a small staff to accomplish its consumer protection and competition goals. Today, the Commission's fiscal year 2010 budget supports 1,167 full-time equivalents (FTEs). This is considerably fewer than it had at its peak in 1979, when the Commission had approximately 1,800 FTEs.⁶⁸ While the U.S. population has increased by 35 percent since then, and the gross domestic product (adjusted for inflation) has more than doubled, the size of the agency staff has not kept pace. The FTC has done and will continue to do more with less, but it needs further resources to tackle the critical problems described above. The FTC appreciates the strong support it has received from Congress and the Appropriations Committees over the last decade. With additional funding, we look forward to doing even more to address the needs of American consumers and promote vigorous, competitive markets in the future.

The fiscal year 2010 enacted appropriation provides the FTC with \$291,700,000, which supports 1,167 FTE. The fiscal year 2010 appropriation enables the FTC to protect more consumers in areas including financial services, healthcare, and high-tech marketing, and to challenge anticompetitive mergers and business practices in the technology, healthcare, pharmaceutical, and energy industries. To meet these challenges going forward, the FTC requests \$314,000,000 which will support 1,207 FTE in fiscal year 2011. This request represents an increase of \$22,300,000 over the fiscal year 2010 enacted level and includes:

- \$11,962,000 in mandatory cost increases associated with contract expenses (CPI adjustment) and personnel (salaries and within-grade increases);
- \$6,164,000 for 40 additional FTE:
 - 23 FTE to staff high-priority consumer protection matters in such areas as financial practices, fraud targeting vulnerable Americans, privacy and data security, health fraud advertising, mobile marketing and new media, data analysis, forensic accounting services, and domestic and international outreach; and otherwise provide support for the effective operation of the consumer protection goal.
 - 17 FTE to meet the needs of increasingly resource-intensive merger investigations and litigation and to challenge anticompetitive business practices in the healthcare, pharmaceutical, energy, and technology sectors among others; promote convergence in competition policy of foreign enforcement practices; and otherwise provide support for the effective operation of the competition goal.
- \$4,174,000 to cover the costs of acquiring and outfitting a new building to replace the 601 New Jersey Avenue building upon the expiration of the lease in 2012, as well as interim space to house anticipated increased staff, which will occur over the next several years.

Offsetting collections will fund a substantial portion of the FTC's fiscal year 2011 budget request. HSR filing fees and Do Not Call fees will provide the agency with an estimated \$129,000,000 in fiscal year 2011. The General Fund in the U.S. Treas-

⁶⁸ Commissioner Kovacic believes the Commission will need additional resources but he disagrees with certain aspects of the analysis in Section IV of this testimony.

ury would make a direct appropriation of \$185,000,000 to fund the agency's operations.

CONCLUSION

The FTC very much appreciates the strong support it has received from Congress. We hope to continue to earn that support by vigorously and aggressively fulfilling our mission to protect American consumers and promote a competitive marketplace.

BEHAVIORAL MARKETING

Senator DURBIN. Well, Chairman Leibowitz—we can tell you're a former Senate staffer; you actually pay attention to the red light.

So, let me start with this "behavioral marketing," because it appears that what is happening is that many people are doing things, joining things, logging on to things, and, in the process, they are giving away their identities and their activities for people to use in a commercial way—or for other purposes, really.

But, tell me how far along this is, what you're doing about it, and how we keep ahead of the game.

Mr. LEIBOWITZ. Well, it's a great question.

With behavioral marketing, there are benefits and there are concerns. So, on the benefit side, consumers prefer to have targeted advertising rather than advertisements that they're not interested in. And the advertising supports the free content that we've all come to like and to expect.

On the other hand—imagine you were walking around a shopping mall and there was someone behind you. He's following you around, and he's taking notes on where you're going, and sending it off to where you're going later, saying "He has a platinum card. He's interested in a particular color shorts." It would be a little disturbing to you. And if the person being followed was a child, if it was my daughter, I'd want to punch that person out.

And, at some level—I don't mean to make light of this—but, at some level, that's exactly what's going on; information is being obtained by companies, and consumers don't know exactly where it's going. Sometimes those companies will change their policies in midstream, and they won't tell consumers about it.

So, we have sort of a two-track approach here—three tracks, actually. One is, we bring enforcement actions. And so, we brought a major enforcement action last year against Sears for illegal data mining. We believe they didn't give consumers adequate notice that they were getting a lot of sensitive information—bank account records, drug information, prescription information, things like that.

Another is, we try to think these issues through, and try to figure out where the marketplace is going, and try to understand it better. So, we did a series of workshops in the last few months under David Vladeck, our head of the Bureau of Consumer Protection, who's sitting right behind me, to look at privacy and to look at behavioral marketing. And we had stakeholders in from industry, from consumer groups, from academia. We held the workshops across the country—two in Washington and one on the west coast. And that's helping us think through these—

Senator DURBIN. Can I ask—

Mr. LEIBOWITZ. Yes, sir.

Senator DURBIN. Like just—let me give you a couple hypotheticals, and you—

Mr. LEIBOWITZ. Sure.

Senator DURBIN [continuing]. Tell me if there is a legitimate concern there.

Assuming that I use my credit card, and it's one of the two giant credit cards, for my purchases, is that information available to others, in terms of where I shop, what I buy, how often I pay?

Mr. LEIBOWITZ. Well, it depends on the terms and conditions of your credit card company. Now, my guess—

Senator DURBIN. Which we all pore over the details of—

Mr. LEIBOWITZ. Well, I mean—

Senator DURBIN [continuing]. Every single—

Mr. LEIBOWITZ. Look—

Senator DURBIN [continuing]. Month.

Mr. LEIBOWITZ [continuing]. We held a workshop a couple years ago on this issue, and it turned out, according to a submission, that people with Ph.D.s, when asked if they understood the privacy policies, only about 35 percent of the Ph.D.s and Ph.D. candidates knew that. And, of course—

Senator DURBIN. They have a tendency—

Mr. LEIBOWITZ [continuing]. Not everybody has a Ph.D.

Senator DURBIN. They have a tendency to exaggerate, anyway.

Mr. LEIBOWITZ. That's exactly right.

And if you think about how many times you read through the privacy policy, or we do. I mean, you're clicking and clicking and clicking.

So, most companies, to protect their brands, and because they think it's the right thing to do, won't trade this information or sell it—but, it is conceivable that some companies do, and that is very, very troubling. And if a company says, "We're not going to do anything with your information," and then it does, we think that's an unfair and deceptive act or practice.

Senator DURBIN. So, is this an opt-in or an opt-out, or none of the above, or both?

Mr. LEIBOWITZ. Well, there is a roiling debate about opt-in versus opt-out. It depends. We believe—or, speaking for myself—sometimes it's better to use opt-in, particularly when you're dealing with more sensitive information, so that the default is, you're not giving anyone your personal information.

But, you can have a good opt-out policy, as well, in which consumers understand what information they're giving. And a lot of consumers, particularly if the information is kept on the Web site you're looking at, and is limited, I think most consumers would be fine with that. But, it's very complicated.

Senator DURBIN. So, there's no uniformity—

Mr. LEIBOWITZ. There's no—

Senator DURBIN [continuing]. No standard.

Mr. LEIBOWITZ [continuing]. Uniformity. There is no uniformity.

Senator DURBIN. And I don't know—aside from my credit card, I don't know, if I buy something online, whether that information is going to be sold.

Mr. LEIBOWITZ. Right. I mean—I think the better companies will not sell that information. They don't want to do that. They want

to have a trust relationship with their customers—the people who buy from them. But you don't know. And so, we brought some cases in this area.

And of course the other issue, which we haven't talked about, is data security. And most companies will have reasonably good data security. But, we've seen so many breaches over the last few years. And we've brought major cases against TJ Maxx and Dave & Buster's for inadvertently allowing information to be released to the public or to malefactors, who just because they had inadequate security, bad guys go around and they try to mine the data. So, it's a very difficult area. We're going to try to write something up, particularly on social networking, in the fall, to give guidance to businesses. And, hopefully, most businesses will try to keep their information at a high standard. We go after the ones that don't.

FEDERAL TRADE COMMISSION BUILDING

Senator DURBIN. For the last minute of my first round, I will let you answer another question. A certain Congressman came to see me and said that it would be a great idea if you moved out of your building. He'd like to use it for the National Gallery. It's been a passion of his for a long time. So, are you ready to move?

Mr. LEIBOWITZ. We are not ready to move. And I think we left on your desk a copy of the photograph of Franklin Delano Roosevelt dedicating our building, the Federal Trade Commission building in 1937, in which he proclaimed it the permanent home of the FTC—for the FTC for all time.

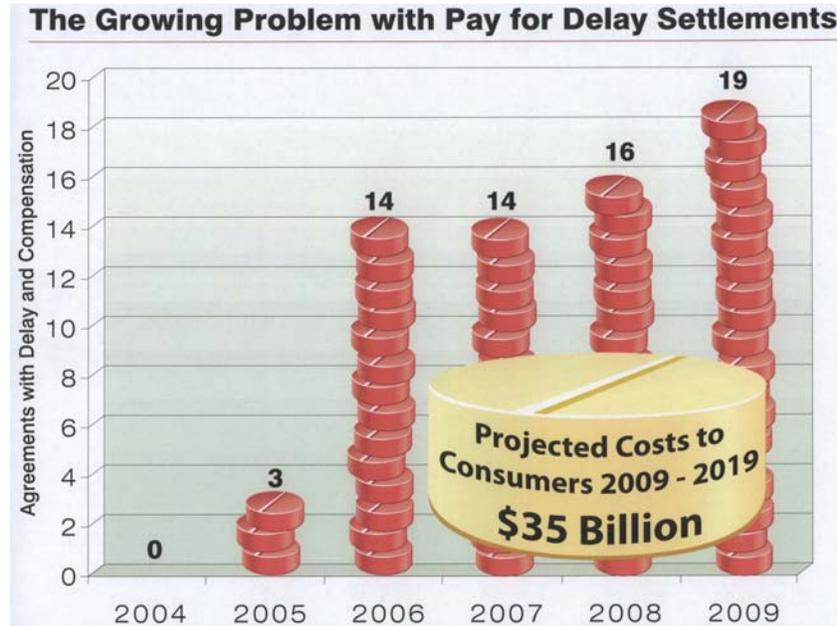


“May this permanent home of the Federal Trade Commission stand for all time as a symbol of the purpose of the Government to insist on a greater application of the Golden Rule to the conduct of corporations and business enterprises in their relationship to the body politic.”

Franklin D. Roosevelt
 Address at the Cornerstone Laying Ceremonies for the
 New Federal Trade Commission Building
 July 12, 1937

No. You know, this has been our home for more than 70 years. The General Services Administration (GSA) has called it “appropriate.” We can get you that information. And I’ve seen that Congressman’s proposal, and it is baffling where he is going to find the money for it. Because, you know, if you move us out of the FTC building, we have to go somewhere else. You can’t just put us on the street. And it costs a lot to buy a new building. It’s not clear whether the National Gallery would pay into the District fund or the Federal fund.

And so, we are as one, as a Commission, in opposing that.
 Senator DURBIN. Senator Collins.
 Senator COLLINS. Thank you, Mr. Chairman.



PAY-FOR-DELAY SETTLEMENTS

First, I want to commend the FTC for pursuing the pay-for-delay settlements. I think that's a huge issue. At a time when healthcare costs are spiraling out of sight, and the cost of prescription drugs is a major part of that, the idea that consumers are paying \$35 billion more, over the last—or over the next 10 years because of these settlements, is truly outrageous.

Your chart doesn't surprise me, however, because, I believe it was in 2002, we passed legislation that I was a cosponsor of—
Mr. LEIBOWITZ. You were.

Senator COLLINS [continuing]. With Senator McCain, Senator Schumer, and Senator—then-Senator Edwards—and, probably, my friend Senator Durbin was a cosponsor, as well—that was an attempt to end this practice.

Mr. LEIBOWITZ. Well, you did. And what we had asked for then—I wasn't at the Commission, it was in the Medicare Modernization Act—was just to get notice of these agreements. Because everyone believed at that time that the deals were per se illegal; absolutely illegal. And if we had notice of these deals in the same way we have notice of mergers, we would be able to go after the anti-competitive arrangements.

Because, of course, if a brand and a generic want to settle their dispute, we have no problem with settlements. We just have a problem with settlements where the brand pays the generic to sit it out.

Senator COLLINS. Exactly.

Mr. LEIBOWITZ. And so you gave us that authority. We review all of these deals. But, what happened after that, in 2005, was that

two courts ruled that these deals were generally permitted; they articulated very permissive rules. And after that, it became the new way of doing business, not for every pharmaceutical company, but for all too many.

Senator COLLINS. Well—

Mr. LEIBOWITZ. So, we see this as really just an extension to make it clear what the antitrust laws mean and what Hatch-Waxman was designed to mean, which is early entry of generic drugs. As you know, generic drugs cost about 15 percent, on average, of brands.

Senator COLLINS. Well, that's something that I'm sure we're going to continue to work on. Both of us are cosponsors of your former boss's bill.

I wonder where he got the idea for that bill. I just can't imagine.

GOOGLE COLLECTION OF DATA VIA WI-FI

Mr. Chairman, I want to turn next to an issue I mentioned in my opening statement, and that is: last Friday, Google issued a statement that it had engaged in the unauthorized collection of user data from Wi-Fi networks in connection with Google's street view mapping activities. And this was an admission by Google that it had accumulated an enormous amount of data; I believe it's some 600 gigabytes of data that was accumulated as its street view cars canvassed residential neighborhoods.

Is the FTC investigating this matter?

Mr. LEIBOWITZ. Well, we don't acknowledge investigations, unless the companies do, until those investigations are completed. But, I can certainly tell you, we're going to take a very, very close look at this.

And, in fact, Google has already come in to talk to our staff about precisely what happened.

Because, obviously, this is just one example of why consumers have very serious privacy concerns about data that's being collected. So, we are going to take a look at it, absolutely.

Because, who would have guessed, as those cars were going by, taking photographs for Google Maps, that, in fact, they were collecting all this personal data. That's just really troubling.

Senator COLLINS. It has this Big Brother connotation to it that is very disturbing.

Mr. LEIBOWITZ. It does. We've already received some letters from Members of Congress. And we will absolutely take a very close look at exactly what's going on.

Thank you.

HOSPITAL MERGERS

Senator COLLINS. I want to bring up a more local issue that has occurred in Maine and—in my State—and it involves hospitals attempting to do mergers. I—without naming the hospitals, I'm just going to read you the first sentence of this newspaper story. And it says that, "A small hospital and a larger hospital said that they expected their proposed merger to sail through the Federal Trade Commission. With one hospital having only 53 licensed acute-care beds, it is much smaller than other hospitals that had merged with the larger hospital, and well below the FTC guidelines that abbre-

viate reviews for small facilities. Other Maine hospital mergers have quickly gained Federal clearance, but not this time.” And it goes on.

I am not taking a position on whether or not this merger should be approved, but I am troubled about what happened in this case. Because, what happened is, the FTC sent what was perceived, at least, as being such a burdensome request for data that the two hospitals interpreted that as a signal that they should not go forward. The hospitals reported providing an additional 2,000 pages of documents required by the FTC. And furthermore, the cost of complying with the request from the FTC, they felt, would be so prohibitively expensive that they abandoned the plans.

Mr. LEIBOWITZ. Well, it’s a fair concern, generally. And with respect to this matter, I’ve talked to the head of the Maine Hospital Association. And I think there was maybe a little bit of miscommunication, because what we do when we go to second request is we try to find out more about a deal.

So, there is a safe harbor for acquisitions of small hospitals, but it’s a presumption. And you want to make sure that it’s within the safe harbor. We had a case in Texas where a hospital thought it was in the safe harbor. It turned out not to be. We actually let that deal go through anyway.

And you want to make sure that it won’t raise prices for payers and ultimately for consumers. And so, if they decide to restart this transaction, we will make sure, as we almost invariably do, that what we call a “second request” is not unduly burdensome. And our staff is going to reach out to that hospital group directly, to let them know about that.

Senator COLLINS. Thank you. That’s—

Mr. LEIBOWITZ. And we’re going to send back a letter to the Hospital Association. We’ll make sure that the subcommittee has it.

Senator COLLINS. That would be very helpful. Thank you.

Mr. LEIBOWITZ. Sure.

[The information follows:]

FEDERAL TRADE COMMISSION,
Washington, D.C., June 22, 2010.

STEVEN MICHAUD,
President, Maine Hospital Association,
33 Fuller Road, Augusta, Maine 04330.

DEAR MR. MICHAUD: Thank you for your letter to the Federal Trade Commission regarding the joint FTC/Department of Justice Statements of Antitrust Enforcement Policy in Health Care (“Statements”)¹ as they may relate to the Commission investigation of the proposed acquisition of Goodall Hospital by MaineHealth.²

In your letter, you raise three questions:

(1) “Why did the FTC staff decline to give clearance to the MaineHealth-Goodall Hospital transaction, given that Goodall Hospital qualified as a small hospital under the ‘safety zone’ guidelines?”

¹The Statements are available on the public Commission Website at <http://www.ftc.gov/bc/healthcare/industryguide/policy/index.htm>.

²I am able to confirm publicly the Commission’s investigation of the acquisition because at least one of the parties to the transaction “has publicly disclosed the existence of [the] transaction or proposed transaction in a press release or in a public filing with a government body.” *Federal Trade Commission Notice of Policy of Disclosing Investigations of Announced Mergers: Notice of Revised Policy*, 62 Fed. Reg. 18630 (Apr. 16, 1997); see also *Federal Trade Commission Policy Concerning Disclosures of Nonmerger Competition and Consumer Protection Investigations: Notice of Revised Policy*, 63 Fed. Reg. 63477 (Nov. 13, 1998).

(2) “What was so extraordinary about the circumstances of the MaineHealth-Goodall Hospital transaction to warrant a departure from the ‘safety zone’ guidelines?”

(3) “Will the FTC follow its guidelines for small hospital mergers going forward, or is the FTC abandoning its guidelines in practice without having yet formally announced that it has done so?”

With respect to your first two questions, I should note that a number of statutory prohibitions and the Rules of the Commission prevent me from disclosing the details of any nonpublic Commission investigation. As a general matter, of course, Congress has empowered the Commission to prevent mergers and acquisitions that may substantially lessen competition or tend to create a monopoly, in violation of Section 7 of the Clayton Act³ or Section 5 of the Federal Trade Commission Act.⁴ In carrying out these law enforcement responsibilities, the Commission and its staff seek to identify and challenge only those mergers or acquisitions which the Commission has a reason to believe violate the foregoing statutes.

In response to your third question, the Statements remain an accurate and current reflection of Commission policy. Of course, any determination as to whether a particular transaction falls within the “safety zone” set forth in the Statements is necessarily a fact-intensive inquiry that requires investigation by Commission staff. In addition to the Statements, both the Commission and the Department of Justice Antitrust Division in certain instances provide more specific guidance on particular proposals through the Commission’s advisory opinion procedure and the Department of Justice’s business review procedure. Information about the Commission’s advisory opinion procedure regarding healthcare proposals is posted on the Bureau of Competition part of the Commission Website at the following location: <http://www.ftc.gov/bc/healthcare/industryguide/adv-opinionguidance.pdf>.

I understand that you discussed this subject in a June 2, 2010 telephone conversation with Matthew Reilly, the Assistant Director within our Bureau of Competition whose office is involved with antitrust hospital merger reviews. Mr. Reilly would be happy to provide any additional information on this subject within the above-mentioned statutory and regulatory parameters. Mr. Reilly’s direct dial telephone number is (202) 326–2350. We appreciate your interest in this subject, and thank you again for your letter.

DONALD S. CLARK,
Secretary of the Commission.

UNSUBSTANTIATED HEALTH CLAIMS

Senator DURBIN. I’m trying to figure out what you don’t look at. And I assume that there are some areas where you clearly are—

Mr. LEIBOWITZ. Yes.

Senator DURBIN [continuing]. Precluded, under the law. But, one area that you have been involved in are false and misleading health claims.

Mr. LEIBOWITZ. Yes.

Senator DURBIN. And I know Kellogg’s was charged with going too far in claiming their Frosted Mini-Wheats made kids smarter, more attentive. I like Frosted Mini-Wheats, don’t get me wrong, but it hasn’t helped my I.Q.

Under another case, the FTC charged the company Roex and two individuals with making false or unsubstantiated claims for advertising products ranging from an infrared sauna for treating cancer to nutritional supplements to reduce the risk of a variety of medical conditions, like HIV and Alzheimer’s.

What resources do you have, when it comes in areas of health claims? How much do you work with other Federal agencies, like the Food and Drug Administration (FDA)?

Mr. LEIBOWITZ. So, our biggest resource is our staff, because they’re terrific in this area, whether it’s phony dietary supplements

³ 15 U.S.C. § 18.

⁴ 15 U.S.C. § 45.

or other sorts of phony healthcare products. And the other thing we do—and we’re very—I think we’re very good at it—is, we reach out to other agencies. So, we work with the FDA quite a bit. We work with the Department of Health and Human Services (HHS). And because—you know, you need to aggregate your resources, here. And we work with State attorneys general, too, because I don’t want to say we’re doing triage, because that’s not the case. But there are many more malefactors out there than we have resources to go after. And so, we try to prioritize the most important cases. And in the House financial reform bill, they gave us easier rule-making authority. And if we get some relief from our very burdensome Magnuson-Moss Act—it’s a sort of medieval form of rule-making, where rules take 8 to 10 years—unless Congress directs us to do standard notice and comment rulemaking, which you’ve done in some instances—then I think we can try to set standards and make things more efficient, and try to be even more useful in this area.

FREE CREDIT REPORTS

Senator DURBIN. So, since the FTC has worked to make certain we have access to free credit reports—

Mr. LEIBOWITZ. Yes?

Senator DURBIN [continuing]. When we see ads on television that a company is paying for to advertise free credit reports, does that put us on guard?

Mr. LEIBOWITZ. Well, you know, this has been a very complicated area from the beginning. We litigated a case against free credit reports. But, we were very supportive, and obviously drafted a rule that we recently released to require that free credit reports be given to consumers. Because, after all, if it says “free credit report,” you ought to be able to get it. Not every consumer knows that you should go to AnnualCreditReport.com.

Senator DURBIN. AnnualCreditReport.com?

Mr. LEIBOWITZ. Yes. AnnualCreditReport.com—or if you happen to go to FreeCreditReport.gov, we have that Web site, or that domain name, and we’ll send you right to AnnualCreditReport.com—free—

But, we’re going to stay on top of this area. We’re looking to see whether companies are following the new rule that we did pursuant to the Credit CARD Act. And if they’re not, we’ll go after them.

IDENTITY THEFT

Senator DURBIN. I’ve had personal experience with identity theft.

Mr. LEIBOWITZ. I know you have.

Senator DURBIN. And it’s an eye-opener, when you get that call. And it seems to me that there’s quite a strong likelihood that most identity thefts go unreported, that people don’t follow through. Do you have any statistics to indicate how many people realize it and do something about it, as opposed to those who—

Mr. LEIBOWITZ. Let me get back to you.

[The information follows:]

The Commission’s most recent identity theft survey reported that 43 percent of victims said that they contacted or were contacted by a company where an account was opened in their name or where an existing account was misused; 26 percent

of victims said that they had contacted the police; 21 percent of victims reported contacting one or more credit reporting agencies; and 4 percent of victims reported contacting the FTC. The survey also reported that 38 percent of victims said they did not contact anyone. This data, which is based on the responses of the 559 individuals surveyed who indicated that their personal information had been misused between 2001 and the date they were interviewed, includes both new account identity theft as well as existing account identity theft. See Federal Trade Commission, *2006 Identity Theft Survey Report: Prepared for the Commission by Synovate*, at 44–45 (November 2007), available at <http://www.ftc.gov/os/2007/11/SynovateFinalReportIDTheft2006.pdf>.

Mr. LEIBOWITZ. My instincts are the same as yours. We periodically do reports about how many people, annually, are victims of identity theft. The number is around 9.5 million victims a year—or instances of identity theft a year in America.

And, you know, if it's identity theft with a credit card, a lot of times consumers won't go to the police or they won't go to law enforcement authorities. They'll call the credit card company, of course. We're fortunate to have this identity theft hotline, and people use it. And that is a good thing.

And then, we also try to do things like bring data security cases, so companies have better data protection, making it harder—

Senator DURBIN. What are the most common sources of a person's identity if they're going to have it pilfered and exploited?

Mr. LEIBOWITZ. Yeah.

Senator DURBIN. What are the most common?

Mr. LEIBOWITZ. What are the most common sources? Probably credit cards more than anything else, or data breaches by companies, which often involve credit card information. Sometimes companies use Social Security numbers. You can buy them online. It's often done by people outside of the country that have a marketplace going, and they sell data for \$1 or \$5—credit card information, Social Security numbers. It's just extraordinary.

We try to do a lot to leverage our resources with our sister law enforcement agencies around the world. But, as you know, it is very hard to have extraterritorial reach, and it is very hard to tamp down on all instances of identity theft. But, we're working very, very hard. And when we see criminal cases, we of course give those to the criminal authorities, because identity theft is really a kind of fraud or—

GASOLINE PRICES AND THE OIL INDUSTRY

Senator DURBIN. I have a—

Mr. LEIBOWITZ [continuing]. Crime.

Senator DURBIN [continuing]. Standard press release that I put out at least once a year complaining that gasoline prices have just gone up way too high, not reflected in the price of a barrel of oil, and clearly these oil companies, once again, are taking advantage of consumers, and I'm calling on the FTC to investigate it right now. I issue that at least once or twice a year.

Mr. LEIBOWITZ. We try to be responsive.

Senator DURBIN. I know you do. But, we basically don't come up with much. At the end of a long investigation, people throw up their hands and say, "I guess we can't prove it, one way or the other." Is that about where it stands?

Mr. LEIBOWITZ. Well, you know, if you want to find an antitrust conspiracy you have to have people talking to each other. And we have done investigations. We continue to do investigations of the oil industry. A lot of the cost of a barrel of oil, as you know, is due to OPEC. Now, OPEC engages in output restrictions. If American companies did that, they would go to jail for an illegal, criminal antitrust cartel. And so, that's a part of it.

But, as for whether the American petroleum companies are engaged in anticompetitive behavior, violating antitrust laws, it is really hard to prove a criminal conspiracy or any kind of conspiracy. But, we will try to stay on top of this.

And we did pass our market manipulation rulemaking, which will give us a little more flexibility going forward.

Senator DURBIN. Senator Collins.

Senator COLLINS. Mr. Chairman, I'm glad that you brought up that last issue. I can't tell you how often my constituents say to me, "But, wait. Supply is ample. Why are prices going up?" And it's not the seasonal change that you see when different kinds of gasoline are refined. It seems to them, and I will say it seems to me, to be disconnected with supply or demand.

Mr. LEIBOWITZ. Well this is an issue that resonates with consumers. No one would be happier than me to be able to bring a case against the oil industry for a violation of the antitrust laws. And our staff would be very happy to. And we do, again, have some investigations in the pipeline. But, it is very hard to prove.

When my older daughter was 8 years old, or 9 years old, we were stopped at—on River Road, in Bethesda, and there were, like, four gas stations right around us, and she said, "Why do they all have the same price?"

And so, I think it is very baffling to many people. The truth is, if there's no meeting of the minds, there's no antitrust violation, even though the effect is the same on consumers.

Senator COLLINS. Yeah. It is a source of frustration, though, I think also—and this is an issue I've raised with the Commodity Futures Trading Commission (CFTC), which also comes before us—I also think that the way the futures markets are working, where we now have investment funds and pension funds chasing the product, when those markets were originally designed for producers and end users and not as an investment hedge, also has something to do with the fluctuations.

Mr. LEIBOWITZ. It may very well. And, you know, we periodically track prices. And so, we have done, in the last 2 or 3 years, investigations into anomalous prices in the Pacific Northwest, into western New England, and into the price of jet fuel, as you know. And it is sometimes hard to find the reasons why prices go up.

CONSUMER EDUCATION

Senator COLLINS. Speaking of the cost of heating oil—home heating oil or gasoline, there was a company in my State that was recently the victim of cybercrime because, unfortunately, the—one of the financial clerks responded to a phony Web site that was mimicking the bank that this company used, and, within moments, the accounts—the banking account of this company was drained, be-

cause she, unfortunately and naively, over the Web site, gave the password and other information.

I mention this because this is a fair-sized company in Maine, and it's not an unsophisticated business; it's a very well-run operation. And yet, it, too, was duped into—to a move that led to a loss of tens of thousands of dollars.

My question to you is, What does the FTC do to try to better publicize scams, whether they're via the Internet or coming through the mail, and educate small businesses and consumers in this area?

Mr. LEIBOWITZ. Well, we have a number of educational materials. I think we put a few of them on your desk. We're very proud of the educational work we do here. And to distribute educational materials, we often either co-brand with companies or community organizations, or we don't brand at all, we simply design them and let others distribute. I think you might have a copy of "Deter. Detect. Defend.," which is an identity theft brochure. So, that's a part of what we do.

And then when we bring cases—because part of this is alerting consumers to be more careful—we try to pair with State attorneys general, because if we do a joint announcement, very often it gets picked up, people read it in the papers, they see it on the television news, and they think a little bit more about it. And then we don't have—going back to Senator Durbin's earlier question, we don't have jurisdiction over banks, but we do try to bring cases involving inadequate data security. And that keeps companies on their toes.

And then, we do workshops and other things where we bring stakeholders together and we try to think through how to respond.

ADMINISTRATIVE PROCEDURES ACT RULEMAKING AND ADDITIONAL AUTHORITIES

Senator COLLINS. And finally, I'd like to pursue the issue that you raised about your rulemaking, because I was surprised that you don't use the Administrative Procedures Act (APA). Most agencies do. The Securities and Exchange Commission (SEC) does. A lot of the agencies that you deal with use the APA. Could you provide me with some information on, What is the history of why you don't use the APA?

Mr. LEIBOWITZ. Well, under the Magnuson-Moss Act, which was passed in 1974, Congress circumscribed our rulemaking in a way to slow it down. I don't think Congress meant to slow it down quite as much as they have. We haven't begun to make a new rulemaking under Magnuson-Moss since the late 1970s. And the reason why is because it can take 8 or 10 years to do a rule. And if a company or an entity—if it's within the ambit of the proposed rule—feels aggrieved, they can call, essentially, regulatory timeouts and ask for independent referees.

Now, in fairness, Congress has given us APA rulemaking for some specific instances. And we've used it in a very thoughtful way. In our mortgage modification rulemaking, it will take, from the time we put out an advance notice of proposed rulemaking (ANPR) to the time we finish it, about 15 months; a little slower than we wanted, but you want to do it deliberately so you can get it right.

But, it has been a real impediment for the Commission, and one that we're trying to get out from under the restrictions of. Because we think we can be more effective, on behalf of the consumers that we serve, if we had some degree of relief.

And the other proposal that's in the House bill that has garnered a little bit of attention is civil fining authority for violations of section V, or unfair or deceptive act and practices rule, and there, I think, more than 40 State attorneys general, who have baby FTC acts, have fining authority under that. We don't. And we're trying to go after real, hardcore malefactors. Because, essentially, sometimes we're going after people who are engaged in fraud because the criminal authorities don't have the capacity to bring those cases. We would like to have fining authority.

Casper Weinberger, when he was Chairman of the Federal Trade Commission in the early 1970s, called for that. And on this issue—I wouldn't say on this issue alone—but, on this issue, I think the vast majority of the Commission supports the Weinberger approach.

Senator COLLINS. Is this a problem where the cases that you develop may be under the prosecutorial guidelines, as far as dollar amount, that they're too—

Mr. LEIBOWITZ. Yes. Yeah, I mean—

Senator COLLINS [continuing]. Small for them to be brought—

Mr. LEIBOWITZ. Look—

Senator COLLINS [continuing]. At the U.S.—

Mr. LEIBOWITZ [continuing]. Criminal authorities—U.S. attorney's offices—and we do try to pair with U.S. attorney's offices whenever we can. And we have taken some of the worse frauds we've gone after and given to the criminal division, for example, in the Department of Justice. But, they have other priorities. And so, we pick up a lot of the sort of small-time—pick up a lot of the fraud against consumers. And, in the aggregate, it can be a fairly substantial amount. And it would be better if we had fining authority. We believe that we would have a more effective deterrent.

Senator COLLINS. Thank you.

PAYDAY LENDING AND DEBT COLLECTION

Senator DURBIN. Mr. Chairman, one of the things that I was disappointed in during the debate on the floor on financial reform was that I had hoped that we would be able to offer an amendment related to the so-called "title loans," or "payday loans," a type of predatory lending. And for reasons which are hard to explain to the normal population in America, we have not been able to get to that issue. That strikes me as one aspect of credit in America that is highly abusive to people in low-income categories and desperate situations. And I noticed that the number two complaint, second only to identity theft, at your agency relates to debt collection.

So, can you tell me what efforts have been made by the FTC to deal with this industry?

Mr. LEIBOWITZ. Yes. Well, it's a couple of things. With respect to payday lenders, we have brought cases. I think we've brought at least two in the last year. Usually, they don't involve too high a rate. The rates may be very, very high, but States have basically set per-State caps on what they can charge. And what we found,

though, is that sometimes they'll charge additional fees but they won't tell the consumers. And so, we brought a case in that area.

We brought another case involving the use of the data. The case was called, I think, "EDebitPay," and it was an online payday lender. And what they had done was fail to disclose certain things to consumers, and garnish wages, without telling the consumers that they were going to do that.

And then, we brought another case against several payday lenders who weren't giving the required statutory APR data. It's required by statute, under TILA, I think.

And so, we try to stay active in this area. And it is one where I think the complaints that we have gotten tell us that there are problems out there.

And, of course, they prey on the people at the lowest rung of the economic totem pole. Congress has—and I think you might have been involved in this—has capped the rates on payday lending outside of military bases.

Senator DURBIN. Yes, we're protecting military families; but not nonmilitary families, we don't protect all families when it comes to these bottom-feeders.

EMERGING INTERNET SCAMS

You've made reference to the Internet and services being offered. It seems like this adds a new level of challenge and complexity, that now certain things can be offered in the ether, on the Internet. And really the source of them might be hard to find, whether they're actually in the United States, North America, Europe, wherever they may come from. So, how do you cope with that Internet challenge?

Mr. LEIBOWITZ. Well, several years ago, you passed something called the SAFE WEB Act, which allowed us to do confidential investigations with our sister law enforcement agencies from around the world. We have to sign agreements with them, and we've done this with a number of jurisdictions. So, that's been helpful.

But, as you know, con artists all around the world are very, very smart, and they're very nimble. We had a foreclosure rescue scam case where the domain name was registered in Berlin, but the company was actually operating out of Orange County, California. And so sometimes it takes a long time to pierce through the corporate veil and find out who these real malefactors are. Now, we were fortunate enough to work with foreign law enforcement authorities to shut this company down. But it's very hard, although it's a challenge that we accept. That's what we're supposed to do.

Senator DURBIN. Do you have such an agreement with Nigeria?

Mr. LEIBOWITZ. We do not believe we have one with Nigeria. But, I do believe, at this point, American consumers are on top of most Nigerian scams.

Senator DURBIN. Thank you.

Senator COLLINS.

Senator COLLINS. Thank you.

Senator DURBIN. Chairman Leibowitz, thanks for being here.

ADDITIONAL COMMITTEE QUESTIONS

We'll work hard on your appropriation, try to find some more resources. You're doing important work. Thanks.

Mr. LEIBOWITZ. Thank you so much. Thank you.

Senator DURBIN. We may have some written questions.

[The following questions were not asked at the hearing, but were submitted to the Commission for response subsequent to the hearing:]

QUESTIONS SUBMITTED BY SENATOR RICHARD J. DURBIN

Question. The Energy Independence and Security Act of 2007 gave the Federal Trade Commission (FTC) authority to issue regulations prohibiting market manipulation involving wholesale transactions of crude oil, gasoline, and petroleum distillates. The FTC issued the Final Rule in August 2009 and provided guidelines to industry for compliance.

How does the "market manipulation" rule change, expand, or enhance the FTC's jurisdiction and enforcement authorities?

Answer. The market manipulation rule (MMR) is a fraud-based rule. The MMR prohibits persons from knowingly engaging in fraudulent or deceptive conduct connected with wholesale transactions of petroleum products. The MMR also prohibits persons from intentionally omitting material facts in statements whenever the omission can be expected to distort wholesale petroleum markets. Thus, in addition to the FTC's traditional enforcement program focused on anticompetitive conduct, including anticompetitive mergers and unfair business practices that result in a sustained diminution of competition, the MMR enables the Commission to prevent specific instances of fraudulent or deceptive conduct, even when that conduct does not have durable competitive consequences.

Question. How will the FTC monitor compliance with the new rule?

Answer. The Commission has established a dedicated e-mail and telephone MMR "hotline" to receive complaints from anyone who has information about conduct prohibited by the MMR. The Bureau of Competition also has a litigating section of approximately 25 attorneys who specialize in energy matters that will have the primary responsibility for bringing appropriate cases under the MMR. In addition, staff from both the Bureau of Competition and the Bureau of Economics regularly monitors the petroleum industry to discern any anomalous price movements that need further investigation to determine whether they are caused by shifts in market conditions or wrongful behavior.

Question. The FTC published an investigation of the increases in gas prices occurring in 2006, concluding that rising gas prices could be explained entirely by market forces and not illegal anticompetitive behavior. Will the new market manipulation rule change the standard for how the FTC will evaluate and reach conclusions on behavior in the petroleum market?

Answer. As noted above, the MMR targets fraudulent or deceptive practices that might not otherwise be reachable by Section 5 of the FTC Act. However, it does not alter the FTC's standard for evaluating behavior in the petroleum industry under either Section 5 or Section 7 of the Clayton Act. The FTC's long-established enforcement aim is to protect consumers from unfair methods of competition or unfair or deceptive business practices. The issuance of the MMR does not change that mission; rather it provides the Commission with an additional tool to fulfill it.

Question. The FTC shares concurrent jurisdiction with other agencies such as the Commodity Futures Trading Commission, the Securities and Exchange Commission, the Department of Justice, and the Food and Drug Administration.

Please describe the FTC's concurrent jurisdiction with these and other agencies and how such jurisdiction is either complementary or duplicative.

Answer. The FTC has concurrent authority with many agencies to a greater or lesser extent. The concurrence is broadly complementary; for example, the agencies may have generally consistent but different missions or goals (e.g., FTC with FDA, EPA, SEC, CFRC, CPSC), or divide up primary responsibility (e.g., FTC with FDA, FCC), or share enforcement over a very substantial number of entities or acts while arranging to avoid duplication (e.g. FTC with DOJ Antitrust Division), or aid each other with special expertise in certain areas (e.g. FTC with FDA, EPA, FCC), or can apply different remedies to the same or similar conduct, such as civil vs. criminal, injunction and restitution vs. seizing product (e.g., DOJ, U.S. Postal Inspector, EPA,

FDA). Attached is a brief summary of the FTC's primary areas of coordination with various Federal agencies.

Question. To curb fraudulent practices in the mortgage industry, the FTC plans to issue a rule banning upfront fees for mortgage modification or foreclosure rescue assistance. The FTC is also contemplating rules on advertising mortgages.

How would new rules related to mortgage advertising practices strengthen the FTC's authorities in the mortgage arena?

Answer. The Commission currently enforces mortgage advertising requirements under the FTC Act, the Truth in Lending Act (TILA), including the Home Ownership and Equity Protection Act (HOEPA), and Regulation Z rules written by the Federal Reserve Board (Board). The Commission lacks authority to obtain civil penalties for violations of these statutes and rules, with the exception of certain Regulation Z rules promulgated pursuant to HOEPA.

The Commission has not published a proposed or final mortgage advertising rule, so I cannot discuss the specific conduct that a final rule might prohibit or restrict. Generally, however, enacting new rules in this area would enable the Commission to protect prospective borrowers more effectively by establishing clearer standards for mortgage advertisers and giving the Commission more effective tools to stop and deter violations. As you know, the Commission is conducting the mortgage advertising rulemaking using the authority Congress granted to it in the Omnibus Appropriations Act of 2009, as clarified by the Credit Card Accountability Responsibility and Disclosure Act of 2009. Those laws authorize the Commission to enact rules with respect to unfair or deceptive mortgage practices, and to enforce those rules, with the states, through a variety of remedies including civil penalties.

Question. The proposed rule prohibiting upfront fees for mortgage modifications is being implemented around the same time as the rule prohibiting upfront fees for debt settlement. Does the FTC plan to prohibit upfront fees for other financial services, given that these fees have been a key tactic for deceiving consumers?

Answer. The Commission's amendments to the Telemarketing Rule governing debt relief services include a ban on the collection of advance fees. The FTC proposed rule on mortgage assistance relief services also would ban advance fees, but that rule is not yet final. With respect to the Telemarketing Rule's debt relief amendments, the Commission concluded that the collection of advance fees by debt relief providers, which often takes place in the context of transactions involving telemarketing that are permeated with deception, is an abusive practice under the Telemarketing Act. The record in the debt relief proceeding—including the public comments, a study by the Government Accountability Office, information gathered at a public forum, consumer complaints, and the law enforcement experience of the Commission and state enforcers—demonstrated widespread deception and substantial consumer injury in the provision of debt relief services. Consumers in the midst of financial distress suffer monetary harm—often in the hundreds or thousands of dollars—when, following sales pitches frequently characterized by high pressure and deception, they use their scarce funds to pay in advance for promised results that, in most cases, never materialize. In finding this practice abusive, the Commission applied the test for an unfair practice in section 5(n) of the Federal Trade Commission Act. The Commission found that the practice (1) causes or is likely to cause substantial injury to consumers, that (2) is not outweighed by countervailing benefits to consumers or competition, and (3) is not reasonably avoidable. The Commission relied on a similar analysis in prohibiting under the Telemarketing Rule the collection of advance fees for credit repair services, recovery services, and offers for certain loans.

At present, there are no other rulemaking proceedings in which the Commission has proposed or issued an advance fee ban. The determination of whether an advance fee ban is appropriate is very much dependent on the specific circumstances, including the extent to which the transactions at issue take place in the context of widespread deception.

Question. The FTC reports that Identity Theft was the number one consumer complaint during 2009. Consumers are worried that in an increasingly high-tech world, their personal data is being collected improperly and stored insecurely.

What responsibilities do Facebook and other companies have to their users to disclose their websites' privacy policy? What about changes to that policy over time?

Answer. Although there is no generally applicable requirement for social networking companies to disclose their privacy practices, they still must satisfy certain responsibilities with respect to privacy policy disclosures. First, any claims they make must be truthful. The Commission has brought one case against a social networking site—Twitter—for making a misrepresentation about the level of security provided. See *In the Matter of Twitter, Inc.*, FTC File No. 092 3093 (June 24, 2010) (consent order approved for public comment). Second, if websites collect information

from children, they must provide parents with notice and an opportunity to consent. The Commission has brought several cases against companies for violating the Children's Online Privacy Protection Act by not securing the required parental consent before collecting information from children through social networking websites. See *United States v. Xanga.com, Inc.*, No. 06-CIV-6853(SHS) (S.D.N.Y.) (final order Sept. 11, 2006); *United States v. Industrious Kid, Inc.*, No. 08-CV-0639 (N.D. Cal.) (final order Mar. 6, 2008); *United States v. Sony BMG Music Entm't*, No. 08-CV-10730 (S.D.N.Y.) (final order Dec. 15, 2008); *United States v. Iconix Brand Group, Inc.*, No. 09-CV-8864 (S.D.N.Y.) (final order Nov. 5, 2009). Third, if companies change their privacy policies in a way that materially affects data that consumers have already provided, they must provide clear notice and the opportunity for the consumers to provide their affirmative express consent to the change. See *In the Matter of Gateway Learning Corp.*, FTC Docket No. C-4120 (Sept. 10, 2004) (consent order).

Question. If users decide to cancel or restrict their accounts on Facebook, photo storage sites, or other sites where they have stored personal information, what assurances do they have that their personal information is completely removed and deleted from storage?

Answer. Several companies make specific disclosures to consumers about what happens to their data once they leave a site. If the disclosures are false, the FTC can bring an enforcement action under Section 5 of the FTC Act. In addition, if a website does not honor requests from parents to delete information being stored about their children, the FTC can bring an enforcement action under the Children's Online Privacy Protection Act.

We have also examined the issue of data retention as part of a series of roundtables we hosted on consumer privacy over the last several months. A number of roundtable participants and commenters emphasized the value of businesses' retaining data only as long as necessary to fulfill a specific business purpose. The Commission staff will make recommendations on this issue as part of an upcoming report on privacy, to be released later this year.

Question. Net Cetera is a guide published by the FTC to assist parents in talking to their children about the Internet.

How has the FTC distributed the Net Cetera guide?

What feedback has FTC received on the guide?

Answer. The FTC is working with outside groups to promote and distribute the booklet. For groups and individuals who want to share it with their families, friends, and communities, Net Cetera is available at OnGuardOnline.gov and in Spanish at AlertaenLinea.gov. People also can order free copies through the FTC's bulk order site, bulkorder.ftc.gov. Like all the FTC's consumer materials, Net Cetera is free and in the public domain. The FTC encourages groups and individuals to order as many copies as they can use, include sections of it in their newsletters and blogs, and grab the web button from OnGuardOnline.gov for use on their own websites.

Many schools use OnGuardOnline.gov and Net Cetera as part of their online safety programs. Because so much computer and other media use takes place in the home, pairing teachers and parents in these efforts more fully encourages safe and responsible online behavior, and reinforces consistent messaging.

Net Cetera has been available to the public since October 21, 2009. To date, the FTC has distributed more than 3,700,000 copies of the guide in English and more than 350,000 copies in Spanish. Distribution highlights include:

- Schools or school systems in all 50 states and D.C. have ordered copies of Net Cetera. This includes large orders by the Prince George's County (MD) Public Schools (~150,000), the Cobb County School District (~120,000), and the Cleveland Metropolitan School District (~50,000).
- Illinois schools, police departments, and community groups have ordered over 100,000 copies of the guide.
- Members in both Chambers signed and circulated letters about Net Cetera to their Hill colleagues, encouraging them to use the guide in their districts and to link to it from their websites. The FTC sent copies of the booklet to district offices as well, and will continue to work with Congress to spread the word about online safety.
- Companies including Facebook, MySpace, and Sprint are linking to Net Cetera from their safety or resources pages.
- Nonprofits such as the Boys and Girls Clubs of America and the Internet Keep Safe Coalition distributed the guide at events across the country.

As the order numbers illustrate, Net Cetera has been very well received by parents, educators, police officers, and online safety experts. The Online Safety and Technology Working Group highlighted Net Cetera as an "outstanding" project that

should be promoted as an opportunity for public-private partnerships in online risk prevention. Also, the FTC has secured opportunities to speak about Net Cetera at conferences for groups including the International Society for Technology in Education and the National Association of School Resource Officers.

Question. To stop advertisements from deceiving consumers into paying for so-called “free” credit reports, the FTC implemented a rule requiring that these advertisements contain a clear disclosure that the only authorized free credit report is available at AnnualCreditReport.com.

How is the FTC enforcing the new rule requiring that a disclosure is displayed on all commercial “free credit report” websites?

Answer. To determine compliance with the rule, the FTC monitors websites offering free credit reports. The FTC recently sent letters to 18 websites offering free credit reports, warning them that they must clearly disclose that a free report is available under Federal law. This campaign appears to have been effective: several of the websites have changed their practices. The Commission anticipates follow up law enforcement action against those companies that do not come into compliance.

Question. What other measures have been taken to inform consumers of AnnualCreditReport.com, and how effective have those measures been?

Answer. The Commission has made extensive outreach efforts to educate consumers about their right to a free credit report through the authorized source, AnnualCreditReport.com. When the free annual credit report program initially took effect in 2004, the FTC issued press advisories and radio public service announcements informing consumers of their new rights, and published a “how to” guide on ordering the Federally-mandated free reports. The Commission also has issued public warnings about “imposter” sites that pose as the official free report site, AnnualCreditReport.com. In addition, the FTC has created videos that highlight the differences between AnnualCreditReport.com and other sites that claim to provide “free” credit reports. Moreover, each time the FTC announces an enforcement action or new rule in the credit reporting area, it publicizes the AnnualCreditReport.com website. Most recently, it did so when it announced the warning letters described above. We believe these measures have been quite effective. Since 2004, consumers have obtained over 150 million free credit reports from the nationwide CRAs.

Question. Experian, the company that ran “Free Credit Report.com” has now shifted its strategy and set up “Free Credit Score.com.” Is the FTC continuing to monitor these companies to make sure they are complying with the new rule? Is there a plan to create a truly free credit score website similar to AnnualCreditReport.com?

Answer. The FTC generally monitors consumer reporting agencies and other companies for their compliance with the provisions of the FCRA and other applicable rules. The Free Credit Report Rule does not apply to credit scores and consumers do not have a general right to a free credit score under the FCRA. Instead, the FCRA provides consumers a right to purchase a credit score from consumer reporting agencies and to obtain a free credit score in specified circumstances, such as when they apply for certain home loans. In addition, under the Risk-Based Pricing Rules which take effect on January 1, 2011, creditors can provide a free credit score, along with information about that score, to all consumers, instead of providing risk-based pricing notices to specific consumers. Finally, the Consumer Financial Protection Act of 2010 will allow consumers turned down for credit or offered less favorable terms because of their credit report or score to get a free credit score disclosure with their adverse action notice. The FTC oversees compliance with all of these FCRA requirements for entities under its jurisdiction to ensure that consumers are able to obtain their credit scores as required by law.

Question. In April 2010, the FTC launched “Admongo,” an online video game where kids explore a virtual world filled with commercial messages to teach them to think critically about advertisements.

What was the cost of developing Admongo?

How does the FTC plan to evaluate the program’s effectiveness?

Are there ongoing costs associated with operating the online game?

Answer. The Federal Trade Commission has developed an interactive campaign to give kids the skills they need to understand how advertising works and to interpret the information that ads contain. The campaign, targeted to tweens (kids ages 8 to 12), is based on the website Admongo.gov, which teaches core ad literacy concepts and critical thinking skills through game play. Other elements of the campaign include in-school lesson plans, developed in cooperation with Scholastic, Inc., that are tied to state standards of learning for grades 5–6; sample ads that can be used at home and in the classroom; and teacher training videos.

Advertising literacy funding was approved for up to \$2.2 million per year for up to 4 years; the full amount was budgeted in the first year, but two subsequent years have seen funding set at \$2 million. Through June 2010, at the end of the second

year of funding, the cost of creating the website, all related lesson plans and materials, and the promotion of the site was approximately \$4.2 million. The ongoing costs to operate the game will include FTC staff time, web hosting fees, and occasional technical support from experts in web programming, as needed. The amount of money involved should be minimal.

Plans are underway now to evaluate the effectiveness of Admongo. FTC staff are initiating the Paperwork Reduction Act (PRA) approval process to conduct a study of student and teacher use of campaign resources. This will supplement the ongoing feedback we receive from teachers via the mailbox at admongo@ftc.gov and through conferences and meetings.

Question. The FTC anticipates reaching 200 million numbers on the Do Not Call List by this summer.

Has the FTC received complaints about unwanted text messages? Does the FTC need specific authority to create a “Do Not Text” list or can it bar messages under the Do Not Call List?

Answer. Since January 1, 2010, the Commission has received approximately 1,300 consumer complaints that primarily concern text messaging practices, including unsolicited text messages. In addition, approximately 5,600 of the more than 1 million Do Not Call complaints received during this period mention text messaging and may relate to unsolicited text messages. Including both groups, the total number of complaints concerning text messaging practices represents less than 1 percent of all complaints received by the Commission since the start of the year.

The Commission has not taken the position that sending an unsolicited text message violates the Telemarketing Sales Rule, which prohibits initiating an “outbound telephone call” to a person whose telephone number has been entered on the National Do Not Call Registry (DNC Registry). Moreover, it is not clear whether the rulemaking authority provided to the Commission under the Telemarketing and Consumer Fraud and Abuse Prevention Act (Telemarketing Act),¹ which was the basis for the DNC Registry, extends to text messages.²

The question whether a text message may fall within the provisions of the Telemarketing Act is muddled, among other reasons, by the facts that text messages typically lack an audio component, and that their dissemination can take many forms.³ Although some unsolicited text messages are sent from one phone to another, others are sent over the Internet to an e-mail address that has been automatically assigned to the subscriber’s account by his or her mobile carrier.⁴ For these reasons, the FTC’s authority under the Telemarketing Act to address text messages is uncertain.⁵

¹Public Law No. 103–297, 108 Stat. 1545 (1994). The Act defines telemarketing to mean “a plan, program, or campaign which is conducted to induce purchases of goods or services by use of one or more telephones and which involves more than one interstate telephone call.” Telemarketing and Consumer Fraud and Abuse Prevention Act, § 7, Public Law No. 103–297, 108 Stat. 1545 (1994).

²The Commission could seek to promulgate a rule establishing a “Do Not Text” registry under the rulemaking procedures of Section 18 of the Federal Trade Commission Act. Section 18 would be an impractical tool for addressing a Do Not Text registry, however, as it includes numerous burdensome and time-consuming requirements that typically have required from 3 to 10 years to complete. See prepared statement of the Federal Trade Commission on “Consumer Credit and Debt: The Role of the Federal Trade Commission in Protecting the Public” before the House Comm. on Energy and Commerce, Subcomm. on Commerce, Energy, and Consumer Protection at 21–23 (Mar. 24, 2009), available at <http://www.ftc.gov/os/2009/03/P064814consumercreditdebt.pdf>.

³The Commission has previously considered the limitations of its authority under the Telemarketing Act. For example, when creating the Telemarketing Sales Rule (TSR), the Commission considered a definition of “telemarketing” that would have covered campaigns involving fax machines, modems, or “any other telephonic medium.” This was rejected, however, upon the Commission’s conclusion that a narrower definition would “follow[] more closely the statutory definition set forth by Congress in the Telemarketing Act.” 60 Fed. Reg. 30411 (June 8, 1995). Instead, the statutory definition of telemarketing was incorporated almost verbatim into the TSR.

⁴Because an effective “Do Not Text” registry might involve the collection of e-mail addresses, the creation of such a registry would raise a number of the same concerns the Commission highlighted in its report to Congress regarding a National Do Not E-mail Registry. Federal Trade Commission, Report to Congress, National Do Not E-mail Registry (June 2004) (detailing security and privacy concerns, including the likelihood that an e-mail registry would be misused by spammers, thereby increasing rather than reducing the volume of spam emails).

⁵We note that the Federal Communications Commission has asserted that a text message is a “call” within the meaning of the Telephone Consumer Protection Act (TCPA), and thereby concluded that the TCPA prohibits the use of an automated dialer to send commercial text messages to a cellular telephone number without the prior consent of the recipient. See Federal

Some tools already exist that may minimize concerns about unsolicited text messages. Unlike telephone calls, text messages are not covered under common carrier regulations and therefore can be filtered by mobile carriers, which state that they block hundreds of millions of unsolicited messages every month.⁶ Consumers can also work with many carriers to block text messages entirely or just those messages from a particular unwanted source.⁷ In addition, consumers who have received certain types of unsolicited text messages may seek damages through a private right of action under the Telephone Consumer Protection Act.⁸

Moreover, to the extent the sending of unsolicited text messages is an unfair or deceptive practice, Section 5 of the Federal Trade Commission Act provides the agency with a flexible tool for addressing commercial practices that are unfair or deceptive. The Commission has pursued a vigorous law enforcement program against unfair or deceptive unsolicited commercial messages in a variety of contexts⁹ and will continue to bring the same resolve to the issue as more of this activity migrates to the arena of text messaging.

In short, while the DNC Registry has proven to be extremely effective in curbing unwanted telemarketing calls, it is not clear at this point that adopting a similar program for unsolicited text messages would be advisable. However, should the Congress determine that a Do Not Text registry would help consumers, we will be happy to assist you with legislative language.

QUESTIONS SUBMITTED BY SENATOR FRANK R. LAUTENBERG

Question. Manufacturers and retailers of electronic cigarettes (e-cigarettes) claim that they are safe, and even that these products can help smokers quit traditional smoking. However, there have been no clinical studies to prove these products are effective in helping smokers quit, nor have any studies verified the safety of these products or their long-term health effects. The World Health Organization (WHO) has stated that it has no scientific evidence to confirm the products' safety and efficacy.

What is the FTC doing to police health claims made in e-cigarette advertisements?

Answer. Electronic cigarettes are battery-powered devices that usually contain cartridges filled with nicotine and other chemicals. The devices are designed to convert the nicotine and other chemicals into a vapor to be inhaled by the user.

Electronic cigarettes are currently the subject of Federal court litigation, stemming from the Food and Drug Administration's (FDA) detention of certain of these products at ports of entry to the United States. Specifically, upon reviewing a number of electronic cigarettes, FDA determined that they qualified as both a drug and device under the Federal Food, Drug, and Cosmetic Act (FDCA), and that agency approval was therefore needed before the products could be marketed in the United States. Because such approval had not been obtained, FDA determined that their sale would violate the FDCA and denied them entry into the country.

In April 2009, a lawsuit challenging FDA's jurisdiction over electronic cigarettes was filed in Federal district court. In January 2010, the district court granted the plaintiff's motion for a preliminary injunction enjoining FDA from detaining or refusing admission into the United States of the plaintiff's electronic cigarette products on the ground that those products are unapproved drugs, devices, or drug-device combinations. *Smoking Everywhere, Inc., v. FDA*, 680 F. Supp. 2d 62 (D.D.C. 2010). The Department of Health and Human Services and the Food and Drug Administration appealed the court's order, and oral argument before the U.S. Court of Appeals for the D.C. Circuit is scheduled for September 2010.

Under the FTC Act, the Commission has jurisdiction over deceptive or unfair claims made in the marketing of most products, including electronic cigarettes, and the Commission has a strong record of exercising its enforcement authority to protect the health and safety of consumers. If the district court's ruling that FDA lacks

Communications Commission, Rule and Regulations Implementing the Telephone Consumer Protection Act of 1991, 69 Fed. Reg. 55765, 55767 (Sept. 16, 2004). The FCC's interpretation of the TCPA, however, does not resolve the separate issue of the FTC's authority under the Telemarketing Act.

⁶Federal Trade Commission, Staff Report, *Beyond Voice: Mapping the Mobile Marketplace* (Apr. 2009).

⁷Id.

⁸See, e.g., *Satterfield v. Simon & Schuster, Inc.*, 569 F.3d 946 (9th Cir. 2009).

⁹E.g., *FTC v. Spear Systems, Inc.*, No. 07-5597 (N.D. Ill. 2007) (\$3.7 million judgment obtained against key players in an international spam ring); *United States v. ValueClick, Inc.*, No. 08-1711 (C.D. Cal. 2008) (\$2.9 million civil penalty).

jurisdiction over electronic cigarettes is sustained on appeal, FTC monitoring of the marketing claims made for these products would be appropriate. However, if FDA's assertion of jurisdiction over electronic cigarettes is ultimately upheld by the courts, sale (and, therefore, marketing) of these products will be prohibited pending agency approval under the FDCA.

Question. In 2003, the FTC recommended that the alcohol industry abide by a voluntary standard that required alcohol advertisements to be placed only in media in which at least 70 percent of the audience for each advertisement consisted of adults 21 and over. Since then, several reports have indicated that youth exposure to alcohol advertising is increasing.

Despite the reported increase in youth exposure to advertising, the FTC's 2008 report entitled "Self-Regulation in the Alcohol Industry" did not increase the advertising standard. I am concerned that the report based this conclusion on premises that are not supported by research or the public health community, or are contradictory to previous statements by the Commission.

Will you commit to reviewing the FTC's 2008 report, the process by which it was created, and any contradictions between the premises upon which the Commission relied and its earlier statements and those of the public health community?

How will you evaluate whether the industry should increase its advertising standards to reduce advertising exposure to those who are not legally permitted to purchase alcohol?

Answer. Underage drinking is a critical public health issue, contributing to risky behavior, injury, and an intolerable 5,000 deaths per year. Fortunately, reliable data show long-term, gradual declines in underage drinking. According to the Monitoring the Future survey, past 30-day alcohol use by 8th, 10th, and 12th graders, combined, has fallen by 27 percent over the past 14 years.¹⁰

Nonetheless, too many teens still drink. Federal, state, and local governments all play a role in reducing teen drinking. The FTC is a member of the Interagency Coordinating Committee to Prevent Underage Drinking. We have particular responsibility over alcohol marketing, and also engage in consumer education designed to help reduce teen access to alcohol, as further described below.

The FTC addresses issues related to underage appeal of alcohol ads by pressing for effective industry self-regulation, through studies and ongoing monitoring. Our 2008 Alcohol Report evaluated industry compliance with the 70 percent standard. It showed that 92.5 percent of ads placed during the study period complied with the 70 percent placement standard, and that when all audiences for all ads were aggregated, more than 85 percent of the audience consisted of adults 21 and older.

The 2008 Alcohol Report made a number of recommendations for improvement of the industry's voluntary standards. Among other things, it announced that industry had agreed to adopt a 70 percent standard, with buying guidelines, for Internet advertising; it recommended that the beer and wine industries apply a 70 percent standard to sports sponsorships (the spirits industry already had done so); it recommended application of the 70 percent standard to product placements in movies; and it recommended that industry consider the need to maintain an 85 percent aggregate audience composition when making placements. Although it did not recommend an immediate change in the baseline standard, the 2008 Alcohol Report placed the industry on notice that it will be necessary to do so when the 2010 census data are released.

Since 2008, the Commission has continued to press for additional changes in the self-regulatory standards. The staff has advised the industry that the baseline placement standard should be raised to 75 percent. Additionally, the staff has advised industry members that ads on sites that have registered users, such as Facebook, MySpace, and YouTube, should be delivered only to persons who have registered as being 21 and older.

This January, the Commission will begin the process of seeking Office of Management and Budget approval, under the Paperwork Reduction Act, to conduct another major study of alcohol marketing and self-regulation.¹¹ The study will evaluate the advertising practices of the major alcohol suppliers and consider the appropriateness of the placement standard. In the course of this study, the Commission will review the FTC's 2008 Alcohol Report, the process by which it was created, and the other issues you raise. Our analysis will be based on the record as a whole, including but not limited to public health concerns, any comments received during the study, the

¹⁰ Johnston, L.D., et al., *Monitoring the Future National Results on Adolescent Drug Use: Overview of Key Findings, 2009* (NIH Publication No. 10-7583), Table 3.

¹¹ OMB approval under the PRA is required in cases where the Commission sends identical information requests to 10 or more entities. See 44 U.S.C. § 3502.

available placement data, and the potential costs and benefits of a modified standard.

The Commission also knows that education is an important consumer protection tool. Data show that most teens who drink alcohol obtain it from social sources, such as older family members and friends. Accordingly, we developed a consumer education program to help parents protect their children from alcohol-related harm. The message of the "We Don't Serve Teens" (WDST) program is, "Don't Serve Alcohol to Teens. It's unsafe. It's illegal. It's irresponsible." Components of the WDST program include a website, www.DontServeTeens.gov; radio ads; and signs. WDST signage is used nationwide by alcohol retailers, police departments, schools, and mental health organizations.

ATTACHMENT

BRIEF SUMMARY OF THE FTC'S PRIMARY AREAS OF COORDINATION WITH VARIOUS FEDERAL AGENCIES

FDA: concurrent jurisdiction with respect to labeling and marketing of foods, OTC drugs, and devices; under a Memorandum of Agreement the FDA has primary responsibility for overseeing product labeling and the FTC has primary responsibility for non-label advertising; the agencies cooperate closely and frequently.

FCC: (1) broadly concurrent jurisdiction with respect to telemarketing; the agencies consulted on rulemaking, developed consistent rules; coordinate on enforcement; (2) concurrent jurisdiction with respect to advertising in broadcast media; under a liaison agreement the FTC has primary responsibility for unfair or deceptive advertising in media and provides that the FCC will take false and misleading advertising into account in licensing and other decisions; in this and other areas, the agencies consult and coordinate as applicable.

DOJ: nearly complete concurrent jurisdiction on antitrust matters; under a clearance agreement the agencies determine which one will examine any particular matter; FTC issues premerger review rules with DOJ concurrence; the agencies cooperate closely on these and other issues.

EPA: concurrent jurisdiction with respect to unfair or deceptive practices involving the environment, e.g., pesticides; the agencies consult and coordinate on scientific issues, such as those involved in the FTC Green Guides and business education and in amending the FTC Care Labeling Rule, and on enforcement as applicable.

SEC: concurrent jurisdiction with respect to unfair or deceptive practices involving securities and investment advice; FTC generally defers to SEC where securities expertise is needed; agencies coordinate on enforcement as applicable.

CFTC: some concurrent jurisdiction with respect to unfair or deceptive practices involving commodities futures; agencies consult as applicable, such as in the FTC's petroleum market manipulation rulemaking.

Postal Service/DOJ: concurrent jurisdiction with respect to mail fraud; agencies cooperate closely on enforcement, sometimes including parallel investigations and criminal referrals.

BATF: concurrent jurisdiction with respect to unfair or deceptive practices involving alcohol, tobacco, and firearms; agencies consult on matters as applicable.

CPSC: some concurrent jurisdiction with respect to unfair or deceptive practices involving product safety; agencies consult and coordinate on enforcement as applicable.

Depository institution regulators: parallel jurisdiction, and limited concurrent jurisdiction, with respect to unfair or deceptive practices and a number of consumer financial laws; agencies consult on rulemaking, and some has been conducted jointly or in coordination; agencies consult or coordinate on enforcement as applicable.

The new Consumer Financial Protection Bureau: concurrent jurisdiction with respect to some financial practices and entities; the statute provides for consultation and coordination on rulemaking, enforcement, and other matters.

CONCLUSION OF HEARINGS

Senator DURBIN. This meeting of the subcommittee will stand recessed.

Thanks, everybody, for attending.

[Whereupon, at 3:50 p.m., Thursday, May 20, the hearings were concluded and the subcommittee was recessed, to reconvene subject to the call of the Chair.]

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