

Questions for the Record
Nomination of Jacob J. Lew to be Secretary of the Treasury
Hearing Date: February 13, 2013

Senator Grassley

Question 1:

In 2007, New York University (NYU) and other schools settled with the New York State Attorney General and pledged to stop steering students to so-called “preferred” lenders. In NYU’s case, while you were Executive Vice-President of the University, the school was receiving \$300,000 per year in kick-backs from its preferred lender, Citigroup. In 2007, after you left NYU and went to Citigroup, NYU signed a settlement and pledged to stop this activity. While you were at NYU, did you have any conversations with Citigroup officials about these kick-backs? If so, please describe them. Did you have any knowledge of this program with “preferred” lenders?

I do not recall having any conversations with Citigroup officials regarding Citigroup’s selection or actions as a preferred lender for NYU students. Also, I do not believe that I approved the selection of Citigroup as a preferred lender for NYU students. Student loans were the responsibility of NYU’s Financial Aid Office, which reported (through various offices) to the Office of the Provost. I was generally aware of the preferred lender designation, but I do not recall how or when I learned of it.

I respectfully disagree with your characterization of the preferred lender designation. In March 2007, NYU released a public Notice to NYU Students, which addresses this issue in detail. According to the Notice, NYU held a competitive process in 2004 to identify a preferred lender for private loans and to assist students and families obtain loans with the best rates. NYU selected Citigroup, because it offered the best rates for the greatest number of students. After NYU selected Citigroup, the bank proposed to return to the University a small portion of its profits (0.25% of the value of the loans), which NYU put in an account for financial aid use only. In other words, NYU used the money to provide more financial aid to NYU students.

Question 2:

You were Vice-President of NYU when it first began its preferred lender arrangement with Citigroup. Did you approve this arrangement?

Did you have any knowledge of this arrangement when it was initiated? At any other time? If so, please explain how and when you learned of it.

Please see my answer to Question 1.

Question 3:

When you worked at Citigroup, Citigroup was part of then-Attorney General Cuomo’s settlement regarding so-called student loan “kick-backs.” Please describe in detail your involvement, if any, regarding Citigroup’s legal strategy in response to then-Attorney General Cuomo’s investigation.

I do not recall having any involvement regarding Citigroup’s legal strategy in response to then-

Attorney General Cuomo's investigation. At the time, I worked for Citigroup Global Wealth Management, which was separate from Citigroup's student loan business.

Question 4:

When you were at Citigroup, did you have any communications with anyone at NYU or its representatives in regards to then-Attorney General Cuomo's investigation or NYU's settlement with the New York State Attorney General? If so, please describe them in detail.

I do not recall any such communications.

Question 5:

At your hearing, I inquired about NYU using offshore accounts to avoid Unrelated Business Income Tax (UBIT). Hedge funds frequently set up so called UBIT blockers in low-tax or no tax jurisdiction, such as the Cayman Islands, that are in turn invested in by tax-exempt entities to get around UBIT debt financing rules. From a policy perspective, how do you view the use of blockers by tax-exempt organizations?

This is a complex area of the tax code, and I have not had an opportunity to study it in detail. Nonetheless, I am generally familiar with the Unrelated Business Income Tax or "UBIT." UBIT applies to tax-exempt entities. It subjects income that is unrelated to their tax-exempt purpose (such as religious or educational activities) to tax. This is intended to ensure that tax-exempt entities cannot use their tax advantaged status to compete with private-sector organizations that pay income tax. If confirmed, I would work with the Committee to ensure that the U.S. tax laws collect the appropriate amount of tax.

Question 6:

In the President's State of the Union Address, he expressed concern about the skyrocketing cost of higher education. The President correctly pointed out that the federal government cannot simply continue throwing ever more money at the problem in the form of financial aid and tax benefits. More needs to be done to encourage colleges and universities to keep the cost of a higher education under control. In response to questions asked of you by the Chairman and Ranking Member regarding your role in setting tuition at NYU, you stated you "worked hard to reduce the University's expenses to limit the need for tuition increases." Yet, during your tenure at NYU the average tuition and fees paid by students increased nearly 40%. Could you provide examples of what you did to keep tuition under control?

As Chief Operating Officer of NYU, one of my responsibilities was to manage operating costs and reduce the pressure to raise revenue, which principally came from tuition. I tried to accomplish this goal through a variety of means, including implementing a hiring freeze, reforming NYU's general procurement and purchasing practices, implementing a standard procedure for business travel, managing real estate in a manner that limited the need for new capital acquisitions, and generally reducing common expenses (such as computer purchases).

Question 7:

As the Executive Vice President and Chief Operating Officer of New York University, you were one of NYU's highest paid employees, earning even more the President and Dean of NYU. In fact, based on data from the Chronicle of Higher Education your salary was higher than most college presidents at either public or private institutions.

a. As you worked hard to reduce expenses to limit tuition increases, which actually increased nearly 40%, did you ever look inward at the expenses of the executive suite?

b. How was your salary at NYU determined? What types of compensation in addition to salary did you receive from NYU?

As I previously disclosed to the Committee, my NYU salary was established in an employment agreement that I signed nearly twelve years ago, in May 2001. NYU recruited me to address a series of particularly challenging management issues, including the unsuccessful merger in 1998 of the Mt. Sinai and NYU medical centers. During my five years at NYU, my salary rose approximately five percent total (or approximately one percent per year). For some years, there was no increase. In addition to my salary, I received housing assistance, tuition remission, and a one-time severance payment upon my departure.

Question 8:

My understanding is that according to Forms 990 filed by New York University from 2002 to 2005 you were provided a sizable loan as part of your employment. The amounts reported include \$1.4 million in 2002, \$748,000 in 2003, \$698,000 in 2004, and \$673,000 in 2005.

a. Please describe the terms of the loan including interest rate, minimum payment requirements, term, and the purpose of the loan. Be sure to explain how a reasonable rate of interest was determined.

b. Please describe how the loan was repaid and whether any portion of it was forgiven.

c. Were any terms of the loan altered at any point? If so, please describe which terms were altered and when.

d. Please provide the promissory note and any other documents related to the loan.

e. If the loan interest rate was below market, or if the loan was forgiven, did you report appropriate amounts as income to the IRS?

The terms of NYU's housing assistance are described in the employment agreement referenced in my answer to Question 7. In short, the University provided a mortgage forgiven in equal installments over five years, and an additional shared appreciation mortgage. I do not recall the interest rate or other specific terms. According to my employment agreement, the interest on

both loans was equal to the rate earned by the bond portion of NYU's endowment in the quarter preceding the signing of the mortgage. NYU provided an annual payment equal to the interest paid on the first mortgage described above. NYU reported income related to housing assistance on my Forms W-2, and I paid all taxes that were due.

Question 9:

As you may know, I have been actively reviewing our tax-exempt laws governing nonprofits of all stripes, including colleges and universities. What role do you see for our tax-exempt laws in ensuring the affordability of a higher education?

I have not had an opportunity to study this issue in detail. If confirmed, I would welcome your thoughts and would be happy to discuss the issue further with the Committee.

Question 10:

One concern I have is that current laws governing executive compensation of nonprofits are inadequate and administratively difficult to enforce. Under current law, an excise tax is imposed on a nonprofit leader that knowingly participates in an excess benefit transaction. A rebuttable presumption, or safe harbor, for the nonprofit is established if the compensation of an officer or key employee is based on an independent compensation study. My concern is that this rebuttable presumption has resulted in a race to the top in officer and key employee compensation.

a. In your view, have current rules governing the compensation of officers and key employees of nonprofits been effective?

b. Would you favor replacing the current rebuttable presumption with a minimum standard of due diligence?

I have not had an opportunity to study this issue in detail. If confirmed, I would welcome your thoughts and would be happy to discuss the issue further with the Committee.

Question 11:

A key focus of my review of colleges and universities has been the accumulation of billion dollar endowments while at the same time tuition continues to rise exponentially. During your tenure, NYU's endowment increased nearly 60 percent from around \$1.1 billion to over \$1.7 billion. How did the size of the endowment inform your budget decisions, including the large tuition increases that occurred and the availability of financial aid?

During my time at NYU, I was responsible for budget, finance, and operations, which included preparing the University's financial plan and making sure that revenues and expenses were aligned. Tuition is the principal source of revenue for NYU, as it is for most private universities. NYU draws some income from its endowment annually. The precise amount is approved by the Board of Trustees, but it is relatively small compared to the University's overall budget. For example, according to NYU's fiscal year 2013 operating budget (which is publicly available online), the University's total budget is approximately \$2.5 billion. The revenue drawn from the endowment (the "endowment distribution and other investment income") is approximately \$109

million, or approximately 4 percent of the NYU's total operating budget.

Question 12:

One proposal that could help ensure large endowments are working for the students is to require colleges and universities to spend a certain percentage of the value of their endowments each year. Private Foundations are currently subject to a 5 percent payout requirement. Do you believe our nation's universities and colleges should be subject to a similar requirement? Why or why not?

During my time at NYU, the University considered numerous factors—such as the long-term viability of the endowment, the need to keep tuition low, and constraints imposed by New York state law—in determining the appropriate annual draw from its endowment. Various options were presented to both the Finance and Investment Committees of the Board of Trustees, and the annual draw was ultimately subject to approval from the full Board. I do not recall the specific details, but I believe the annual draw was typically based on a percentage of the annual yield from the endowment. A rule that mandated a minimum payout based on the value of the endowment—rather than the annual yield—could harm the long-term viability of an endowment during periods of economic stress. I have not had an opportunity to study this issue in detail, however, and I would be happy to discuss the issue further with the Committee.

Question 13:

In 2006, I authored updates to the Internal Revenue Service (IRS) whistleblower program to increase the tools available to track down and expose tax cheats. It has proven to be the most successful program the administration has to go after the big time tax cheats. Yet, I am concerned that some within Treasury and the IRS view whistleblowers and the whistleblower program with hostility. I have highlighted my specific concerns in several letters to Treasury and IRS. Please review my letters and inform me of what actions you plan to take to ensure the effectiveness and efficiency of the IRS whistleblower program. In doing so, please be sure to address concerns about a lack of communication with whistleblowers and the length of time it takes to process claims.

I agree that the IRS whistleblower program is an important tax administration tool, and, if confirmed, Treasury and the IRS will continue to work with you on ensuring the effectiveness and efficiency of the IRS whistleblower program and addressing your concerns on the program's operation.

Question 14:

At your hearing, you stated that you believe it is best if corporate and individual tax reform is done together. Yet, the tax reform framework issued by the President in February 2012 focused only on corporate reform. When can we expect the President to issue a similar framework for individual tax reform?

As you noted, the President's Framework for Business Tax reform was released in February 2012. In his FY 2013 Budget, the President called for fundamental reform that meets five key principles: (1) simplifying the tax code and reducing tax rates; (2) reforming inefficient and unfair tax breaks; (3) decreasing the deficit while improving progressivity; (4) increasing job

growth and creation in the U.S.; and, (5) observing the Buffett rule so that those making over \$1 million do not face a lower tax rate than middle-class taxpayers.

If confirmed, I look forward to engaging with the members of this Committee to move forward on tax reform measures so that we can efficiently and fairly raise the tax revenue we need.

Question 15:

In response to a question from Senator Crapo, you indicated that a lower corporate tax rate should be accompanied by "a minimum worldwide tax rate." The concept of an international "minimum tax" was first included in the President's February 2012 tax reform framework, but there has since been very little, if any, detail provided on how that proposal would work. Will the President's FY 2014 budget proposal include this proposal and will the Treasury department provide a more specific explanation? If not, when can Congress expect Treasury to provide these details?

The President's Framework is intended to lay the foundation for a dialogue with Congress and stakeholders on tax reform. I understand that the Administration has been engaged in an ongoing process, consulting with stakeholders, tax policy experts, members of Congress, and other policymakers, however, the President's FY 2014 Budget has not yet been released, so I cannot speak to what may or may not be included therein.

Question 16:

In further response to Senator Crapo, you said that there is "room to work together" with Congress to reform our worldwide tax system and negotiate a competitive territorial tax system in the corporate code. You said "We actually have a debate between whether we go one way or the other, and we have a hybrid system now. It's a question of where we set the dial." The President's Framework for Business Tax Reform included a number of proposals that would curtail deferral, including the proposal for a "minimum worldwide tax rate" that you referenced. These proposals would increase the amount of active foreign business income that would be subject to current federal tax.

a. Wouldn't these proposals turn the "dial" of our hybrid system toward the worldwide end of the spectrum and away from the territorial end?

b. In your view, would "a competitive territorial tax system" be a hybrid that is more or less worldwide than our current system?

c. Please describe what types of foreign income would receive territorial treatment or worldwide treatment under such a system. Would income that is subject to the international "minimum tax" be exempt upon repatriation?

The President's Framework for Business Tax Reform supports a hybrid approach that reduces incentives for companies to shift profits and investment to low-tax countries, puts the United States on a more level playing field with our international competitors, and helps end the global race to the bottom on corporate tax rates—while also making American companies more competitive globally. There is considerable debate as to how to reform the international tax

system, but I believe that there is common ground on this subject, including a mutual concern about preserving the U.S. tax base by reducing incentives that encourage the shifting of investment and income overseas, and making the United States more competitive globally. I look forward to working with the Committee on a bipartisan basis to develop approaches to international taxation that will ensure the United States will retain and attract high-quality jobs.

Question 17:

The biodiesel tax credit expired at the start of 2012 and was retroactively extended at the beginning of 2013. It has come to my attention that new procedures put in place by the IRS to claim the biodiesel credit for the first three quarters of 2012 may pose a barrier to partnerships, joint ventures, and Coops retroactively claiming the credit for 2012. Under the procedures, biodiesel producers organized as a partnership, joint venture, cooperative or LLC will not be able to claim the credit directly, but instead will have to issue statements to the partners who in turn would have to claim the credit. As most producers have contracts with petroleum companies or blenders to rebate to them the value of the credit, having the credit paid the partners instead of the entity puts these producers in a very difficult position. This issue impacts most biodiesel producers greatly frustrating the purpose behind Congress retroactive extension of the law. If you are confirmed as Treasury Secretary, will you direct IRS to solve this issue so the law will work as intended?

If confirmed, I will look into the issue you raise.

Question 18:

The research and development (R&D) tax credit requires businesses to perform complicated calculations to determine their eligibility. This has been a major roadblock to medium and small sized businesses claiming the credit. In 2006, Congress added the alternative simplified credit (ASC) to make it easier for businesses, especially smaller sized businesses, to determine their eligibility for the credit. However, the Treasury and IRS through regulation in 2008 – without any support in the statute – greatly limited the benefits of the ASC by not allowing it to be taken on amended returns. President Obama has been referencing the importance of the R & D credit to the nation and even calling for it to be made permanent. Why then would the Administration inhibit the use of the credit to small and medium businesses? If you are confirmed as Secretary of the Treasury, will you review these regulations and consider allowing the ASC to be claimed on amended returns?

The Administration strongly supports the continuation of the Research and Experimentation (R&E) credit and has proposed to make the R&E credit permanent and to simplify and expand it. If confirmed, I would be happy to look into the specific issue you raise.

Question 19:

Implementing the Affordable Care Act (ACA) is a massive undertaking for the IRS. However, the Administration has been less than forthcoming with the administrative costs and resources that will be necessary for the IRS to implement it over the next several years.

a. Can you give me a better picture of the resources the IRS has devoted to

implementing ACA?

b. How many employees are devoted to these projects (full and part-time)? How much has the IRS paid or committed to paying outside contractors to implement ACA?

Since the passage of the Affordable Care Act (ACA), no additional appropriated funding has been provided to the Internal Revenue Service (IRS) for implementation. The ACA included a \$1 billion fund, the Health Insurance Reform Implementation Fund (HIRIF), to be administered by HHS and to be used to fund the early phases of ACA implementation. The IRS spent \$488 million of HIRIF funding on ACA implementation from FY 2010 through FY 2012.

In FY 2012, the IRS had just under 700 full-time equivalent staff working on ACA. From FY 2010 through FY 2012, the IRS spent \$297.1 million on information technology contract costs.

c. I am sure the IRS has done budgeting for the upcoming year. What are projected staff numbers and cost of implementation for the next year?

The FY 2013 President's Budget requested \$360 million and 859 FTE, about 70 percent of which is for IT implementation and program management.

Question 20:

As a former Citigroup employee, do you believe that Citigroup's size played a role in its ultimate collapse and need for a taxpayer bailout?

I believe there were many factors that contributed to the 2008 financial crisis and Citigroup's need for taxpayer support. These factors included the emergence and rapid growth of institutions and financial activities outside the scope of classic banking regulation (commonly referred to as the "shadow banking" system); a dramatic and widespread increase in leverage and risk; increased reliance on short-term funding sources (such as the repurchase or "repo" market); fundamental breakdowns in risk management practices across the financial sector; increased complexity and lack of transparency regarding the over-the counter derivatives markets; and, an outdated and inadequate regulatory structure, with weak or nonexistent capital requirements. I believe these factors played a more significant role in the crisis than the size of any one individual firm.

Question 21:

Do you believe that the "Too Big to Fail" provisions in Dodd-Frank ensure that the failure of large financial institutions will not cripple the economy? If not, what additional measures are needed?

The Dodd-Frank Act provides regulators with critical tools and authorities that they lacked before the crisis to resolve large financial firms whose failure would have serious adverse effects on financial stability. I understand the emergency resolution authority for failing firms created under Title II prohibits any bailout, while protecting taxpayers and the U.S. economy. For any

financial firm that is placed into receivership under this Dodd-Frank emergency resolution authority, management, and directors responsible for the failed condition of the firm will be removed and shareholders will be wiped out.

Question 22:

Regulators should not be afraid to take large financial institutions to trial when they have broken the law. If you are confirmed as Treasury Secretary, you will be a frontline regulator of the financial system. Do you agree that the threat of a trial has an important deterrent role in preventing illegal behavior by large financial institutions?

I believe that it is important to enforce the criminal laws vigorously, fairly, and in a consistent manner. How the Justice Department chooses to exercise its prosecutorial discretion is solely theirs.

Question 23:

Is LIBOR a safe and reliable benchmark rate for American investors? Would you consider the construction of American-based benchmark interest rate similar to LIBOR?

I am committed to protecting market integrity. Important steps are being taken by the relevant regulatory and law enforcement agencies in the United States and abroad to investigate issues related to LIBOR and to address misconduct where they find that it may have occurred. I urge them to continue this important work. As I understand, there are ongoing efforts by the global regulatory community to comprehensively strengthen the integrity and governance of LIBOR, as well as to evaluate potential alternatives.

Question 24:

Were you aware that Citigroup had 121 Cayman subsidiaries?

a. Were you aware of any of Citigroup's Cayman subsidiaries?

b. If so, please describe in detail the nature and extent of your work involving any of the particular Cayman subsidiaries?

During my time at Citigroup, I served as chief operating officer for two different business units. I did not have any role in creating investment funds or deciding where they were located. I do not recall being aware of any particular Citigroup subsidiaries located in the Cayman Islands.

Question 25:

Did you plan any role in the development of Citigroup's tax strategy? If so, what role?

No.

Question 26:

Did you at any point in your tenure at Citigroup raise opposition to the use of Cayman Islands-based corporation in transacting company business? If so, when and how?

Please see my answer to Question 24.