

OFFICE OF
INSPECTOR GENERALDEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

MEMORANDUM TO FILE

FROM:

[REDACTED]
Special Agent-in-Charge

SUBJECT:

Closing Memorandum
Secretary of the Treasury – GSE Ownership
OIG File Number 2004-0306

PREDICATION: On May 26, 2004, the Secretary of the Treasury requested the U.S. Department of the Treasury, Office of Inspector General (Treasury OIG), conduct an independent review of an ethics determination made by the Treasury Office of General Counsel (OGC). (Exhibit 1)

ALLEGATION(S): Having reviewed the Secretary's Public Financial Disclosure Report for 2003, OGC reached the conclusion that there was no conflict of interest when the Secretary previously owned "*Government Sponsored Enterprise*" (GSE) debt instruments (i.e., Federal National Mortgage Association (Fannie Mae), the Federal Home Loan Mortgage Corporation (Freddie Mac), and the Federal Home Loan Banks (FHLB)). The Office of Government Ethics (OGE) did not agree with the OGC determination; noting the Secretary's role as the Administration's lead spokesperson for GSE matters.

Applicable law and regulations involved:

- 18 USC § 208 – Conflict of Interest
- 5 CFR 2635.402(a) – Disqualifying financial interest
- 5 CFR 2640.103(a) – Prohibition of financial interest

FINDINGS: The results of the Treasury OIG investigation were presented to the Public Integrity Section, Criminal Division, U.S. Department of Justice (DOJ), which concluded that federal criminal prosecution was not warranted. Similarly, the DOJ Civil Division also declined to seek civil remedies. In light of these decisions, we have closed our investigation.

No evidence or information was developed during the course of the investigation which would suggest Secretary Snow knowingly held GSE securities. Such knowledge is an element of the applicable law and regulations. In fact, interviews and related document reviews reasonably suggest misunderstanding and/or miscommunication involving the reference to "Treasury Securities" versus GSEs in discussions of the Secretary's investment portfolio by and/or between personnel who had been retained to act on behalf of the Secretary. The Secretary earned interest income from these securities in the two years at issue, which was reported on his Public Financial Disclosure Reports. Once the Secretary became aware that he owned the GSEs and

had a potential conflict of interest, the GSEs were promptly sold on May 14, 2004. The proceeds from that sale were deposited directly into a money market account.

SYNOPSIS of OI Activity: Upon receipt from the Treasury OGC, Marilyn Glynn, Acting Director, OGE, completed a review of the Secretary's 2003 Standard Form (SF) 278. Glynn had concerns about a possible conflict of interest violation (i.e., 18 USC § 208) regarding the Secretary's ownership of the GSE's at the same time he was the Administration's point person for GSE matters, which could include advocacy of legislative proposals regarding changes to the GSEs' structures, authorities, and independence. Glynn stated that the Department of Justice's interpretation of a violation of the conflict of interest statute is that a violation occurs when the questionable action "would have a direct and predictable effect on a matter." (Exhibit 2)

[REDACTED] Treasury OGC, advised [REDACTED] had provided guidance on behalf of the Department during the Secretary's nomination and confirmation process. [REDACTED] said [REDACTED] did not speak to any of the financial advisors for the Secretary, but during the nomination and confirmation process [REDACTED] advised the Secretary's privately retained legal counsel - [REDACTED] Melveny & Myers, Washington, DC - that the Secretary could purchase "Treasury Securities" (i.e., debt instruments backed by the full faith and credit of the United States government versus GSEs which are not) as long as they were purchased prior to the Secretary being sworn in (i.e., if he knowingly made purchases after that date, the Secretary would violate 31 U.S.C. § 329(a)(1)(D), which prohibits the Secretary from being "involved in buying or disposing of obligations of a State or the United States Government"). During [REDACTED] review of the Secretary's 2003 SF 278, [REDACTED] discovered that the GSEs (as opposed to "Treasury Securities") had been purchased and were being held by the Secretary at that time. (Exhibit 3)

[REDACTED]'s supervisor - Kenneth Schmalzbach, Assistant General Counsel for General Law and Ethics, Treasury OGC - advised that he drafted a letter to OGE Director Glynn shortly after he was informed about the Secretary's GSE holdings. Schmalzbach outlined the Department's view with regard to whether the Secretary's GSE holdings had and continued to present a conflict of interest. In Schmalzbach's letter to Glynn, dated May 24, 2004, he opined, "...we do not believe that any of the matters discussed above would have a direct or a predictable effect on the market value of GSE debt instruments or would directly or predictably affect the ability or willingness of the issuers to honor their debt obligations." (Exhibit 4)

During [REDACTED]'s interview, [REDACTED] related that the Secretary had been quite clear that he did not want to be perceived as having, much less have, any conflict of interest that would keep him from fully performing any Treasury duties. Ultimately, [REDACTED]'s team recommended the Secretary invest in "Treasury Securities" the monies due him from his prior service as the Chairman and Chief Executive Officer of the CSX Corporation and CSX Transportation, Inc. (CSX), Richmond, VA. However, [REDACTED] stated that [REDACTED]'s team's deliberations, which resulted in recommending the purchase of "Treasury Securities," never involved the participation of the Secretary and, to the best of [REDACTED]'s recollection, GSEs were never discussed. Having been present for at least two of these discussions, [REDACTED] felt [REDACTED] Human Resources, CSX, was clear that the transfer of approximately \$10.8 million from CSX to the Secretary would involve the purchase of "Treasury Securities." (Exhibit 5, 6)

Our interview of [REDACTED] confirmed [REDACTED] understanding that "Treasury Securities" were an appropriate investment vehicle for the Secretary's CSX funds. However, for the purchase of "Treasury Securities" to be consistent with the limitations imposed by 31 U.S.C. § 329(a) (1) (D), it had to occur before the Secretary was sworn into office on February 3, 2003.

[REDACTED] could not recall the exact date(s) of the purchase orders, but said [REDACTED] did remember receiving a proposal to purchase ten (10) "U.S. Government Agency Notes" from [REDACTED] at Bank of America (BOA). According to [REDACTED] also advised that a \$1 million bridge loan would be used to secure the BOA purchase of "U.S. Government Agency Notes." [REDACTED] only recalled focusing on the projected return on this investment before authorizing [REDACTED] at BOA to proceed with making the proposed purchases – all but one of which were placed by BOA before the Secretary was sworn into office on February 3, 2003. (Exhibit 6)

During an interview of [REDACTED] Investments, BOA, New York, NY, [REDACTED] related that there is a difference between the use of terminology like "US Government Agency Notes" and GSEs. [REDACTED] specified that the financial industry does not use the term GSEs when referring to Fannie Mae, Freddie Mac, and Federal Home Loan investments. Instead, the financial sector generally uses the term "U.S. Government Agency Notes" or "U.S. Government Bonds." Technically speaking, [REDACTED] admitted this may not be the correct way to refer to the use of Fannie Mae, Freddie Mac, and the Federal Home Loan financial investment instruments, but, in reality, that is how they are referred to throughout the industry. According to [REDACTED] [REDACTED] inquired about purchasing "U.S. Government Agency Notes." [REDACTED] was aware that [REDACTED] was working directly with the lawyers handling the Secretary's confirmation and nomination process. [REDACTED] recalled that after [REDACTED] had "worked out the numbers," [REDACTED] then prepared a letter addressed to Mr. Snow along with an attached spreadsheet showing the breakdown of the ten (10) "U.S. Government Agency Notes" to be purchased. Included was the expected return on these investments as well as their maturity dates. [REDACTED] stated that [REDACTED] faxed this documentation to Mr. Snow's attention, which was later returned bearing the signature of [REDACTED] Mr. [REDACTED] Snow. (Exhibit 7)

Although [REDACTED] was responsible for the ultimate execution of the overall financial transaction, [REDACTED] identified an assistant at BOA in New York [REDACTED] as the person who actually received the telephone call from Mr. Snow authorizing the purchase of the "bonds". Our interview of [REDACTED] revealed that [REDACTED] did not discuss the contents of the letter (or go over the attached spreadsheet) with Mr. Snow on a "line-by-line" basis – something which, if that had been done, might have drawn the Secretary's attention to, and demonstrated his knowledge regarding, the existence of GSEs in his financial portfolio. [REDACTED] said that simply did not happen. (Exhibit 8)

During the course of our investigation, additional BOA officials were identified as having been involved in this financial transaction as well. Our interview of [REDACTED] BOA, Richmond, VA, revealed that [REDACTED] understood this purchase involved "Agency Bonds" – yet another variation of what [REDACTED] called "U.S. Government Agency Notes." In fact, [REDACTED] recalled that on or about May 14, 2004, [REDACTED] and [REDACTED] BOA, Richmond, VA were on the telephone with the Secretary, having placed him on speaker

phone; during which time [REDACTED] stated, to the best of [REDACTED] collection, the Secretary saying, "I authorize you to sell the Agency Bonds – yes, I give you authorization." (Exhibit 9, 10)

Peter Fisher, former Treasury Under Secretary for Domestic Finance, was also identified as having participated in briefing the Secretary for his upcoming confirmation hearings. Fisher confirmed that he and others in the Department, whom he could not recall, met with and briefed the Secretary. However, Fisher said he had no specific recollection of those briefings having involved any discussion of the Administration's position on GSEs. (Exhibit 11)

During our interview of the Secretary, which was conducted in the presence of his private counsel, he stated that at no time were there any discussions between him and the lawyers handling his nomination and confirmation process that pertained to the purchase of any GSEs. As far as the Secretary knew, he was purchasing "Treasury Securities" with his funds from CSX. Sometime in late January 2003, the Secretary did recall having received a fax from [REDACTED] at BOA. The Secretary was shown a copy of a two page facsimile document sent by [REDACTED] on January 31, 2003. Regarding page two of this document, the Secretary was asked how he reconciled having no knowledge of having purchased GSEs when this page clearly showed what he had purchased were GSEs – in fact, breaking them down into purchases of Fannie Mae, Federal Home Loan, and Freddie Mac instruments. The Secretary responded by saying, that at the time he [REDACTED] signed this document, he did not pay close enough attention to the second page because, "like a lot of other things I was signing, it was prepared by professionals." On February 3, 2003, the day he was sworn into office, the Secretary placed a call to [REDACTED] at BOA and, although the Secretary did not recall the specifics of their conversation, the Secretary, in essence, recalled telling [REDACTED] to proceed with the purchase. Other than that, the Secretary advised that [REDACTED] handles all of the family financial matters. As such, the Secretary did not review any of the monthly statements received from BOA. Moreover, the Secretary said – because he truly believed he had purchased "Treasury Securities" – he understood that he would not be able to sell or change his investments until such time as he was no longer the Treasury Secretary. Therefore, he said he would not have been concerned about reviewing the BOA statements since, as was his understanding at the time, the interest rate and return would be unchanged. (Exhibit 12)

Secretary [REDACTED] Snow's Certified Public Accountant (CPA) was identified as [REDACTED] KPMG. According to [REDACTED] over the years he has primarily dealt with [REDACTED] when it comes to preparing and submitting documentation to support the Snow's tax returns. In preparation of [REDACTED] Snow's 2003 tax return, KPMG sent to the Snow's residence in Richmond, VA, an organizer in which tax documents were to be placed and returned to KPMG. As regards the GSE purchases [REDACTED] did he calculated and recorded the interest income on the Snow's 2003 Federal tax return. When asked if [REDACTED] knew what GSEs were, [REDACTED] said [REDACTED] did not. When told by the Reporting Agent what GSEs were, [REDACTED] responded by saying, "I always thought of those as being Government Bonds or Government Agency Notes (Exhibit 13)

Our interview of [REDACTED] confirmed [REDACTED] handles all the family financial affairs – to include the keeping of the Secretary's various records. [REDACTED] said [REDACTED] became involved with the Secretary's divestiture and reinvestment of his financial portfolio as he was about to be nominated and put forward for confirmation as the Secretary of the Treasury around late

December 2002. [REDACTED] had been in contact with [REDACTED] and [REDACTED] regarding the divestiture of the Secretary's then current financial portfolio. [REDACTED] was advised by [REDACTED] and [REDACTED] that the Secretary could own "U.S. Government Bonds." [REDACTED] did not know that Freddie Mac, Fannie Mae, and Federal Home Loan securities were considered GSEs. [REDACTED] thought that these instruments were, in reality, government bonds. [REDACTED] advised when BOA statements were received each month at their residence in Richmond, VA [REDACTED] would place them, along with all of the Secretary's other financial papers, in a filing cabinet. Therefore, on the occasions when the Secretary did travel home [REDACTED] had already filed such paperwork – thus, the Secretary did not ask to see, nor was he ever shown, such documentation. [REDACTED] confirmed [REDACTED] submitted the Secretary's Public Financial Disclosure Report (SF 278). In doing so, [REDACTED] also affirmed that [REDACTED] dealt directly with [REDACTED] Treasury OGC. When shown page 3 (3rd line down), which indicates the ownership of "US Treasury bonds," [REDACTED] stated that [REDACTED] was not sure why [REDACTED] used that terminology. However, [REDACTED] believes it was because the BOA monthly statements referred to the investments as Government bonds on the first page of the statement. Therefore, [REDACTED] thought they had purchased "Treasury Securities." (Exhibit 14)

RECOMMENDATION/DISPOSITION: All other investigative activity can be found in the index of related investigative activity. (Exhibit 15) With the approval of this memorandum, based on the DOJ declinations, this Treasury OIG investigation is concluded.

EXHIBITS

NUMBER

DESCRIPTION

1. Referral letter to Acting Inspector General from Secretary Snow, dated May 26, 2004.
2. Memorandum of Activity, interview of Marilyn Glynn, dated June 1, 2004.
3. Memorandum of Activity, interview of [REDACTED] dated June 23, 2004.
4. Memorandum of Activity, interview of Kenneth Schmalzbach, dated June 18, 2004.
5. Memorandum of Activity, interview of [REDACTED] dated July 15, 2004.
6. Memorandum of Activity, interview of [REDACTED] dated September 21, 2004.
7. Memorandum of Activity, interview of [REDACTED] dated October 21, 2004.
8. Memorandum of Activity, interview of [REDACTED] dated April 25, 2005.
9. Memorandum of Activity, interview of [REDACTED] dated November 10, 2004.
10. Memorandum of Activity, interview of [REDACTED] dated November 19, 2004.
11. Memorandum of Activity, interview of Peter Fisher, dated April 25, 2005.

12. Memorandum of Activity, interview of Secretary John Snow, dated May 20, 2005.
13. Memorandum of Activity, interview of [REDACTED] dated July 12, 2005.
14. Memorandum of Activity, interview of [REDACTED] dated June 23, 2005.
15. Index of Related Investigative Activity.

Approved:

Nick D. Swanstrom
Assistant Inspector General for Investigations