U.S. SENATE BANKING COMMITTEE

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Chairman Christopher Dodd
"Turmoil in U.S. Credit Markets: The Role of the Credit Rating Agencies"

Remarks as Prepared:

This morning, the Committee continues its examination of the role played by credit rating agencies in the subprime mortgage crisis.

Last fall, Senator Reed chaired a hearing at the full Committee on this topic. I thank him for his efforts in that regard.

In addition, I would be remiss if I did not acknowledge the debt that we owe to Senator Shelby on the subject of credit rating agency reform. During his tenure as Chairman, the Committee held hearings on this topic. In addition, the Committee passed legislation. That legislation, the "Credit Rating Agency Reform Act of 2006", was signed into law on September 29, 2006. It makes important reforms in this area of the capital markets – reforms which in my view were prescient.

Credit rating agencies play a crucial role in our economy. They provide opinions to investors about the ability of debt issuers to make timely payments on debt instruments. That may sound like a simple, modest function. But it is an indispensable one. Decisions about how to invest enormous sums of money are based at least in part on credit ratings. As one commentator has said, credit rating agencies "can, with the stroke of a pen, effectively add or subtract millions from a company's bottom line, rattle a city budget, shock the stock and bond markets, and reroute international investment."

We have seen over the past few months just how influential a role credit rating agencies play in our markets – and, particularly in the structured finance markets, not in a positive sense.

Credit rating agencies have played a central role in the subprime mortgage crisis – and by extension on the volatility and illiquidity plaguing our capital markets. During the past several months, these agencies – which are technically referred to as Nationally Recognized Statistical Rating Organizations, or NRSROs – have downgraded their ratings of thousands of tranches of residential mortgage-backed securities.

Bloomberg recently reported that the three largest NRSROs "began cutting in July and have since either downgraded or put on review a total of 38,000 subprime bonds . . . . Moody's and S&P combined have downgraded more than 9,513 of these securities dating from 2005."

These downgrades meant that – with "the stroke of a pen" – assets once seen as safe and profitable were suddenly something quite the opposite. Many investors – who by Federal or State law must invest in securities with investment grade ratings – were suddenly forced to sell. Others suddenly found the value of their securities reduced to a fraction of their previous value. The net result is that investors have lost tens of billions of dollars.

The impact of these downgrades has spread beyond the downgraded bonds themselves. Imagine going into a grocery store to buy food for your family. You are told that almost all of the food in the store is safe and healthy – but that a small fraction of the items contain a toxic substance that can cause serious illness. It's doubtful that you or anyone else would risk buying anything in that store without some assurance that it was free of taint.

In the same manner, the downgrading of some subprime mortgage securities has sewn doubt and fear in investors about a much larger universe of securities. It has cut investors' appetite for subprime mortgage securities generally, and for a host of other asset-backed securities. As a result, our credit markets are experiencing unprecedented levels of volatility and illiquidity.

These recent rating downgrades have raised serious questions about the role, function and performance of credit rating agencies.

For instance, do the credit rating agencies give ratings that are overly optimistic in order to obtain more business?

Do they sufficiently analyze the data they are given by clients before issuing ratings?

Do they properly manage real or perceived conflicts of interest with clients who pay for a rating and/or for consulting services?

Lastly, when Congress acted two years ago, it gave the SEC the authority "to prohibit, or require the management and disclosure of, any conflicts of interest." Has the SEC used this authority effectively? Can or should it do more?

These are some of the important questions I hope our witnesses will address this morning.

The investing public deserves to know that every step is being taken to protect one of their most basic rights: the right to sound, reliable, credible information.

They deserve to know that our regulatory agencies will apply and enforce the law with vigor on their behalf.

And they want to see the credit rating agencies demonstrate that they have learned from their mistakes and have reformed their practices so that this sorry chapter in their history will never be repeated.

I want to welcome Chairman Cox back to the Committee. We know he is currently working to implement by rule-making the new Act. We look forward to learning of his progress.

Let me also welcome our other distinguished witnesses. We appreciate your willingness to appear this morning, and we look forward to your testimony.

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