Statement of Senator Tim Johnson
Senate Committee on Banking, Housing and Urban Affairs
"The State of the Banking Industry"
June 5, 2008

Thank you, Mr. Chairman, for bringing back together the financial institutions' regulators for our second hearing on the "The State of the Banking Industry."

If we take a look back to the week of March 4th, when the Committee held the first hearing on this topic, it is clear that we are in a very different place today. At that point, the so-called "Bear Stearns bailout" had not yet occurred, the Federal Reserve had not yet made other changes to lending at its discount window, and the Senate had not yet passed the Foreclosure Prevention Act, nor had the Committee marked up the Federal Housing Finance Regulatory Reform Act of 2008. That said, the economic outlook still remains tenuous, at best.

Last week, the FDIC reported the lowest quarterly net income for the industry since insured institutions posted an aggregate net loss in the fourth quarter of 1990, and announced the fourth bank closure of the year. To-date, these bank closures have been institutions with smaller assets, but I heed the warning from the FDIC that the small institutions are not the only institutions being closely monitored by the FDIC. There are also increasing concerns that the hundreds of thousands of subprime mortage loan modifications taking place are not meaningful.

That said, banks remain well-capitalized. Business Week provided a bright spot this week reporting that private equity deals are beginning to be completed once again. It also reported that Britain's largest home lender, HBOS, sold roughly $1 billion in highly rated mortgage-backed securities, and the U.S. financing firm AmeriCredit had a successful offering of $750 million worth of bonds backed by auto loans. This may signal some liquidity returning to the market.

I also cannot stress enough the importance of good supervision and appropriate risk management by the agencies, and the significance of sound underwriting standards and transparency by financial institutions regulated by these agencies. This said, there are three areas I have particular interest in: the "originate to distribute" model, bank examination procedures, and the overall effectiveness of the current regulatory structure of the financial institutions. In recent years, banks have increasingly adopted the "originate to distribute" model when they underwrite loans. What impact has the banks' adoption of the "originate to distribute" model had on the underwriting standards and on the safety and soundness of the financial institutions, and overall financial system? What steps are regulators taking to adjust their oversight approach and what challenges do they face?

The recent turmoil in the financial services market has also raised a number of questions about the bank examinations, in particular the financial regulators' risk-based examination approach, and the regulatory structure and oversight mechanisms. Has this approach been adequate?

I look forward to hearing from the agencies before us today about the continuing challenges and weaknesses of the industry, as well as their input on what regulatory and supervisory changes need to be made to prevent another crisis like the current one from happening again, and the steps necessary to safeguard the safety and soundness of our banking industry.