U.S. Senate Committee on Banking, Housing, and Urban Affairs

U.S. SENATOR RICHARD C. SHELBY, AL, RANKING MEMBER

EMBARGOED UNTIL BEGINNING OF HEARING

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OPENING STATEMENT OF SENATOR RICHARD C. SHELBY

Turmoil in U.S. Credit Markets: The Role of the Credit Rating Agencies

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"Thank you, Mr. Chairman."

"Since our last hearing on this subject, the situation in our financial markets has underscored the role played by the rating agencies. The past months have also demonstrated that the rating agencies were not meeting their responsibilities. We have witnessed a series of ratings downgrades, particularly in structured finance. It seems that the rating agencies grossly underestimated the risks associated with these securities. Unfortunately, these products were widely distributed and held by a broad array of investors and institutions."

"The severity of these downgrades sent banks, pension and money market funds scrambling for capital. Plunging investor confidence ultimately led credit markets to seize up world-wide. The markets for commercial paper, municipal securities, and auction rate securities have all experienced disruptions in part because financial institutions no longer trust the credit ratings of issuers, bond insurers and other counterparties. Rather than conduct their own due diligence, too many investors appear to have relied solely on credit ratings to assess credit risk."

"While credit ratings play, and should continue to play, an important part in evaluating risks in our economy, over-reliance on the ratings of just a few firms appears to have diminished the amount of independent risk assessment undertaken by market participants. Because rating agencies underestimated the risks of subprime-based securities, these securities were allowed to spread throughout our financial system without their real risks being detected until it was too late. In our modern economy, we need not only better ratings, but also more market participants assessing risks to prevent this from happening again."

"Before the current crisis began, this Committee worked to enact the Credit Rating Agency Reform Act of 2006. This Act sought to improve the quality of ratings and to foster accountability, transparency, and competition in the industry. The Securities and Exchange

Commission was given broad authority to enforce the Act. Last year the SEC issued initial rules governing registration of NRSROs and prohibiting certain conflicts of interest. These rules have opened up the process for new firms to become NRSROs, fostering more competition in the industry. The SEC is now preparing to propose additional rules to implement the Act."

"Today, I look forward to hearing Chairman Cox discuss the types of rules the SEC is considering adopting and what additional reforms he believes are needed. The SEC has a chance to help restore confidence in our markets and establish a more competitive and accountable credit rating industry. For example, rules that improve the transparency of the ratings process will make it easier for investors to assess and compare ratings."

"I am also interested in the preliminary findings of the SEC's ongoing examination of the rating agencies. I would like to learn more about the relationship between the agencies and the investment banks. A rating, after all, is only as good as the information on which it is based. If there was insufficient due diligence and risk assessment in the process of creating and underwriting structured financial products, the ratings will be flawed from their inception."

"Mr. Chairman, given the critical role underwriters played in this crisis, I believe our examination is incomplete without the participation of the firms that created these products. The sophisticated underwriters that structured and sold these securities reaped huge fees for their efforts regardless of how the securities performed for investors. I hope that their absence from this discussion is not permanent."

"Thank you Mr., Chairman."