United States Senate
Committee on Banking, Housing, and Urban Affairs
Christopher J. Dodd (D-CT), Chairman

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OPENING STATEMENT OF CHAIRMAN CHRISTOPHER J. DODD
HEARING ON REGULATING AND RESOLVING INSTITUTIONS CONSIDERED "TOO BIG TO FAIL"
WEDNESDAY, MAY 6, 2009

Remarks as Prepared for Delivery:

Good morning. This morning marks the thirteenth in a series of hearings since January to identify causes of the financial crisis and specific responses that will guide the Committee's formulation of a new architecture for 21st century financial services regulation. I want to welcome all our witnesses.

This morning we will discuss regulating and resolving institutions whose failure would pose a risk to the financial sector and our underlying economy.

To be sure, we meet at a moment when many of these so-called "too big to fail" institutions are under a microscope – and for good reason. Consider for a moment the following financial institutions:

Bear Stearns, Fannie Mae and Freddie Mac, Lehman Brothers, Merrill Lynch, AIG, Washington Mutual, Wachovia, Citigroup, Bank of America.

Inside of 14 months, every one of these institutions either failed or posed a risk of failing absent government intervention.

Some were sold under duress. Others failed outright. Many were saved because the government resorted to an array of loans, guarantees and capital injections to keep these large, complex financial firms afloat.

But regardless, the result of all this turmoil is clear – with 20,000 layoffs and 10,000 homeowners entering into foreclosure each and every day.

As this Committee works to modernize our financial architecture, it is essential that we identify ways to give the government the tools it needs to "unwind" troubled systemically important institutions in an orderly way and put adequate safeguards in place to prevent unwarranted, risky behavior on the part of the largest market actors that puts our entire economy at risk.

And I would commend the Administration again for sharing my belief that the resolution authority be given to the FDIC, with whom the expertise of unwinding failed institutions clearly lies.

To be sure, we have seen unprecedented consolidation in the banking industry over the last few decades. In 1992, the 25 largest insured depository institutions accounted for a quarter of banking industry assets. As of 2008, the top 25 held over 60 percent of industry assets. Four U.S. bank holding companies now have over $1 trillion each in banking assets.

At the same time the industry became increasingly consolidated, the institutions themselves became more interconnected and, as many of these failures have illustrated, their relationships with one another more complex.

The growth of the largely unregulated credit derivatives market and the ability to process transactions with increasing speed added to the unprecedented level of complexity.

But it was the performance of our regulators that spun this all out of control – allowing these financial institutions to take on more and more risk, more and more leverage with far too much autonomy and far too little accountability.

Essentially, regulators took our largest financial institutions at their word that they understood what they were doing – and clearly they didn't. In fact, they had no idea at all.

The question before this Committee today is how to prevent this from ever happening again.

Some have looked at the failure of many large, complex financial firms to manage their risks—and the failure of regulators to adequately supervise them—and concluded that we can no longer afford to let institutions grow to a point where they put our financial system at risk. As economist Joseph Stiglitz has put it, many of these institutions became "not just too big to fail but also too big to save and too big to manage."

Some would strictly limit the size of balance sheets or restore some of the restrictions on business line affiliations lifted a decade ago. Another option would be to impose more stringent capital requirements, deposit insurance assessments, and other costs to provide disincentives to becoming either too big or too complex.

Still others suggest that it's unrealistic to believe that we could somehow "abolish" large, complex financial organizations.

They suggest designing a regulatory framework that would make sure that taxpayers are not on the hook each time one of these companies gets in trouble. That would mean finding ways to ensure that the creditors as well as shareholders can suffer losses when these companies get in trouble. As Warren Buffett said last week, the key to ensuring large financial institutions are run well is not only proper incentives for success – but also severe disincentives for failure.

The truth is, unlike the average family in New London or Hartford who has no choice but to live within its means, the large institutions throughout this crisis were always able to borrow more, draw down more, and relax their underwriting standards as their regulators stood by.

Whatever else we do, that has to stop.

Large financial companies may well need a different set of capital rules to ensure that they will have sufficient funds to absorb large unexpected losses. They may need new disclosure and reporting requirements that would enable regulators to close them in an orderly way if they become troubled.

If the AIG counterparty mess that this Committee helped expose has taught us anything, it is that regulators need a much clearer picture of the arrangements these firms got themselves into – not only to regulate them better but to extricate them from those arrangements if need be.

Each of these approaches has merit – and it is my hope that today's hearing offers an opportunity to fully explore all these options.

I will say again that I believe there is a need for systemic risk regulation to ensure that we no longer need to treat any institution as "too big to fail." It is my preference that authority not lie in any one body. We cannot afford to replace Citi-sized financial institutions with Citi-sized regulators. The goal of our financial modernization efforts must be more transparency, more accountability and more checks and balances.

Today's witnesses will help us take an important step toward making that possible.

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