

Opening Statement of Senator Richard C. Shelby
Committee on Banking, Housing and Urban Affairs
Credit Rating Agency Hearing
August 5, 2009

- Thank you, Mr. Chairman.

- The nature of today's credit rating industry reflects decades of regulatory missteps rather than market preferences. Over the years, the government granted special regulatory status to a small number of rating agencies and protected those firms from potential competitors.

- Beginning in 1975, the Securities and Exchange Commission began embedding NRSRO ratings into certain key regulations. Once credit ratings acquired regulatory status, they crept into state regulations and private investment guidelines.

- The staff of the SEC controlled access to the prized “nationally recognized statistical rating organization” or NRSRO designation by subjecting potential entrants to a vague set of criteria and an incredibly slow time line.
- The SEC did little to oversee NRSROs once so designated. Nevertheless, because of the doors they opened, ratings from an NRSRO became an excuse for some investors to stop doing their own due diligence.
- Widespread over reliance on ratings meant that the effects of poor quality or inadequately updated ratings could ripple through the markets.

- By encouraging reliance on a small number of big credit rating agencies, bureaucrats at the SEC exposed the economic system to tremendous risk.
- Our current financial crisis, which was caused in part by the credit rating agencies' failure to appreciate the risks associated with complex structured products, demonstrates just how big that systemic risk was.
- The troubles caused by the SEC's flawed regime, however, did not come as a surprise.

- When I was Chairman of this Committee, we acted to address the problem after the SEC failed to take action on its own. I felt that the industry's heavy concentration and high profits were symptoms of an industry in serious need of reform.
- We then passed the Credit Rating Agency Reform Act of 2006. The Act set forth clear standards for the NRSRO application process. It also gave the SEC authority to regulate disclosures and conflicts of interest, as well as unfair and abusive practices.

- Unfortunately, the law that we passed in 2006 did not have time to take root before the problems that they were intended to remedy took their toll.
- The SEC adopted rules pursuant to that legislation in June of 2007. Over the following months, the number of NRSROs doubled, just as the performance of many “highly rated” subprime securities revealed that such securities were not as safe as the rating agencies said they were.
- Today, we will consider a legislative proposal by the Administration to revisit the regulation of credit rating agencies.

- In determining whether new legislative steps are required, we should keep in mind that the 2006 reforms are still working their way through the system. That doesn't mean, however, that we shouldn't consider further changes. Every option should be on the table.
- One option is to remove rating mandates from regulations. Another is materially improving disclosure. As with any regulatory reform, however, we must also be mindful of unintended consequences.

- I strongly believe that the credit rating agencies played a pivotal role in the collapse of our financial markets. Any regulatory reform effort must take that into consideration.
- Thank you, Mr. Chairman.