



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
“Enhancing Investor Protection and the Regulation of Securities Markets”**

Remarks as Prepared:

The purpose of today’s hearing is to examine what went wrong in the securities market and discuss how we can prevent irresponsible practices that led to our financial system seizing up from ever happening again, and how to protect investors – including small investors – from getting burned by the kinds of serious abuses and irresponsible behavior we have seen in certain quarters of the markets in recent years. We will hear about proposals to regulate the securities market so that it supports economic growth and protects investors rather than threatens economic stability.

As important, today we will begin to chart a course forward – a course that acknowledges how complex products and risky practices can do enormous damage to the heart of our financial system—the American people—absent a strong foundation of consumer and investor protections.

Half of all U.S. households are invested in some way in securities, meaning the path we choose for regulating this growing segment of our financial system will determine the futures not only of traders on Wall Street but of families on Main Street.

A year ago this coming Saturday, the collapse of Bear Stearns underscored the important role that securities play in our financial system today. When I was first elected to the Senate in 1980, bank deposits represented 45 percent of the financial assets in the United States and securities represented 55 percent. Today, the securities sector dominates our financial system, representing 80 percent of financial assets, with bank deposits a mere 20 percent.

As the securities market has expanded, so too has its influence on the lives of average Americans. Much of that expansion has been driven by the process known as “securitization” in which everyday household debt is pooled into sophisticated structures – from mortgages and auto loans to credit card lines and student loans.

In time, however, Wall Street not only traded that debt – it began to pressure others into making riskier and riskier loans to consumers. And lenders, brokers and credit card companies were all too willing to comply – pushing that middle-class family in Bridgeport, Connecticut, who would have qualified for a traditional, secure product, into a riskier subprime mortgage, or giving that 17 year-old college student who never should have qualified in the first place a credit card with teaser-rates that were irresistible but terms that were suffocating.

As one trader said of one notorious subprime lender, they were moving money out the door to Wall Street so fast, with so few questions asked, these loans were not merely risky – they were, in fact, “built to self-destruct.”

As we knew it, securitization did not “re-allocate” risk – it spread risk throughout our financial system, passing it on to others like a high-stakes game of “hot potato.”

With no incentive to make sure these risky loans paid off down the road, each link in the securitization chain – the loan originators, Wall Street firms and fund managers with the help of credit rating agencies – generated more risk. They piled on layers of loans into mortgage-backed securities, which were piled into collateralized debt obligations, which were, in turn, piled into CDO-squared and –cubed – severing the relationship between the underlying consumer and their financial institutions.

Like a top-heavy structure built on a shoddy foundation, it all came crashing down.

I firmly believe that had the Fed simply regulated the mortgage lending industry as Congress directed with a law we passed in 1994, much of this could have been averted. But despite the efforts of my predecessor at this Committee, myself and others for many, many years, the Fed refused to act.

But the failure of regulators was not limited to mortgage-backed securities. As many constituents in Connecticut have told me, auction-rate securities misleadingly marketed as cash equivalents left countless investors and city pension funds across the country with nothing when the auctions failed and the securities could not be redeemed.

As this committee uncovered at a hearing about AIG last week, the unregulated credit derivatives market contributed to the largest quarterly loss in history.

In recent months, we have unearthed two massive Ponzi schemes bilking consumers, investors, charities, and municipal pension funds out of tens of billions of dollars that two separate regulators failed to detect in their examinations.

In January, I asked Dr. Henry Backe of Fairfield, Connecticut, to address this Committee about the losses suffered by the employees at his medical practice in the Bernard Madoff fraud. His testimony prompted Senator Menendez and me to urge the IRS to dedicate serious resources to helping victims like Linda Alexander, a 62-year old telephone operator from Bridgeport who makes less than \$480 a week and lost every penny of her retirement savings. In an instant, the ten-thousand dollars she had saved over a lifetime evaporated because regulators had no idea a massive fraud was occurring right under their noses.

This crisis is the result of what may have been the greatest regulatory failure in human history. If you need any further evidence, consider this:

At the beginning of the credit crisis in 2008, the SEC regulated five investment banks under the consolidated supervised entity program: Lehman Brothers, Bear Stearns, Merrill Lynch,

Goldman Sachs, and Morgan Stanley – names synonymous with America’s financial strength, having survived World Wars and the Great Depression. And though the seeds of their destruction had been planted nearly a decade earlier, each was sold, converted to a bank holding company or failed outright inside of six months. Every single one.

Our task today is to continue our examination of how to begin rebuilding a 21st century financial architecture. We do so not from the top down, focusing solely on the soundness of the largest institutions with the hope that it trickles down to the consumer, but from the bottom-up – ensuring a new era of responsibility in financial services, and a tough new set of protections for regular investors who thought those protections were already in place.

This bottom-up approach will create a new way of regulating Wall Street. For the securities markets, that means examining everything from the regulated broker-dealers and their sales practices to unregulated credit default swaps.

It means ensuring that the creators of financial products have as much “skin in the game” when they package these products as their customers do when they buy them, so that instead of passing on risk, everyone shares responsibility.

And that means we need more transparency – from public companies, credit rating agencies, municipalities, and banks. We are going to send a clear message with these modernization efforts: the era of “Don’t Ask, Don’t Tell” on Wall Street is over.

For decades, vitality, innovation and creativity have been a source of genius in our system. It’s time we recognize transparency and responsibility are every bit as paramount – that whether we are homebuyers, city managers, or entrepreneurs, we can only make responsible decisions if we have all the information.

I want the American people to know that this Committee will do everything in its power to get out of this crisis by putting the needs of people first – from my constituent Linda Alexander to the millions more whose hard-earned dollars are tied to our securities markets.

Today’s hearing will provide an opportunity to hear ideas and build a record upon which we can legislate a way forward for the American people, rebuild confidence in the securities markets, and put our country back on a sound economic footing.