



United States Senate Committee on Banking, Housing, and Urban Affairs

Christopher J. Dodd (D-CT), Chairman

For Immediate Release
February 4, 2009

Contact: Kate Szostak
(202) 224-1088

Opening Statement of Chairman Christopher J. Dodd “Modernizing the U.S. Financial Regulatory System”

Remarks as Prepared:

Today we continue the Committee’s examination of how to modernize our outdated financial regulatory system. We undertake this examination in the midst of a deepening recession and the worst financial crisis since the Great Depression. We must chart a course forward to restore confidence in our nation’s financial system, upon which our economy relies.

Our mission is to craft a framework for 21st century financial regulation, informed by the lessons we have learned from the current crisis and designed to prevent the excesses that have wreaked havoc with homeowners and consumers, felled financial giants, and plunged our economy into recession. This will not be easy. We must act deliberately and thoughtfully to get it right. We may have to act in phases given the current crisis. But inaction is not an option, and time is not neutral: we must move forcefully and aggressively to protect consumers, investors and others within a revamped regulatory system.

Last Congress, this Committee built a solid foundation upon which we will base our work today. The Committee and subcommittees held 30 hearings to identify the causes and consequences of the crisis – from predatory lending and foreclosures, to the collapse of Bear Stearns, the role of the credit rating agencies, the risks of derivatives, the regulation of investment banks and the insurance industry, and the role and condition of banks and thrifts.

The lessons we have learned thus far have been clear.

Lesson One – Consumer protection matters: The current crisis started with brokers and lenders making subprime and exotic loans to borrowers unable to meet their terms. As a former bank regulator recently remarked to me, quite simply, consumers were cheated. Some lenders were so quick to make a buck, and so certain they could pass the risk onto the next guy, they ignored all standards of prudent underwriting. The consumer was the canary in the coal mine. But no one seemed to notice.

Lesson Two – Regulation is fundamental: Many of the predatory lenders were not regulated. No one was charged with minding the store. But soon the actions of these unregulated companies infected regulated institutions. Banks and their affiliates purchased loans made by mortgage brokers or the securities or derivatives backed by these loans, relying on credit ratings that turned out to be wildly optimistic. So we find that far from being the enemy of well-functioning markets, reasonable regulation is fundamental to sound and efficient markets, and necessary to restore the shaken confidence in our system at home and around the world.

Lesson Three – Regulators must be focused, aggressive, energetic cops on the beat:

Although banks and thrifts made fewer subprime and exotic loans than their unregulated competitors, they did so with impunity. Their regulators were so focused on banks' profitability, they failed to recognize that loans so clearly unsafe for consumers were also a threat to the banks' bottom line. If any single regulator did recognize the abusiveness of these loans, not one was willing to stand up and say so. And with the Fed choosing not to use its authority to ban abusive home mortgages—which I had been calling for for years—the regulators were asleep at the switch.

Lesson Four – Risks must be understood to be managed: Complex instruments – collateralized debt obligations and credit default swaps – designed to manage the risk of the faulty loans that backed them turned out to magnify that risk. The proliferation of these products spread the risk of subprime and Alt A loans like an aggressive cancer through the financial system. Institutions and regulators alike failed to appreciate the hidden threat of these opaque instruments. And the current system of regulators, acting in discrete silos, did not equip any single regulator with the tools to identify or address enterprise- or system-wide risks. On top of that, CEOs had little incentive to ferret out risks to the long-term health of their companies because they were often compensated for short term profits.

I believe these lessons should form the foundation of our efforts to shape a new, modernized and above all, transparent structure that recognizes consumer protection and the health of our financial system are inextricably linked. And so in our hearing today, and those to come, I will be looking for answers to the following questions:

- *What structure best protects the consumer? What additional regulations are needed to protect consumers from abusive practices?* We will explore whether to enhance the consumer protection mission of the prudential regulators or to create a regulator whose sole job is protecting the American consumer.
- *How do we identify and supervise the institutions and products on which the health of our financial system depends?* Financial products must be more transparent for consumers and institutional investors alike. But heightened supervision must not stifle innovation of financial actors and markets.
- *How do we ensure that financial institution regulators are independent and effective?* We cannot afford a system where regulators withhold bold and necessary action for fear that institutions will switch charters to avoid stricter supervision. We should consider whether a single prudential regulator is preferable to the alphabet soup of regulators we have today.
- *How should we regulate companies that pose a risk to our system as a whole?* Here, we must consider whether to empower a single agency to be the systemic risk regulator. If that agency is the Federal Reserve Board, we must be mindful of ensuring the independence and integrity of the Fed's monetary policy function. Some have expressed a concern about overextending the Fed when they haven't properly managed their existing authority – particularly in the area of protecting consumers.

- *How should we ensure that corporate governance fosters more responsible risk-taking by employees?* We will seek to ensure that executives' incentives are better aligned with the long term health of their companies, not simply short-term profits.

Of course, my colleagues and our witnesses may suggest other areas to pursue and I welcome their good ideas. I look forward to moving forward collaboratively on this historic endeavor to create an enduring regulatory framework that builds on the lessons of the past, restores confidence in our financial system, and recognizes that our markets and our economy will only be as strong as those who regulate them and the laws by which they abide. That is our responsibility today.