SENATOR HUTCHISON OPENING STATEMENT

BEFORE THE

SENATE BANKING, HOUSING AND URBAN AFFAIRS COMMITTEE

EXECUTIVE SESSION

MARCH 22, 2010

Thank you Chairman Dodd.

Today we gather 18 months after the moments when our nation's economy stood on the brink of an economic meltdown amidst the worst financial crisis since the Great Depression.

Companies we once thought to be the titans of finance and business failed, leading to taxpayer-funded bailouts in the name of market stabilization. The effects of the financial crisis rippled across our broader economy, and indeed the world, leading to huge government spending programs in the name of economic stimulus.

Despite these actions, with each passing day, we continue to see constant reminders of the effects the crisis has wrought on all Americans. National unemployment continues to hover near 10%, its highest level in 26 years. Foreclosure rates are not abating, and, while there are signs of relief in the credit markets, small businesses and consumers still have difficulty finding credit.

While each passing day moves us further and further from the financial crisis that hit its apex in September 2008, the lingering symptoms of the economic downturn, including joblessness, lost income and wealth, and home foreclosures, the crisis remains firmly entrenched in our national consciousness.

The crisis also remains in our consciousness as a result of the immense government intervention seen over the past two years. Trillions of dollars in bailouts and spending packages have been poured into our financial markets and the economy as a whole. It continues to this day, as evidenced by another $18 billion spending package enacted last week. This huge amount of spending is sending our national debt spiraling out of control.

It is because of this extraordinary government action, and the financial crisis that brought it on, we gather here today. Our Committee is tasked with proposing necessary reforms to our financial regulatory authority so we can help prevent another meltdown. It is a great undertaking: to bring more oversight to our financial system while still fostering the innovation and independence that has made our American economy the best and most powerful in the world.

The Chairman's proposal before us today is an improvement on his preliminary draft from last November. And while I think there are some good measures in this draft, I still have some reservations that these vast reforms could have unintended consequences on all components of our economy, while failing to still address the roots of the crisis.

Of particular concern to me is the effect that financial regulatory reform legislation will have on our nation's community banks. As many of my distinguished colleagues can agree, community banks across the country serve as the backbone of our economy, providing the lending and depository services for our nation's small businesses, so they may continue to operate, invest, create jobs, and drive our economy. Unlike the big financial institutions that have constantly been in the headlines for bailouts and bonuses, community banks do not pose systemic risk to our financial system, nor are they identified as primary contributors to our latest crisis.

However, our community banks would soon be subjected to a considerable amount of new costs and regulatory burdens as a result of this legislation, a burden that would hamper their ability to effectively provide depository and lending services to our American consumers and small businesses.

As a former small business owner and banker, I am acutely aware of how important credit is for small businesses across Texas and around the country. Credit allows the West Texas exploration company to drill new wells to deliver the oil and gas that fuels our state and nation. Credit allows the Dallas developer to invest in real estate and to develop shopping centers that house a myriad of new retail businesses springing up across Texas to serve our growing population on a daily basis. Credit allows the Austin area tech start up to create a new product line that could soon revolutionize the way the world communicates.

Throughout the financial crisis, our nation's community banks were there to provide the needed capital to small businesses such as these. At a time when many banks took TARP funds only to park them in the Federal Reserve, in 2009, 45 percent of the banks with under $1 billion in assets increased their business lending. It is this business lending that will help grow our economy, and create jobs.

Tom Hoenig, President of the Federal Reserve Bank of Kansas City, said recently that our nation's largest banks would be well-served to take lessons from our community banks. Why? Because community banks have been committed to providing the vital credit and services needed for small businesses to create the jobs that will lead our nation into recovery. It is precisely this ability to foster bottom-up growth through small businesses that sets community banks apart from other financial institutions.

Community banks should not be punished as a result of this legislation, and it is that principle that draws my concern about this legislation. We should preserve and enhance our dual-banking system, rather than impose additional federal regulation. We should ensure state-chartered banks have options, including the ability to retain supervision from the Federal Reserve if they so choose.

In the Chairman's bill, the Federal Reserve would only have supervisory authority of the 35 largest financial institutions, a move that will effectively silence the voice of state-chartered banks in Texas and across the country. By stripping the Fed's supervision, this legislation will gear the Fed's monetary policy to these large banks mainly in New York without any regard for the 6,800 regional and community banks located across the country. While the Fed has been subject to much criticism for its handling of the crisis, from myself included, I realize that to effectively conduct monetary policy for our nation, the Federal Reserve needs to maintain supervision of a broad cross section of banks, not just those that pose a systemic risk.

That being said, I remain concerned that the legislation before us does not adequately address system risk. We absolutely must end the notion that institutions can be "too big to fail," our government's policy to provide assistance to prevent the failure of large financial institutions deemed systemically significant to our economy. Federal Reserve Chairman Ben Bernanke said this past Saturday that it is unconscionable that the fate of the world economy should be so closely tied to the fortunes of a relatively small number of giant financial firms, and that "we have to end the too-big-to-fail problem once and for all."

I agree! Under the Chairman's proposal, the Federal Reserve will retain its regulatory authority over banks and bank holding companies with assets of $50 billion or more. Additionally, the Financial Stability Oversight Council being created would also be authorized to place any other nonbank financial entity under the Fed that the Council believes could "pose risks to the financial stability of the United States." I am concerned that by designating these firms as potential threats to our financial stability, we in fact are designating them as too big to fail. Doing such would in effect ensure their competitive survival since, as every small banker knows, the implicit protection of the government confers a lower cost of funds and conveys with it significant advantages.

It is a perversion to free market capitalism to suggest that entities can privatize their profits, yet socialize their risks. While it is my hope that the provisions we put in place will diminish our need to use systemic resolution authority to mitigate future financial crises, we must be prepared. I remain concerned that under the Chairman's proposal, smaller, community banks and better business models will be unable to compete under a system that provides implicit protection to larger entities.

I also remain concerned that the Chairman's mark does not definitively provide for the resolution of failing companies deemed too big to fail. Under the proposal, the FDIC, as receiver with the authority to liquidate a company, would be enabled to pay creditors more than what they would otherwise receive in bankruptcy. This sends the wrong signal to creditors. It tells creditors that they will get a better deal if they lend to the big regulated firms rather than small firms. Instead, as stated by Chairman Bernanke, "Market participants must be convinced that if one of these firms is unable to meet its obligations, its shareholders, creditors, and counterparties will not be protected from losses by government action."

Additionally, the proposal does not require that a financial firm placed into receivership be liquidated or otherwise wound down. I believe we owe it to the American taxpayers to truly end taxpayer bailouts that leave us on the hook.

I specifically want to ensure that institutions which do not pose systemic risk to our financial system are not required to contribute to a resolution regime for institutions that do pose such systemic risk. A significant improvement over November's draft is increasing the threshold for institutions to pay into the proposed orderly resolution fund. I believe that the only appropriate way to fund a resolution authority is to base contributions to such an orderly resolution fund on risks posed to the system. Institutions that do not undertake risky behavior should not be called upon to subsidize those that do. While I am still unconvinced that a "bright-line" asset test is the best means to determine the risk a firm poses to the system, I realize that raising the threshold of the asset-test to $50 billion in assets will effectively exclude all community banks and credit unions that pose no systemic risk, and I am pleased to see this change.

Mr. Chairman, I remain concerned about the lack of improvements with regard to over-the-counter derivatives. As a result of the financial crisis, and especially the collapse of AIG, the term derivative entered our lexicon as the risky tool of speculators seeking massive profits. However, this fails to take into account the many end users that use derivatives purely to hedge against risk in order to pass along the price stability to consumers. Airlines, utilities, and energy companies hedge the cost of fuel and other commodities. Manufacturers hedge against crop prices. Importers and exporters hedge against changes in interest rates and foreign exchange rates. These end users do not use these hedges as a primary profit center; rather, they use them to control price risk. I believe that there needs to be greater reporting and transparency in the use of derivatives, so that we know the size and scope of the market. However, our Committee should proceed with caution in instituting changes that discourages legitimate behavior that also brings stability to the marketplace.

Finally, Mr. Chairman, I remain concerned by creation of a new Consumer Financial Protection Bureau. As an independent body operating within the Federal Reserve, this new consumer agency would regulate consumer financial products such as home mortgages and credit cards. As we've learned during this downturn, it is so important, when applying for a credit card or seeking a loan, for consumers to be as well informed as possible and know all the covenants of a transaction. However, creating a new bureaucracy with near endless authority over all facets of our economy is not the best answer. The best consumer protection policy is to integrate consumer protections with solid safety and soundness regulation.

Our Committee has been called to fill the gaps and loopholes in our regulatory structure that brought on our current downturn. We have been called to ensure that taxpayers on Main Street will never again be on the hook for excessive risks on Wall Street. The Chairman has made significant strides with this draft over that of November; however I believe we can make additional improvements to better address the problems that surfaced during our recent financial crisis. The task to reform our financial system is great, Mr. Chairman, but I believe we can find a way to work together on behalf of all Americans to promote reform that will truly address the weaknesses in our financial regulatory authority, without having unintended consequences that will hurt our economy.