Congressman Scott Garrett Testimony for Senate Banking Committee Hearing "Covered Bonds: Potential Uses and Regulatory Issues" (9-15-10)

Thank you, Chairman Dodd and Ranking Member Shelby, for holding this hearing today and inviting me to testify before you. I also want to thank Senator Corker for all of his hard work and advocacy on creating a U.S. covered bond market.

As our nation continues to recover from the recent financial crisis and certain credit markets remain locked, Congress must examine new and innovative ways to encourage the return of private investment to our capital markets. We must also consider creative ways to enable the private sector to provide additional consumer, commercial, public sector and other types of credit. Establishing a U.S. covered bond market would further these shared policy goals.

One reason I am particularly fascinated with covered bonds is the fact that they can be a purely private means of finance without government guarantees or subsidies. Many proposals to help alleviate the current strains in our credit markets focus on government loans or guarantees. However, I believe covered bond legislation offers a way for the government to provide additional certainty to private enterprise and generate increased liquidity through the innovation of a new marketplace without putting the taxpayers on the hook.

There are many potential benefits for a wide variety of interested parties that can be derived from a U.S. covered bond market:

- Consumers will experience lower loan rates because of the additional liquidity in the various asset classes.
- Consumers will also be able to more easily have their loans modified because the loans will still be on the balance sheet of the originating institution.
- Investors will have a new transparent and secure vehicle to invest in. This will allow for additional diversification within their portfolios.
- And finally, the broader financial markets will benefit by having an additional, low cost, diverse funding tool for financial institutions.

Covered bonds will ensure more stable and longer term liquidity in the credit markets, which reduces refinancing risks as well as exposure to sudden changes in interest rates and investor confidence. And they will allow U.S. financial institutions to compete more effectively against their global peers.

In the House, we have worked in a very constructive bipartisan fashion to push the ball forward on comprehensive covered bond legislation. Chairman Kanjorski, Ranking Member Bachus, and I have introduced 3 different versions of covered bonds legislation. The most recent is H.R. 5823, the U.S. Covered Bond Act of 2010.

A week before the August recess, we successfully marked up the legislation and reported it out of Committee by a unanimous vote. It is my hope that we can pass this legislation out of the House over the next several weeks.

Some have asked why we need covered bond legislation. Simply, to get the market off the ground and provide investors with the needed confidence to invest in the product, the resolution procedure of a bond when an issuer fails needs to be spelled out specifically in statute. Otherwise, without the certainty of a legally binding process, there is not significant enough appetite from the investor community to make covered bonds cost-effective for issuers to offer. Also, a regulatory regime needs to be put in place to ensure proper oversight of the marketplace.

Throughout this process, there have been some people who have said, “Let’s wait and do this next year with housing finance reform.” But the proposal we are discussing today is broader than just housing finance. Covered bonds offer a complementary source of funding that can spur much-needed lending to consumers, small businesses, and State and local governments.

The reason why I have been so active in pushing covered bonds this year is because I believe they could help NOW. We hear almost daily about the liquidity concerns throughout various asset classes. The House Financial Services Committee held a recent hearing about the lack of liquidity in the Commercial Real Estate market. The Senate just passed a bill already approved by the House with the intent of providing more liquidity to small businesses.

Also, we have all spoken to local and state officials about the problems municipalities face with increased funding costs for their projects. The President has continuously stressed the need to help these segments of the economy and this legislation is one we can pass immediately. More importantly, this is something we can pass immediately at NO cost to the taxpayer.

Another reason to move quickly on establishing a covered bond market in the U.S. is because billions of U.S. investment dollars are moving overseas and north of the border. So far, in 2010, there have been a dozen covered bond deals issued by foreign banks to U.S. investors totaling close to $18 billion. This is U.S. private capital that could be invested here and help with our consumer needs.

Private industry realizes that we are currently missing out on an opportunity as well. I have formal letters of support for the U.S. Covered Bond Act from: the National Association of Realtors, the Mortgage Bankers Association, the American Bankers Association, the National Multi-Family Housing Council, the National Apartment Association, the CRE Finance Council, the Real Estate Roundtable, SIFMA, the American Securitization Forum, the Financial Services Roundtable, and others.

Now, I don't pretend to believe that covered bonds are some sort of magic bullet that will help solve all of our funding needs. However, what I do know is that during a time of economic uncertainty, lack of liquidity and rising budget deficits, we must consider innovative approaches to help attract private investment back into our capital markets. I believe this legislation can help us in that regard.

I thank the Chairman and Ranking Member again for holding this hearing and inviting me to testify. I look forward to any questions you may have.