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OPENING STATEMENT OF SENATOR RICHARD C. SHELBY

Mark Up: Restoring American Financial Stability Act

November 19, 2009

"Thank you, Mr. Chairman.

"Earlier this year I called for a comprehensive investigation into the causes of our financial crisis because I believed that the American people deserved a full accounting of what happened.

"I also believed that such an accounting would be absolutely necessary to lay a foundation for any future legislation.

"I drew a parallel between the Great Depression of the 1930's and the near collapse of our financial system in late 2008.

"Eighty years ago, as this nation began its descent into what Milton Friedman termed 'The Great Contraction,' this Committee launched what was to become known as the Pecora Investigation.

"It was by all accounts an exhaustive examination of not only the origins of the 1929 Crash, but also of the individuals involved, including some of the most powerful financial figures in the country.

"The Committee's investigation went on for more than two years and laid the foundation for groundbreaking legislation including the Banking Act of 1933, which created the FDIC, the Securities Act of 1933, and the Securities Exchange Act of 1934, which created the SEC.

"Ultimately, Chairman Dodd chose not to pursue a Committee-led investigation.

"Rather, over my initial objections, he advocated for the creation of an independent Commission to examine and report on the origins and causes of the crisis.

"In the absence of a Committee effort, I reluctantly supported its creation.

“The irony is that the Commission will not report their findings and recommendations until late next year, long after the President apparently wants a bill on his desk.

“As the Chairman has said many times over the past year, this Committee has held dozens of hearings. Some of them were focused on topics that were directly relevant to the crisis. Many were not.

“The Committee has heard from a number of witnesses over the past several months. Many of them are experts in their fields and they had a good deal to say about what they thought happened and how we should go about fixing it.

“Expert opinions are interesting and often valuable. But, in the end, they are just opinions. Legislation should be based on more than just opinions.

“We meet today to begin consideration of a 1,139 page bill that purports to remake the entire financial services regulatory structure.

“I don’t believe that I can express in words what a monumentally significant undertaking this is. Every American citizen and every American business will be touched in some way by this legislation.

“Its reach can be predicted in some ways, and is entirely unknown in others.

“It is the type of legislation that should be supported by an exhaustive factual record, and then be thoroughly scrutinized in its own right. I am afraid that this bill fails both tests.

“The Chairman has proposed legislation that he has said will protect ‘consumers and our economy . . . from another crisis like the one we are now in.’ Comforting words, but are they true?

“One way to find out is to compare what we know about what happened with what this bill would actually do. The problem is that we don’t actually know what happened. That work is still being done by the Commission.

“Certainly, at this point, we must know something about what happened. Many witnesses have recounted their impressions and conclusions. All too often, however, even the experts had done little to no due diligence of their own. Once again, opinions are nice, but facts are better.

“If our goal is to ‘protect consumers and our economy from another crisis,’ we should gather every bit of information available on every facet of the current crisis. We could then conduct our own analysis and reach our own conclusions.

“Unfortunately, we didn’t do that.

“For example, AIG was at the epicenter of the crisis. One would think that this Committee would have gathered all of the relevant data associated with the activities within AIG’s Financial Products Division and interviewed everyone that had anything to do with that debacle including its senior management.

“One would think we would have done this, but one would be wrong.

“Bear Stearns was the first major financial institution to falter at the beginning of the crisis. One would think that we would have gathered all the information associated with Bear Stearns activities and interviewed everyone that had anything to do with the failure of that institution.

“One would think we would have done this, but one would be wrong.

“Lehman Brothers was the next to fall when it became apparent that the federal government was not going to bail them out. One would think that we would have conducted a thorough review of Lehman’s activities and its risk management practices.

“Once again, one would be wrong.

“The Chairman has repeatedly asserted that one of the main causes of this crisis was predatory lending.

“With that in mind, one would think that the Committee would have conducted an exhaustive examination of predatory lending practices by investigating claims of fraud and deposing dozens of alleged predators.

“I think by now you get my point.

“Mr. Chairman, I will repeat, probably for the last time knowing your determination to proceed, that this Committee has not done the necessary work to even begin discussing changes of this magnitude.

“Nevertheless, you have laid a bill before the Committee and I will explain, as quickly as possible, why I will not be supporting it at this time. I apologize if this takes some time, Mr. Chairman; it is, after all, a very, very big bill.

“I will start by saying that we began this process sharing many of the same goals and I don’t believe that has changed. We both seek to end ‘Too Big to Fail,’ and to enhance our resolution regime.

“We both believe that the regulatory structure needs to be modernized and streamlined while preserving the dual-banking system.

“We agree that the Federal Reserve should have a limited range of responsibilities and that its main focus should be on conducting monetary policy.

“We also agree that consumer protections need to be strengthened.

“Finally, we concur in the need to modernize the derivatives market to increase transparency, standardization, and competition.

“I had hoped that these shared goals could form the basis for a bipartisan agreement. Unfortunately, such an agreement has eluded us.

“Our hope was that the Dodd proposal would provide a base bill that could be amended and then agreed upon. As I will now detail, we have concluded that the bill requires a complete rewrite and we intend to offer a substitute at the appropriate time. Our substitute will seek to address the problems I will now enumerate.

“The Chairman has stated that his bill will end ‘Too Big to Fail.’ As I mentioned earlier, this is a goal we share.

“Unfortunately, the Dodd bill does not end ‘Too Big to Fail.’ In fact, it significantly expands the federal government’s ability to bail out not only banks, but any large, politically connected company.

“For example, Section 210 of the legislation allows the FDIC to provide open bank assistance not only to banks, but to any company outside of the resolution process. Ironically, this dramatic expansion of authority is contained in a section entitled ‘Miscellaneous.’

“Section 1201 allows the Federal Reserve to lend to insolvent firms, providing another avenue for regulators to avoid winding down companies.

“The ability of the FDIC and the Fed to bail out insolvent institutions gives regulators a way to avoid invoking the resolution authority, significantly diminishing the possibility that resolution will ever be achieved.

“Even if invoked, the Dodd bill’s resolution authority does not effectively require companies to be resolved. Section 208(a)(1) explicitly states that companies placed into receivership do not have to be liquidated, placed into a bridge bank, or otherwise wound down.

“Although Sections 203 and 208 state that creditors and stockholders should take losses, the Dodd bill overrides this requirement in Section 208(d) by explicitly authorizing the receiver to make additional payments to creditors with no express limitations.

“This, of course, means that the Dodd bill permits creditors to receive a 100% bailout from the Federal government.

“Because large companies can avoid bankruptcy by either receiving a bailout from the FDIC, the Fed, or the Resolution Authority, it will undermine incentives for investors and executives to effectively monitor risks.

“They will likely take even more risks because they know that they will reap the benefits, while taxpayers will have to cover the costs. The moral hazard created by this bill will make our markets less safe and could set the stage for an even more severe and more expensive financial crisis in the future.

“Mr. Chairman, if the end result is increased moral hazard and greater taxpayer exposure, this entire legislative effort will have been in vain.

“There is a way to craft a resolution authority to effectively wind down systemic institutions without creating more moral hazard. Unfortunately, the Dodd bill fails to do so. Rather, it actually codifies ‘Too Big to Fail’ and government bailouts. This is something to which I can never agree.

“The Dodd bill also proposes a revolutionary regulatory consolidation scheme wherein all prudential banking authority is consolidated in a single federal regulator.

“Heretofore, I have expressed serious concerns with this particular approach especially as it relates to our dual banking system.

“The Chairman asserts that his new regulatory construct ‘preserves and protects’ our dual banking system. Once again, I disagree.

“In fact, the Dodd proposal threatens the very existence of the dual banking system by placing all banks – state and federal – under a single, mammoth federal regulator.

“The dual banking system, which allows for both the federal government and the States to charter financial institutions, is one of the cornerstones of American federalism. By subjecting all insured depositories – state and federal – to the same rules, regulations, and supervision, the Dodd plan will, over time, erase the distinction between state and federal charters. As a result, I fear state charters will eventually be pushed to the side.

“Perhaps realizing this danger, the Chairman has included throughout his proposal a number of bureaucratic Band-Aids – such as the State Bank Advisory Board and Community Bank Division.

“I believe these will be ineffective and could even do more harm than good.

“Under Section 314 of the bill, the Community Bank Division would regulate and supervise state and federal banks alike – the emphasis being on size rather than charter.

“The State Bank Advisory Board would require five state banking commissioners, serving two-year terms, to make non binding recommendations regarding state-chartered institutions – thus performing the role of a token appendage to the consolidated regulator.

“Although the Dodd proposal recognizes a legitimate need for consolidation among the various current prudential regulators, the proposal strips the FDIC of all its power to be the primary regulator for many state-chartered institutions.

“Furthermore, the whole reason that state-chartered depositories are subject to any federal prudential regulation in the first place is because they have deposit insurance.

“It stands to reason that the FDIC – and not the national bank supervisor – is the most appropriate agency to oversee these state-chartered banks. Our substitute will preserve the FDIC’s authority in this area.

“The Dodd bill also would create a new and independent consumer protection agency. While we share the goal of enhancing consumer protection, we do not yet agree on the means to achieve it.

“I believe that a safe and sound banking system is the best consumer protection. For example, a prudently underwritten loan provides protection for both the consumer and the bank that issues it.

“In order to achieve that goal, the prudential regulator must be responsible for consumer protection.

“The Dodd plan would separate safety and soundness regulation from consumer regulation. This is a fundamentally flawed construct that was clearly demonstrated when Fannie and Freddie went under.

“To the extent that current regulators failed to protect consumers, we should hold them accountable. Instead of doing so, the Dodd Plan creates a massive new bureaucracy to which it then delegates a considerable amount of congressional authority.

“In a hearing held just yesterday, Chairman Dodd indicated that it was unreasonable to expect Congress to act every time a commercial practice needs to be addressed.

“I would argue that it is unreasonable and unwise to delegate our constitutional responsibilities just because it may take longer than some would wish.

“Finally, the Dodd consumer proposal would give the new bureaucracy a dual mandate to ‘protect’ consumers and ensure that they have ‘access’ to credit and financial products.

“An agency that requires financial firms to provide products to consumers repeats the same dangerous practices that led to unqualified consumers receiving mortgages they couldn’t afford. I think two failed GSEs are enough for now.

“Our substitute will propose a construct where consumer protection is housed within the prudential regulator, but, at the same time, is elevated and granted parity with the other regulatory disciplines.

“It will also enjoy greater access to and visibility with Congress.

“The Chairman’s derivatives proposal claims to address systemic risks and protect taxpayers from bailouts by forcing more derivatives trading into clearinghouses.

“In reality, his proposal fails to address certain risks and actually increases the possibility that taxpayers will need to bail out one or more of these new ‘too big to fail’ clearinghouses.

“The Dodd plan is supposed to bring transparency and accountability to the derivatives market.

“In reality, it establishes a bureaucratic labyrinth, introducing unnecessary complexity that creates inefficiencies for market participants and regulators.

“The Dodd proposal claims to address excessive risk taking in the over-the-counter derivatives market. The regulations imposed on the use of derivatives, however, will prohibit manufacturers and other companies from protecting themselves from many risks.

“As a result, they will build fewer plants, hire fewer workers, and expose consumers to greater price volatility. In other words, the job creators of Main Street will pay for the sins of Wall Street.

“The Chairman’s derivatives plan relies heavily on complex bureaucratic processes involving multiple regulators, including the SEC, the CFTC, and the newly proposed Agency for Financial Stability.

“This approach creates unnecessary bureaucracy and will delay critical changes, such as the establishment of a comprehensive transaction reporting system.

“Moreover, it blurs the lines of regulatory accountability, laying the groundwork for future regulatory failures and cross-agency finger-pointing.

“Finally, the derivatives title imposes punitive capital requirements for uncleared trades that will serve as a perverse incentive to clear trades that are not suitable for clearing. As a result, central clearinghouses will be under pressure to engage in unwarranted risk-taking.

“Finally, the Dodd bill contains a number of provisions that have nothing to do with the financial crisis, but everything to do with politics.

“Whatever the impetus behind these provisions, each would be a significant change in policy requiring some sort of committee examination. As we all know, the Committee has held no specific hearings to examine any of them.

“Once again, Mr. Chairman, I apologize for the length of my statement, but you have given us a great deal to consider.

“For every reason I have enumerated here, and for an number I have not, I will be opposing this legislation. Not because we disagree on its ends, but rather on its means. For this reason I remain hopeful that we may yet find some common ground.

“As has been my custom over the years, I remain open to discussions on every aspect of this bill.

“Because we continue to share a number of overall goals and disagree only on the means to achieve them, I still have every confidence that we can find a way forward if we commit to doing so.

“Thank you.”