

OPENING STATEMENT OF CHAIRMAN PAUL E. KANJORSKI
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AND GOVERNMENT SPONSORED ENTERPRISES
HEARING ON REFORMING CREDIT RATING AGENCIES
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Today, we meet to discuss one of the most important issues Congress will address as part of our overhaul of financial regulations: the reform of credit rating agencies. This issue has already generated much debate.

Credit rating agencies play an integral role in our markets. Even though they operate as independent firms, they hold quasi-regulatory powers. Investors around the world also heed their words (or letters as the case may be).

These entities also greatly contributed to our current economic problems by inappropriately issuing triple-A ratings for mortgage-backed securities and other complex financial instruments that later failed spectacularly. These agencies further used the same faulty assumption as so many others: that real estate prices would never go down. They were wrong.

Perhaps most troubling, these agencies failed to learn more about the quality of the products they rated. Investors have come to rely on the judgment of credit rating agencies, and it now appears that rating agencies with their “ask me no questions, I’ll tell you no lies” approach betrayed not only that trust, but also their special status under our laws.

To correct these problems, I have worked to draft legislation that achieves a balance between improving the regulatory oversight of credit rating agencies, while also creating incentives for investors to recognize that “caveat emptor” is still the ultimate rule for any financial transaction. Today’s hearing is therefore on a discussion draft that aims to reform and regulate these gatekeepers to our markets using these two principles as guide.

This summer, the Administration released a promising proposal to reform rating agency regulation. I have incorporated many useful provisions from that document into my discussion draft, including reforms aimed at enhancing the oversight of the rating agencies by the Securities and Exchange Commission and requiring new disclosures about how issuers pay rating agencies.

Under these reforms, rating agencies will remain independent. The Commission will not opine on the methods used for determining ratings, but it will ensure that rating agencies follow their internal procedures. The changes additionally require new duties for compliance officers at each rating agency to monitor and manage the many conflicts of interest inherent in this industry.

We must, however, go further. My draft therefore includes the sensible proposals to promote accountability through liability as first suggested by my friend, Senator Jack Reed. One of the most repeated complaints I hear in my district is that no one has been held accountable for the credit crisis. While the Justice Department belatedly works to take legal action against wrongdoers who caused this economic meltdown, going forward I believe that all responsible parties, including the rating agencies, should be held accountable for their actions, good or bad.

We can promote accountability in credit ratings through the threat of liability. While these legal reforms are an important change from current law, I want to assure everyone that I am committed to working to refine them as we move through the legislative process.

To get at the tremendous conflicts of interest created by the issuer-pays model, I have also proposed a new idea: making the rating agencies responsible for each others' ratings through collective liability. This reform will hopefully incent participants in this oligopoly to police one another and release reliable, high quality ratings. This reform, however, is not the only way to fix this problem, and I am open to other ways to achieve this objective.

My discussion draft further includes many other new reforms, like a duty for supervisors to manage the work of their subordinates and the establishment of boards with independent directors. Many of us also share the policy goal of diminishing the reliance on credit ratings. I wish we could just snap our fingers and take away the countless references to credit ratings in laws and regulations. While I have proposed in this discussion draft the elimination in federal statutes of all credit rating agency references, I have serious concerns about the unintended consequences of this plan.

In sum, this is the start of a process. I want to thank my cosponsors, Representatives Cleaver, Kilroy and Kosmas, for joining me in producing this bill. Going forward, I remain optimistic that that many more Members – from both sides of the aisle – will join me as we find the best ways to reform the regulation of these gatekeepers to our markets.
