OPENING STATEMENT OF

CHAIRMAN PAUL E. KANJORSKI

SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE,

AND GOVERNMENT SPONSORED ENTERPRISES

HEARING ON APPROACHES TO IMPROVING

CREDIT RATING AGENCY REGULATION

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Today, we meet to examine the operations of credit rating agencies and approaches for improving the regulation of these entities. Given the amount of scrutiny that these matters have garnered in recent months, I expect that we will have a lively and productive debate.

The role of the major credit rating agencies in contributing to the current financial crisis is now well documented. At the very best, their assessments of packages of toxic securitized mortgages and overly complex structured finance deals were outrageously optimistic. At the very worst, these ratings were grossly negligent.

In one widely reported internal e-mail exchange between two analysts at Standard and Poor's in April 2007, one of them concludes that the deals "could be structured by cows and we would rate it." I therefore fear that in too many instances the truth lies closer to the latter option rather than the former possibility.

Moreover, if we were to turn the tables today and rate the ratings agencies, I suspect that most Members of the Capital Markets Subcommittee would agree that during the height of the securitization boom the rating agencies were double-A, if not triple-A failures. Clearly, they flunked the class on how to act as effective gatekeepers to our capital markets.

Along with the expressions of anger, outrage, and blame that we will doubtlessly hear today, I hope that we can also explore serious proposals for reform. Unless we can find a way to improve the accountability, transparency, and accuracy of credit ratings, the participants in our capital markets will discount and downgrade the opinions of these agencies going forward.

One could hope that the agencies would do a better job in policing themselves. But if past is prologue, we cannot take that gamble. This time their failures were not in isolated, case-by-case instances. Instead, they were systemic problems across entire classes of financial products and throughout entire industries. Stronger oversight and smarter rules are therefore needed to protect investors and the overall credibility of our markets.

As a start, the rating agencies must face tougher disclosure and transparency requirements. For example, investors receive too little information on rating methodologies. The financial crisis has illustrated the danger flawed methodologies pose to the system. If methodologies remain hidden, there exists no check by which to expose their weaknesses.

In addition to establishing an office dedicated to the regulation of rating agencies within the Securities and Exchange Commission, oversight must also focus more intently on surveillance of outstanding ratings. The industry has done an inadequate job of downgrading debt before a crisis manifests or a company implodes. Moreover, we must examine how we can further mitigate the inherent conflicts of interest that rating agencies face.

In this regard, among our witnesses is a subscriber-pays agency. This alternative model is worthy of our consideration. At one time, all rating agencies received their revenue from subscribers, but they evolved into an issuer-pays model in response to market developments. I look forward to understanding how a subscriber-pays agency succeeds in today's marketplace.

Additionally, the question of rating agency liability is of particular interest to me. The First Amendment defense that agencies rely upon to avoid accountability to investors for grossly inaccurate ratings is generally a question for the courts to determine, but Congress can also have its say on these matters. Much like the other gatekeepers to our markets, namely lawyers and auditors, we could choose to impose some degree of public accountability for rating agencies via statute. The view that the agencies are mere publishers issuing opinions bears little resemblance to reality, and the threat of civil liability would force the industry to issue more accurate ratings.

In sum, the ongoing financial crisis requires us to reevaluate how rating agencies conduct their business, even though we enacted the Credit Rating Agency Reform Act just three years ago. As this Congress considers a revised regulatory structure in the broader context, this segment of our markets also needs to be examined and transformed. By considering proposals aimed at better disclosure, real accountability, and perhaps even civil liability, we can advance that debate today and ultimately figure out how to get the regulatory fit just right.

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