OPENING STATEMENT OF
CHAIRMAN PAUL E. KANJORSKI

SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE, AND GOVERNMENT SPONSORED ENTERPRISES

HEARING ON "THE STATE OF THE BOND INSURANCE INDUSTRY"

THURSDAY, FEBRUARY 14, 2008

Good morning. The Capital Markets Subcommittee meets today to learn about the causes and effects of recent bond insurer ratings downgrades. We will, in particular, focus on the spillover effects for municipalities and the financial services industry.

Bond insurance represents a microscopic segment of the insurance marketplace. In 2006, bond insurers collected less than one-third of a percentage point of the total premiums collected by the insurance industry.

We now know, however, that even though it is very small, the importance of the bond insurance industry is significantly greater. Its recent volatility, unless quickly addressed, could produce many negative consequences and affect the financial stability of the broader economy.

Since the issuance of the first license in the early 1970s, bond insurers have guaranteed a stable risk: the timely payment of principal and interest on municipal bonds. In recent years, many bond insurers expanded into insuring structured finance products, including those backed by subprime mortgages.

These business decisions and the decline of the value of subprime debt have now resulted in downgrades or the threat of downgrades by credit-rating agencies. It now appears that like a child who finds a book of matches, they have gotten burned. We must hope that they did not ignite our economic house, as well.

The ratings downgrades of a few bond insurers has produced spillover effects and caused considerable anxiety. A report or rumor about a bond insurer has already led to swings of several hundred points in the Dow Jones average.

The limited availability of bond insurance has also led to a number of recent failures in the offering of auction rate securities. These breakdowns have caused significant problems in the financing of student loans. They have also resulted in some municipalities paying 10 percent or more on their outstanding short-term debts.

Ratings downgrades additionally have the potential to reduce the value of bank holdings and insurer reserves, causing them to take write-downs or increase capital levels. Moreover, individual investors holding bonds could feel the impact if they want to sell the bonds they hold.

Most troublesome to me is the effect of these downgrades on municipalities. Municipal markets issue approximately $2.6 trillion in bonds, about one-half of which are insured. States and localities often use municipal bonds to operate more efficiently, ease budgeting shortfalls, repair bridges, fix roads, and build schools, among other things.

The recent downgrades could therefore cause cities and towns to make difficult decisions about whether they can afford to pay more for bond insurance, pay higher interest on bonds issued without insurance, or delay much-needed projects. In this regard, I am especially pleased that Mayor Tom Leighton of Wilkes-Barre, Pennsylvania is here today. He can describe how municipalities use bond insurance and what the implications of the ratings downgrades are.

In preparation for today's hearing, I previously contacted key regulators to open discussions about these serious matters and determine the most efficient and responsible manner to act. Today, we will hear from many of them. We will also hear from bond insurers, their critics, market analysts, and rating agencies.

Everyone, even state insurance regulators, agrees on the need for regulatory reform. We need to prevent a similar situation from happening again in the future. I am hopeful that as we further our understanding of these issues today we will also begin to explore what we should do going forward. Some policy options include prohibiting bond insurers from guaranteeing complex structured financial products in order to protect municipal bond issuers, and creating a federal bond insurance corporation, modeled after the FDIC.

We could also mandate federal insurance supervision in this narrow field in order to provide greater stability for our entire financial system. Additionally, we could enact a law allowing the Federal Home Loan Banks to enhance municipal bonds with letters of credit like Fannie Mae and Freddie Mac already do. Moreover, we could work to better transparency in the municipal bond markets. Other policy options include imposing new requirements for credit rating agencies and addressing the differences between ratings on structured finance products, corporate debt, and municipal bonds.

In closing, I look forward to an open dialogue today. I want to thank each of the witnesses for appearing. Your thoughts will help the Members of the Capital Markets Subcommittee to understand these issues and determine the best course of action to ensure that our municipal finance markets remain viable and our financial system stays dynamic and strong.
