Statement by Congressman Gary L. Ackerman to the Financial Services Committee

"Recent Events in the Credit and Mortgage Markets and Possible Implications for U.S. Consumers and the Global Economy"

September 5, 2007

Thank you, Mr. Chairman.

Mr. Chairman, from 1995 until not so long ago, America's subprime mortgage market seemed to be in the midst of a boom. The law of gravity didn't seem to apply. Subprime products were so lucrative that brokers approved the loans hastily and sometimes recklessly, sometimes without requiring complete and proper documentation. Additionally, subprime products were being marketed to individuals who were not credit-worthy enough for a mortgage. Who are originators looking for when they advertise mortgages with no background check and that you can't be turned down? By all accounts, this rush to pass out high-risk loans was the first mistake. Individuals who had no business being approved for car loans were moving into new houses massively leveraged on easy money.

Originators then took these loans – many of which should have been assessed as much riskier than they were – and packaged them into securities to sell to investors. If there had been full disclosure, smart and careful investors would have judged that these mortgage backed bonds carried a disproportionately high level of risk. In an effort to deliberately mislead investors, however, some originators and credit-rating agencies, so-called Nationally Recognized Statistical Rating Organizations (NRSROs), colluded. First, the credit-rating firms would consult, or maybe we should say collaborate, with the originators – receiving high fees, of course – to advise the originators how to design the packaged securities to ensure that the riskiest piece of the product was adequately masked. Then, for another fee, the credit raters would assign overly favorable ratings to these mortgage-backed bonds, giving investors the impression that a neutral, unbiased party with a proven track record of assessing risk thought highly of these volatile products.

Essentially, the originators and credit raters shoved enough pigs and laying hens in with the beef herd that investors expecting prime ribs on their silver platter and money in their pocket ended up with pork ribs on their paper plate and egg on their face. The credit-rating firms were doubledipping; profiting first from helping to put these shady securities together, and then collecting fees for deliberately rating these risky products at a higher value than they were worth. It's like hiring a judge to advise you as to how to commit an act and then paying him to decide whether you have committed a crime. My strong view is that NRSROs conspired with financial institutions to fool investors by packaging and rating securitizations in a manner that was deliberately aimed at misleading them. This is the accounting firm telling shareholder companies how to fool their investors and then getting hired as independent auditors.

That's not the free market at work. That's fraud. Fraud is a crime, not a correction.

What I find, perhaps, to be most perplexing of all is that Congress already identified problems stemming from NRSROs and passed legislation seeking to increase statutory authority to oversee the credit-rating agency industry. In the 109th Congress, the Credit Rating Agency Reform Act of 2006 was passed by the House and Senate, and was signed into law by President Bush almost exactly one year ago. This legislation granted the Securities Exchange Commission much greater authority to regulate and supervise NRSROs. To my knowledge, and as the current financial debacle makes clear, the SEC has not acted to either discipline those NRSROs that were involved in these types of practices, or to make certain that these insidious practices are thwarted in the future. The SEC simply is continuing to examine the credit-rating industry, a study that has been ongoing since before the Credit Rating Agency Reform Act became law last year.

Here's a conclusion for the SEC: you're more than a few days late and more than few billion dollars short.

The SEC has all the tools it needs to act swiftly and appropriately, but it has failed to do so. Unless the SEC demonstrates to investors, quickly and convincingly, that they intend to clean up the mess that the banks and credit-rating agencies have created, Congressional action will be necessary. This Committee and this Congress will not be passive spectators as banks and credit-rating agencies use their control of information to fool investors into believing that a pig is a cow and a rotten egg is a calf.