OPENING STATEMENT

CHAIRMAN EDOLPHUS TOWNS

COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM

HEARING: CREDIT RATING AGENCIES AND THE NEXT FINANCIAL CRISIS

September 30, 2009

Good morning and thank you all for being here today.

Today, the Committee continues its investigation of credit rating agencies—companies at the heart of the last financial collapse. Companies that will be at the heart of the next financial collapse.

The average American has probably never heard of credit rating agencies.

But these companies play a powerful role in our economy. And they played a starring role in the collapse of the financial system last year.

The main mission of credit rating agencies is to tell investors how risky bonds and other debt securities are. Pension plans, banks, insurance companies, and other investors depend on these ratings to help them decide where to invest their funds.

Unfortunately, for the past decade, the credit rating system has not worked well at all. A year ago this committee learned that ratings did not capture the true risk of many deals, because the rating agencies were more concerned with their own bottom lines.

As one ratings agency official said in an internal email, “We rate every deal. It could be structured by cows, and we would rate it.”

The result was a marketplace flooded with toxic debt: so-called “structured securities” such as CDO’s and other complicated securitizations, backed by risky mortgages, and propped up by inflated ratings.

More and more money was funneled into bonds and other debt that were destined to fail. Predatory lending flourished, while families got in over their heads buying houses they could not afford. Investors were left holding bonds and other securities that were dramatically overvalued.

When the housing bubble finally burst, we wound up in the deepest recession since the great depression.

A year after the collapse of Lehman brothers and the massive government bailout of AIG, Bank of America, and others, it looks like not much has changed.

Today we will hear testimony from Mr. Eric Kolchinsky, until recently, an insider at Moody’s, one of the largest credit rating agencies.

We have obtained a memo written by Mr. Kolchinsky to his superiors at Moody's detailing very serious allegations about Moody's rating practices.

If true, these allegations indicate troubling behavior in the credit rating industry. According to Mr. Kolchinsky, they continue to use inaccurate and outdated models; they continue to have conflicts of interest; and they continue to rate novel securities with little historical data, that no one really understands.

He was not alone in having concerns about the way Moody's operates. We will also have testimony from Mr. Scott McCleskey, who was Senior Vice President for Compliance at Moody's – until he rocked the boat too hard.

Mr. McCleskey's job was to ensure compliance with SEC regulations and other requirements. In theory he was a senior executive with important responsibilities. In practice, he got the old mushroom treatment: keep him in the dark and bury him in fertilizer. In short, it looks like not much has changed since the Crash of 2008.

We ignore this situation at our peril. In the next financial crisis, will the credit rating agencies be part of the problem or part of the solution?

Both the House and the Senate are drafting legislation to rein in these types of abusive practices by credit rating agencies. Our second panel of witnesses will provide suggestions on how to accomplish this.

One other note: I would particularly like to thank my good friend Senator Al D'Amato, the former Chairman of the Senate Banking Committee, for being here today. Also, Floyd Abrams, another well known and highly regarded New Yorker.

With that, I look forward to the testimony today.

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