U.S. CONGRESS
JOINT ECONOMIC COMMITTEE
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Statement of Carolyn Maloney
Joint Economic Committee Hearing
December 2, 2009
As prepared for delivery

Good morning. I want to welcome our distinguished panel of witnesses today as we discuss proposals to regulate the over-the-counter derivatives market and under-regulated credit markets.

The financial crisis and the ensuing recession were triggered in part by the collapse in the price of homes and the resulting defaults in the mortgages used to purchase them. In the absence of regulation, financial institutions aggressively purchased over-the-counter derivatives, such as mortgage-backed securities, with the expectation that they would generate high returns with minimal risk. To hedge against any risk, they also purchased unregulated credit default swaps that would pay them if the mortgages underlying the derivatives defaulted. This created an illusion that the assets were risk-free and a tangled web of counterparties. At its peak, this unregulated market was tied to$680 trillion in assets – an astonishing amount equal to 50 times US GDP, putting the stability of the US and the world economy at risk.

This crisis didn’t have to happen.

Many years earlier, one of our distinguished witnesses, Brooksley Born, then chair of the CFTC, had the foresight to recognize the dangers of unchecked growth, lack of transparency, and overleveraging in the over-the-counter derivatives. Some have called her “the woman who knew.”

However, she was ignored by a chorus of critics who hailed over-the-counter derivatives as the greatest financial innovation of the decade because they would spread risk efficiently among market participants. With the economy booming, regulatory attempts were voted down. I know from personal experience, having introduced two amendments that would take initial steps to regulate this market. These amendments were not passed.

Siding with her critics, Congress passed the Commodity Futures Modernization Act of 2000, which literally prevented the CFTC from regulating the over-the-counter market.

This was a mistake and we are acknowledging it now. Next week, on the floor of the House, we will be voting on a regulatory reform bill that will regulate over-the-counter derivatives to bring transparency to these complex financial products, and expand the authority of the CFTC and SEC to regulate counterparties in derivatives transactions. Many have argued that derivatives contracts were the prime reason AIG needed to be bailed out taxpayer funds -- because the quantity and value of their contracts were never disclosed so that the impact of breaking those contracts via a possible bankruptcy was unknowable.

We have confidence that this bill will pass.

The House Financial Services Committee and House Agriculture Committee are meeting this week to merge their two versions of the bill that will finally regulate the over-the-counter market bringing the “dark” market into the light.

The merged bill will promote transparency by requiring that these previously unregulated derivatives be traded on exchanges or clearinghouses. Capital and margin requirements will be established so that financial institutions can no longer make risky bets. And information about prices and trading volumes will be publicized so that market participants will no longer be uncertain of the value of their securities.

Although these bills exempt some derivatives from regulation, the exemptions are an attempt to balance concerns of some businesses that need customized derivatives and the potential risk to the financial system.

The House Financial Services Committee has also passed a bill establishing the Consumer Financial Protection Agency to shield consumers from deceptive financial practices.

Although our economic recovery is far from complete, the economy is moving back on track, helped along by the Recovery Act. Third quarter GDP grew 2.8 percent, after contracting for four consecutive quarters. Financial markets have recovered substantially and interbank lending is back to its pre-crisis level.

Now is the time to act. The financial crisis has made clear the need for common-sense regulation of the financial services industry to insure stability and safety of the system.

I thank the witnesses for coming before the committee this morning and I look forward to hearing your testimonies.

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