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COMMITTEE ON OVERSIGHT AND
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COMMITTEE ON EDUCATION AND LABOR

Opening Statement
Dennis J. Kucinich, Chairman
Domestic Policy Subcommittee
July 11, 2007

Good afternoon.

This hearing's purpose is to shed light on a serious challenge to America decades-long commitment to protecting small investors, brought to public attention by the recent public offering of Blackstone LP.

Hedge funds and private equity funds are risky and they operate under exemptions from traditional investor protections. Under current law, hedge funds and private equity funds may not be sold to small investors. They deploy investment strategies that are otherwise prohibited, and they possess the potential for rich rewards. But at the same time they are characterized by real potential risks of colossal failure, illustrated by the collapse of two Bear Stearns hedge funds just two weeks ago, and the collapse of Amaranth Partners and Long Term Capital some years ago.

The public offering of Blackstone LP two weeks ago, and the offering of the Fortress Investment Group that preceded it, mark the attempt to mainstream a new financial arrangement that effectively presents small investors with the ability to invest in the management of hedge funds and private equity funds. I am concerned that the effect is to expose small investors to risks that heretofore have been permitted only for large institutional investors and wealthy individuals. Blackstone is the latest and by far the largest family of hedge funds and private equity funds that have devised a way to be traded publicly without compliance with the Investment Company Act of 1940, but it will be no means the last. The Kohlberg, Kravis, Roberts private equity group and the Och-Ziff (PRON. "AH-k Ziff") Capital hedge funds have already filed with the SEC to take their management companies public following the Fortress and Blackstone models and news reports indicated that other funds such as the Carlyle Group and Apollo may not be far behind.

The subject of the hearing is this: Has the SEC adequately used its existing authority to protect small investors with regard to the initial public offering of these arrangements? Is the existing law adequate to the task of protecting investors in the face of the desire and resourcefulness of hedge fund and private equity fund managers to go public? What are the new risks to small investors posed by these new financial arrangements?

I want to be clear that this hearing is **not** about the abolition or even the further regulation of private equity and hedge funds. Nor is this hearing biased toward forbidding future offerings like Blackstone LP.

The bias is toward the protection of small investors and how best regulation may accomplish that goal. In other words, what steps all actors in the broader regulatory system, including Congress, can and should take to militate against the risk of these novel investment vehicles.

The backbone of our financial system—one that makes it the envy of the world and an efficient machine to balance risk and reward—is our strong system of regulating public offerings. The SEC has attempted to institute some regulation of hedge funds for even sophisticated and wealthy investors, and all the others witnesses that you will here from today think that when small investors are allowed access to hedge funds and private equity funds there needs to be regulation. The question is what type of regulation is both necessary and reasonable to strengthen our financial system.

Blackstone LP provides the point of departure. This subcommittee wrote the SEC on June 21 out of concern that insufficient time and opportunity had been allotted to examine those new risks and the soundness of the new financial arrangements. Chairman Waxman and I felt that the stakes were high, since a careful reading of Blackstone's registration statements by our staff revealed that public investors in the IPO would be assuming risks without the traditional investor protections of corporate governance that allow investor control; and without transparency and the disclosure of what is being invested in. Those risks include: Excessive compensation arrangements; management self-dealing transactions with affiliates; use of substantial leverage; no diversification requirements; difficult to value investments; illiquid investments; no independent board members; no substantive voting rights; few fiduciary duties on management.

Eagerness by Blackstone to launch this IPO and stymie Congress's examination of these questions is unfortunate. It should be noted that Blackstone moved up its offering date by a week, precisely when we and several other members of Congress asked the SEC to scrutinize further the offerings. They could have allowed the inquiry to take place, and I believe it was unfortunate they did not. But if Blackstone was able to market a black box to ordinary investors by gaming their offering date, others that follow will not.

The alternative to oversight is not pretty: it is to wait for something bad to happen – for the failure of one or several of these management companies and for, as in the Enron debacle, ordinary investors to lose everything, including their retirement income, and to allow the legal and economic fallout to be resolved through protracted and expensive litigation.

So our hearing today is timely and, we hope, helpful, to the cause of protecting ordinary investors. These are individuals and families who are saving for college and retirement through IRA's and 527s, mutual funds and on-line trading houses. They depend upon the SEC and Congress to afford them the opportunities of our market system with protections from excessive risks and dangers which can otherwise cause ruin and defeat the American Dream. We will examine today, with the help of some of the nation's leading experts, if we are living up to that challenge, or if we are irresponsibly exposing small investors to excessive risk and danger.