United States Senate
Committee on Banking, Housing, and Urban Affairs
Christopher J. Dodd (D-CT), Chairman

For Immediate Release
October 16, 2008

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Statement of Chairman Christopher J. Dodd
"Turmoil in the U.S. Credit Markets: The Genesis of the Current Economic Crisis"

This morning the Committee examines the genesis of the crisis in our credit markets.

Such an examination is in keeping with this Committee's extensive work over the past 21 months to understand the implosion of the mortgage markets and how that implosion has infected the wider economy. All told, this Committee has held a total of 73 hearings and meetings since January of 2007. No less than 31of them have addressed, in one form or another, the origins and nature of the current market turmoil.

Today's meeting is essential to understanding not only how we got here, but more importantly where we as a nation need to go. Only if we undertake a thorough and complete post mortem examination of the corpus of this damaged economy, will we have any chance to create a world where the mistakes of the past are less likely to be repeated, and where all Americans will have a fair chance at achieving security and prosperity.

It is by now beyond dispute that the current conflagration threatening our economy started several years ago in a relatively discreet corner of the credit markets known as subprime mortgage lending. Chairman Bernanke, Secretary Paulson, and many other respected individuals have all agreed on that fact.

Mortgage market participants – from brokers to lenders to investment banks to credit rating agencies – formed an unholy alliance conceived in greed and dedicated to exploiting millions of unsuspecting, hard-working American families seeking to own or refinance a home. Relying on two faulty assumptions – that housing prices would continue to rise and that new financial instruments would allow them to shift the risk to others – these market participants flouted the fundamentals of prudent lending.

Certainly, some borrowers themselves sought unjust enrichment in the mortgage process. They deserve neither our sympathy nor our assistance. But of the millions of American homebuyers who today face foreclosure and financial ruination, the vast majority were victims – not perpetrators – of what will be remembered as the financial crime of the century.

Indeed, the misdeeds of some have robbed nearly every American. Whether they suffer from the loss of a home, retirement security, a job, or access to credit, Americans are reeling from the credit crisis. Sadly, this crisis was entirely preventable.

It is clear that greed and avarice overcame sound judgment in the marketplace – causing some very smart people to act in very stupid ways. But what makes this scandal different from others is the abject failure of regulators to adequately police the markets.

Regulators exist to check the tendency to excess of the regulated. They are supposed to step in to maintain transparency, competition, and fairness in our economy. In this case, though, our nation's financial regulators willfully ignored abuses taking place on their beat, choosing to embrace the same faulty assumptions that fueled the excessive risk-taking in the marketplace. Instead of checking the tendency to excess, they permitted and in some ways even encouraged it. They abandoned sensible and appropriate regulation and supervision.

No one can say that the nation's financial regulators were not aware of the threats posed by reckless subprime lending to homeowners, communities, and indeed the entire country. That threat had already been recognized by Congress. In fact, the Congress had already taken strong steps to neutralize it. In 1994, then-President Clinton signed into law the Home Owners and Equity Protection Act. This law required – let me repeat, required – the Federal Reserve Board as the nation's chief financial regulator to "prohibit" unfair, deceptive, and evasive acts and practices in the mortgage lending market.

Despite this direct requirement, the Federal Reserve under its previous leadership decided to simply ignore the law. Not for days. Not for months. But for years.

Indeed, instead of enforcing the law by simply imposing the common-sense requirement that a mortgage loan be based on a borrower's ability to repay it, the Fed's leadership actually encouraged riskier mortgage products to be introduced into the marketplace.

The Fed's defiance of the law and encouragement of risky lending occurred even as the Fed's own officials warned that poor underwriting in the subprime mortgage market threatened homeownership and wealth accumulation, and was incompatible with safe and sound lending practices. It occurred despite warnings issued by Members of Congress – including some of us who have served on this Committee. It occurred despite warnings from respected economists and others that the Fed and its sister agencies were playing with fire.

It was only this year – 14 years after the enactment of the 1994 law – that the Fed finally published regulations to enforce HOEPA's needed protections. By that time, the proverbial horse was out of the barn. Trillions of dollars in subprime mortgages had already been brokered, lent, securitized, and blessed with unrealistic credit ratings. Millions of American homeowners face foreclosure. Tens of millions more are watching as their most valuable asset – their home – declines in value. And the entire global financial marketplace has been polluted by toxic financial instruments backed by these subprime mortgages – which has caused a financial meltdown of unprecedented proportions, and laid low our economy.

The evidence is overwhelming. This crisis is a direct consequence of years of regulatory failures by government officials. They ignored the law. They ignored the risks to homebuyers. They ignored the harm being done to our economy.

Despite this clear and unimpeachable evidence, there are still some who point fingers of blame in the direction of Fannie Mae, Freddie Mac, and the Community Reinvestment Act. These critics are loud, they are shrill -- and they are wrong. It is no coincidence that they are some of the very same sources who were the greatest cheerleaders for the very deregulatory policies that created this financial crisis.

Let's look at the facts.

On Fannie Mae and Freddie Mac, the wrong-headed critics say Fannie and Freddie "lit the match" of the subprime crisis.
In fact, Fannie and Freddie lagged in the subprime market – they didn't lead it. Between 2004 and 2006 – the height of the subprime lending boom – Fannie and Freddie's share of subprime securitizations plummeted from 48% to 24%.

The dominant players were not Fannie and Freddie, but the Wall Street firms and their other private sector partners – the mortgage brokers and the unregulated lenders. In fact, in 2006, at the height of the subprime boom, more than 84% of subprime mortgages were issued by private lenders.

One of the reasons Fannie and Freddie lagged is because they were subject to tougher underwriting standards than those rogue private, unregulated, lenders.

So it was the private sector – not the government or government-sponsored enterprises – that was behind the soaring subprime lending at the core of this crisis.

At the risk of stating the obvious, it is worth noting that at the height of the housing boom, President Bush and his supporters in and out of government did nothing to criticize or stop predatory lending. They did nothing to support , much less advance, the legislation that some of us were working to move in the Congress that would have cracked down on this predatory lending.

Regarding the Community Reinvestment Act, the critics are also speaking in ignorance of the facts.

The overwhelming majority of predatory subprime loans were made by lenders and brokers who were not – I repeat, were not – subject to CRA. In 2006, for example, 24 of the top 25 subprime lenders were exempt – exempt – from the CRA.

In fact, CRA lending is in no way responsible for the subprime crisis. CRA has been the law of the land for 3 decades. If it were responsible for creating a crisis, the crisis would have occurred decades ago.

The late Ned Gramlich, a former Fed Governor, put it well when he said that two-thirds of CRA loans did not have interest rates high enough to be considered subprime. Rather than being risky, lenders have found CRA loans to have low default rates. According to former Governor

Gramlich, banks that have participated in CRA lending have found “that this new lending is good business.”

So people are entitled to their own opinions. But they are not entitled to their own facts. And as Ronald Reagan once said, “facts are stubborn things.”

The lessons of this crisis are already becoming clear to us. One of the central lessons is that never again should we permit the kind of systematic regulatory failures that allowed reckless lending practices to mushroom into a global credit crisis. Another is that never again should we allow federal financial regulators to treat consumer protection as a nuisance, or of secondary importance to safety and soundness regulation. If we have learned one thing from this debacle, it is that the American consumer, when all is said and done, remains the backbone of the American economy and that consumer protection and the safe and sound operation of financial institutions are inextricably linked.

I look forward to hearing from our distinguished witnesses today about their view of how our economic travails were created, and how we might chart a course to put our nation on a more secure and hopeful path.

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