OPENING STATEMENT OF
CONGRESSMAN PAUL E. KANJORSKI

SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE, AND GOVERNMENT SPONSORED ENTERPRISES

HEARING ON CREDIT DEFAULT SWAPS ON GOVERNMENT DEBT: POTENTIAL IMPLICATIONS OF THE GREEK DEBT CRISIS

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Good morning. At the request of our colleague, Congresswoman Maloney, we gather today to examine important policy questions that have arisen from the Greek debt crisis. The crisis, which quietly evolved over a number of years, has demonstrated that innovative Wall Street bankers acting alone or in concert with their clients have the potential to destabilize not only a single country but an entire economic region, especially if the transactions they concoct distort transparency or heighten speculation.

Among other things, this hearing will allow us to explore whether the titans of Wall Street act as traders of government debt by underwriting bonds or traitors of governments by using credit default swaps to gamble that sovereign debt will fail. Those who bet on and seek to cause the default of a government are as bad as Benedict Arnold.

When used for genuine hedging purposes, credit default swaps are an appropriate financial tool. But when these instruments are used for speculation, they have the potential to become a Trojan horse that will insidiously infect our markets. Some very smart and sophisticated investors have characterized naked credit default swaps as "weapons of mass destruction" that can "create imaginary value out of thin air."

The tragic situation in Greece underscores the urgent need for Wall Street reform at home. Some recent news reports suggest that bankers crafted derivatives to hide Greek debt, and other stories note that the U.S. market for credit default swaps on municipal debt is growing. Congress must respond by creating more transparency in our derivatives markets as provided for in the House-passed bill. The derivatives bill recently approved by the Senate Agriculture Committee similarly advances the goal of greater disclosure.

Additionally, the response of the markets to the Greek debt crisis raises more questions about the utility of rating agencies. As we all know, the ratings agencies greatly contributed to our recent financial crisis by failing to appropriately rate collateralized debt obligations and other structured debt. The growth in the issuance of these faulty financial instruments, which the rating agencies blessed, contributed to the explosion of the credit default swap market.

While some have raised concerns, other experts have concluded that a large and liquid market for credit default swaps, including naked positions, leads the cash bond market in price discovery and predicting adverse credit events. If this is true, then I question why the rating agencies waited so long to downgrade Greece's debt. After all, the cost for purchasing credit default swaps on Greek debt has soared for many months, but Moody's and Standard and Poor's have only downgraded the country's bonds in recent days.

The reform bill already passed in the House takes strong steps to impose a liability standard on rating agencies and reduce conflicts of interest and market reliance on them. As we proceed today, I look forward to understanding whether naked credit default swaps do indeed promote efficient price discovery and whether we should do more to reform rating agencies.

The Greek debt crisis also parallels a problem in our financial markets: the problem of too big to fail. Greece's problems have placed an enormous strain on the European debt markets and the European Monetary Union. In fact, the European Central Bank president has said that "a Greek default is out of the question."

With respect to our financial markets, the demise of Lehman Brothers, American International Group, and Washington Mutual, among many others, has shown that Congress must act to mitigate systemic risk. That is why the House-passed legislation and the pending Senate bill include provisions to end the era of too big to fail, like my amendment directing regulators to break up financial firms that have become too big, too interconnected, too concentrated or too risky.

In sum, today's hearing continues to build the case for financial services regulatory reform. More than two years have passed since the financial crisis began, and the Senate must take swift action on its bill so that we can finally end Wall Street's narcissistic pursuit of profit and change the way our financial markets operate.