Statement of Ranking Member Spencer Bachus, Capital Markets Subcommittee Hearing Entitled "The State of the Bond Insurance Industry"

February 14, 2008

Thank you, Mr. Chairman, for convening today's very timely hearing.

Three months ago, very few Americans were familiar with the bond insurance industry and the role these financial institutions play in the capital markets. This once obscure industry is now at the center of the ongoing credit and liquidity crisis that has roiled financial markets in recent months, causing tens of billions of dollars of losses to investors and financial institutions, and an unraveling of many secondary debt markets. Unlike other events that have destabilized markets since the credit crunch began last summer - where the pain has been felt largely on Wall Street - the fall-out from the troubles in the bond insurance industry is already hitting Main Street.

Bond insurers guarantee over $2 trillion of debt securities. Roughly 50% of municipal bonds and a large number of structured finance vehicles (pools of bonds, debt swaps, or residential mortgage backed securities) are guaranteed by the bond insurers in order to make them "safe" investments with a triple-A rating. This provides the credit markets with increased liquidity and reduced borrowing costs, particularly for cities, counties, and States that pay lower interest on debt issued to support their infrastructure needs.

The bond insurers' decision several years ago to expand their business lines beyond municipal issues and into more complex securities - including mortgage pools backed by subprime mortgages - has had disastrous consequences. Bond insurers fundamentally misjudged the risk associated with the cyclical mortgage markets and lenders' lax subprime underwriting standards. The credit rating agencies have now downgraded 7 of the top 9 bond insurers, calling into question their ability to make good on hundreds of billions of dollars in potential mortgage-related defaults. Investors in insured bonds relied heavily on analyses by credit rating agencies that were fundamentally flawed. Too late, the credit rating agencies have recognized the added risk of subprime-related guarantees to the thinly capitalized bond insurers, which has served to exacerbate the credit crunch and create massive uncertainty among market participants.

Local governments across the country are now facing an unfavorable environment in which to raise funds, with new issues plummeting and many municipalities forced to pay significantly higher interest rates. For example, in my home district in Jefferson County, Alabama, the rate on their insured sewer bonds issued in 2002 has skyrocketed from 3.06% to 10% -- a more than triple increase in their payments. These costs will inevitably be passed along to local taxpayers in the form of reduced services or higher fees and taxes. The impact has also extended to the credit markets, as new offerings of commercial mortgage backed securities have largely dried up.

Fortunately, our economy is still fundamentally sound, and not all market participants rolled the dice in the subprime markets. Two bond insurers have had their credit ratings affirmed, providing some measure of stability to the bond markets. Several other bond insurers are seeking or have obtained private equity financing, and quick action by our regulators has helped bring new entrants, such as Berkshire Hathaway, into the industry to support the ongoing viability of the municipal bond insurance markets.

Last year, SEC Chairman Cox presented a vision for increasing integrity, transparency, and accountability in the municipal securities market. Chairman Cox's initiative would require meaningful public disclosures that are current and understandable, with a full accounting of all material information at the time of a new municipal bond issuance. This

Committee should closely consider Chairman Cox's proposal, keeping in mind that any Federal reforms of the municipal securities market must take account of the legitimate interests of States and municipalities.

Systemic risk related to the bond insurance marketplace, while remote, is a risk that could have been avoided with prudent oversight by our credit rating agencies and regulators. We need to ensure that our regulators maintain a larger perspective on the potential impact of difficulties in one sector of the financial services industry spilling over into others, as has happened with bond insurance. In addition to guarding against risk to the financial system, Congress must make sure that someone is watching out for the taxpayers. Fourteen months ago, well before the subprime crisis called into question the financial soundness of bond insurers, I communicated my concerns about the municipal securities markets in a letter to Chairman Cox, which I would like to enter into the record. Now my fears are being realized as the situation in Jefferson County, Alabama unfolds. Protecting taxpayers and ratepayers as well as investors is a major concern for me, and will guide my efforts going forward. Hopefully Chairman Cox's efforts and forthcoming proposals by the Treasury Department on the need for more comprehensive regulatory oversight of the financial services industry will help to inform this Committee's review of these complex issues.

Thank you again, Chairman Kanjorski, for holding this hearing. We are grateful to all of today's witnesses for joining us and look forward to their testimony.