Statement of Ranking Member Spencer Bachus, Full Committee Hearing on "Auction Rate Securities Market: A Review of Problems and Potential Resolutions"

September 18, 2008

Thank you, Mr. Chairman, for holding this hearing on the $330 billion auction rate securities market and the efforts of Federal and state regulators to help investors salvage their investments in these instruments.

The past 25 years have witnessed astonishing growth in the auction rate securities market, for the simple reason that these securities offered higher rates of return than Treasuries or money market funds, along with the illusion of safety. Auction rate securities were able to offer these returns through an auction mechanism that reset interest rates and dividend yields at regular intervals, usually every 7 to 35 days. But what we are learning is that many of the firms that sold these securities failed to make clear to investors that with increased yield came additional risk. Indeed, many investors who purchased auction rate securities have asserted that they were marketed as the equivalent of highly liquid money market accounts.

These investors faced a rude awakening in February of this year, when the large commercial and investment banks that had traditionally supported the auctions stopped bidding, causing the market to freeze. This left investors unable to withdraw funds that many needed to pay their children’s tuition, finance their businesses, or purchase homes. Almost overnight, auction rate securities became the financial version of the “roach motel”: investors could check in, but they could not check out. For municipalities that relied upon auction rate securities to meet their short-term funding needs, the failure of the market resulted in sharply higher borrowing costs, contributing to budget constraints that have begun to affect communities across the country.

The good news is that over the past six weeks, eleven of the institutions that underwrote and marketed these securities have settled claims brought against them. These settlements will allow individual investors, small businesses, and charities to get their money back. But the problem goes far beyond these eleven institutions. Forty different firms currently have complaints pending against them, and many investors remain unable to access their funds. I look forward to hearing from our witnesses about ongoing efforts to make these investors whole.

The collapse of the auction rate securities market has left many other questions for this Committee to consider. How did big Wall Street firms supervise the employees selling these products? Did these firms instruct their employees to promise investors that these firms would support these auctions no matter what happened? Was the senior management of these firms less than forthcoming about the risk that in a deteriorating market, these auctions could fail?

On a broader policy level, what does the auction rate securities debacle tell us about the interconnected nature of our financial markets, in which problems in one sector can spread almost immediately and without warning to other sectors, leaving millions of investors wondering what hit them?

These are important questions, Mr. Chairman, and I commend you for directing the Committee’s attention to them. Thanks also our witnesses for being here today. We look forward to your testimony.

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