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Thank you, Chairman Dodd and Ranking Member Shelby, for the opportunity to appear before the Committee at this momentous time in the life of our markets.

Seven decades ago, this Committee conducted hearings similar to these in a situation eerily reminiscent of the situation we now find ourselves in.

Between September 1, 1929 and July 1, 1932, the value of all stocks listed on the New York Stock Exchange fell from nearly $90 billion to just under $16 billion – a decline of 83 percent. The value of bonds listed on that Exchange declined by 37 percent, from $49 billion to $31 billion.

"The annals of finance," the Senate Banking Committee memorably would write, "present no counterpart to this enormous decline in security prices."

Seventy-six years later, we now have that counterpart, and like then, today everything must be on the table. No notion is unreasonable. No idea is unthinkable.

The unthinkable has happened – we are in the worst market crisis I have seen in my forty-plus years in and around the markets -- and we must be creative and daring in order to get our markets working again.

To do this, we must examine what went wrong.

From where we stand at this moment in the crisis, we already know that there is plenty of blame to go around: the banks and mortgage brokers who first made these loans. The financial engineers on Wall Street who securitized them. The credit rating agencies who gave AAA ratings to mortgage-backed securities that they helped to construct. The insatiable appetite of some investors that blinded them to the risks involved.

Let me be absolutely clear about one point. We are here today not because of what happened this year or last, but because of at least two decades of societal and political adherence to a deregulatory approach to the explosive growth and expansion of America's major financial institutions.

Furthermore, it is now readily apparent that our regulatory system failed to adapt to important, dynamic, and potentially lethal new financial instruments as the storm clouds gathered.

The list of failures goes well beyond the Securities and Exchange Commission, but today I want to focus my remarks on that agency.

In doing so, let me stress that there is not one individual action or decision made by the SEC that deserves to be singled out for blame. It's how a series of decisions made and actions taken – and not taken – contributed to a market failure and then meltdown.

Remember that financial markets are not naturally occurring phenomena.

They are the creation of men and women, and as a result, for them to be "free," men and women must construct the rules and oversight necessary to give potential participants the confidence to enter these markets. They must lay down clear rules of the road that open the marketplace to all and that bring a high degree of transparency so investors of all sizes can get the information they need to make the best investment decisions with the confidence that information is not being selectively shared. And they must establish an entity to enforce these rules of the road rigorously, fairly, and swiftly.

Taken together, this independent regulation and strong regulatory enforcement create the trust that is a necessary precondition for a free and functioning market.

Let us not forget that regulation is not inconsistent with free markets and financial innovation. Strong regulation ensures that the system supports and fosters such innovation by ensuring that the financial system earns and sustains the trust of investors.

Right now, the key problem plaguing our markets is a total breakdown in that trust – in investor confidence.

Investors and lenders of all sizes and types have little faith in the information they have been given. Little faith in the gatekeepers tasked with protecting their investments. And little faith in the regulators to hold anyone accountable for misusing those funds.

That is why $7 trillion in market capitalization has been wiped out; why investors are cashing out of the markets entirely and effectively stuffing their cash in their mattresses; and why the credit markets have been crippled.

Since 1934, the SEC has played the role of the investor's advocate in our markets…the guarantor, if you will, of investor confidence.

Created in a crisis similar to what we are now experiencing, the SEC was founded precisely to start rebuilding the trust lost in the Crash of 1929. Congress believed that the financial markets needed a specialized agency, with clear enforcement powers, to insist on full disclosure of all material information, and most of all, to end the loopholes that frustrated the ability of the states and the stock exchanges to enforce rules designed to prevent fraud, market manipulation, and insider trading.

For most of its nearly 75 year history, a strong SEC – staffed by consummate professionals and led by independent-minded commissioners – has succeeded in restoring investor confidence and helping making our markets the envy of the world.

Consider the numbers: in 1930, 1.2 percent of the population owned stock; in 2008, the number was a little more than 30 percent – and tens of millions more indirectly invest in our securities markets through retirement accounts and mutual funds.

Unhappily, over the past few years, the SEC has not lived up to this storied history.

As the markets grew larger and more complex – in scope and in products offered – the Commission failed to keep pace. As the markets needed more transparency, the SEC allowed opacity to reign. As an overheated market needed a strong referee to rein in dangerously risky behavior, the Commission too often remained on the sidelines.

As this Committee examines the past, I believe it will find a lack of transparency, a lack of enforcement, and a lack of resources all played key roles.

Lack of Transparency

Being able to gather and understand relevant information about a company's financial health and performance is critical to the proper functioning of the markets. If people believe the numbers, they will believe that their investments will be made by their best judgment.

If they do not, they will not invest.

That's why transparency is so important to restoring trust and why we need to dedicate ourselves to a decade of transparency – improving transparency to win back investor trust.

Looking back, transparency was certainly lacking with respect to the off-balance sheet transactions involving Structured Investment Vehicles, the latest version of the Special Purpose Entities used by Enron to mask its true performance and risks.

In the text of Sarbanes-Oxley, Congress rightfully asked the SEC to study the issue and work with the FASB to fix this shortcoming in transparency. Unfortunately, they did not, and these accounting methods were used once again to mask the financial health of many companies. Financial firms were not transparent to shareholders. These vehicles must be brought on the balance sheet immediately.

Fannie Mae and Freddie Mac also engaged in creative accounting making it appear they had capital that just did not exist. At the time of the government takeover, for instance, Freddie Mac had $34.3 billion of paper losses on mortgage-related securities that it did not count toward its calculations of capital requirements; and Fannie Mae had $11.2 billion of such losses. Fannie and Freddie were not regulated by the SEC, but by a regulator who lacked adequate supervisory and enforcement authority and the results were clear.

Even today, we do not know the full extent of the losses from these risky investments; as a result, a lack of information about where risk resides is keeping investors suspicious and out of the markets.

One of the biggest steps we can take to bring to light a fuller picture of companies' financial health would be to expand fair-value accounting to cover all of the financial instruments -- the securities positions and loan commitments -- of all financial institutions. Fair value accounting has been called for by the United States Comptroller, the head of the GAO, the Chairman of the Federal Reserve, and the CEOs of every major American accounting firm since after the savings and loan crisis. Such action has been implemented at a dangerously slow pace.

In recent weeks fair-value accounting has been used as a scapegoat by the banking industry – the financial equivalent of shooting the messenger. If financial institutions were accurately marking their books, they would have seen the problems they are experiencing months in advance and could have made the necessary adjustments – and we could have avoided the current crisis.

Instead, we are still left in the dark as to the full extent of the damage.

The IMF and Bridgewater Associates have pegged the losses from those risky investments to be approximately $1.4 to $1.6 trillion. Yet according to one estimate, less than half of these losses have been reported in financial statements provided to investors.

And as another measure of how unrealistic these balance sheets are, recall the latest deal for Wachovia. Its book value – assets minus liabilities – was reported to the public at $75 billion. Yet, it was bought by Wells Fargo for $15.4 billion, a discrepancy of $60 billion dollars. That's a huge disparity that mirrors the size of the credibility gap in financial reporting. Until holes like this in financial reporting are filled, investors will not return to the markets.

A lack of transparency has also hurt the market for credit derivatives, a market that grew to over $62 trillion in value but with only $6 trillion in actual loans.

Credit default swaps themselves are not bad; in fact, they serve an important purpose as hedges for bondholders. But when they are abused by those who don't own bonds and who use rumor and innuendo to affect the market, serious problems occur that reverberate throughout the system. Indeed, regulators and investors alike have been unable to get their arms around the magnitude of the risks this market has created for companies and investors alike – and this lack of information has now paralyzed the economy.

In response, we need to bring this market into the sunlight. It's time that the SEC is given the authority to establish regulation of credit derivatives including giving the regulator

the necessary authority to enhance the transparency of the disclosures and markets for these transactions.

Likewise, there must be greatly improved disclosures for credit derivatives including disclosure of notional amounts, a roll forward of notional amounts as well as fair values of the derivatives, the terms and conditions that can result in a call for collateral, the weighted average duration of such contracts, and information regarding the counter-party risk involved.

In addition, we should demand the disclosure of key indicators of future performance, especially those that can have an effect on liquidity and capital, by public companies – a move backed by the major international accounting firms.

Lack of Oversight

As the markets grew more complex, there also was a failure of oversight to keep up with growing and risky parts of it.

After the Supreme Court's 2007 ruling in the *Stoneridge* case, the SEC could – and should – have pushed Congress to establish third-party liability in cases where knowing, fraudulent conduct has occurred and destroys trust in the capital markets. Yet, they did not. Instead, investors were left with the sense that they could be taken advantage of with impunity.

In 2005, the banking and securities regulators recognized the risks inherent in the credit derivatives market when they convened a meeting of institutions and regulators at which they expressed concerns about the market, trading, and lack of internal controls. Yet the credit derivatives market remains unregulated today with enormous risks.

In 2004, the SEC adopted new CSE rules, in part due to a lack of authority granted by Congress, to revise the supervision and capital requirements for investment bank holding companies.

The program – a voluntary regulatory program for our largest and most complex investment banks – was, in the words of Chairman Cox, "fundamentally flawed."

And as the report of the SEC's Inspector General detailed, it appears that in at least one instance -- the case of Bear Stearns – the SEC failed to act on the many red flags that showed the bank taking on unacceptable and unrealistic levels of risk. There was, simply, a fundamental breakdown in oversight – one that allowed the collapse of companies representing more than 40 percent of the CSE's original membership

This program has been shut down, but the Congress should give the SEC enhanced authority to regulate investment banks as well as the credit rating agencies. And any

question regarding the authority of the SEC to regulate hedge funds should be resolved quickly through appropriate legislation.

In addition, the SEC also has failed to empower investors with what they need to hold managers and boards accountable.

Because of purposeful action and inaction, American shareholders do not have access to the proxy or a say on pay. These boards represent the shareholders. These executives work for the owners of the company, the shareholders. And with a carefully designed system to prevent abuse, there is no reason why shareholders should not be able to hold directors and managers accountable.

Mutual fund investors also have been left with boards of directors who are not suitably independent.

And millions of Americans have their retirements through their pensions invested in hedge funds – many of which are not regulated at all.

To regain investor confidence, timely action must be taken on each of these matters. The Senate should adopt legislation on say on pay, as the House has, and the SEC should adopt proxy access and rules governing regulation of hedge funds as well as the independence of mutual fund boards.

Finally, based on my own experiences with an investigation of the City of San Diego, I believe Congress should repeal the Tower Amendment, giving the SEC the same oversight responsibility and authority over municipal markets it has over the stock markets.

The capitalization of these markets now runs into the trillions of dollars, face many of the same risks faced by other markets, and as we have seen from a number of SEC enforcement actions this decade, are subject to the same abuses as other capital markets.

Simply put, they are too important to leave unregulated. If we do, we risk yet another crisis.

Lack of Enforcement

The last area where we have seen a deviation from decades of SEC history, tragically, has been the enforcement of the laws on the books.

In part, this is the result of a lack of adequate resources. Budget and staffing levels have not kept pace with inflation or financial innovation.

The Enforcement division is slated in FY 2009 to be more than 11 percent smaller than it was in 2005 – a little more than the percentage decrease in total SEC staff.

This critical part of the SEC also has been unnecessarily hamstrung in negotiating corporate penalties because of recent procedural changes at the Commission. The result has been a lessening of the imposition of corporate penalties against egregious wrongdoers, a reduction in the corporate penalty numbers over the past year, and a demoralizing of the enforcement staff undermining their efficacy.

To remedy these deficiencies, we – at the very least – need to return the SEC to previous staffing and resource levels. To that end, an increase in appropriations of $85 million would be a good starting point.

And in choosing future commissioners, priority should be given to individuals identified with investor interests rather the traditional choices of securities lawyers, exchange chairmen, and academics. Investors need a seat at the table.

Restoring Trust

Resources alone will neither reinvigorate the SEC nor revive our markets.

Enforcement is so important not because the SEC can catch every cheat and prevent every abuse.

It's important because it holds people accountable and serves as a powerful deterrent to bad behavior – and is the most powerful tool a regulator has to keep a market functioning.

Indeed, the signals the SEC can send to investors are critical. By bringing a tough enforcement action, making a well-timed public statement, or taking action on a critical need, the SEC builds the investors' confidence that someone is looking out for them which, in turn, builds market trust.

Yet at critical moments and on critical issues, the SEC has been reactive at best or has shown no real willingness to stand up for investors.

And it's these moments that weaken the power of the agency and investors' faith in the markets.

What regulators quickly learn is that more important than any rule that can be written, regulation that can be passed, or standard that can be set is the power of the bully pulpit.

For the past 75 years, the SEC has been the crown jewel of the financial regulatory infrastructure and the administrative agencies because its leadership, representing both

political parties – like Kennedy and Douglas at the SEC's founding, and Ruder, Breeden, and Donaldson in recent times – understood the importance of public pronouncements and signals sent to the marketplace.

They recognized the important role the SEC plays in maintaining investor confidence and in keeping our markets functioning. And they knew that being present and active often was the reassurance that investors needed.

Looking forward, restoring trust in our markets will require rejuvenating the SEC. It is the only agency with the history, experience, and specific mission to be the investor's advocate.

Losing that legacy would be devastating to our ability to regulate the markets and restore investor confidence.

But let me be clear: a restoration of the SEC to its position from before this current slide is not enough. At this moment, we need a dramatic rethinking of our financial regulatory architecture – the biggest since the New Deal.

The markets and the financial system have profoundly changed, and that will undoubtedly mean the SEC will need to undergo changes and evolve to keep pace with the marketplace.

But as we move forward in the process, we must make sure that there is an agency that is independent of the White House, dedicated to mandating transparency with robust law enforcement powers and with wherewithal and knowledge to oversee and if necessary guide risk management, and built around one mission: protecting the interests of investors.

For 75 years, that agency has been the SEC, and I believe that if we restore that legacy to the SEC and modernize it for today's markets, investors will know that they have someone in their corner, that the markets will be free and fair, and that they will invest with confidence.

And once that trust is restored, I believe that we will come through this crisis – as we have come through many other market crises in the past – with markets that are stronger and more robust and with an economy that benefits from them and benefits us all.

Thank you.