Ranking Member Spencer Bachus (AL) Opening Statement at the Hearing on â€œHedge Funds and Systemic Risk in the Financial Marketsâ€•

March 13, 2007

Thank you, Chairman Frank, for calling this hearing today to review hedge funds and their role in the financial markets.

It is important for this Committee to gain a better understanding of hedge funds and other alternative investment vehicles. The hedge fund industry has seen tremendous growth in the last nine years. There are more than 9000 hedge funds today. Since 1999, hedge fund assets under management have grown by more than 400%, totaling approximately $1.4 trillion. Last year, the 100 largest hedge fund firms had combined assets representing about 65% of the industry total. Hedge funds are also generating an increasing share of trading volume. Some experts estimate they may represent up to 50% of trading in certain circumstances.

The strategies employed by hedge fund managers vary significantly, although many hedge against downturns in the markets. The primary goal of most hedge funds is to reduce volatility and risk and simultaneously provide liquidity, preserve capital and deliver positive returns under all market conditions. Hedge funds use complex and sophisticated strategies to achieve their investment goals.

Ever since the implosion of Long-Term Capital Management in 1998 – which required a bail-out orchestrated by the Federal Reserve, Treasury Department, and other regulatory bodies – the subject of the systemic risk posed by the operations of large hedge funds has been a concern of financial regulators, and rightly so. Systemic risk is not theoretical, and if not properly contained and managed, could threaten the stability and soundness of our financial markets. There is always the potential for a single event, such as massive losses at a large, complex financial institution, to trigger a cascading effect that could impact the broader financial markets, and ultimately, the global economy.

For this reason, last month’s announcement by the President’s Working Group on Financial Markets of “Principles and Guidelines on Private Pools of Capital” is a welcome development. The President’s Working Group appropriately focused on systemic risk and investor protection. Private pools of capital are sophisticated investments used by sophisticated market participants. And I am confident that these market participants understand they must engage in constant due diligence and an ongoing evaluation of market exposure and risk created by their relationships with hedge funds. I applaud Secretary Paulson, Chairman Cox, and the other regulators who developed this guidance, which relies upon market discipline and sound risk management techniques – rather than the heavy hand of government regulation – to achieve the desired objective.

An overly prescriptive, rules-based approach to regulating these private pools of capital could stifle innovation, and drive hedge funds and their capital offshore. Such an approach would hardly benefit the competitive standing of our capital markets.

The Committee has assembled a distinguished panel of experts for today’s hearing, and I look forward to their testimony.

# # #