Opening Statement of Ranking Member Spencer Bachus, Full Committee Hearing on "Systemic Risk: Examining Regulators' Ability to React to Threats in the Financial System"

October 2, 2007

Mr. Chairman, thank you for calling this morning’s hearing to review systemic risk to our financial system and how regulators and market participants should manage that risk.

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, complex financial institutions 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 massive losses at a single financial institution to trigger a cascading effect that could impact the broader financial markets, and ultimately, the global economy.

The recent instability we have seen in global capital markets -- arising primarily out of problems in subprime mortgage lending in the U.S. – has renewed concerns about systemic risk. These concerns were underscored by the collapse of large hedge funds operated by Bear Stearns and Goldman Sachs in August, and reports that other highly leveraged hedge funds had suffered substantial losses from investments in residential mortgage-backed securities. The fact that hedge funds and other lightly regulated private pools of capital operate under a less stringent disclosure regime than banks and other regulated entities helped fuel some of the panic we saw in the markets over the summer. This relative lack of transparency complicates the task of identifying and mitigating the types of losses at individual firms that could give rise to systemic risk.

While the financial contagion that many predicted when credit markets first began experiencing disruptions two months ago has not materialized, that is certainly no cause for complacency on the part of either regulators or market participants. For hedge fund investors and counter-parties, the challenge is to demand a level of financial transparency and market discipline that allows for a meaningful assessment of the risks involved in the complex trading strategies employed by many funds. As for financial regulators, they must insist that the institutions they oversee are well-capitalized and have the risk management systems in place to weather financial shocks and severe market downturns.

At the same time, regulators must avoid the type of heavy-handed market intervention that could stifle innovation and actually harm those investors -- including public employee and private pension funds – who have enjoyed strong returns from their investments in hedge funds in recent years. Finally, given the global nature of our financial markets, U.S. regulators must work closely with their international counterparts to promote cooperation – not competition – among regulatory bodies, and ensure that information about potential systemic risks is shared promptly.

Let me close by again thanking Chairman Frank for his continued attention to this issue, and by welcoming our distinguished panel of witnesses to today’s hearing. We look forward to hearing your insights on this very important subject.