Opening Statement of Ranking Member Bachus, Full Committee Hearing on Systemic Risk and the Financial Markets, July 10, 2008

July 10, 2008

Mr. Chairman, thank you for holding this hearing on systemic risk and appropriate regulatory responses to managing that risk. The two public servants who appear before us today are eminently qualified to speak to these issues, and we welcome Secretary Paulson and Chairman Bernanke back to the Committee.

They head agencies whose mandates and responsibilities are broad and deep, but the issue of systemic risk also requires the involvement of other significant and capable regulators, including particularly the SEC and Federal banking regulators. It is my expectation that the leaders of these agencies will appear at a subsequent hearing where their comments will supplement our understanding of this difficult issue. I trust Secretary Paulson and Chairman Bernanke agree that a collaborative effort that includes these agencies will be needed to achieve a successful outcome.

To say that we are living through interesting times in our financial markets is to state the painfully obvious. We have seen a run on what was then the nation’s fifth-largest investment bank, Bear Stearns. We have seen the Federal Reserve intervene in order to avoid a cascading effect from Bear Stearns’ collapse that could have spread throughout the financial system with decidedly negative implications for the larger economy. And we have seen the Federal Reserve take a series of other steps that – in the short-term at least – have brought a measure of confidence and stability to financial markets.

Now that the immediate crisis created by the run on Bear Stearns has passed, we face some difficult long-term policy questions.

Perhaps, the most critical question is, have we arrived at a place where virtually every primary dealer is considered “too big or too interconnected to fail?”

The logical extension of this “too big to fail” perception is that markets no longer work and that government must not only exercise greater control of our capital markets, but also be the ultimate guarantor of financial solvency. That would be a conclusion I could not endorse. A far better alternative is to restore market discipline within appropriate regulatory bounds.

I believe we have reached a consensus that we must establish a modern regulatory structure to strengthen the safety and soundness of our institutions and discourage financially unsound practices and conduct. However these regulations should not and cannot ensure that institutions will never fail.

And if one does fail, we must ensure that taxpayers are not left holding the bag. Thanks to the fast action of the Federal Reserve in cooperation with the SEC and Treasury we dodged a bullet when Bear Stearns collapsed. We may not be so lucky next time. For that reason, I look forward to hearing from today’s witnesses about what we can do to provide for an orderly resolution in the event a large financial institution fails.

The regulatory regime we establish must accomplish three things: ensure market discipline, provide a shock absorber against systemic risk, and first and foremost protect the taxpayer.

To preserve market discipline and discourage moral hazard, we must see to it that no firm should be considered too big or interconnected to fail.

To protect against systemic risk, we must ensure that when a firm fails, it does not bring down the entire financial system with it.

And to protect the taxpayer, we have to make sure that the costs of that failure are borne by the firm’s shareholders and creditors, and not passed on to the taxpaying public.

Of necessity, we have to plan for how to handle the failure of a major institution. It is important, however, that we create a system focused not on failure but on success. In doing so, we must also resist the temptation to over-regulate in our zeal to discourage practices such as over-leveraging and excessive risk taking that put institutions at risk of failure. This is a tall order.

Thank you again for holding this hearing and thanks to Secretary Paulson and Chairman Bernanke for being with us today. We look forward to your testimony.

# # #