Opening Statement of Ranking Member Spencer Bachus Full Committee Hearing on "Systemic Risk and the Financial Markets"

July 24, 2008

Mr. Chairman, thank you for holding this second hearing on the issue of systemic risk. Today, we are joined by two regulators who have been at the center of the government's response to the recent turmoil in our financial markets. We welcome them both to the Committee and look forward to hearing their perspectives.

Mr. Chairman, before we can begin a serious discussion of greater government involvement in our capital markets, we need to have a clear understanding of exactly where we are and how we got here.

We need to know how we arrived at a system in which the issuers of credit default swaps are allowed to provide guarantees that so far exceed their capital reserves that there is virtually no possibility they can pay in the event of defaults of the underlying obligations.

We need to know why our regulators have allowed credit default swaps to remain essentially unregulated while they became intertwined in transactions throughout our economy.

In light of the Bear Stearns episode, we need to know whether the SEC's current approach to the supervision of investment banks and their holding companies is sufficient to prevent further melt-downs in that sector of our financial services industry.

And perhaps most critically of all, we need to know how we ended up with a financial system in which almost every primary dealer is considered "too big or interconnected to fail."

If we accept this premise - that every primary dealer is "too big to fail" - then we also have to conclude that our financial markets are no longer capable of self regulation and that government must exercise greater control, both as a regulator and as a lender - if not a buyer - of last resort. As I indicated at our first hearing on this subject two weeks ago, that is a conclusion that I am not prepared to accept.

A far better approach is one that restores market discipline and discourages moral hazard. Unfortunately, the Bear Stearns rescue and recent proposals to invest taxpayer dollars in the debt and equity of the housing GSEs send a different signal to the market - that taxpayers can always be counted on to indemnify risk-taking that reaches levels sufficient to place the entire financial system in jeopardy.

What we ultimately need is to ensure that our regulators maintain a framework in which individual firms can fail while the system continues to function. We need to ensure that our firms strike the right balance between risk and leverage. Capital and credit must continue to flow to where they are most needed, but our financial institutions should not be taking outsize risks that will require repeated government interventions to save the system from recurring crises.

Chairman Cox, you have taken significant steps to protect the integrity of our capital markets during turbulent times. One of your most important initiatives has been to help make sure investors have access to accurate and reliable information. In this regard, your credit rating agency reforms, your firm stance against the spreading of false information, and your emergency order to curb abusive short selling practices in the securities of the 17 primary dealers and Fannie Mae and Freddie Mac were welcome developments. On July 15, the SEC also noted that it will undertake a rulemaking to address these issues across the entire market and I look forward to working with Commission to ensure that a rulemaking recognizes the legitimate role of short selling but does not eliminate liquidity from the capital markets.

Mr. Chairman, thank you again for holding this hearing, and thanks to Chairman Cox and Mr. Geithner for being with us today. We look forward to your testimony.

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