"Where Were the Watchdogs:
Systemic Risk and the Breakdown of Financial Governance"
Homeland Security and Governmental Affairs Committee
Chairman Joseph Lieberman
March 4, 2009

Good morning and welcome to our hearing today, the second in our series examining the structure of our nation's financial regulatory system in the aftermath of its obvious failure to protect us from the economic crisis we are experiencing now.

We are undertaking this series of hearings pursuant to the Committee's traditional "Governmental Affairs" mission. Under Senate rules, this Committee has responsibility for the "Organization and reorganization of the executive branch of the Government," as well as for the study of "the efficiency, economy, and effectiveness of all agencies and departments of the Government." By examining what changes should be made to improve and modernize the organization of the federal financial regulatory system, we are not only fulfilling these responsibilities but we hope to be preparing ourselves to make

recommendations to our colleagues on the Senate Banking Committee. We see our unique role here as reaching a judgment about the structures not so much the day to day regulation.

And as we learned from our last hearing on this subject, our nation's outdated and fragmented system of financial regulation is especially ill-suited to handle risks that occur across many different types of institutions, markets, and activities.

Today's hearing will examine the pros and cons of creating a systemic risk regulator for the financial services industry – and by "systemic risk", I mean the risk that a failed institution, a risky activity or a particular event could broadly affect the financial system rather than just one institution or one activity.

As we concentrate our efforts toward recovering from the greatest financial crisis since the Great Depression, we cannot ignore the fact that there is no one government agency or market participant responsible for monitoring systemic risks to the integrity of our entire financial system.

This bears repeating. In our current financial regulatory structure, there is no agency, board, or overseer responsible for regulating the entirety of our financial system - across instruments, markets, and geographical borders - asking questions and engineering solutions to prevent systemic risks from becoming systemic financial failures.

That is a very unsettling fact.

Many experts believe this gap should be bridged by creation of a "systemic risk regulator" who would supervise the financial system holistically. Federal Reserve Chairman Ben Bernanke has referred to this entity as a "macro-prudential" regulator.

Part of the reason our current watch dogs failed is because each has just a piece of the system to oversee. What we need is a watchdog with a universal perspective, a complete picture of the variety of institutions and activities that pose the greatest risks to our economy.

For as long as there have been markets, there have been speculative bubbles and resulting financial crises. But through sensible regulation I do believe we can improve the ability of our financial

system to prevent and withstand severe shocks, reduce vulnerability to extreme crises, and limit the damage to our economy when a crisis occurs.

As always, the devil is in the details – and it is those details that we hope to illuminate today.

If we determine that we need a governmental agency focused on the issue of systemic risk, we must then figure out how to design such an entity. Can the role of monitoring and responding to systemic risks be accomplished within our existing regulatory structure, or should Congress create a new body to act as systemic risk regulator? What would be the responsibilities of this body? What tools would it need to meet those responsibilities? And what would its relationship be with other regulators?

At today's hearing we have a panel of witnesses who have thought constructively about these issues. Dr. Robert Litan, of the Kauffman Foundation, Damon Silvers, a member of the TARP Congressional Oversight Panel, and Robert Pozen, Chairman of MFS Management, a

well respected financial manager. Among other things, we have asked these distinguished gentlemen to consider whether a systemic regulator is necessary and, if so, what sorts of risks, activities, and institutions should come within its purview, and what authorities such a regulator would require.

We cannot expect the creation of a systemic regulator to be a universal remedy for all that ails our financial services industry today.

First, we must enact sensible regulation for day to day supervision of all our financial institutions so that a systemic regulator would have a sensible structure to oversee.

Given our current situation, it is fair to say that the cost of a systemic meltdown is far greater than the cost of reasonable and prudent regulation. So, I will ask our witnesses whether they believe our future economic growthdepends on the creation of a systemic risk regulator, and, if so, where in our government would it work best.

Senator Collins?