JOINT ECONOMIC COMMITTEE
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Opening Statement of Sen. Charles E. Schumer
Chairman, Joint Economic Committee
Hearing: *"From Wall Street To Main Street, Can Troubling Financial System Risks Be Limited By Government Regulation?"*
May 14, 2008

I want to thank you, Chairman Volcker, as well the other witnesses who will join us on the second panel, for coming to this hearing today about the financial system, and the steps we need to take to reform our regulatory structures.

I'm worried that, because things do not seem as bad as they were a month or so ago, we're already starting to become complacent about the critical need to address the regulatory and market failures that have had much to do with the troubling economic situation we find ourselves in.

The past year has been a stark reminder of the direct link between Wall Street and Main Street, between the health of the financial markets and the economic well-being of all Americans.

A year ago, most of us had never heard of CDO's and CMO's and SIV's, of option ARM's and credit default swaps and auction rate securities. Now, we know that those who knew about these complex financial instruments clearly didn't know enough to protect consumers, investors, and our economy from them. And we've learned too much about the central role these financial tools have played in the worst housing crisis since the Great Depression, the freezing of credit markets worldwide, and the onset of our current recession.

Financial innovation is vital, both for the health of our financial system and our economy, but it is just as vital that financial regulation keep up with innovation. It has not.

In my view, this credit crisis is as much a failure of regulation as it is a failure of the marketplace. The goal of regulation should always be to encourage entrepreneurial vigor while ensuring the health of the financial system. We found that balance in the past, but it seems to have been lost. We have a 21st century **global** financial system, but a 20th century **national** set of financial regulations. That needs to change soon.

To begin, we need to acknowledge that consolidation has transformed the financial industry. We no longer have the clear distinctions between commercial banks, investment banks, broker-dealers and insurers that we did sixty years ago, or even twenty years ago. Instead, there are a large number of financial institutions surrounded by many smaller institutions – such as hedge funds and private equity funds – with their own specialties. It's as though we have a handful of large financial Jupiters that are becoming more and more similar encircled by numerous small asteroids. Our regulatory structure has to recognize that change. As large investment banks have come to act more and more like commercial banks -- especially now that they can borrow from the Fed's discount window -- then they need to be supervised more strictly.

We need to think very seriously about moving towards more unified regulation, if not a single regulator. We have too many regulators, each watching a different part of the financial system, while no one keeps an eye on the greater threats of systemic risk. In the U.K., they have a single, strong regulator who has responsibility for the entire system and the authority to act when necessary. Maybe a regulator with that authority could have prevented a debacle like the collapse of Bear Stearns by acting quickly and forcefully before things began to unravel.

We must figure out how to regulate the currently unregulated parts of financial markets. **For example, credit default swaps are a multi-trillion dollar industry almost completely outside the purview of regulators.** Recently, there's has been talk about creating a clearinghouse for credit default swaps. I think this an excellent idea, and the sort of innovation we should be thinking about more broadly. I also believe we need to think about whether a unique exchange for these swaps might be an even more effective way to bring about greater transparency and limit systemic risk.

We must have greater transparency in the financial system. The credit crunch has been as much a crisis of confidence as it has been a real economic crisis. Financial markets operate on trust, on the belief participants have that they can rely on the people they are entering into contracts with. As long as so many black holes remain in the financial system, it will be hard for that trust to be restored.

We must involve our international partners. National regulations can only achieve so much in a global financial market. It does us no good to enact new rules if other countries remain lax in their regulations or their enforcement. **The global financial regulatory system should not be the arithmetical equivalent of the lowest common denominator.** This crisis and the complexity of our system requires much more.

And finally, we must put aside the 'laissez-faire', no government is good government, mantra that we hear from this administration and the other side of the aisle. The market does not solve all problems by itself and neither does the government. That's why we need firm, forward looking regulation, to prevent the sort of crises we're facing now from recurring in the future.

I share with Treasury Secretary Paulson and Chairman Bernanke the hope that the worst of the credit crisis is behind us. But I am not convinced that it is over. **Whatever calm has been brought to financial markets today has been the result largely of extraordinary actions taken by the Federal Reserve.** Chairman Bernanke deserves credit, but the actions he has had to take are sign of just how unprecedented, and how troubling, this credit crisis has been.

We cannot sit back, relax and hope for the best. The American people, our economy and the global financial system cannot afford it.