JOINT ECONOMIC COMMITTEE
SENATOR CHARLES E. SCHUMER, CHAIRMAN
REPRESENTATIVE CAROLYN B. MALONEY, VICE CHAIR

Statement of Carolyn Maloney, Vice Chair
Joint Economic Committee Hearing
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Good morning. I would like to thank Chairman Schumer for holding this hearing to examine the risks in the U.S. financial system and potential solutions. I want to welcome former Chairman Volcker and our other witnesses and thank you all for your testimony today.

At the core of the ongoing liquidity crisis is the decline in home prices, which is causing banks to readjust their balance sheets and to build up capital. Congress is currently focusing its attention on keeping families in their homes and stemming the deepening decline in home prices.

The crisis in the housing market has brought to light the inability of our most sophisticated and respected institutions to measure their exposure to opaque assets and manage the risks associated with them. Detangling the DNA of assets has become increasingly difficult for investors. We clearly need greater transparency for complex investment products to assure smoothly functioning markets.

Our entire regulatory system is also in serious need of renovation because financial innovation has surpassed our ability to protect consumers and hold institutions accountable. In our rather fragmented system, financial regulators do not have authority to broadly address systemic risk.

The Financial Services Committee will soon turn its attention to rethinking financial services regulation. Meanwhile, the Treasury Secretary has a sweeping proposal for revising the federal regulation of all financial institutions. That plan would grant the Federal Reserve power to serve as an overarching “market stability” regulator, with the ability to collect information and require corrective action across the broad spectrum of financial services.

Our current system of multiple regulators leaves big holes that a “super regulator” could plug. For example, the unwillingness up to this point of the Federal Reserve and the S.E.C. to require working capital limits has been criticized as exacerbating risk-taking. Only now has the S.E.C. joined other federal regulators in working with the Basel Committee to extend the capital adequacy standards to deal explicitly with liquidity risk.

The Bear Stearns rescue also exposed the lack of federal regulatory authority to supervise investment bank holding companies with bank affiliates, as the Fed supervises commercial bank holding companies. Thus, investment bank holding companies don’t have to maintain liquidity on a consolidated basis.

In the wake of the Bear Stearns debacle, S.E.C. Chairman Cox has said that investment banks can no longer operate outside on a statutory consolidated supervision regime. Giving investment banks access to the Fed’s discount window, which was created for depository institutions, creates

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problems since they are not regulated like depository institutions. In particular, they have no restrictions on how highly leveraged they can be.

We need reform, but the Treasury plan is so sweeping that it risks being disruptive while we are working hard to stabilize our economy. Moreover, it risks eliminating regulatory voices that should be heard. The American system of government relies on checks and balances, and we can all think of instances when the lone voice of the multiple federal regulators has pushed the group to an action that was unpopular but proved to be right.

We should focus first on targeted reforms with maximum effect. Improving the transparency and accountability of trading in credit default swaps and derivatives is an example. A key factor that apparently pushed the Fed to rescue Bear Stearns was concerns about a domino effect from the interlocking relationships between thousands of investors and banks over credit default swaps, which are presently traded by investment banks off any exchange and without any transparency. Requiring the use of exchanges and clearing houses for credit default swaps and derivatives is worth exploring.

Mr. Chairman, thank you for holding this hearing and I look forward to our witnesses views on correcting the imbalances in our financial markets.

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