U.S. Senate Committee on Banking, Housing, and Urban Affairs

U.S. SENATOR RICHARD C. SHELBY, AL, RANKING MEMBER

EMBARGOED UNTIL BEGINNING OF HEARING

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OPENING STATEMENT OF SENATOR RICHARD C. SHELBY
"Turmoil in U.S. Credit Markets: Examining the Recent Actions of Federal Financial Regulators"
4-3-08

"Thank you, Mr. Chairman, for calling today's hearing. The collapse of Bear Stearns and the unprecedented regulatory response led by the Federal Reserve call for a thorough examination by this Committee."

"In deciding to commit $29 billion to help finance JP Morgan Chase's take-over of Bear Stearns, the Fed has set a new precedent on the type of response the Federal government may provide during financial panics. It may be that the Fed's actions were warranted by the unique financial conditions prevailing in our markets. However, such policy decisions must be fully considered by this Committee. After all, the ultimate responsibility for financial regulation rests with this Committee and the Congress."

"In examining the events of the past few weeks, we must certainly be mindful that regulators and market participants had to make prompt decisions using available tools in the midst of a financial storm. This will not be the last time we face financial upheavals in our history, however. It would be unwise if we did not take this opportunity to thoroughly examine what transpired, including how Bear Stearns was regulated, what caused its collapse, whether any other institutions face similar risks, and if there are any shortcomings in our regulatory structure."

"Two aspects of the Fed's response deserve particular attention. First, for the first time since at least the Great Depression, the Fed has funded a bailout of an investment bank. Previously, assistance by the Fed had been extended to only FDIC-insured depository institutions. By expanding the Federal safety net to an institution not supported by an explicit Federal guarantee, the Fed's actions may create expectations that any major financial institution experiencing difficulties is eligible for a Federal bailout. We must guard against creating a moral hazard that encourages firms to take excessive risks based on expectations that they will reap all the profits, while the Federal government stands ready to cover any losses."

"A second point of concern is the legal authority for the Fed's actions. The financial assistance extended by the Federal Reserve was provided under the Federal Reserve's emergency lending authority, which allows the Fed to lend to any entity, not just banks, in ‘unusual and exigent circumstances’ with the approval of 5 members of the Board of Governors. This unilateral regulatory authority is in sharp contrast to the regulatory scheme set forth under FDICIA for bank failures involving systemic risk, which includes roles for the FDIC, the Fed, the Treasury Secretary, and the President.”

“The Fed’s recent actions may have been warranted. Nonetheless, the Committee needs to address whether the Fed, or any set of policymakers, should have such broad emergency authority going forward. If the evolution of our markets leads to the Federal safety net being extended to non-banks, attention should be given to ensure that the proper decision-making process and safeguards are in place.”

“I look forward to exploring these and other issues with our witnesses today. Thank you, Mr. Chairman.”

- 30 -