OPENING STATEMENT OF SENATOR RICHARD C. SHELBY
Hearing on "Establishing a Framework for Systemic Risk Regulation"
July 23, 2009

"Thank you, Mr. Chairman.

"At the core of the Administration's financial regulatory reform proposal is the concept of systemic risk. The President believes that it can be regulated and that the Fed should be the regulator. As we begin to consider how to address systemic risk, my main concern is that while there appears to be a growing consensus on the need for a systemic risk regulator, there is no agreement on how to define systemic risk, let alone how to manage it.

"I believe that it would be legislative malfeasance to simply tell a particular regulator to manage all financial risks without having reached some consensus on what systemic risk is and whether it can be regulated at all. Should we reach such a consensus, we then must be very careful not to give our markets a false sense of security that could actually exacerbate our 'too big to fail' problem. If market participants believe that they no longer have to closely monitor risks presented by financial institutions, the stage will be set for our next economic crisis.

"If we can decide what systemic risk is and that it is something that should and can be regulated, our next question should be: who should regulate it? Unfortunately, the Administration's proposal largely places the Federal Reserve in charge of regulating systemic risk. It would grant the Fed authority to regulate any bank, securities firm, insurer, investment fund or any other type of financial institution that the Fed deems a systemic risk. The Fed would be able to regulate any aspect of these firms, even over the objections of other regulators. In effect, the Fed would become a regulatory leviathan of unprecedented size and scope.

"I believe that expanding the Fed's powers in this manner could be very dangerous. The mixing of monetary policy and bank regulation has proven to be a formula for taxpayer-funded bailouts and poor monetary policy decisions. Giving the Fed ultimate responsibility for the regulation of systemically important firms will provide further incentive for the Fed to hide its regulatory failures by bailing out troubled firms. Rather than undertaking the politically painful task of resolving failed institutions, the Fed could take the easy way out and rescue them by using its lender-of-last-resort facilities or open market operations. Even worse, it could undertake these bailouts without having to obtain the approval of Congress.

"In our system of government, elected-officials should make decisions about fiscal policy and the use of taxpayer dollars, not un-elected central bankers. Handing over the public purse to an enhanced Fed is simply inconsistent with the principles of democratic government.

“Augmenting the Federal Reserve’s authority also risks burdening it with more responsibility than one institution can reasonably be expected to handle. In fact, the Federal Reserve is already overburdened with its responsibility for monetary policy, the payment system, consumer protection, and bank supervision. I believe anointing the Fed as the systemic risk regulator will make what has proven to be a bad bank regulator even worse.

“Let us not forget that it was the Fed that pushed for the adoption of the flawed Basel II capital accords, which would have drained our banking system of capital. It was the Fed that failed to adequately supervise Citigroup and Bank of America, setting the stage for bailouts in excess of $400 billion. It was the Fed that failed to adopt mortgage underwriting guidelines until well after this crisis was underway. It was the Fed that said there was no need to regulate derivatives.

“It was also the Fed that lobbied to become the regulator of financial holding companies as part of Gramm-Leach-Bliley. The Fed won that fight and got the additional authority it sought. Ten years later, however, it is clear that the Fed has proven that it is incapable of handling that responsibility.

“Ultimately, if we are able to reach some sort of agreement on systemic risk and whether it can be managed, I strongly believe that we should consider every possible alternative to the Fed as the systemic risk regulator.

“Thank you, Mr. Chairman.”