THE FINANCIAL CRISIS AND THE ROLE OF FEDERAL REGULATORS

HEARING

BEFORE THE

COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM

HOUSE OF REPRESENTATIVES

ONE HUNDRED TENTH CONGRESS

SECOND SESSION

OCTOBER 23, 2008

Serial No. 110–209

Printed for the use of the Committee on Oversight and Government Reform

Available via the World Wide Web: http://www.gpoaccess.gov/congress/index.html
http://www.house.gov/reform

U.S. GOVERNMENT PRINTING OFFICE

55–764 PDF WASHINGTON : 2010

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
Fax: (202) 512–2104 Mail: Stop IDCC, Washington, DC 20402–0001

COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM

HENRY A. WAXMAN, California, *Chairman*

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THE FINANCIAL CRISIS AND THE ROLE OF FEDERAL REGULATORS

THURSDAY, OCTOBER 23, 2008

HOUSE OF REPRESENTATIVES,
COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM,
Washington, DC.

The committee met, pursuant to notice, at 10 a.m., in room 2154, Rayburn House Office Building, Hon. Henry A. Waxman (chairman of the committee) presiding.

Present: Representatives Waxman, Maloney, Cummings, Kucinich, Tierney, Watson, Lynch, Yarmuth, Norton, McCollum, Cooper, Van Hollen, Hodes, Murphy, Sarbanes, Davis of Virginia, Shays, Mica, Souder, Platts, Issa, Bilbray, and Sali.

Staff present: Phil Barnett, staff director and chief counsel; Kristin Amerling, general counsel; Stacia Cardille, counsel; David Rapallo, chief investigative counsel; Theo Chuang and John Williams, deputy chief investigative counsels; Roger Sherman, deputy chief counsel; Margaret Daum, counsel; David Leviss, senior investigative counsel; Karen Lightfoot, communications director and senior policy advisor; Caren Auchman, communications associate; Daniel Davis, professional staff member; Zhongrui Deng, chief information officer; Rob Cobbs, Mitch Smiley, and Jennifer Owens, special assistants; Brian Cohen, senior investigator and policy advisor; Earley Green, chief clerk; Jennifer Berenholz, assistant clerk; Leneal Scott, information systems manager; Larry Halloran, minority staff director; Jennifer Safavian, minority chief counsel for oversight and investigations; Brien Beattie, Molly Boyl, Benjamin Chance, and Alex Cooper, minority professional staff members; John Cuaderes, Nick Palarino, and Larry Brady, minority senior investigators and policy advisors; Adam Fromm and Todd Greenwood, minority professional staff members; Patrick Lyden, parliamentarian and Member services coordinator; and Brian McNicoll, minority communications director.

Chairman WAXMAN. The committee will please come to order.

Today is our fourth hearing into the ongoing financial crisis. Our previous three hearings focused on the private sector. Our first hearing examined the bankruptcy of Lehman Brothers. We learned that this investment bank failed after it made highly leveraged investments that plummeted in value.

Our second hearing examined the fall of AIG. We learned that this huge insurance company was brought to the brink of bankruptcy by speculation in unregulated derivatives called credit default swaps.

Our third hearing, which we held yesterday, examined the role of credit rating agencies. We learned that these firms sacrificed their rating standards—and their credibility—for short-term gains in sales volumes.

Each of these case studies is different, but they share common themes. In each case, corporate excess and greed enriched company executives at enormous cost to shareholders and our economy. In each case, these abuses could have been prevented if Federal regulators had paid more attention and intervened with responsible regulations.

This brings us to today's hearing. Our focus today is the actions and inaction of Federal regulators. For too long, the prevailing attitude in Washington has been that the market always knows best. The Federal Reserve had the authority to stop the irresponsible lending practices that fueled the subprime mortgage market, but it's long-time chairman, Alan Greenspan, rejected pleas that he intervene. The SEC had the authority to insist on tighter standards for credit rating agencies, but it did nothing, despite urging from Congress.

The Treasury Department could have led the charge for responsible oversight of financial derivatives. Instead, it joined the opposition. The list of regulatory mistakes and misjudgments is long, and the cost to taxpayers and our economy is staggering.

The SEC relaxed leverage standards on Wall Street, the Offices of Thrift Supervision and the Comptroller of the Currency preempted State efforts to protect home buyers from predatory lending. The Justice Department slashed its efforts to prosecute white-collar fraud.

Congress is not exempt from responsibility. We passed legislation in 2000 that exempted financial derivatives from regulation, and we took too long, until earlier this year, to pass legislation strengthening oversight of Fannie Mae and Freddie Mac.

Over and over again, ideology trumped governance. Our regulators became enablers rather than enforcers. Their trust in the wisdom of the markets was infinite. The mantra became government regulation is wrong, the market is infallible.

Our focus today is financial regulation, but this deregulatory philosophy spreads across government. It explains why lead got into our children's toys and why evacuees from Hurricane Katrina were housed in trailers fail filled with formaldehyde.

Today we will ask our witnesses hard questions about the regulatory decisions they made and they failed to make, but I want them to know I value their public service and their cooperation with the committee. Our committee house stayed busy in recent weeks, as we have held hearings on the financial crisis, and I want all the Members to know how much I appreciate their involvement in these hearings.

It's not easy to travel to Washington when Congress is out of session, especially with an election looming. But the issues we are examining are of immense importance to our Nation, and I am proud of the work we are doing, and especially the contribution of members of the committee.

[The prepared statement of Hon. Henry A. Waxman follows:]

Opening Statement of Rep. Henry A. Waxman
Chairman, Committee on Oversight and Government Reform
The Financial Crisis and the Role of Federal Regulators
October 23, 2008

Today is our fourth hearing into the ongoing financial crisis.

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The SEC had the authority to insist on tighter standards for credit rating agencies. But it did nothing despite urgings from Congress.

The Treasury Department could have led the charge for responsible oversight of financial derivatives. Instead, it joined the opposition.

The list of regulatory mistakes and misjudgments is long, and the cost to taxpayers and our economy is staggering. The SEC relaxed leverage standards on Wall Street. The Offices of Thrift Supervision and the Comptroller of the Currency preempted state efforts to protect homebuyers from predatory lending. And the Justice Department slashed its efforts to prosecute white collar fraud.

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Chairman WAXMAN. Mr. Davis, I want to recognize you.

Mr. DAVIS OF VIRGINIA. Thank you, Mr. Chairman.

Let me just say yesterday I agreed with your opening statement and associated myself with it. Today I am in disagreement with much of what you have to say.

Of all the hearings we have had so far on the causes and effects of the economic crisis, I think today's testimony and discussion gives us the opportunity to talk for the first time about the systems and structures meant to maintain stability and root out abusive practices in financial markets.

I hope this distinguished panel will help us cut to the core of the financial problems we have encountered. At that core lies Fannie Mae and Freddie Mac: Government-sponsored enterprises that dominated the mortgage finance marketplace and gave quasi official sanction to the opaque, high-risk investments still radiating global toxic shock waves from the epicenter of their subprime sinkhole. By the way, these were areas where we did try to regulate in some on our side and were stopped from the other side of the aisle from bringing regulation in earlier.

Our earlier hearings have focused on important, but to be honest, somewhat tangential issues, a unique case bailout, a bankruptcy, flawed credit ratings, executive compensation, and the cost of corporate retreats. No one is minimizing or defending corporate malfeasance. We share the outrage of most Americans at the greed that blinded Wall Street to its civic duty to protect Main Street.

But this committee can take a broader view of the patchwork of Federal financial regulators built by accretion after each cyclical crisis and artificially subdivided behind Congress' jurisdictional walls. No single agency, by action or omission, caused this crisis, and no existing agency alone can repair the damage or prevent the next, some believable, inevitable, booming and bust.

It wasn't deregulation that allowed this crisis. It was the mishmash of regulations and regulators, each with too narrow a view of increasingly integrated national and global markets. The words "regulation" and "deregulation" are not absolute goods and evils, nor are they meaningful policy prescriptions. The dynamic structure of our markets has made creating an enduring regulatory system a perennial and bipartisan challenge.

After the 1933 commercial bank failures, the Glass-Steagall Act separated investment and commercial banking activities and established the Federal Deposit Insurance Corporation, restoring public confidence in the banking system.

But by 1999, the marketplace had outgrown these post-depression rules. The increasingly global market led the Congress and a Democratic president to adopt the Gramm-Leach-Bliley Act, repealing Glass-Steagall, and allowing commercial banks to diversify and underwrite in trade securities. That was not regulation for deregulation's sake. These activities were seen by many as actually reducing risk for banks through diversification, and allowing banks to compete in a rapidly globalizing marketplace.

When Enron and other scandals erupted earlier this decade, Congress respond with Sarbanes-Oxley, putting new regulations on public companies. The bipartisan Band-Aid approach to oversight and regulation continued.

In the past few years, the market, as it tends to do, changed again. New securities were created and traded and, once again, analog government was out of sync with the digital world.

While regulators pushed paper, the quants pushed electrons, moving money around the globe at the speed of light. Free markets are constantly evolving and innovating. Regulators by law, bureaucratic custom or just bad habit tend to remain static. Modernization to Federal regulatory structures have to take account of the new global dynamics to restore the transparency, confidence and critical checks and balances necessary to sustain us as a great economic power.

All of our witnesses today voiced some level of alarm about dangers to the total financial system posed by hyperactive subprime lending and its high yield, high-risk progeny, collateralized debt obligations, derivatives and other exotic and other unregulated mortgage backed instruments.

Some of those were intentionally designed to slip between existing regulatory definitions. Is a credit default swap an investment vehicle or insurance agreement? Should they be considered futures contracts regulated by the Commodities Future Trading Commission or securities under the purview of the SEC? Today's testimony should help us begin to answer these questions and describe the shape and scope of a modern, flexible, digital regulatory structure for the future. We need smart regulation that aligns the incentives of consumers, lenders and borrowers to achieve stable and healthy markets based on transparency and good faith.

Mr. Greenspan, Mr. Snow, Mr. Cox, I hope you will give us your thoughts on the core issues that led to this crisis, and, more importantly, your ideas on a framework for the lean but supple regulatory approach that can defect, and hopefully protect, the irrational exuberance, over-the-top risk taking and consequent collapse that inflicts such damage to our economic life.

In this political season, the search for villains is understandable, and, in some respects, healthy.

While we are at it, we might ask ourselves why the Congress didn't convene these hearings last March when market turbulence first turned toxics. There's plenty of blame to go around as we try to unravel the wildly complex tangle of people, private companies, government agencies and market forces that is choking modern capitalism.

We have all played a part in this crisis, and, hopefully, we have all learned invaluable lessons. But retribution needs to be tempered by wisdom. There's an apocryphal tale by about the great American industrialist, Andrew Carnegie, that I think explains why. It seems one of his lawyers made a mistake in drafting a contract that cost Carnegie $100,000. When he was asked why he didn't fire the attorney, Carnegie replied, "Well, I just spend $100,000 training him."

Well, we are learning some expensive lessons and hopefully will put them to good use.

Thank you, Mr. Chairman.

Chairman WAXMAN. Mr. Davis——

Mr. MICA. Mr. Chairman, I have a unanimous consent request.

Chairman WAXMAN. The gentleman will state his unanimous consent request.

Mr. MICA. Mr. Chairman, I would like to submit for the record, and also distribute to the Members, a copy of a letter which is signed by myself, in fact, all Members that are here today, on our side of the aisle, and other leaders in Congress, requesting the attorney general of the United States appoint a general counsel, a special prosecutor. As you recall——

Chairman WAXMAN. The unanimous consent is to put the document into the record?

Mr. MICA. Yes. If you recall, during the hearing——

Chairman WAXMAN. Over the objection—is there any objection, because you are not recognized for a speech.

The unanimous consent request——

Mr. MICA. Well, I just wanted to explain that this hearing is being hijacked.

Chairman WAXMAN. Well, there is objection, and the gentleman is no longer recognized.

Mr. MICA. Coverage before——

Chairman WAXMAN. We have before us now——

Mr. MICA. Fannie Mae and Freddie Mac. After next week.

Chairman WAXMAN. The gentleman will cease his comments so we can go ahead with our hearing.

Mr. MICA. Thank you for allowing me to successfully put that thought.

Chairman WAXMAN. We are pleased to welcome for our hearing today three very distinguished witnesses. Alan Greenspan, former chairman of the Federal Reserve Board, Dr. Greenspan served as chairman of the Board of Governors of the Federal Reserve system for 18 years.

Under President Ford, Dr. Greenspan was the chairman of the President's Council of Economic Advisors. He also served as chairman of the National Commission on Social Security reform and the Economic Policy Advisory Board under President Reagan. He currently serves as president of Greenspan Associates, LLC.

Christopher Cox, chairman of the Securities and Exchange Commission, Mr. Cox is currently the chairman of the Securities and Exchange Commission. He was sworn in on August 3, 2005. Mr. Cox was a Member of Congress for 17 years, serving in the majority leadership of the U.S. House of Representatives. Under President Reagan he served as a senior associate counsel in the White House.

John Snow, former Secretary of the Treasury. Mr. Snow is the former Secretary of the Treasury under President Bush. Mr. Snow served for 3 years in that position and worked closely with the White House on a broad portfolio of economic policy issues. Prior to becoming Treasury Secretary, Mr. Snow served as chairman and CEO of CSX Corp. Mr. Snow also served at the Department of Transportation during both the Nixon and Ford administrations.

We are pleased to welcome the three of you today. Your testimony will be in the record in its entirety. It is the practice of this committee that all witnesses testify before us do so under oath. So I would like to request the three of you please to stand and raise your right hands.

[Witnesses sworn.]

Chairman WAXMAN. The record will indicate that each of the witnesses answered in the affirmative.

We are here today in this hearing to hear from you and to be able to question you. I want to thank each of you for coming, because you have an enormous amount to contribute to our understanding of the financial mess that we are in now, and to give us our ideas of where we go for the future.

As I said, your prepared statements were going to be in the record in full.

I am going to recognize each of you. We ordinarily ask that oral presentations be no more than 5 minutes. We will keep a clock, but we will not enforce that 5 minutes rigorously, but we do want that clock to be there to inform you that the green light is on for 4 minutes, the orange light means there's 1 minute left. When the red light is on, the 5 minutes has expired.

If you are mindful of that fact, you might then contemplate winding down, but we will not interrupt any of the witnesses' presentations because what you have to say is so very important, and you are the only three witnesses we have for today's hearing.

Dr. Greenspan, we want to start with you. There's a button on the base the mic. You are not inexperienced in testifying before Congress, so I will recognize you to proceed as you see fit.

Mr. GREENSPAN. Thank you very much, Mr. Chairman.

Chairman WAXMAN. Pull the microphone a little closer to you.

STATEMENTS OF ALAN GREENSPAN, FORMER CHAIRMAN OF THE FEDERAL RESERVE BOARD; CHRISTOPHER COX, CHAIRMAN OF THE SECURITIES AND EXCHANGE COMMISSION; AND JOHN SNOW, FORMER SECRETARY OF THE TREASURY

STATEMENT OF ALAN GREENSPAN

Mr. GREENSPAN. Thank you very much, Mr. Chairman. I appreciate having an extra few minutes, because I will run slightly over. I will try to do it as expeditiously as possible.

Mr. Chairman, Ranking Member Davis and members of the committee, thank you for this opportunity to testify.

Mr. SHAYS. Could you just put the mic a little closer, Mr. Greenspan. Thank you, that will help.

Mr. GREENSPAN. Thank you for this opportunity to testify before you this morning. We are in the midst of a once in a century credit tsunami. Central banks and governments are being required to take unprecedented measures. You, importantly, represent those on whose behalf represent economic policy is made, those who are feeling the brunt of the crisis in their workplaces and homes. I hope to address those concerns today.

This morning, I would like to provide my views on the sources of the crisis, what policies can best address the financial crisis going forward and how I expect the economy to perform in the near and long term. I also want to discuss how my thinking has evolved and what I have learned this past year.

In 2005, I raised concerns that the protracted period of underpricing of risk, if history was any guide, would have dire consequences. The crisis, however, has turned out to be much broader than anything I could have imagined. It has morphed from one grip by liquidity restraints to one in which fears of insolvency are now paramount.

Given the financial damage to date, I cannot see how we can avoid a significant rise in layoffs and unemployment. Fearful American households are attempting to adjust as best they can to a rapid contraction in credit availability, threats to retirement funds and increased job insecurity.

All of this implies a marked retrenchment of consumer spending, as households try to divert an increasing part of their incomes to replenish depleted assets, not only in 401(k)'s, but in the value of their homes as well. Indeed, a necessary condition for this crisis to end is the stabilization of home prices in the United States. They will stabilize and clarify the level of equity in U.S. homes, the ultimate collateral support for the value of much of the world's mortgage-backed securities.

At a minimum, stabilization of home prices is still many months in the future. When it arrives, the market freeze should begin to measurably thaw, and frightened investors will take tentative steps toward reengagement with risk. Broken market ties among banks, pension and hedge funds, and all types of nonfinancial businesses, will become reestablished, and our complex global economy will move forward.

Between then and now, however, to avoid severe retrenchment, banks and other financial intermediaries will need the support that only the substitution of sovereign credit for private credit can bestow. The $700 billion Troubled Assets Relief Program is adequate to serve that need. Indeed, the impact is already being felt. Yield spreads are narrowing.

As I wrote last March, those of us who have looked to the self-interest of lending institutions to protect shareholders equity, myself especially, are in a state of shocked disbelief. Such counterparty surveillance is a central pillar of our financial markets state of balance.

If it fails, as occurred this year, market stability is undermined.

What went wrong with global economic policies that had worked so effectively for nearly four decades? The breakdown has been most apparent in the securitization of home mortgages. The evidence strongly suggests that without the excess demand from securitizers, subprime mortgage originations, undeniably the original source of the crisis, would have been far smaller and defaults, accordingly, far fewer.

But subprime mortgages, pooled and sold as securities, became subject to explosive demand from investors around the world. These mortgage-backed securities, being subprime, were originally offered at what appeared to be exceptionally high risk-adjusted market interest rates. But with the U.S. home prices still rising, delinquency and foreclosure rates were deceptively modest. Losses were minimal. To the most sophisticated investors in the world, they were wrongly viewed as a steal.

The consequent surge in global demand for U.S. subprime securities by banks, hedge and pension funds, supported by unrealistically positive rating designations by credit agencies, was, in my judgment, the core of the problem. Demand became so aggressive that too many securitizers and lenders believed they were able to create and sell mortgage-backed securities so quickly, that they never put their shareholders' capital at risk, and, hence, did not have the incentive to evaluate the credit quality of what they were selling.

Pressures on lenders to supply more paper collapsed subprime underwriting standards from 2005 forward. Uncritical acceptance of credit ratings by purchasers of these toxic assets has led to huge losses.

It was the failure to properly price such risky assets that precipitated the crisis. In recent decades, a vast risk management and pricing system has evolved, combining the best insights with mathematicians and finance experts, supported by major advances in computer and communications technology.

A Nobel Prize was awarded for discovery of the pricing model that underpins much of the advance in derivatives markets. This modern risk management paradigm held sway for decades. The whole intellectual edifice, however, collapsed in the summer of last year, because the data inputted into the risk management models generally covered only the past two decades, a period of euphoria.

Instead, the model has been fitted more appropriately to historic periods of stress, capital requirements would have been much higher, and the financial world would be in far better shape today, in my judgment.

When, in August 2007, markets eventually trashed the credit agencies rosy ratings, a blanket of uncertainty descended on the community. Doubt was indiscriminately cast on pricing of securities that had any taint of subprime backlog—backing.

As much as I would have preferred otherwise, in this financial environment I see no choice but to require that all securitizers retain a meaningful part of the securities they issue. This will offset, in part, market deficiencies stemming from the failures of counterparty surveillance.

There are additional regulatory changes at this breakdown of the central pillar of competitive markets requires in order to return to stability, particularly, in the areas of fraud, settlement and securitization.

It is important to remember, however, that whatever regulatory changes are made, they will pale in comparison to the exchange already evident in today's markets. Those markets for an indefinite future will be far more restrained than with any currently contemplated new regulatory regime.

The financial landscape that will greet the end of the crisis will be far different from the one that entered it little more than a year ago. Investors, chastened, will be exceptionally cautious. Structured investment vehicles, Alt-A mortgages, and a myriad of other exotic financial instruments are not now, and are unlikely to ever find willing buyers.

Regrettably, also on that list are subprime mortgages, the market for which has virtually disappeared. Home and small business ownership are vital commitments to a community. We should thus seek ways to reestablish a more sustainable subprime mortgage market. This crisis will pass, and America will reemerge with a far sounder financial system.

Thank you, Mr. Chairman.

Chairman WAXMAN. Thank you very much, Dr. Greenspan.

[The prepared statement of Mr. Greenspan follows:]

Testimony of Dr. Alan Greenspan
Committee of Government Oversight and Reform
October 23, 2008
Word Count: 1,133

Mr. Chairman and Members of the Committee:

Thank you for this opportunity to testify before you this morning.

We are in the midst of a once-in-a century credit tsunami. Central banks and governments are being required to take unprecedented measures. You, importantly, represent those on whose behalf economic policy is made, those who are feeling the brunt of the crisis in their workplaces and homes. I hope to address their concerns today.

This morning, I would like to provide my views on the sources of the crisis, what policies can best address the financial crisis going forward, and how I expect the economy to perform in the near and longer term. I also want discuss how my thinking has evolved and what I have learned in this past year.

In 2005, I raised concerns that the protracted period of underpricing of risk, if history was any guide, would have dire consequences. This crisis, however, has turned out to be much broader than anything I could have imagined. It has morphed from one gripped by liquidity restraints to one in which fears of insolvency are now paramount. Given the financial damage to date, I cannot see how we can avoid a significant rise in layoffs and unemployment. Fearful American households are attempting to adjust, as best they can, to a rapid contraction in credit availability, threats to retirement funds, and increased job insecurity. All of this implies a marked retrenchment of consumer spending as households try to divert an increasing part of their incomes to replenish depleted assets, not only in 401Ks, but in the value of their homes as well. Indeed, a necessary condition for this crisis to end is a stabilization of home prices in the U.S. They will stabilize and clarify the level of equity in U.S. homes, the ultimate collateral support for the value of much of the world's mortgage-backed securities. At a minimum, stabilization of home prices is still many months in the future. But when it arrives, the market freeze should begin to measurably thaw and frightened investors will take tentative steps towards reengagement with risk. Broken market ties among banks, pension, and hedge funds and all types of nonfinancial businesses will become reestablished and our complex global economy will move forward. Between then and now, however, to avoid severe retrenchment, banks and other financial intermediaries will need the support that only the substitution of sovereign credit for private credit can bestow. The $700 billion Troubled Assets Relief Program is adequate to serve that need. Indeed the impact is already being felt. Yield spreads are narrowing.

As I wrote last March: those of us who have looked to the self-interest of lending institutions to protect shareholder's equity (myself especially) are in a state of shocked disbelief. Such counterparty surveillance is a central pillar of our financial markets' state of balance. If it fails, as occurred this year, market stability is undermined.

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It was the failure to properly price such risky assets that precipitated the crisis. In recent decades, a vast risk management and pricing system has evolved, combining the best insights of mathematicians and finance experts supported by major advances in computer and communications technology. A Nobel Prize was awarded for the discovery of the pricing model that underpins much of the advance in derivates markets. This modern risk management paradigm held sway for decades. The whole intellectual edifice, however, collapsed in the summer of last year because the data inputted into the risk management models generally covered only the past two decades, a period of euphoria. Had instead the models been fitted more appropriately to historic periods of stress, capital requirements would have been much higher and the financial world would be in far better shape today, in my judgment.

When in August 2007 markets eventually trashed the credit agencies' rosy ratings, a blanket of uncertainty descended on the investment community. Doubt was indiscriminately cast on the pricing of securities that had *any* taint of subprime backing. As much as I would prefer it otherwise, in this financial environment I see no choice but to require that all securitizers retain a meaningful part of the securities they issue. This will offset in part market deficiencies stemming from the failures of counterparty surveillance.

There are additional regulatory changes that this breakdown of the central pillar of competitive markets requires in order to return to stability, particularly in the areas of fraud, settlement, and securitization. It is important to remember, however, that whatever regulatory changes are made, they will pale in comparison to the change already evident in today's markets. Those markets for an indefinite future will be far *more* restrained than would any currently contemplated new regulatory regime.

The financial landscape that will greet the end of the crisis will be far different from the one that entered it little more than a year ago. Investors, chastened, will be exceptionally cautious. Structured investment vehicles, Alt-A mortgages, and a myriad of other exotic financial instruments are not now, and are unlikely to ever find willing investors. Regrettably, also on that list are subprime mortgages, the market for which has virtually disappeared. Home and small business ownership are vital commitments to a community. We should seek ways to reestablish a more sustainable subprime mortgage market.

This crisis will pass, and America will reemerge with a far sounder financial system.

Chairman WAXMAN. Mr. Cox.

STATEMENT OF CHRISTOPHER COX

Mr. COX. Thank you, Chairman Waxman, Ranking Member Davis and members of the committee for inviting me to discuss the lessons from the credit crisis and the lessons for the future of Federal regulation.

I am pleased to join with former Chairman Greenspan and with former Secretary Snow, who, together, have given more than 30 years in service to their country.

Chairman WAXMAN. Will you pull the mic a little closer. Thanks.

Mr. COX. The SEC's place in the regulatory structure is, of course, different than the Federal Reserve and the Treasury.

The SEC sets the rules for disclosure of material information by public companies. We set the rules for the securities exchanges and the broker dealers, who trade on those exchanges, and, above all, the SEC is a law enforcement agency.

The lessons of the credit crisis all point to the need for a strong SEC, which is unique in its arms-length relationship to Wall Street.

The genesis of the current crisis, as this committee has highlighted in recent hearings, was the deterioration of mortgage origination standards. As the SEC's former chief accountant testified at one of your earlier hearings, if honest lending practices had been followed, much of this crisis, quite simply, would not have occurred.

The packaging of risky mortgages into complex structured securities with AAA ratings spread the risks into the securities markets, and what significantly amplified this crisis around the globe was the parallel market in credit default swaps, which is completely unregulated. Credit default swaps multiplied the risk of the failure of bad mortgages by orders of magnitude. And they ensured that when housing prices collapsed, the effects cascaded throughout the financial system.

Like each of you, I have asked myself what I would do differently with the benefit of hindsight. There are several things.

First, I think that every regulator wishes that he or she had been able to predict the unprecedented meltdown of the entire U.S. mortgage market which was the fundamental cause of this crisis. Second, although I was not at the SEC in 2004 when the voluntary Consolidated Supervised Entities Program was unanimously adopted by the Commission, knowing what I know now I would have wanted to question every one of the program's assumptions from the start.

In particular, I would have wanted to question its reliance on the widely used Basel standards for commercial banks and the Federal Reserve's 10 percent well-capitalized standard for bank holding companies. Those standards, as we have seen, proved insufficient for commercial banks as well.

Third, knowing what I know now, I would have urged Congress to pass legislation to repeal the credit default swaps loophole in the Commodity Futures Modernization Act. Last month, I formally asked Congress to fill this regulatory gap, and I urged this committee to join in this effort, which cannot wait until next year.

Fourth, I would have been even more aggressive in urging legislation to require stronger disclosure to investors in municipal securities. Individual investors account for nearly two-thirds of this multi trillion dollar market, and yet neither the SEC, nor any Federal regulator, has the authority to insist on full disclosure. Most importantly, we have learned that voluntary regulation of financial conglomerates does not work. Neither the SEC nor any regulator has the statutory authority to regulate investment bank holding companies, except on a voluntary basis, and that must be fixed.

The current crisis has also highlighted what does work, in particular, the SEC's regulation of broker dealers and its protection of their customers. So in strengthening the role of the SEC, Congress should build on that 74-year tradition, as well on the agency's strong law enforcement and its public company disclosure regime that provides transparency for investors.

Finally, we have learned that for regulators to make accurate predictions requires a comprehensive picture of capital flows, liquidity and risks throughout the system. But coordination among regulators, which is so important, is enormously difficult in the current Balkanized regulatory system.

Here, the organization of Congress itself is part of the problem. Legislative jurisdiction is split so that banking, insurance and securities fall within the province of the House Financial Services Committee, and the Senate Banking Committee, while futures fall under the Agriculture Committees in both the House and the Senate. This long-running turf battle is one of the reasons that credit default swaps aren't regulated.

But the Congress has overcome these jurisdictional divides before in urgent circumstances with the appointment of a select committee. As soon as possible, Congress should appoint a select committee on financial services regulatory reform, that includes representatives from all the affected jurisdictions.

As you know, I chaired such a committee for 2 years after 9/11, following which the House created the permanent Homeland Security Committee.

A select committee could address these urgent questions from a comprehensive standpoint. It could tackle the challenge of merging the SEC and the CFTC, which I strongly support. This would bring futures within the same general framework that currently governs economically similar securities.

Mr. Chairman, these are some of the lessons learned during this crisis and some of the future opportunities, but just as important is dealing with the current emergency. The SEC is using our new authority, under the Credit Rating Agency Reform Act, to strengthen the ratings process. We have worked with the Financial Accounting Standards Board on off-balance sheet liabilities, fair-value standards in inactive markets and bank support for money market funds.

We have, required disclosures of short positions to the SEC and strengthened investor protections against naked short selling, and we are working to establish one or more central counterparties for credit default swaps. Our enforcement division has over 50 subprime investigations underway, and we have mounted a nationwide investigation to potential fraud in the securities of the some of the Nation's largest financial institutions.

This past year, the SEC brought the largest number of insider trading cases in the agency's history and the second highest number of cases overall. And our recently announced preliminary settlements with some of the largest financial institutions on Wall Street will return $50 billion to investors in auction-rate securities. These will be, by far, the largest settlements in the SEC's histories.

Mr. Chairman, the role of the SEC has never been more important. I am humbled to work side by side with the dedicated men and women who fight each day for the protection of America's investors in our markets. Thank you for the opportunity to discuss the role of the SEC and the lessons from the current crisis. I will be happy to take your questions.

Chairman WAXMAN. Thank you very much, Mr. Cox. We will have questions for you, all three of you, after all of you have testified.

[The prepared statement of Mr. Cox follows:]

TESTIMONY
OF

CHRISTOPHER COX
CHAIRMAN
U.S. SECURITIES AND EXCHANGE COMMISSION

CONCERNING
THE ROLE OF FEDERAL REGULATORS: LESSONS FROM THE CREDIT CRISIS FOR THE FUTURE OF REGULATION

BEFORE THE
COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM

U.S. HOUSE OF REPRESENTATIVES

OCTOBER 23, 2008

U.S. Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549

Testimony Concerning the Role of Federal Regulators: Lessons from the Credit Crisis for the Future of Regulation

by Chairman Christopher Cox
U.S. Securities and Exchange Commission

Before the Committee on Oversight and Government Reform
United States House of Representatives

Thursday, October 23, 2008

Chairman Waxman, Ranking Member Davis, and Members of the Committee, thank you for inviting me to discuss the lessons from the credit crisis and how what we have learned can help the Congress shape the future of federal regulation. I am pleased to appear here today with the distinguished former Chairman of the Federal Reserve and the distinguished former Secretary of the Treasury, who together have given more than 25 years of service to our country. I should say at the outset that my testimony is on my own behalf as Chairman of the SEC, and does not necessarily represent the views of the Commission or individual Commissioners.

Introduction

To begin with, it will be helpful to describe the SEC's function in the current regulatory system, to better explain our role in the events we are discussing.

The SEC requires public companies to disclose to the public their financial statements and other information that investors can use to judge for themselves whether to buy, sell, or hold a particular security. Companies do this through annual and quarterly reports, as well as real-time announcements of unusual events. Administering this periodic reporting system has been a fundamental role of the SEC since its founding 74 years ago.

The SEC regulates the securities exchanges on which stocks, bonds, and other securities are traded. The SEC makes rules that govern trading on the exchanges, and also oversees the exchanges' own rules. The primary purpose of this regulation is to maintain fair dealing for the exchanges' customers and to protect against fraud.

The SEC also regulates the securities brokers and dealers who trade on the exchanges. Our authority to do this comes from the Securities Exchange Act, written in 1934. Although the law has been amended several times in the intervening 74 years, it lays out today essentially the same role for the SEC that the agency has always had in this area.

The agency's Investment Management Division regulates investment advisers, and also investment companies such as mutual funds, under statutes written in 1940.

Here, too, the SEC is concerned primarily with promoting the disclosure of important information, and protecting against fraud.

The Office of the Chief Accountant oversees the independent standard setting activities of the Financial Accounting Standards Board, to which the SEC has looked for accounting standards setting since 1973. It also serves as the principal liaison with the Public Company Accounting Oversight Board, established by the Sarbanes-Oxley Act to oversee the auditing profession.

Above all, the SEC is a law enforcement agency. Each year the SEC brings hundreds of civil enforcement actions for violation of the securities laws involving insider trading, accounting fraud, and providing false or misleading information about securities and the companies that issue them.

Some have tried to use the current credit crisis as an argument for replacing the SEC in a new system that relies more on supervision than on regulation and enforcement. That same recommendation was made before the credit crisis a year ago for a very different, and inconsistent, reason: that the U.S. was at risk of losing business to less-regulated markets. But what happened in the mortgage meltdown and the ensuing credit crisis demonstrates that where SEC regulation is strong and backed by statute, it is effective -- and that where it relies on voluntary compliance or simply has no jurisdiction at all, it is not.

The lessons of the credit crisis all point to the need for strong and effective regulation, but without major holes and gaps. They also highlight the need for a strong SEC, which is unique in its arm's-length independence from the institutions and persons it regulates.

If the SEC did not exist, Congress would have to create it. The SEC's mission is more important now than ever.

Genesis of the Current Crisis

That brings us to the issue of how the credit crisis came about. The answers are increasingly coming into sharper relief, and this Committee has been looking at several of the contributing causes.

Because the current credit market crisis began with the deterioration of mortgage origination standards, it could have been contained to banking and real estate, were our markets not so interconnected. But the seamlessness which characterizes today's markets saw financial institutions in every regulated sector suffer significant damage -- from investment banks such as Bear Stearns and Lehman Brothers, to commercial banks and thrifts such as Wachovia, Washington Mutual, and IndyMac, to the government-sponsored enterprises Fannie Mae and Freddie Mac, as well as the nation's largest insurance company, AIG. Every sector of the financial services industry has been vulnerable to the effects of this toxic mortgage contagion. And as the bank failures in

Europe and Asia have made clear, regulated enterprises around the world are susceptible as well.

It is abundantly clear, as the SEC's former Chief Accountant testified at this Committee's recent hearing on the failure of AIG, that "if honest lending practices had been followed, much of this crisis quite simply would not have occurred." The nearly complete collapse of lending standards by banks and other mortgage originators led to the creation of so much worthless or near-worthless mortgage paper that as of last month, banks had reported over one-half trillion dollars in losses on U.S. subprime mortgages and related exposure. This was typified by the notorious no down payment loans, and "no-doc" loans in which borrowers not only didn't have to disclose income or assets, but even employment wasn't verified.

Securitization of these bad loans was advertised as a way to diversify and thus reduce the risk. But in reality it spread the problem to the broader markets. When mortgage lending changed from originate-to-hold to originate-to-securitize, an important market discipline was lost. The lenders no longer had to worry about the future losses on the loans, because they had already cashed out. Fannie Mae and Freddie Mac, which got affordable housing credit for buying subprime securitized loans, became a magnet for the creation of enormous volumes of increasingly complex securities that repackaged these mortgages. (Fannie and Freddie together now hold more than half of the approximately $1 trillion in Alt-A mortgages outstanding.)

The credit rating agencies, which until late September 2007 were not regulated by statute, notoriously gave AAA ratings to these structured mortgage-backed securities. But that was not all: the ratings agencies sometimes helped to design these securities so they could qualify for higher ratings. These ratings not only gave false comfort to investors, but also skewed the computer risk models and regulatory capital computations. Both the risk models used by financial institutions and the capital standards used by banking and securities regulators had the credit ratings hard-wired into them.

All of this made financial institutions and the broader economy seriously vulnerable to a decline in housing prices. But the economy has been through real estate boom and bust cycles before. What amplified this crisis, and made it far more virulent and globally contagious, was the parallel market in credit derivatives. If the original cause of the mortgage crisis was too-easy credit and bad lending, the fuel for what has become a global credit crisis was credit default swaps.

Credit default swaps resemble insurance contracts on bonds and other assets that are meant to pay off if those assets default. Lenders who did not sell all of the loans they originated were able to buy relatively inexpensive protection against credit risks through credit default swaps. That further encouraged unsound lending practices and encouraged greater risk-taking. At the same time, credit default swaps became a way for banks, financial firms, hedge funds, and even Fannie Mae and Freddie Mac to hedge their risk – but in the process, to expose themselves to new risk from their often unknown counterparties.

By multiplying the risk from the failure of bad mortgages by orders of magnitude, credit default swaps ensured that when the housing market collapsed the effects would be felt throughout the financial system.

For example, as this Committee heard during your hearing on AIG, when mortgage-related securities fell in value, issuers of credit default swaps around the world were forced to post collateral against their positions. This led to increasingly large losses. Credit rating downgrades for such firms would then lead to further requirements for additional collateral, accelerating the downward spiral. Investors concerned about these firms' deepening problems fled from their stocks. In the case of financial institutions, the slumping stock price led to a loss of customer confidence, often precipitating customer withdrawals and "runs on the bank" that have been averted only with central bank guarantees and liquidity.

Lessons for the Future of Financial Services Regulation

There are important lessons to be learned from this experience -- for the SEC, and for the Congress. Like each of you, I have asked myself what I would have wanted to do differently, knowing what we all know now. There are several things.

First, I think every regulator wishes that he or she would have been able to predict before March of this year what we have recently seen not just in investment banks and commercial banks but the broader economy: the meltdown of the entire U.S. mortgage market, which was the fundamental cause of this crisis. I would want the agency's economists and experts to have seen in the gathering evidence what we now know was there, but what virtually no one saw clearly. Looking back, it is evident that even as the stock market reached its all-time high in October 2007, the deterioration in housing prices and the rise of credit spreads on mortgage backed securities were early signals of a trend that grew so quickly and so powerfully it would within months wipe out both Fannie Mae and Freddie Mac. But none of the investment banks, commercial banks, or their regulators in the U.S. or around the world in March 2008 used a risk scenario based on a total meltdown of the mortgage market. It clearly would have been prescient for the SEC to have done so.

Second, I would have wanted to question every one of the assumptions behind the Consolidated Supervised Entities program for investment bank holding companies. Although I was not at the SEC when the Commission unanimously approved the program in 2004, when I arrived at the SEC a year later this new program represented the best thinking of the agency's professional staff. Nonetheless, I would have wanted the Division of Trading and Markets to challenge its reliance on the Basel standards and the Federal Reserve's 10% well-capitalized test, for reasons including the fact that unlike commercial banks, investment banks didn't have access to Fed lending. That, as we have seen, can be a crucial distinction.

When the Commission wrote the rules establishing the CSE program in 2004, they chose to rely upon the internationally-accepted Basel standards for computing bank capital. They also adopted the Federal Reserve's standard of what constitutes a "well-capitalized" bank, and required the CSE firms to maintain capital in excess of this 10% ratio. Indeed, the CSE program went beyond the Fed's requirements in several respects, including adding a liquidity requirement, and requiring firms to compute their Basel capital 12 times a year, instead of the four times a year that the Fed requires.

Nonetheless, the rapid collapse of Bear Stearns during the week of March 10, 2008 challenged the fundamental assumptions behind the Basel standards and the other program metrics. At the time of its near-failure, Bear Stearns had a capital cushion well above what is required to meet supervisory standards calculated using the Basel framework and the Federal Reserve's "well-capitalized" standard for bank holding companies.

The fact that these standards did not provide adequate warning of the near-collapse of Bear Stearns, and indeed the fact that the Basel standards did not prevent the failure of many other banks and financial institutions, is now obvious. It was not so apparent before March of this year. Prior to that time, neither the CSE program nor any regulatory approach used by commercial or investment bank regulators in the U.S., or anywhere in the world, was based on the assumption that secured funding, even when backed by high-quality collateral, could become completely unavailable. Nor did regulators or firms use risk scenarios based on a total meltdown of the U.S. mortgage market. That is why, in March of this year, I formally requested that the Basel Committee address the inadequacy of the capital and liquidity standards in light of this experience. The SEC is helping to lead this revision of international standards through our work with the Basel Committee on Banking Supervision, the Senior Supervisors Group, the Financial Stability Forum, and the International Organization of Securities Commissions.

Third, both as SEC Chairman and as a Member of Congress, knowing what I know now, I would have wanted to work even more energetically with all of you to close the most dangerous regulatory gaps. I would have urged Congress to repeal the swaps loophole in the 2000 Commodity Futures Modernization Act. As you know, in this bipartisan law passed by a Republican Congress and signed by President Clinton, Congress specifically prohibited the Commission from regulating swaps in very precise language. Indeed, enacting this loophole eight years ago was a course urged upon us in Congress by no less than the SEC Chairman and the President's Working Group at the time. We now know full well the damage that this regulatory black hole has caused.

The unprecedented $85 billion government rescue of AIG, necessitated in substantial part by others' exposure to risk on its credit default swaps, is but one of several recent alarms. As significant as AIG's $440 billion in credit default swaps were, they represented only 0.8% of the $55 trillion in credit default swap exposure outstanding. That amount of unregulated financial transactions is more than the GDP of every nation on earth, combined. Last month, I formally asked the Congress to fill this regulatory gap, and I urge this Committee to join in that effort.

Fourth, I would have worked even more aggressively than I have over the last two years for legislation requiring stronger disclosure to investors in municipal securities. Now that the credit crisis has reached the state and local level, investors need to know what they own.

This multi-trillion dollar market entails many of the same risks and is subject to the same abuses as other parts of the capital markets. Individual investors own nearly two-thirds of municipal securities, directly or through funds, and yet neither the SEC nor any federal regulator has the authority to protect investors by insisting on full disclosure. The problems in Jefferson County, Alabama are only the most recent reminder of what can go wrong. The multi-billion dollar fraud in the City of San Diego, in which we charged five former City employees this past year, has injured investors and taxpayers alike. The economic slowdown will now make it even harder for many states and localities to meet their obligations. Many municipalities continue to use interest rate swaps in ways that expose them to the risk that the financial institution on the other side of the derivatives contract may fail.

That is why, repeatedly over the last two years, I have asked Congress to give the SEC the authority to bring municipal finance disclosure at least up to par with corporate disclosure. Knowing what we now know, I would have begun this campaign on my first day on the job.

Even more important than what I would have wanted to do differently in the past is what we can do together in the future to make sure that this astonishing harm to the economy is not repeated. The work that you are doing in this hearing and others like it this month is helping to build the foundation for the modernization of financial services regulation. What was formerly viewed as an opportunity for improvement sometime in the future has become absolutely essential now.

We have learned that voluntary regulation does not work. Whereas in 1999 the Chairman of the SEC could testify before the House on Gramm-Leach-Bliley that he "strongly supports the ability of U.S. broker-dealers to voluntarily subject their activities to supervision on a holding company basis," experience has taught that regulation must be mandatory, and it must be backed by statutory authority. It was a fateful mistake in the Gramm-Leach-Bliley Act that neither the SEC nor any regulator was given the statutory authority to regulate investment bank holding companies other than on a voluntary basis.

To fully understand why this is so begins with an appreciation for the enormous difference between an investment bank and an investment bank holding company. The holding company in the case of Lehman Brothers, for example, consisted of over 200 significant subsidiaries. The SEC was not the statutory regulator for 193 of them. There were over-the-counter derivatives businesses, trust companies, mortgage companies, and offshore banks, broker-dealers, and reinsurance companies. Each of these examples I have just described falls far outside of the SEC's regulatory jurisdiction. What Congress did give the SEC authority to regulate was the broker-dealers, investment companies, and investment adviser subsidiaries within these conglomerates.

When I ended the Consolidated Supervised Entities program earlier this year, it was in recognition of the fact that this short-lived experiment in reviewing the consolidated information for these vast global businesses that could opt in and out of the program did not work. Throughout its 74-year history, the SEC has done an outstanding job of regulating registered broker-dealers, and protecting their customers. The SEC's investor protection role has consistently been vindicated when financial institutions fail: for example, following the bankruptcies of Drexel Burnham Lambert and more recently Lehman Brothers, customers' cash and securities have been protected because they were segregated from the firms' other business. They have also been covered by insurance from the Securities Investor Protection Corporation.

But prior to the Federal Reserve's unprecedented decision to provide funding for the acquisition of Bear Stearns, neither the Fed, the SEC, nor any agency had as its mission the protection of the viability or profitability of a particular investment bank holding company. Indeed, it has been a fact of life in Wall Street's history that investment banks can and will fail. Wall Street is littered with the names of distinguished institutions -- E.F. Hutton, Drexel Burnham Lambert, Kidder Peabody, Salomon Brothers, Bankers Trust, to name just a few -- which placed big bets and lost, and as a result ended up either in bankruptcy or being sold to save themselves. Not only is it not a traditional mission of the SEC to regulate the safety and soundness of diversified financial conglomerates whose activities range far beyond the securities realm, but Congress has given this mission to no agency of government.

The lesson in this for legislators is threefold.

First, eliminate the current regulatory gap in which there is no statutory regulator for investment bank holding companies. This problem has been temporarily addressed by changes in the market, with the largest investment banks converting to bank holding companies, but it still needs to be addressed in the law.

Second, recognize each agency's core competencies. The mission of the SEC is investor protection, the maintenance of fair and orderly markets, and the facilitation of capital formation. In strengthening the role of the SEC, build on these traditional strengths -- law enforcement, public company disclosure, accounting and auditing, and the regulation of exchanges, broker-dealers, investment advisers, and other securities entities and products. The vitally important function of securities regulation is best executed by specialists with decades of tradition and experience.

Third, ensure that securities regulation and enforcement remain fiercely independent. This point bears emphasis. Strong securities regulation and enforcement requires an arm's-length relationship, and the SEC's sturdy independence from the firms and persons it regulates is unique. For example, banks regulated by the Federal Reserve Bank of New York elect six of the nine seats on the Board of the New York Fed; both the CEOs of J.P. Morgan Chase and Lehman Brothers served on the New York Fed board at the beginning of the credit crisis. In contrast, the SEC's regulation and enforcement is completely institutionally independent. Not only the current crisis, but the significant corporate scandals such as Enron and WorldCom earlier this decade, have amply demonstrated the need for such independent, strong securities regulation and enforcement. That is why an independent SEC will remain as important in the future as ever it has been before.

Communication and coordination among regulators serving distinct but equally important purposes must also be a priority for regulatory reform. During my Chairmanship, the SEC has initiated Memoranda of Understanding with the CFTC, the Federal Reserve, and the Department of Labor, and we are working on an agreement with the Department of the Treasury. The fact that these agreements are necessary highlights the importance of better information flows among regulators, to communicate meaningful information sooner. But instead of ad hoc arrangements, an overarching statutory scheme that anticipates and addresses these needs would represent fundamental improvement. Through the sharing of market surveillance information, position reporting, and current economic data, federal regulators could get a more comprehensive picture of capital flows, liquidity, and risk throughout the system.

There is another reason that a new, overarching statutory scheme is necessary. The current regulatory system is a hodge-podge of divided responsibility and regulatory seams. Coordination among regulators is enormously difficult in this fragmented arrangement, where each of them implements different statutes that treat various financial products and services differently. Today's balkanized regulatory system undermines the objectives of getting results and ensuring accountability.

The remarkably rapid pace of change in the global capital markets has also placed new importance on international coordination. American investors simply cannot be protected any longer without help from fellow regulators in other jurisdictions, because so much of the fraud directed at investors today is international in scope. In recent years the Commission has entered into law enforcement and regulatory cooperation agreements with securities regulators in Europe (including London, Paris, and Brussels), Ottawa, Hong Kong, Tokyo, Beijing, New Delhi, Mexico City, and elsewhere that promote collaboration, information sharing, and cross-border enforcement.

We have all witnessed over the past weeks the connections between financial markets around the world. The same phenomena affecting our markets are roiling markets abroad. Regulators in other countries are also under many of the same pressures as those of us here. While our existing cooperation agreements are helping to protect investors in the current circumstances, the new administration must open negotiations on a new global framework for regulations and standards.

Perhaps the most important change to the marketplace in recent years, from the standpoint of investor protection, is the enormous growth in financial products that exist wholly outside the regulatory system. We simply cannot leave unregulated such products as credit default swaps, which can be used as synthetic substitutes for regulated securities, and which can have profound and even manipulative effects on regulated markets. The risk is too great.

Across the board, other regulatory anomalies cry out for rationalization: outdated laws that treat broker-dealers dramatically differently from investment advisers, futures differently from economically equivalent securities, and derivatives as something other than investment vehicles or insurance. Now is the time to make sense of this confusing landscape. But doing so will require enormous leadership from the Congress.

There are two main reasons that our regulatory system has grown into the current dysfunctional patchwork, and one of them is traceable to the organization of Congress itself.

The first is that our laws are relatively ancient, at least from the standpoint of today's modern markets. They were crafted mainly in the 1930s and 40s. The speed of change in the financial marketplace has only accelerated the divergence of the legal framework and reality. Regulation has embroidered a semblance of modernity onto this outdated framework, but it has not been enough to keep up.

The second is that legislative jurisdiction in both the House and the Senate is split so that banking, insurance, and securities fall within the province of the Financial Services and Banking Committees, while futures fall within the domain of the Agriculture Committees in each chamber. This jurisdictional split threatens to forever stand in the way of rationalizing the regulation of these products and markets.

I know from experience how difficult it will be to challenge the jurisdictional status quo. But the Congress has overcome jurisdictional divides in urgent circumstances before. Appointing a Select Committee, with representation from each of the existing standing committees with responsibility for financial services regulation, is a model that has worked well. As you know, I chaired such a Committee for two years after 9-11, following which the House created the permanent Homeland Security Committee with oversight jurisdiction over the new Department of Homeland Security. A Select Committee on Financial Services Regulatory Reform could cut across the existing jurisdictional boundaries and address these urgent questions from a comprehensive standpoint.

As the Congress undertakes a top-to-bottom review and reassessment of the federal framework for regulation of our financial markets, we must not fall prey to the age-old response of fighting the last war. If we continue to do what we were doing, and just do more of it, we will undoubtedly repeat history. I remember working in the White House in 1987, helping to determine how to respond to a 25% drop in the markets in one day. I see the very real similarities to current events -- institutions borrowing short and lending long, housing bubbles in California and Florida, pressure to change accounting rules to give savings and loans time to right their balance sheets. The nation subsequently spent upwards of $150 billion to clean up the wreckage.

While the nation learned much in 1987, and Congress made some constructive changes in regulation, people and institutions too quickly fell back into old habits in old ways. We read now with disappointment the history of regulatory turf battles and missed opportunities, of old-fashioned greed and misguided economic incentives, of regulations that either failed or had unintended consequences.

It is time to think anew. We should begin with a clear-eyed view of the purpose of our capital markets. The financial system administered by Wall Street institutions exists to raise money for productive enterprise and millions of jobs throughout our economy, and to help put the savings of millions of Americans to work in our economy. It should not be an end in itself – a baroque cathedral of complexity dedicated to limitless compensation for itself in the short-term, paid for with long-term risk capable of threatening the entire nation's sustenance and growth. Transparency has been sorely lacking from enormous swaths of our market. It should by now be abundantly clear that risk in the system which cannot be clearly identified can neither be priced nor effectively disciplined by the market. And it can no longer be tolerated.

In redesigning the regulatory structure, we should also bear in mind the advantages of market forces over government decision-making in allocating scarce resources -- including capital -- throughout an economy as vast as America's, as well as what we can and cannot leave to the market alone. Government intervention, taxpayer assumption of risk, and short-term forestalling of failure must not be a permanent fixture of our financial system.

Addressing the Current Crisis

These are some of the regulatory lessons learned during this crisis, and some of the future opportunities. But just as important as reflecting on what could have been done in the past and what should be done in the future is actually dealing with the current emergency. While other federal and state agencies are legally responsible for regulating mortgage lending and the credit markets, the SEC has taken the following decisive actions to address the extraordinary challenges caused by the current credit crisis:

We have worked on a number of fronts to improve transparency, including using our new authority under the Credit Rating Agency Reform Act to expose weaknesses in the ratings process and to develop strong new rules.

We gave guidance on how financial institutions can give fuller disclosure to investors, particularly with respect to hard-to-value assets.

We have worked closely with the Financial Accounting Standards Board to deal with such issues as consolidation of off-balance sheet liabilities, the application of fair value standards to inactive markets, and the accounting treatment of bank support for money market funds.

We are in the midst of conducting a Congressionally-mandated 90-day study of the impacts of fair value accounting on financial firms in the current crisis.

We have initiated examinations of the effectiveness of broker-dealers' controls on preventing the spread of false information.

We have required disclosures of short positions to the SEC, complementing the existing requirements for reporting of long positions.

We have adopted a package of measures to strengthen investor protections against naked short selling, including rules requiring a hard T+3 close-out, eliminating the options market maker exception of Regulation SHO and expressly targeting fraud in short selling transactions.

We are working with firms in the private sector to speed the development of one or more central counterparties, clearance and settlement systems, and trading platforms for credit default swaps, as an operational step toward bringing this unregulated finance into the sunlight. This work is being closely coordinated with the CFTC and the Federal Reserve.

Beyond all of this, the SEC is first and foremost a law enforcement agency. During the market turmoil of the last several months, the professional men and women of the SEC have been working around the clock, seven days a week, to bring accountability to the marketplace and to see to it that the rules against fraud and unfair dealing are rigorously enforced.

In the fiscal year just ended, the SEC's Enforcement Division brought the second-highest number of cases in the agency's history. For the second year in a row, the Commission returned over $1 billion to injured investors. In the last few months, our Enforcement Division successfully negotiated agreements in principle to obtain $50 billion in immediate relief for investors in auction rate securities after these markets seized up. Every one of these cases, when finalized, will set a record for the largest settlements in the history of the SEC, by far.

The agency has been especially aggressive at combating fraud that has contributed to the subprime crisis and the loss of confidence in our markets. We have over 50 pending law enforcement investigations in the subprime area. Most recently, the Commission charged five California stockbrokers with securities fraud for pushing homeowners into risky and unsustainable subprime mortgages, and then fraudulently selling them securities that were paid for with the mortgage proceeds. We have brought fraud charges against the managers of two Bear Stearns hedge funds in connection with last year's collapse of those funds. And we have brought the first-ever case against a trader for spreading knowingly false information designed to drive down the price of stock.

The Division of Enforcement is currently in the midst of a nationwide investigation of potential fraud and manipulation of securities in some of the nation's largest financial institutions through means including abusive short selling and the intentional spreading of false information.

As part of this aggressive law enforcement, the Commission approved orders requiring hedge funds, broker-dealers and institutional investors to file statements under oath regarding trading and market activity in the securities of financial firms. The orders cover not only equities but also credit default swaps. To assist in analyzing this information, the SEC's Office of Information Technology is working with the Enforcement Division to create a common database of trading information, of audit trail data, and of credit default swaps clearing data. Our Office of Economic Analysis is also supporting this effort by helping to analyze the data across markets for possible manipulative patterns in both equity securities and derivatives.

In the days ahead we will continue to work to bring to justice those who have violated the law, and to help mitigate the effects of the credit crisis on investors and our markets.

Mr. Chairman, the role of the SEC has never been more important. The several thousand men and women who have devoted themselves to law enforcement and the protection of investors, markets, and capital formation represent this nation's finest. The last several months have been difficult for the country and for our markets, but this adversity has brought out the best in the people with whom I work. Every day, the staff of the SEC devote themselves with passion to protecting America's investors and ensuring that our capital markets remain strong. I am humbled to work side-by-side with them.

Thank you for the opportunity to discuss the role of the SEC in our financial system, and the lessons from the current crisis for fundamental regulatory reform in the future. I am happy to answer any questions you may have.

Chairman WAXMAN. Mr. Snow. Is your microphone on? There's a button.

STATEMENT OF JOHN SNOW

Mr. SNOW. Thank you very much, Mr. Chairman, Ranking Member Davis, members of the committee, it's an honor and a privilege to be here with you today to talk about this issue of extraordinary importance to the American people.

Millions and millions of Americans now realize that the health of the financial system isn't some abstraction, it's the stuff of real, day-to-day life for them.

We meet in an extraordinary time. Nowhere that I can recall, during my adult lifetime, has the financial system been so deeply troubled, so fractured, frozen.

The consequences of the frozen financial system, of course, Mr. Chairman, are spilling over to the real economy, and we now seem to be on a clear path to much slower growth rates, probably going negative, if they are not negative already, with significant consequences for the lives of our citizens, with many jobs put in jeopardy, and the prosperity of the American people put in jeopardy. But this is a global problem. This is not just a U.S. problem, as the leaders of the world now recognize.

I served, and was honored to serve, at the Treasury Department from early 2003 until the middle of 2006. Treasury doesn't have direct regulatory authority, as you know, but it does have broad policy responsibilities.

One of the key responsibilities of Treasury is to try and identify risks, the risks that threaten the health and prosperity of the American people, the risks, the systemic risks that could produce far-reaching contagion in the financial system and spill over into the global economy, into the U.S. economy.

I tried, when I was Treasury Secretary, to keep my eye on what those risks were, the focus on them. Where we saw clear visible risks, and some of you saw them as well with—I am thinking here, of Congressman Shays, where we saw clear visible risks as in the case of the GSEs, we acted.

I testified before the Congress in 2003. I testified again in 2005. I gave countless speeches, had countless meetings with Members of Congress pointing, out that the GSEs represented a huge systemic risk, a risk that unfortunately grew during that period, Mr. Chairman, as they continued to broaden out, an extraordinary blowout, growth of their own investment, their own investment portfolios.

I called for a strong regulator. We called for a disclosure. We called for application of the securities laws. We called for a regulator who would have authority over capital standards. We called for a regulator who could limit the growth of their portfolios. We called for a regulator who could limit the lines of business they could get into, and, most importantly, to deal with the implied guarantee, which was at the heart of the problem, the fact their paper traded like U.S. Government paper.

We called for a regulator with the ability to have a restucturing through liquidation and bankruptcy of those entities, sending a clear message to the markets that they weren't, "too big to fail."

I think if we had acted then, Mr. Chairman, there may not have been the need for this hearing today. I regret I wasn't more effective in trying to persuade Congress of the need for action to deal with the risk that I saw as the largest and most visible systemic risk at the time.

Beyond Fannie and Freddie, we were also continuously on the lookout for the problems that could emerge. As I thought about the problems that could emerge in 2003 and 2004, it became clear to me that we needed a new regulatory system. We needed to change it.

We have a fractured regulatory system, one in which no single regulator has a clear view, a 360-degree view of the risks inherent in the system. We need to change that. We need to move to a 360-degree view regulatory system.

During my time at Treasury, I commissioned a blueprint to put that in place. I am pleased to see that now a version of that have blueprint is before you, and I hope you will act on it.

So, basically, Mr. Chairman, where we saw at Treasury in our policy role, visible risks, as is with the GSEs, we acted, we called for the strong regulator. Where the risks where inchoate, where they were not yet clearly visible, we recognized that a much stronger, mother effective regulatory system should be put in place.

I look forward to responding to your questions. Thank you very much.

Chairman WAXMAN. Thank you very much, Mr. Snow.

[The prepared statement of Mr. Snow follows:]

Statement of
The Honorable John W. Snow
Before the Committee on Oversight and Government Reform
United States House of Representatives
October 23, 2008

Mr. Chairman, Ranking Member Davis, and Members of the Committee, we meet today under unprecedented circumstances.

Average Americans have been asking--quite properly--how this financial mess came about, how it will affect their financial future, and what remains to be done to get our economy going again. I very much appreciate the opportunity to share my perspective with you. I am not here to point fingers, but instead to share my thoughts on what we tried to accomplish during the years in which I served as Secretary of the Treasury, what went wrong in financial markets, and what we can do to avoid a comparable threat to our economic well-being in the future.

For the average American, a smooth-functioning banking system has helped make realization of the American dream possible. For decades, financial institutions provided the auto loans, student loans, and home mortgages that brought that dream closer. They provided the loans that small businesses used to meet their payrolls and to expand their operations. They provided a means of saving for retirement, or for a family vacation. In short, they helped us as a Nation to prosper.

Today, this system is badly shaken. For the sake of savers, small businesses, and homeowners, as well as American taxpayers more generally, problems in the system need to be corrected and confidence needs to be restored. In doing so, policy makers need to avoid saying or doing anything that could decrease confidence, increase market volatility, or undermine ongoing efforts by those in responsible positions to address the situation. In that spirit, I welcome the opportunity to offer some suggestions on what further steps might be undertaken to address the problems we as a Nation face. But before talking about what should be done, we need to assess what brought us to this stage.

What Went Wrong. The breakdown in our capital markets is the product of many complex and inter-related forces that were not fully apparent at the time and defy clear understanding even today. We continue to be surprised--even shocked--by unfolding events. In my view, we will spend years sorting out the many contributing factors and their relationship with each other, a partial view of which is now emerging.

Speaking broadly, what we have witnessed is a breathtaking breakdown in traditional risk management activities in the financial sector, from lax lending practices--including the now infamous "liar loans"--to the spread of highly complex and opaque financial products the risks of which weren't properly evaluated by issuers, investors, or rating agencies, all of which combined to create immense risks the scale of which wasn't readily apparent to anyone. All of this was occurring during a global savings glut that resulted in low interest rates. As a result, risk was under-priced on a global basis. The under-pricing of risk created the basic condition for the "search for yield" that led to new, exotic, opaque financial instruments, the inherent risks of which even issuers and investors failed to fully understand.

As has happened throughout history, low interest rates led to an increase in asset values, which fueled the housing boom. This environment of low interest rates underpinned the loose lending practices that led to the housing boom and the significant increase in consumption through equity extraction loans. This rise in consumption of course reduced household savings rates and exacerbated global asset imbalances, which were a major contributing factor in the boom which turned into a bubble that has now burst.

Throughout the housing finance value chain, many participants contributed to the creation of bad mortgages and the selling of bad securities, apparently feeling secure that they would not be held accountable for their actions. A lender could sell exotic mortgages to homeowners, apparently without fear of repercussions if those mortgages failed. Similarly, a trader could sell toxic securities to investors, apparently without fear of personal responsibility if those contracts failed. And so it was for brokers, realtors, individuals in rating agencies, and other market participants, each maximizing his or her own gain and passing problems on down the line until the system itself collapsed. Because of the lack of participant accountability, the originate-to-distribute model of mortgage finance, with its once great promise of managing risk, became itself a massive generator of risk.

In this environment, a critical lack of transparency in secondary markets left policy makers and regulators unable to discern the true nature and extent of the systemic risk that continued to build until it began to cascade unchecked here and then through the world economy. Unfortunately, our 20th century regulatory structure was ill-suited to addressing 21st century challenges.

This lack of transparency made it increasingly difficult for regulators to do their job. There were problems developing throughout the housing finance value chain, but regulators and market participants could not see them clearly. The financial instruments backed by Fannie Mae and Freddie Mac, for example, were marketed as low risk because of faith in rising housing markets and an implied government guarantee. But accounting irregularities hid the growing concentration of risk in them. Moreover, their use of hedging devices further masked this concentration. Finally, the law exacerbated these risks because it permitted a basic misalignment of incentives in the organizations, where losses could be socialized to taxpayers, but gains could be kept for shareholders. With this advantage, they operated like government-sponsored hedge funds, arbitraging low borrowing costs resulting from their implied government guarantee, driven to seek higher and higher profits for their private shareholders by expanding portfolio assets beyond those required to meet their public policy purpose: Their over-leverage, however, created systemic risks that became so large that government action would eventually become inevitable, in part because their instruments were held by so many large and small institutions around the globe.

The investment banking community also responded to the search for higher yields by manufacturing a variety of complex and opaque asset-backed financial vehicles, many linked to mortgage-backed securities. Many of these were given higher credit ratings than they deserved. While these instruments were being aggressively marketed as essentially risk-free, investment banks were simultaneously "shorting" them, hedging their bets against the very product they were selling with credit default swaps that further masked risk. Market participants kept adding to the growing risk, all assuming that the music would never end, or at least that they would be able to grab a chair before it did.

It was only when housing values began to fall in the second half of 2006, and when financial markets began to turn in August of 2007, that the true depth and breadth of the systemic risk to the market began to become apparent.

Our Efforts at Treasury. During my tenure as Secretary of the Treasury (February 3, 2003 to June 28, 2006), we began to see potential problems with over-leverage and attendant systemic risks. These potential problems--which were most visible in the context of Fannie Mae and Freddie Mac--intensified over time. In October 2003, I told Congress that we did not face a "current crisis, but we never want to get close to the point where we would face [a] problem" with the entire financial system. By April 2005, I told Congress that, "if something unravels," the size and concentration of GSE-related hedges "could cause systemic risk to the whole financial system." Other of my colleagues at the Treasury Department spoke out clearly about the more general breakdown in the market's under-valuation of credit risk. What eluded us, however, was a clear picture of the full extent of the risks to the financial system because of insufficient transparency.

Out of concern that the existing regulatory structure over all housing GSEs (Fannie Mae, Freddie Mac, and the Federal Home Loan Banks) was inadequate, I came before Congress for the first time in September 2003 to urge enactment of legislation to protect taxpayers and the integrity of the housing finance market. At the time, as I pointed out, there was "a general recognition that the supervisory system for housing-related government sponsored enterprises (GSEs) neither has the tools, nor the stature, to deal effectively with the current size, complexity, and importance of these enterprises." I thus urged Congress to enact legislation to create a new federal agency to regulate and supervise the financial activities of these entities and to enhance the government's conservatorship powers to handle a possible failure of the GSEs.

In April 2005, I testified again in support of much-needed GSE reform legislation, saying in part:

> Events that have transpired since I testified . . . in 2003 reinforce concerns over the systemic risks posed by the GSEs and further highlight the need for real GSE reform to ensure that our housing finance system remains a strong and vibrant source of funding for expanding homeownership opportunities in America. . . .
>
> Allow me to state succinctly why the Administration is so committed to bring about real reform. The risks undertaken by the GSEs, if not properly managed, may pose a threat to their solvency, the stability of other financial institutions and the strength of the economy.

Throughout this period, we were met with stiff resistance by the housing industry and the mortgage industry. But we pressed on. Unfortunately, we were unable to persuade Congress to pass any version of the legislative options we put forward.

Members of Congress and the Administration justifiably wanted to continue to promote the American dream through home ownership. We thus strove to achieve the right balance between regulatory oversight and expanded opportunity. In retrospect, the bipartisan consensus to promote housing went too far. There was a push for too much of a good thing. Those excesses eventually came home to roost. Policy makers put too much emphasis on home ownership to the exclusion of other goals--thrift, savings, deficit reduction, and other productive investments. The United States as a whole saved too little, and spent too much. The housing bubble came to be a manifestation of those imbalances. Given the lack of transparency in the market, neither regulators nor market participants fully appreciated the systemic risks that were growing as a result of these imbalances.

In addition to the focus on the federal housing enterprises, I and other members of the President's Working Group on Financial Markets were active on a broad range of related policy issues. Within the Treasury Department, I established an economic surveillance and risk management process to monitor housing and other markets. We took additional steps as it became clear that the bank regulators, who were on the front lines of monitoring lending activity, had the best perspective on emerging housing markets conditions. In part due to laws stemming from the S&L crisis and others passed during the previous Administration, the Department was prohibited from participating in enforcement or regulatory actions of the bank regulators (including the Office of the Comptroller of the Currency and the Office of Thrift Supervision). It was rather unprecedented, then, when in 2005 I called in all of the housing and banking regulators to get a more comprehensive picture of what was going on in the housing markets. It was the only way to attempt to get such a picture.

At that time, the regulators were just starting to see spikes in the new no down-payment, adjustable rate, and negative amortization loans, and that activity was isolated in certain geographical areas. It was not seen as a national phenomenon. Default rates were low by historical standards, and the proportion of mortgages outstanding in those categories was still quite small. Given low unemployment and high GDP growth at the time, the potential for a decline in national housing prices was viewed as highly improbable. There was simply nothing in the historical record to support that kind of view. However, there was enough for us to know that better lending guidance would be useful. Following these meetings, the regulators proceeded with joint guidance on revised lending practices. In 2005, they published guidance on home equity lending, guidance that was revised in 2006 and expanded to include a focus on sub-prime lending.

It also had become clear that the regulatory system had contributed to the lack of transparency because of a bewildering array of federal and state authorities, with no one regulator having a full view. The regulatory process was proving out of date and in need of modernization. As a result, I commissioned work on a comprehensive blueprint for changing the system of financial regulation, including the creation of a systemic risk regulator, with the goal of issuing it to the next Congress. This study included the creation of a federal charter for insurance, something I publicly endorsed at the time. That effort ultimately led to the blueprint put forward by the Department earlier this year, which is now beginning to get the attention it deserves.

We also began an initiative with our colleagues in the United Kingdom and the European Union to make sure we were prepared to manage and respond to financial crises should one arise for any reason.

Where Do We Go From Here? Whatever the cause of a banking crisis, a lesson from history is that early, decisive government action is needed to stem the pain and cost of it. We must recognize as well that booms and busts in our financial markets, while unwelcome, have been a recurring part of our economic history. They seem to be an inevitable--though clearly undesirable--aspect of financial markets. Our history, however, also tells us that financial markets recover.

An important part of the recovery is correcting the excesses that led to the boom. With the recent enactment of sweeping rescue legislation at the beginning of October, Congress has given our regulatory authorities an extraordinary range of tools. In addition, we are seeing banks, credit card companies, and other financial institutions significantly tighten lending standards. The guidance of credit rating agencies is certainly being scrutinized more carefully today and banks are going back to asking the question "Can the borrower repay this loan?" rather than relying on a FICO score or the value of the underlying collateral. In addition, purchasers of financial instruments are certainly doing a lot more due diligence. LBO activity has dwindled and risk premiums have increased. In fact, the current credit crunch reflects something of an over reaction that hopefully good governmental policy to increase liquidity and banking capital along with the loan guarantees will help alleviate.

In addition to the efforts by regulators here, international coordination of efforts is finally underway. I want to commend Prime Minister Gordon Brown and Governor Mervyn King for the leadership they have shown in this regard. Their move to guarantee interbank lending offers a positive model for unfreezing markets that have been slow to unlock.

Longer term, we need to fix the U.S. financial system and recast the international financial architecture as well. Let me suggest a number of steps.

First, I propose that financial policy be re-organized around a clear principle: increasing transparency of excessive leverage as a means of preventing institutions from creating excessive systemic risk. This would mean reorienting our entire regulatory scheme to focus on leverage. We now know that looking solely at capital standards has proven to be inadequate. We need a new framework to stem the excessive leveraging and deleveraging that accentuate boom and bust cycles. This doesn't mean that securitizing assets is fundamentally flawed. Far from it. But we do need mechanisms to ensure transparency and accountability. We need to restore a focus on good risk management practices. Those who make loans need to ask how they will be repaid, and get reliable information to support loan decisions. When loans are packaged for the secondary market, originators should be required to hold on to a portion of the underlying loans. One would expect the market to reward this extra sign of due diligence.

As a related matter, we need to move beyond "too big to fail." We have to restore market discipline by taking steps to minimize the instances where financial institutions could ever be deemed too big to fail, while making sure that the institutions themselves--rather than taxpayers--bear the costs of failure. We should create a permanent mechanism for the dissolution of financial institutions, not just depository institutions.

Second, we need a more coordinated and less fragmented approach to financial regulation. We need one strong national regulator with the field of vision to spot excessive leverage, no matter what or where the institution is located. We need to move away from the alphabet soup of regulatory responsibility that has prevented a comprehensive approach. This change too would facilitate treating financial institutions engaged in like activities in a similar manner, and avoid regulatory arbitrage. In addition, we need stronger oversight of rating agencies and elimination of conflicts of interest that have clouded their work.

As a corollary matter, we need to forge greater international cooperation to deal with spillover effects from under-pricing of risk and excessive leverage. We need a level playing field for market participants. More rapid convergence of national standards and greater cooperation of national regulators are needed.

Third, we need to make sure our markets stay open and that we encourage expanded trade in goods and services. Capital flows from sovereign wealth funds, for example, have played an important role in stabilizing our financial system. They should continue to be welcomed. Moreover, a renewed push to restart and conclude the global trade round would give a much needed lift to the U.S. economy and financial markets, as our export sector has provided such an important source of support during this downturn.

Finally, we need to avoid an overreaction that could stunt prudent risk taking and innovation, which could reduce living standards for a decade or more. Congress has given the Treasury Department and the Federal Reserve Board an impressive array of tools to work with to restore the market. Let's give these policy makers and regulators a chance to use these tools, and let's encourage the next Administration and the Congress to consider how best to build a regulatory structure for the 21st century.

In conclusion, the American people are looking now for constructive steps to protect their economic future, and to put the economy back on the path to growth and job creation. While the cyclical nature of the economy will never be outlawed, steps to restore transparency and responsibility in the marketplace will go a long way towards restoring stability and confidence. With their leaders working cooperatively to put good policies in place, I remain confident that the American public's inherent resilience and strength will carry the day.

Thank you again for the opportunity to appear today.

Chairman WAXMAN. We will now proceed to questioning by the Members. Without objection, the questioning of witnesses will proceed as follows.

Questioning will begin with a 12-minute block of time for each side with the chairman and the ranking member each having the right to reserve time for later use.

I will start the questioning.

Dr. Greenspan, I want to start with you. You were the longest-serving chairman of the Federal Reserve in history, and during this period of time, you were, perhaps, the leading proponent of deregulation of our financial markets. Certainly you were the most influential voice for deregulation. You have been a staunch advocate for letting markets regulate themselves. Let me give you a few of your past statements.

In 1994, you testified at a congressional hearing on regulation of financial derivatives. You said are, “There's nothing involved in Federal regulation which makes it superior to market regulation.” In 1997, you said, “There appears to be no need for government regulation of off-exchanged derivative transactions.” In 2002, when the collapse of Enron led to renewed congressional efforts to regulate derivatives, you wrote the Senate, “We do not believe a public policy case exists to justify this government intervention.” Earlier this year, you wrote in the Financial Times, “Bank loan officers, in my experience, know far more about the risks and workings of their counterparties than do bank regulators.”

My question for you is simple, were you wrong?

Mr. GREENSPAN. Partially.

Chairman WAXMAN. Be sure the mic is turned on.

Mr. GREENSPAN. Sure. Partially, but let's separate this problem into its component parts. I took a very strong position on the issue of derivatives and the efficacy of what they were doing for the economy as a whole, which, in effect, is essentially to transfer risk from those who have very difficulty—have great difficulty in absorbing it, to those who have the capital to absorb losses if and when they occur. These derivatives are working well. Let me put it to you very specifically.

Chairman WAXMAN. So you don't think you were wrong in not wanting to regulate the derivatives?

Mr. GREENSPAN. Well, it depends on which derivatives we are talking about. Credit default swaps, I think, have serious problems associated with them.

But, the bulk of derivatives, and, indeed, the only derivatives that existed when the major discussion started in 1999, were those of interest rate risk and foreign exchange risk.

Chairman WAXMAN. Let me interrupt you, because we do have a limited amount of time, but you said in your statement that you delivered the whole intellectual edifice of modern risk management collapsed. You also said, “those of us who have looked to the self-interest of lending institutions to protect shareholders' equity, myself especially, are in a “state of shock, disbelief.” Now that sounds to me like you are saying that those who trusted the market to regulate itself, yourself included, made a serious mistake.

Mr. GREENSPAN. Well, I think that's true of some products, but not all. I think that's the reason why it's important to distinguish the size of this problem and its nature.

What I wanted to point out was that the—excluding credit default swaps, derivatives markets are working well.

Chairman WAXMAN. Well, where did you make a mistake then?

Mr. GREENSPAN. I made a mistake in presuming that the self-interest of organizations, specifically banks and others, were such is that they were best capable of protecting their own shareholders and their equity in the firms.

And it's been my experience, having worked both as a regulator for 18 years and similar quantities, in the private sector, especially, 10 years at a major international bank, that the loan officers of those institutions knew far more about the risks involved and the people to whom they lent money, than I saw even our best regulators at the Fed capable of doing.

So the problem here is something which looked to be a very solid edifice, and, indeed, a critical pillar to market competition and free markets, did break down. And I think that, as I said, shocked me. I still do not fully understand why it happened and, obviously, to the extent that I figure out where it happened and why, I will change my views. If the facts change, I will change.

Chairman WAXMAN. Dr. Greenspan, Paul Krugman, the Princeton Professor of Economics who just won a Nobel Prize, wrote a column in 2006 as the subprime mortgage crisis started to emerge.

He said, "If anyone is to blame for the current situation, it's Mr. Greenspan, who pooh-poohed warnings about an emerging bubble and did nothing to crack down on irresponsible lending."

He obviously believes you deserve some of the blame for our current conditions.

I would like your perspective. Do you have any personal responsibility for the financial crisis?

Mr. GREENSPAN. Well, let me give you a little history, Mr. Chairman.

There's been a considerable amount of discussion about my views on subprime markets in the year 2000, and, indeed, one of our most distinguished Governors at the time, Governor Gramlich who, frankly, is, regrettably deceased, but was unquestionably one of the best Governors I ever had to deal with—came to my office and said that he was having difficulties with the problem of what really turned out to be fairly major problems in predatory lending.

Chairman WAXMAN. Well, he urged you to move with the power that you as chairman of the Fed, as both Treasury Department and HUD suggested, that you put in place regulations that would have curbed these emerging abuses in subprime lending. But you didn't listen to the Treasury Department or to Mr. Gramlich.

Do you think that was a mistake on your part?

Mr. GREENSPAN. Well, I questioned the facts of that. He and I had a conversation. I said to him, I have my doubts as to whether it would be successful.

But to understand the process by which decisions are made at the Fed, it's important to recognize what are lines of responsibilities and lines of authority are within the structure of the system. The Fed has incredibly—professional large division, that covers consumer and community affairs. It has probably the best banking lawyers in the business, in the legal department, and an outside counsel of expert professionals to advise on regulatory matters. And what the system actually did was to try to corral all of this ongoing information and to eventually filter into a subcommittee of the Federal Reserve board——

Chairman WAXMAN. Dr. Greenspan, I am going to interrupt you. The question I had for you is you had an ideology. You had a belief that free, competitive—and this is shown—your statement, "I do have an ideology. My judgment is that free, competitive markets are by far the unrivaled way to organize economies. We have tried regulation, none meaningfully worked."

That was your quote. You have the authority to prevent irresponsible lending practices that led to the subprime mortgage crisis. You were advised to do so by many others.

Now, our whole economy is paying its price. You feel that your ideology pushed you to make decisions that you wish you had not made?

Mr. GREENSPAN. Well, remember, though, whether or not ideology is, is a conceptual framework with the way people deal with reality. Everyone has one. You have to. To exist, you need an ideology.

The question is, whether it exists is accurate or not. What I am saying to you is, yes, I found a flaw, I don't know how significant or permanent it is, but I have been very distressed by that fact. But if I may, may I just finish an answer to the question——

Chairman WAXMAN. You found a flaw?

Mr. GREENSPAN. I found a flaw in the model that I perceived is the critical functioning structure that defines how the world works, so to speak.

Chairman WAXMAN. In other words, you found that your view of the world, your ideology, was not right, it was not working.

Mr. GREENSPAN. Precisely. That's precisely the reason I was shocked, because I had been going for 40 years or more with very considerable evidence that it was working exceptionally well.

But let me just, if I may——

Chairman WAXMAN. Well, the problem is that the time has expired.

Mr. DAVIS OF VIRGINIA. He wishes to answer. Can you just let him answer.

Chairman WAXMAN. We have many Members.

Mr. GREENSPAN. If I could have just a minute. The reason, basically, is this—Governor Gramlich said to me, that he had problems. Indeed, I agreed that I had heard very much the same thing. I frankly thought that when our meeting ended, that a subcommittee of the board which supervises all of the various aspects of consumer and community affairs within the Board of Governors and the Federal Reserve system, would move forward and prevent to the board as a whole, recommendations to be made. That was not made, and I presumed, at the time, that essentially the subcommittee didn't think it rose to the higher level.

But, just quickly, to say that the overall view that I take of regulation is that I took a pledge, when—I took an oath of office when I became Federal Reserve chairman, and I recognized that you do with that, what I did is I said that I am here to uphold the laws of the land passed by the Congress, not my own predilections.

I think you will find that my history is that I voted for virtually every regulatory action that the Federal Reserve board moved forward on. Indeed, I voted with the majority at all times, and I was doing so because I perceived that was the will of the Congress. In fact, you go back and you look at the record, I felt required by my oath of office to adhere to what I am supposed to do, not what I would like to do. And that is my history, and I think the evidence very strongly supports that.

Chairman WAXMAN. Well, I appreciate that. On the other hand, you didn't get to vote on regulations that didn't put before the Federal Reserve Board, even though you have the legal authority for those regulations. That's more—not a question but a comment.

Mr. Davis.

Mr. ISSA. Mr. Chairman, Mr. Davis, I was just going to ask if you needed more than the 12 minutes, because we had run over, but it's done.

Mr. DAVIS OF VIRGINIA. Thank you. Let me start with all of you, but, Dr. Greenspan, I will start with you. I think what we see now as laying a predicate for what I always fear happens when there's a crisis, and that it is that Congress overreacts to the situation.

It seems to me that it wasn't just deregulation that allowed this crisis, it was the mishmash of regulations and regulators with too narrow a view of the increasingly integrated national global markets. But I would like to get all of your reactions to the following.

In terms of legislation passed by the Congress, what effects, if any, and were they right or wrong in Gramm-Leach-Bliley, the Commodities Futures Modernization Act and our failure to regulate Freddie and Fannie. If you would look at those three all congressional actions or inactions, to what effect, if any, did they have on this crisis and if there are any suggestions you would make in the future in terms of how we would proceed.

Mr. GREENSPAN. I have been talking at great length——

Mr. DAVIS OF VIRGINIA. Mr. Cox, let me start with you, Chris.

Mr. COX. Thank you, Mr. Chairman.

Regulatory gaps have been the be deviling solution to this crisis now during the last year. It's been 1 year since we had the all-time stock market high. Are you still having trouble hearing?

During the past year, regulators have been cooperating at the international level and within the Federal Government, and Federal to State, more closely than ever before. But what we are seeing is different parts of the elephant. We are trying to integrate that as closely as we can.

The coordination is complicated by the fact that, first, the agencies themselves administered different laws and governed economically similar products in different ways.

Second, their jurisdiction comes to an abrupt stop and, sometimes, the next regulatory agency doesn't pick up with where that leads off.

One of the most significant regulatory gaps is the one to which several of you have alluded here this morning, and that is the gap in the 2,000 CFMA that left completely unregulated and leaves open today as we meet here the $58 trillion notional market in credit default swaps.

The reason that has turned out to be so important is not simply the dollar amount of risk involved, but the fact that its opaque, the fact that parties and counterparties don't know where the exposures are. It makes it very, very difficult to price risk throughout the system. It's why I think it's so urgent that we address that gap, that we address the gap——

Mr. DAVIS OF VIRGINIA. Chairman Cox, that particular act where we failed to address that was a mistake in retrospect, it basically legalized gambling.

Mr. COX. Well, I think it's important to note, as Chairman Greenspan does, how much has changed since this was first look at in the Clinton administration in 1999. Because back then, as Chairman Greenspan points out, the credit default swaps market had barely emerged.

It was a share of the total derivatives markets that was too small to be noticed. It has grown enormously in the recent years. It has doubled just in the last 2 years. So it's absolutely urgent—now that we know how important it is in the context of the current crisis and the difficulty that the markets and the investors are having pricing risk that we bring disclosure to this corner of the market, that we let the market see where the risk is and market it accordingly.

Mr. DAVIS OF VIRGINIA. Thank you. Mr. Snow, also on the Freddie and Fannie issues, you have addressed that in your opening markets.

Mr. SNOW. Thank you, Congressman Davis. It seems to me the root issue here, when you get right down to it, is risk and leverage.

Nowhere in our financial regulatory system is there anyone with full accountability and full 360-degree view on that proposition, risk and leverage.

I saw that in my days at the Treasury Department. I remember in 2005 sensing that there were developments in the debt markets, the subprime and the mortgage markets that needed to be better understood. I took what was deemed to be a fairly extraordinary step and called in all of the substantive regulators of the mortgage market.

I asked them to give their considered views on whether or not undo risk was being created. We didn't yet have a housing crisis. We didn't yet have a subprime crisis.

But I wanted to get their view that did eventually lead to new guidance to the regulators.

But the Congressman was quoting me that no one of them had that view. They had pieces of the puzzle. It's like the blind man and the elephant. They are all touching a piece of it, but they don't know what the big picture is. That's why I did commission the effort to produce the blueprint for a new regulatory system.

As you know, the Treasury has set up a new blueprint to create some agency with that 360-degree view. With the GSEs, I think we all made a mistake in not acting much, much more earlier. If that strong regulator had been put in place in a timely way, if the market had had more visibility——

Mr. DAVIS OF VIRGINIA. Well, let me ask this: If a strong regulator had been put in earlier, would that really have averted this crisis?

Mr. SNOW. Nobody really knows for sure whether it would have averted it, but I am confident that it would have been a much different kind of crisis. Because the GSEs were the source of such an extraordinary amount of risk in the system, risk that wasn't really visible, risk that really wasn't seen to most of the participants.

Mr. DAVIS OF VIRGINIA. And they had the appearance of government backing?

Mr. SNOW. And it absolutely had the appearance of government backing, which was at the center of the risk creation process. Because if you can borrow at government rates, you can make money on any other instruments, any other financial instruments.

So it created an incentive to borrow at an extraordinary rate and then go out and buy all the paper you could get ahold of. That's why we see the explosion, it's not an exaggeration, in their for-profit activities, their own held portfolio that went way beyond anything that was needed to carry on their public policy mission of making the secondary market.

Mr. DAVIS OF VIRGINIA. Dr. Greenspan, the Commodities Futures Modernization Act, which passed Congress by an overwhelming margin based the House on suspension. I think only their view is a handful of dissenting votes signed by President Clinton.

In retrospective, as we look at that, was this a question of regulation, deregulation or just gaps in regulation where you had so many stovepipes no one could actually see the total landscape and things started to occur underneath it, and we weren't able to react. And also, I would ask you about Freddie and Fannie and their roles in this.

Mr. GREENSPAN. Well, it's important, when talking about a regulation, not to talk in blanket terms, but to focus on specific issues.

For example, as I mentioned before, the discussion that came out of the original 2000 act relevant to derivatives, actually has worked reasonably well with the exception of a major change, which is credit default swaps.

In the year 2005, the Federal Reserve Bank of New York became quite concerned about the issue of the settlement process on credit default swaps and started to try to get a very significant improvement in the technologies which they were involved with. That effort has continued considerably.

The reason why there's a big problem there is partly because of the huge surge, as Chairman Cox says, it was negligible in 2000, and they just, from, you know, 2 percent of the total market, they are up over 10 percent now in a very few years.

The problem basically is the credit default swap requires that legally, when bankruptcy occurs, the person who has given the protection has the legal right to the instrument.

That's fine, so long as you have a small amount of credit default swaps. They are now running 10 times the size the actual instrument being insured and because of the default they are required to do cash settlements. But that's a voluntary basis. It's not legally mandated.

In my judgment, it's very important that issue be resolved because at some point, the voluntary agreement process is going to break down, and we will have a very serious problem. So, where I think critical regulatory issues have to occur is on the legal question of defining the process by which the resolution occurs.

Mr. DAVIS OF VIRGINIA. It didn't help that the rating agencies were rating all of these instruments the way they were. That made it look like less risk for the people that were in the swaps.

Mr. GREENSPAN. Indeed it did. Yes.

Mr. DAVIS OF VIRGINIA. I will reserve the balance of my time.

Chairman WAXMAN. Thank you, Mr. Davis.

Mrs. Maloney.

Mrs. MALONEY. Thank you, Mr. Chairman. And I welcome all the panelists. I have some questions for Mr. Snow, Mr. Cox and Dr. Greenspan on market manipulation.

Dr. Greenspan, prior to the bankruptcy of Lehman Brothers last month, one of the largest bankruptcies in our history, was the collapse of Enron. I want to ask you about Enron and your views about the regulation of derivatives. After Enron's collapse investigations by the State of California and other States revealed widespread manipulation of energy markets by Enron and other energy companies. Using schemes like Fat Boy, Death Star, and Get Smarty, Enron created artificial shortages, bypassed regulatory protections and drove energy prices sky high.

At the time there was no regulation of Enron's trading in energy derivatives. There was no public disclosure requirements and no record keeping requirements. There were no anti-fraud or anti-manipulation provisions. Basically there was absolutely no oversight whatsoever, and what was there was removed. And what happened is that Enron and other companies took advantage of this lack of regulation and oversight.

In 2000, before the Enron collapse, I tried to close this loophole. I offered an amendment at the Banking Committee which would have required regulation of energy derivatives. Unfortunately despite bipartisan support, the amendment failed. After Enron other Members of Congress tried to close this loophole, most notably Senator Feinstein, who introduced amendments and legislation about trading in energy derivatives. She tried to do this through freestanding bills and additional amendments to other pieces of legislation.

Dr. Greenspan, you adamantly opposed these efforts. I would like to show you a letter that you sent on September 18, 2002. In this letter you stated that, "public disclosure of pricing data would not improve the overall price discovery process." You argued in these letters that "disclosure would actually increase the vulnerability of our economy to potential future stresses," and despite Enron's abuses you said, "We do not believe a public policy case exists to justify this government intervention."

I sincerely believe that efforts such as my effort in the Banking Committee and Senator Feinstein's efforts in the Senate would have passed without your opposition. So, Dr. Greenspan, in retrospect do you think you were right to oppose these efforts to regulate energy derivatives?

Mr. GREENSPAN. Senator Feinstein said the same thing to me. She's a longtime friend and we have debated this issue to considerable extent.

First of all, the major problem I was having with the energy derivative issue was that it was an electric power problem. Electric power, as you know, cannot be stored and as a result——

Mrs. MALONEY. Excuse me, Dr. Greenspan, my amendment was that—and my effort was that it be listed on the Commodities Future Exchange. It was listed. Then there was an effort to remove it from listing. So there was absolutely no knowledge of what was happening in energy derivatives. So mine was a broader one. It was not specifically to California.

Mr. GREENSPAN. OK. Let me do this——

Mrs. MALONEY. So basically it was regulation of energy derivatives.

Mr. GREENSPAN. I generally remember the issue, but I'd have to go back and refresh my memory. And if I may, let me look at it and come back to you as soon as I can if you allow me to do so.

[The information referred to follows:]

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November 4, 2008

The Honorable Henry A. Waxman
Chairman
Committee on Oversight and Government Reform
2157 Rayburn House Office Building
Washington, DC 20515-6143

Dear Mr. Chairman:

During the October 23 hearing on Financial Institutions and Markets, Representative Maloney quoted a letter on pending energy legislation, co-signed by Federal Reserve Chairman Greenspan, SEC Chairman Donaldson, CFTC Chairman Newsome, and myself. Representative Maloney asked: "why was it inappropriate to require transparency and disclosure for energy derivatives?" Following the hearing, your staff was kind enough to provide me with a copy of the letter. I am pleased to provide this further response for the hearing record.

The four members of the President's Working Group on Financial Markets submitted the referenced letter when the Senate was considering the energy derivatives amendment by Senator Feinstein, an amendment that proposed fundamental changes to the Commodity Exchange Act, as modified by Commodities Futures Modernization Act of 2000. We were concerned because the proposed amendment--purportedly intended to close a loophole--would have undermined legal certainty in the market, could have created regulatory problems, and would have imposed new capital requirements on facilities trading energy derivatives. As we explained in the letter, businesses, financial institutions, and investors rely on energy derivatives to protect themselves from market volatility. Their ability to use energy derivatives to manage risk is important to them personally as investors and to the economy as a whole. In sum, I think the President's Working Group made the right call on the Feinstein amendment.

With respect to the housing markets, for which we felt legislation was necessary, I worked hard as Treasury Secretary to encourage the Congress to create a strong regulator for the housing GSEs and to give that regulator the tools needed to effectively regulate Fannie Mae and Freddie Mac. Unfortunately, as we discussed at the hearing, the legislation we recommended was not enacted into law until it was too late.

Thank you again for the opportunity to appear before the Committee and to share my views.

Sincerely,

John W Snow

John W. Snow

cc: The Honorable Tom Davis
The Honorable Carolyn Maloney

Mrs. MALONEY. Thank you. I'd appreciate that.

Now in light of what has happened in the markets, do you believe there should be some oversight and regulation of derivatives in general?

Mr. GREENSPAN. Well, I have just cited one, the credit default swaps.

Mrs. MALONEY. OK. I have some questions for the others. Thank you for your service.

Mr. Snow, you also opposed this effort, joining Dr. Greenspan in another letter the next year. Here is what you wrote: "In our judgment the ability of private counterparty surveillance to effectively regulate these markets can be undermined by inappropriate extensions of government regulation."

Why was it inappropriate to require transparency and disclosure for energy derivatives, Mr. Snow?

Mr. SNOW. Thank you for the question. As is the case with the chairman, I don't recall the ins and outs of your amendment or the debate around it but——

Mrs. MALONEY. In this case I'm asking about your statements and letters where you said you opposed it——

Mr. SNOW. But I don't have them with me and——

Mrs. MALONEY. I'll get you a copy.

Mr. SNOW [continuing]. I don't have your amendments or your language. But generally let me respond this way.

There is always a balance when it comes to markets and regulation. It's not in my view one or the other. It's finding the right balance. And one of the arguments that always was in the back of my mind whenever anybody proposed more regulation is will this make the market work better or will it get in the way of the way markets work? And there is what exists call a moral hazard issue associated with regulation where the market itself begins to look to the regulation to say, well, that's the government's good housekeeping seal of approval on these activities and when there is a perception of a government good housekeeping seal of approval, some of the incentives for the due diligence on the part of the counterparties gets undermined.

I don't recall the specifics, but I think that was probably what I was referring to.

Chairman WAXMAN. We'll be pleased to hold the record open to get any further comments on this particular issue from both Dr. Greenspan and Mr. Snow.

Mrs. MALONEY. Mr. Waxman, may I request 30 seconds to ask my question of Dr. Cox?

Chairman WAXMAN. Well, I think that would be 30 seconds to ask the question and who knows how long to answer the question.

Mrs. MALONEY. Then I will send it to you in writing.

Chairman WAXMAN. On the Republican side, Mr. Issa—Mr. Mica.

Mr. SHAYS. Mr. Chairman, can I just make a unanimous consent motion?

Chairman WAXMAN. The gentleman wishes to be recognized for unanimous consent?

Mr. SHAYS. Because of the questioning that you allocated each of you and our ranking member, you had to consume 11 minutes and 53 seconds and our ranking member 10 minutes and 14 seconds, and I'd like to make unanimous consent that both sides be given another 10 minutes because I think it's important for either you and us to be able to inject ourselves.

Chairman WAXMAN. Any objection to that very generous unanimous consent? If not, that will be the order.

Mr. Mica, you're recognized.

Mr. MICA. Thank you. As I said at the beginning, I tried to enunciate along with my request for unanimous consent to put in a letter to request a special prosecutor to be appointed. I'm truly disappointed that these hearings have been hijacked and put off now until November 20th. November 20th is the date that now has been chosen for the people to know who the real culprits were. Let's put this out here. And I have a question for all of the panelists. Do you know what comes before November 20th?

Mr. SNOW. The 19th.

Mr. MICA. Chris, you might recall. A little thing like an election. What we don't want is the trail to lead to people who have done the wrong thing. What we don't want is this committee to hold people who started this whole mess, this fiasco, accountable. What we've been doing is we're sort of tiptoeing around the tulips when somebody's driven a bulldozer through our financial garden.

Well, let's see. Chris, you weren't around—excuse me, Mr. Cox, you weren't around. You two were around. Mr. Greenspan, you go for two, well, three Presidents. How many years total?

Mr. GREENSPAN. Eighteen and a half.

Mr. MICA. Mr. Snow, when were you Secretary?

Mr. SNOW. I was Secretary in February 2003 until the end of June 2006.

Mr. MICA. OK. You testified a few minutes ago, Mr. Snow, that you tried to regulate, right? That you tried to bring some new regulation into this process. Did you know $178 million was spent in 10 years by Fannie Mae and Freddie Mac to lobby to stop what you were trying to do? Did you know that?

Mr. SNOW. I didn't know the number, Congressman, but I knew there was a ferocious opposition.

Mr. MICA. The three of you, who is the big subprime producer in the United States? Who? What private company? Countrywide. I will answer it for you. Countrywide?

Mr. SNOW. I'll agree.

Mr. MICA. Did any of you know that Countrywide was giving preferential discounted loans to public officials and the heads of a government-sponsored mortgage security agency? Did you know that when you were in charge?

Mr. GREENSPAN. I did not.

Mr. MICA. Did you know that, Mr. Snow?

Mr. SNOW. No, I didn't.

Mr. MICA. Well, Chris, you came along later. Did you ever get one?

Do you know who the largest recipient of campaign contributions is in 20 years from Fannie Mae and Freddie Mac, their political action organization? Do you know?

Mr. GREENSPAN. I do not.

Mr. MICA. Do you know?

Mr. SNOW. I don't.

Mr. MICA. I said in 20 years. Maybe you're thinking it's Senator Dodd because he was there 20 years. You know, it wasn't Senator Dodd. Do you know who it was? Senator Obama in less than 4 years.

Nobody wants to get to the bottom of this. Nobody wants to stop the money trail. And I'm going to ask in a minute to put in the record Exhibit A and it's called Follow the Money Trail. For those of you who have difficulty distinguishing who participated, I have pictures, photographs of the individuals involved.

You testified in 2003, September 10th, and you came back and testified again asking for regulation. Did you ever see—and you did it before the whole committee. Did you ever see the proceedings of October 6, 2004, of one of the subcommittees of Financial Services and hear the now chairman, Mr. Frank, and what he said about what kind of risks some of these speculative investments posed? Did you ever see that?

Mr. SNOW. I don't believe I did.

Mr. MICA. I recommend you all go on YouTube and see that hearing of October 6. Mr. Frank said there's no risk. Mr. Frank said we ought to roll the dice. Maxine Waters, a member of the committee, did you hear what she said? She said, "If it ain't broke, don't fix it." Did you hear that, Mr. Greenspan? Did you hear those comments?

Mr. GREENSPAN. I did not.

Mr. MICA. Did you hear them, Mr. Snow?

Mr. SNOW. No, I didn't.

Mr. MICA. You ought to see that and you ought to see the language one of the members of the committee used about how he was mad because people were proposing legislation. Well, I will tell you the language that he used is the language that people are using out there that want folks held accountable.

Now, this is a nice dog and pony show and maybe it's theater, but people want someone held accountable. They want people to go to jail who brought down our financial markets. Do you agree we should have some means for those folks to pay who've ripped us off? Could you answer my question?

Mr. GREENSPAN. That's not the type of thing—issue with which I deal.

Mr. MICA. Thank you.

Chairman WAXMAN. The gentleman's time has expired.

Mr. MICA. Could I just have them answer——

Chairman WAXMAN. Just a minute, Mr. Mica. Mr. Mica, just a minute. You've asked your questions and your time is up. Now I will give the opportunity of the witnesses to answer them but not to have you continue to engage them. Your time is up.

Mr. Cox, do you want to respond to it?

Mr. COX. Certainly. Aggressive law enforcement is now needed more than ever. The SEC is a law enforcement agency dedicated to making sure that anyone who broke the securities laws is held accountable, and we are very, very busy on that right now.

Mr. SNOW. Any criminal behavior, fraudulent behavior obviously ought to be investigated and acted upon by the appropriate authorities.

Mr. MICA. Thank you, Mr. Chairman. I yield back the balance of my time.

Chairman WAXMAN. The Chair yields himself some of the generous time that's been allotted to us to say that we've held four hearings and we have two more scheduled. We have them scheduled after the election. But this isn't an issue that's going to go away after the election. It's one we seriously need to examine. And we have sent a request for further documents from Fannie Mae and Freddie Mac and we are going to hold a hearing on them and the role they played in this current crisis as well as hedge funds. But I think what we have heard from Mr. Mica is a political statement, not one looking into the real issues. It's a political statement. And just to put the facts in perspective, the explosion in subprime lending was primarily driven by Wall Street, and the majority of those loans were originated by unregulated mortgage brokers. According to the Home Mortgage Disclosure Act data, in 2006 during the height of the subprime boom, Fannie Mae purchased 2.5 percent of subprime loans, Freddie Mac .4. Combined they purchased a total of 2.9 percent of the subprime loans. In 2007, Fannie Mae increased its purchases of subprime loans to 11.2 percent while Freddie Mac increased it to 2.5. So their combined purchase total went up to 13.7 percent of subprime loans. These are hardly market driven—driving numbers. Both companies also invested in subprime securities created by Wall Street. Again, they were not the dominant factor in Wall Street. In 2006 their combined market share was less than 25 percent of the secondary market.

I point those facts out not in any way to excuse Fannie Mae or Freddie Mac and the responsibility they have. We're going to look at their responsibility. But they were not the cause of the financial crisis. And I'd be interested to know if any of the three witnesses believe that Fannie Mae and Freddie Mac was the cause of our financial crisis. They certainly played a role in it, but do any of you believe they were the cause of this financial crisis?

Dr. Greenspan.

Mr. GREENSPAN. I think it was a significant factor but not the primary cause.

Chairman WAXMAN. Mr. Cox.

Mr. COX. I would agree with that. I think there's no question that the GSEs, Fannie Mae and Freddie Mac, played a significant role in the subprime crisis and in fact in the creation of structured securities and the market for those.

Chairman WAXMAN. Let me hear from Mr. Snow on that.

Mr. SNOW. I agree with that. There's no single cause of this. Many, many things contributed to it, but one of the primary contributors among all the contributors is certainly the role of Fannie and Freddie.

Chairman WAXMAN. I agree with the three of you, and that's why we are going to look at those issues. But I don't think it makes a difference that we're looking at it after the election or before the election. We are going to look at hedge funds after the election and we've got a problem we have to deal with. That is not connected to this election calendar unless of course you want to make it a connection to the electoral calendar, which is the purpose of the gentleman from Florida.

Mr. DAVIS OF VIRGINIA. Mr. Chairman, can I yield myself——

Chairman WAXMAN. Mr. Davis.

Mr. DAVIS OF VIRGINIA. Mortgage brokers were regulated; they were just regulated at the State level, isn't that right? So it wasn't that they didn't have any regulation. Their regulation was at the State. And as I've said before, one of the problems here—these were stovepipes. Nobody had a view of what anybody else was doing, and when you regulate these entities at the State level nobody has a view of what's going on nationally. I'd asked Secretary Snow prior had Fannie and Freddie been brought under control earlier, there's no question this crisis would not have been to the dimensions it was and you would agree with that, don't you, Mr. Secretary?

Mr. SNOW. I agree with that.

Mr. DAVIS OF VIRGINIA. Mr. Mica.

Mr. MICA. First of all, did you all know too that Fannie Mae was cooking the books and increasing the mortgages that they were putting out, the subprime, so that they could get bonuses and walk away with tens of millions of dollars in compensation? Did you know that, Mr. Snow?

Mr. SNOW. Well, I know there was an investigation by the regulator——

Mr. MICA. Yeah, I have a copy of that.

Mr. SNOW [continuing]. That found some irregularities in the accounting practices——

Mr. MICA. Fannie Mae was pumping out these subprimes. Fannie Mae was a government-sponsored mortgage security operation and then competing with folks like Lehman Brothers; so you had them discounting the amount of capital they had as a reserve from 10. They didn't do that, now. I guess Andrew Cuomo did that. But you had them discounting their reserve from 10 to 2½ and you had them pumping out there no doc, no down payment subprime loans; is that not the case? And then who follows? Wall Street, who's trying to—in our system they are trying to make a buck, so they are discounting——

Mr. COX. Congressman Mica, with respect to cooking the books, the Securities and Exchange Commission sued Fannie Mae for fraud in one of the largest settlements in the history of the SEC.

Chairman WAXMAN. The gentleman's time has expired.

Mr. MICA. I have a unanimous consent request. All I'm asking, Mr. Chairman, as I mentioned, this in my first round——

Chairman WAXMAN. State your unanimous consent request.

Mr. MICA. I ask unanimous consent that Exhibit A, Follow the Money, and I guess we could do—the pictures be included in the record.

Chairman WAXMAN. Without objection, what you seek to submit for the record, some article called Follow the Money, will be put into the record. It's called Exhibit A.

Mr. Cummings.

Mr. CUMMINGS. Thank you very much, Mr. Chairman. And today, Mr. Chairman, I just want to—I want to ask questions that my constituents would ask, all of those that are losing their investments, unable to get student loans, businesses unable to get lines of credit, businesses going out of business, people losing their jobs.

I want to ask some questions on behalf of them. And I'm going to direct my questions to you, Mr. Cox. I want to ask you about your position on regulating derivatives, especially credit default swaps, which now amounts to greater than the world's annual economic output weighing in at $54 trillion as of September. You've given the committee very strong testimony urging greater regulation in this area. By the way, I completely agree with you. As our hearing on AIG demonstrated, the lack of regulation of credit default swaps has created chaos in the financial markets all around the world.

My question is where have you been all these years? Mr. Cox, last month you announced that the SEC would begin requiring hedge fund managers, broker dealers, and institutional investors to disclose their credit default swap holdings. That's a terrific step. That's real, real nice. But you took that step after Senator McCain said, "he has betrayed the public trust," and after Carly Fiorina, the former head of Hewlett-Packard, said that you were, "asleep at the switch." I want to know—and then of course it was after—you made these decisions after Senator McCain to his credit saying that the first thing he would do as President was to fire you.

Now, you became SEC chairman over 3 years ago. Why didn't you act sooner to require the disclosure of credit default swaps?

Mr. COX. Thank you. As you know, I have been in the vanguard of regulators and indeed I believe I'm the first Federal regulator incumbent to call for this legislation. But we would have liked to have known what we know now I think years ago. If you wish me to answer explicitly where was I, I was here with you. Indeed I was vice chairman of this committee when Congress had the opportunity to do what I'm asking Congress to do now, which is close this regulatory hole.

Mr. CUMMINGS. But I'm talking about the 3 years that you were there. We paid your salary. The taxpayers, the ones that are losing their homes right now, paid your salary for 3 years. I know what Mr. Mica said. He kept telling you you weren't there; so I'm going to excuse you, I'm going to excuse you. I'm talking about the times you were there.

Mr. COX. During the time I have been chairman, what we have seen is a market that was completely unregulated outside the jurisdiction of the SEC. I have to live within the statutory authorities that Congress gives me, that this market has grown substantially, that it has created risk that is difficult for markets to appraise.

Mr. CUMMINGS. OK. I only have a limited amount of time.

Mr. COX. I would just redouble my challenge—my request to Congress—all I can do is tell you what I see as chairman that we don't have authority to do. We don't have authority to regulate credit default swaps because Congress hasn't given us that authority. I think Congress——

Mr. CUMMINGS. Well, let me—Mr. Cox, let me ask you about what you could do. Your predecessor, Bill Donaldson, before he left he set up a task force specifically to look into the problem of financial derivatives such as credit default swaps, in March 2005, a few months before you became SEC chairman. The Financial Engineering News reported that the SEC had assembled, "people from each SEC division," Corporation Finance, Enforcement, Market Regulation, and Investment Management to look at issues relating to the derivatives market and the implication of the growth of credit derivatives. What happened to that task force under your leadership?

Mr. COX. We have increased the number of people that are focused on risk in the derivatives——

Mr. CUMMINGS. What happened to the task force? Is it still in existence?

Mr. COX. The number of people focused on risk, Congressman, are increased under my chairmanship.

Mr. CUMMINGS. Well, let me tell you what your staff says, the ones that come to work every day that we pay. Let me tell you what they said. They said we have been told by former SEC staff that you failed to support the work of the task force. In fact, you basically defunded the whole Office of Risk Assessment that had been assembled for the task force. In July 2006, you testified at the Senate Banking Committee hearing, you took a completely different position. You said there should be no interference with the investment strategies or operations of hedge funds, including their use of derivative trading, leverage, and short selling.

Are you now telling us, sir, that you were mistaken 2 years ago when you expressed opposition to any regulation of derivative trading?

Mr. COX. First, I don't think that's an accurate representation of my position. Second, the Office of Risk Assessment was not ever responsible for specifically looking at derivatives. The Office of Risk Assessment when I came to the SEC had seven people. It has seven people now. But what we have done is increased throughout the agency the number of people that are focused on risk assessment. We've done that in each of the divisions and offices that you've named. It's a vitally important function and it's one to which the agency and I are still strongly committed. But there are more people doing this now than ever before.

With respect to hedge fund regulation, I have strongly supported the efforts of the SEC to get at this even though we have inadequate legal authority. We put out rules that got to the margin of our authority that regulated hedge fund advisers in order to do this. Those rules were struck down by the court. But as a result of standing up for those rules, as I did, we now have almost all of the hedge fund advisers voluntarily registered. I think we need legislation, however, to——

Mr. CUMMINGS. I wish I had more time.

Chairman WAXMAN. The gentleman's time has expired.

Mr. Souder is recognized for 5 minutes.

Mr. SOUDER. Thank you, Mr. Chairman. One of the huge challenges, you've referred to the moral hazard and risk, and the frustration you're hearing here and across America is the irresponsibility and greed of people in Wall Street and other people who were risk takers has endangered the lives, the jobs, the savings of just millions of Americans. I have a letter from one of the many thousands of e-mails lobbying me for my vote of a lady from my hometown of Grabel, where I grew up, and she said, I turned down a bigger house. I don't understand. We've lived so cautiously, and now we're asking in effect what you all referred to as to take the moral hazard. I took two tough votes for this rescue bill and voted "yes." It may have endangered my career. I did it because I was worried about the people in my district. But they are legitimately angry that people seem to sit here hearing after hearing, well, it wasn't my responsibility and that you kind of knew it was happening. Whether it was Congress or here or there, but they're furious. And I have a couple of questions we've been going through hearing after hearing in different angles with this. And Mr. Cox or my friend Chris, has the SEC, your law enforcement agency, initiated any investigations and attempts, without getting into specifics, without saying where they are, since August and we have had this crisis, have you started the process to see whether there is any legal culpability of some of the people who have caused this mess?

Mr. COX. That is an intense national focus right now from the SEC's Washington headquarters and our 11 regional offices. We have over 50 subprime investigations underway. We also have a coordinated national effort, coordinated also with criminal authorities and with other civil law enforcement authorities in the States to look at manipulation and fraud in the securities of the Nation's largest financial institutions. As you know, this crisis has particularly beset the financial sector. The volatility in the market has particularly been visited upon the financial sector. The crisis in banking, the credit crisis that we're living through, is a mortal danger to many of these institutions. And so determining the extent to which violations of the law may have contributed to this and holding anyone who violated the law accountable is of vital importance, and we are admitting massive resources to it.

Mr. SOUDER. We were hearing yesterday in the rating authorities, as we saw AIG—I mean in AIG we had in July they are paying bonuses, in August they're broke, in September they are getting bailed out at $61 billion. It is inconceivable to me with a business background and knowing how they were exposed that there wasn't knowledge in the rating services. The number of loans that went out doubled in a short period of time. The interest rates go up. Anybody with a slight investigation would have known that they were bundling, that they were doing things that were probably illegal in the sense of taking origination fees, high interest loans, packing them higher than the value of the house. And it isn't just the culpability of the people in the direct subprime. It's a culpability of the people who knew what they were buying who were pretending to see no evil, hear no evil, report no evil, and the question is even in an unregulated market my belief is that many of them are criminal. We have talked a lot of different things in the credit swaps and so on. But one of the questions here is where are the corporate boards? Those of us who believe in the private sector believe that there was supposed to be some kind of corporate check on the stockholders.

Do any of you have any suggestions of what we might be looking at here because clearly they were asleep at the wheel, that if anything else, cooperation; that the fault firings on Merrill Lynch and others only dealt with that they committed a crime and that we seem to have locked in a corporate structure of hedge fund for management that you win if you do well and you win if you lose; that we have to have tougher accountability in some way. And I wonder if any of you have any suggestions because this is critical as to how much government is going to do this because if the private sector does not have a mechanism to hold people accountable, if the private sector rewards any type of thing and the moral hazard goes to the taxpayers, we have a problem. Do any of you have any suggestions?

Mr. GREENSPAN. Well, if I may, Congressman, the markets have already punished the people whom you are referring to. A lot of these products have disappeared and they probably will never return. Some of the fees that were charged and paid when euphoria and essentially which led to significant greed showed up, they're gone. And I suspect that we are going to find that this is a very chastened market and that many of the problems that we've observed during the euphoria stage of the expansion will not be back if—at any time if ever.

Mrs. MALONEY [presiding]. The gentleman's time has expired.

The Chair recognizes Mr. Kucinich for 5 minutes.

Mr. KUCINICH. I thank the gentlelady. Apropos of Mr. Greenspan's comments that the markets are punishing people, our constituents are getting punished. They're losing their homes. And Mr. Greenspan, you have well acquitted yourself as a spectator but I'm not sure you've done that with respect to your being a participant. The epicenter of the financial crisis, as we understand, is the securitization of home mortgages. There are about 10 million homes that are still in jeopardy. In your testimony you blame securitizers, banks, credit rating agencies, risk management models, but what about your role as head of the Fed? In your testimony you spoke of the Fed structure having the best banking attorneys, expert outside counsel. According to the Federal Reserve Web site, the Fed has one of the finest research staffs, 450, half of them Ph.D.'s, but under your term as head of the Fed, public and private debt exploded from $10.5 trillion to $43 trillion. Yet as documented by Jim Oleske in his book called "Yeah, Right," you, Mr. Greenspan, promoted adjustable rate mortgages that fueled the subprime market. You said in February 2004, "American consumers might benefit if lenders provided greater mortgage product alternatives to the traditional fixed rate mortgage. The traditional fixed rate mortgage may be an expensive method of financing a home."

In June 2005, you stated, "Although we certainly cannot rule out home price decline especially in some local markets, these declines were they to occur would not have substantial macroeconomic implications.

In September 2005, you stated, "The vast majority of homeowners have a sizable equity cushion with which to absorb a potential decline in housing prices."

The next year in May 2006, you said, "We are not about to go into a situation where prices will go down," speaking about housing. "There is no evidence home prices are going to collapse."

By mid-2006 there was evidence that the housing market was beginning to have trouble. But you said in October 2006, "The worst may well be over. I suspect we're coming to the end of this down trend."

One month later in November 2006, you said, "It looks as though the worst is behind us. The global economy is in extraordinarily good shape. Things don't look so bad."

Now, Mr. Greenspan, before the collapse of the housing bubble didn't you also say that the United States has not experienced housing slumps to justify your policy that there would be no bubble and can you tell this committee when it occurred to you that there was a housing bubble?

Mr. GREENSPAN. Well, first let me correct several issues here which I regret have been carried on for quite a significant period of time.

Mr. KUCINICH. Could you speak closer to the mic?

Mr. GREENSPAN. Yes, I'm sorry. First with respect to adjustable rate mortgages, it is true as you point out that I gave a speech which was essentially constructed by—it was reporting on a Federal Reserve staff study which is stating the obvious, that if you're going to be somebody who can only live in a home for 2 years before you move elsewhere, you may—you should look at the adjustable rate mortgage issue. The point, however, is it then came out that I was trashing the 30-year mortgage. A week later I appeared at the Economic Club of New York with a thousand people and I basically said that the remarks that I made the previous week clearly did not mean I in any way was talking about——

Mr. KUCINICH. With all due respect, Mr. Greenspan, did you retract what you said?

Mr. GREENSPAN. I did.

Mr. KUCINICH. Well, I've got here from USA Today, if we could put it up on the screen, relative to what you were just saying. You said "I'd reproduce that speech word for word today." Now, I'm not sure——

Mr. GREENSPAN. No. The point at issue is that speech per se taken literally is an unexceptional speech. It essentially said obviously if you've got interest rates rising significantly, then you would basically run into the problem——

Mr. KUCINICH. Here's your words, Mr. Greenspan. On one hand you're saying there was no connection. On the other hand you're saying you would reproduce that speech word for word today. When did you know there was a housing bubble and when did you tell the public about it? Answer the question.

Mrs. MALONEY. The gentleman's time has expired. Mr. Greenspan can answer, but your time has expired.

Mr. KUCINICH. When did you tell the public about it?

Mr. GREENSPAN. If I may respond, that speech was essentially a report on a staff study which if you read today you would find or should find it was exceptional. The problem with respect to my arguing for adjustable rate mortgages as a general proposition is false. I went before this Economic Club of New York just days later and very significantly pointed out that the 30-year mortgage is the most important mortgage we have and that whenever I took out a mortgage I didn't take out an adjustable mortgage because I thought it was too risky.

Chairman WAXMAN [presiding]. The gentleman's time has expired.

Mr. KUCINICH. With all due respect, and maybe some other Member could take this up, he didn't actually respond to the question about when he knew there was a housing bubble.

Mr. GREENSPAN. The housing bubble became clear to me sometime in early 2006 in retrospect. I did not forecast a significant decline because we had never had a significant decline in prices, and it's only as the process began to emerge that it became clear that we were about to have what essentially was a global decline in home prices.

Chairman WAXMAN. Thank you, Mr. Kucinich.

Mr. Sali.

Mr. SALI. Thank you, Mr. Chairman. Gentlemen, I hope you keep in mind that 5 minutes is a pretty short time to get through some questions. I would like to get through a couple of items pretty quickly.

It was mentioned earlier in testimony that there was a great level of expertise in your agencies and you would all agree that's a great deal more than anything we have here in Congress in terms of the level of expertise and the number of people working on those issues; is that correct? Do you all agree with that? You're all saying yes. OK.

Well, Mr. Mica just rattled off a list of what I think most people would consider are fairly important things, and each of you said that you knew nothing about it. Would you agree that's in spite of all the expertise some sort of failure on the part of the three agencies that you're involved with?

Mr. SNOW. Congressman, let me start this time. I don't think I could have been clearer, as some of you know, about the huge threat to the financial system posed by the GSEs. I was up here, testified a number of times, gave speeches on it, called for action over and over and over again. I don't think I could have been clearer.

Mr. COX. If I may respond with respect to the GSEs, in both the 108th and 109th Congresses, as a member of the relevant committees of jurisdiction, I joined with Congressman Shays in cosponsoring legislation by Representative Baker that was designed to give the GSEs a strong regulator—we have all seen the importance of a strong regulator for the GSEs, for Fannie Mae and Freddie Mac, but that legislation was making its way through the Congress as early as 2003 when I originally sponsored the bill. I note that I got a chance to vote for it in the Financial Services Committee in 2005. I note that it passed the House on a bipartisan basis in this November 2005 right after I left and became chairman of the SEC. And I also read with chagrin in the newspaper the sad tale of exactly how it was prevented from coming to a vote in the Senate or at least the influence that was brought to bear to make sure that legislation never happened. But the House did its part, I'd want to point out. I think many of the Members here did and I certainly very early on saw that important task, as did Secretary Snow and I'm sure Chairman Greenspan and many others here. The role of the GSEs is now abundantly clear to just about everybody in retrospect because the Federal Government had to bail them out.

Mr. SALI. Mr. Cox, I guess in looking at Idaho's mom and pop investors who have lost so much of their hard-earned savings, their retirement funds, while some of the corporate CEOs have received golden parachutes and those kinds of things, what do you say to the people in Idaho who have lost their investment? I mean are the people that have caused this—is somebody going to go to jail?

Mr. COX. There's no question that somewhere in this terrible mess many laws were broken. Right now the criminal authorities and the civil authorities not only in the Federal Government and the State governments but in other countries because this is now, as you know, a matter of attention of international focus are working to make sure that law breakers are held accountable and people are brought to justice. The SEC has anti-fraud authority that we are very aggressive about using. As I mentioned earlier, we have over 50 subprime investigations underway right now and we also have a nationwide dragnet involving all 11 of our regional offices and our headquarters, working in coordination with other law enforcement authorities. But cleaning up the mess through law enforcement after the fact, while important, is not ideal. And the best thing that we can do of course, as many of you are focused on, indeed this hearing is focused on this, is to infer lessons from what happened and prevent anything like this astonishing harm can happen again.

Mr. SALI. The chairman is taking us in a direction that indicates he thinks we need more regulation, that perhaps we need more people out there doing regulating with more authority. And I guess I would challenge each of you in the three agencies that you have represented, I think you have sufficient authority—with perhaps exception of the GSEs you had sufficient authority to probably avoid most of the troubles that we have seen. And I guess what the chairman suggested, it begs the question if we didn't get the job done with enough authority to get it done, how will giving more regulators more power do anything different when each of you said you weren't even aware of all the things that Mr. Mica pointed out that were a tremendous problem? How do you respond to that?

Mr. SNOW. Congressman, let me take a crack at it. As I said in my period at the Treasury, it became clear to me that no single regulator had a clear view, had a 360 view of the problem. When I invited the various mortgage market regulators to come and talk to me about what they saw in the subprime markets and with respect to these new instruments, the interest only and mortgage amortization and so on, no one had a clear view of it. They had differing and very different views of it. My suggestion here is that nobody sees the whole picture and we ought to put in place some institution of our government that has a clear view of transparency on risk and leverage in the system. When you get right down to it, this is about excessive risk and excessive leverage and nobody saw because no regulator has that full scope of authority had the full field of view.

Mr. GREENSPAN. If I may just add a word or two, I think that it's interesting to observe that we find failures of regulation all the time, and one of the reasons is a very significant amount of regulation in the economic area is based on a forecast to know in advance whether or not particular products will go bad or the cycle will turn. If we are right 60 percent of the time in forecasting, we're doing exceptionally well. That means we are wrong 40 percent of the time, and when you observe the extent of the broad failure, the difficulty is that nobody can forecast. And if you try to take a look at what the private sector does it's precisely the same thing that goes on in government.

We at the Federal Reserve had a much better record forecasting than the private sector, but we were wrong quite a good deal of the time and that is reflected in how one views what the appropriate regulatory authorities are because unless you can anticipate the types of problems that are going to happen, it's very difficult to know what to do. And I think that's the problem that this type of thing confronts and I don't see any way in which that's going to be fundamentally changed. We can try to do better, but forecasting is never—never gets to the point where it's 100 percent accurate.

Mr. SALI. Chairman Greenspan——

Chairman WAXMAN. The gentleman's time has expired.

Mr. COX. Mr. Chairman, may I answer on behalf of the SEC?

Chairman WAXMAN. Yes. The time for asking questions has expired, but we will allow the answers to the questions.

Mr. COX. I just want to respectfully disagree with the premise of the question that there is adequate regulatory authority in our current regulatory system for the regulators to deal with the problems that we're seeing in the markets today. There are significant regulatory holes, significant regulatory gaps. We have seen them, for example, with respect to the fact there is no statutory regulator whatsoever anywhere in the system for investment bank holding companies. We've seen it with respect to credit default swaps, a $58 trillion market with no regulator. There has been allusion made to the fact that in the mortgage brokerage market there is not adequate regulation. And certainly with respect to the multi-trillion dollar market in municipal securities, there is—the SEC and no one has any authority just to require disclosure to investors of what they're getting. It's not really a simple question of more or less regulation. Once you've got a regulated industry, which we do in financial services, then when you create these big what were pockets that then become a whole universe of unregulated activity it's really distortive.

So you've got to have a system that actually hangs together and makes sense. You can't regulate futures in one way and then economically equivalent securities in another way with different margin rules and so on and expect all of this not to produce discontinuities or disruptions in the market. So there is an enormous opportunity to fix this problem in Congress.

Chairman WAXMAN. The gentleman's time has expired.

Mr. MICA. Mr. Chairman, I have a unanimous consent——

Chairman WAXMAN. I'm sorry. You will have to hold off on that. You can make it later.

The Chair yields himself some time because there was a representation made about my view of regulation and the gentleman from Idaho said I want more regulation. Well, I want smart regulation. But I want to point out that what I'm hearing from our witnesses today is they just didn't know. They couldn't make projections about what the future was or they're not always right. The truth of the matter is there were a lot of warning signs. And we have a large staff in some of these agencies. For example, the Federal Reserve has one of the finest economic research staffs in the United States, including a staff of 450, about half of whom are

Ph.D. economists. The reasons why we set up your agencies and gave you budget authority to hire people is so that you can see problems developing before they become a financial crisis. To tell us afterwards when we are now faced with the disaster that we're seeing that you couldn't have foreseen it, it just doesn't satisfy me.

Now, Mr. Cox has come in with a whole long list of regulations he'd like to see in place that make a lot of sense to me because they sound reasonable. I wanted to have Mr. Arthur Levitt here. He couldn't be here, but I can't imagine he would have had too much of a difference of opinion on the proposals that you've made. But the reality is, Mr. Cox, you weren't doing that job of proposing these regulations beforehand. You didn't either anticipate the problem or you agreed with the philosophy that we don't need regulation, the markets could correct themselves. So I just want to suggest—and I'm not really asking a question. I really want to suggest to my colleagues for them to say that there's no way you could have known what was going on, there's no way you could have acted, there is a long list of warning signs and prominent economists were saying things should have been done and this problem is going to get out of hand, and yet the Federal Reserve, the SEC, the Department of Treasury and other agencies didn't act, and to say now we need regulations is helpful.

I also want to say something about the GSEs because I think it's a political point that's been thrown out there for politics. It's about as—to say the GSEs started this whole crisis is about as accurate as saying that offshore drilling will solve our energy crisis. It's a political argument. It's not a factual one. And I'd like us to go into the facts. Sometimes by looking at the facts we can learn from what happened and hopefully not repeat the mistakes in the future.

I gather Mr. Cox and others are suggesting we have a task force, that we bring everybody together to redo all our regulatory system. Well, that may make sense but it is certainly dealing with closing the barn door after the—whatever the metaphor is, after the horses or cows have already escaped. We're already in the mess and now we've got to figure out how to get out of it and learn from the past, not rewrite it.

Mr. DAVIS OF VIRGINIA. Can I yield myself a few minutes?

Chairman WAXMAN. The gentleman is recognized.

Mr. DAVIS OF VIRGINIA. Let me just say I mean we're talking culpability here. What was Congress doing all this time?

Chairman WAXMAN. Yes, good point.

Mr. DAVIS OF VIRGINIA. I mean I think at this point we had all the warning signals that everybody else did, and the inability to move particularly on Freddie and Fannie where the warnings came from the administration on down constantly, warnings in the newspapers, warnings from economists, and we had party-line votes in the Senate not to move forward on regulating that aspect which all of our witnesses said——

Chairman WAXMAN. Will the gentleman yield?

Mr. DAVIS OF VIRGINIA. I'd be happy to.

Chairman WAXMAN. Well, the law that was being proposed was adopted in the House by a bipartisan vote overwhelmingly.

Mr. DAVIS OF VIRGINIA. In the Senate it was——

Chairman WAXMAN. And in the Senate it was bipartisan as well for those who opposed it, and we couldn't—those of us who supported legislation—get enough votes to stop a filibuster because of Democrats and Republicans.

Mr. DAVIS OF VIRGINIA. Mr. Chairman, let me reclaim my time. I mean, look, it was the chairman of the Financial Services Committee who said there wasn't a problem, and we've been through all this. But rather than culpability, it lies all around. And I just came in the room as you were going through—lecturing Mr. Cox and others on culpability. I think we all agree there's a lot of blame to go around here but it doesn't lie with any party or any agency. This was global in its nature. It even for the mortgage brokers goes back to State regulation. You can go back to New York. What were they doing during this time period as well? What we need to focus on is what are we going to do from here on out? And we're hearing a lot of rhetoric about regulation, deregulation. The fact of the matter, we're dealing with so many silos here that nobody gets the whole picture. It reminds me of 9/11 where everybody knew a little bit of everything but nobody knew the whole story. And as we listened to people that have been intimately involved with this, that seems to be what they are saying.

I would give my remaining time to Mr. Sali.

Chairman WAXMAN. You have 15 seconds.

Mr. DAVIS OF VIRGINIA. So 15 seconds for a quick question.

Mr. SALI. For the three of you, is the best that we can hope for here that because you rely on projections that whatever regulation we give, and I hope we will be smart about it and not be in overhanded with this—overly harsh with this, is the best we can expect, though, a regulation that will have a 40 percent chance of being wrong no matter what happens, as Chairman Greenspan has said? Do you all three agree with that premise?

Chairman WAXMAN. The gentleman's time has expired, but we will let the witnesses answer.

Mr. GREENSPAN. I obviously agree with it. I made the statement.

Chairman WAXMAN. Mr. Cox.

Mr. COX. That's a little more quantitative than I feel comfortable being in, estimating the future probability of success of regulation. But I think the point that it's a fallible human process always has to humble anyone in Congress or anyone in regulation. Nonetheless when we look at it structurally, it's just very clear we can do a much better, more rational job. And we have to take a look at the fact that this system of regulation was fundamentally designed in the 1930's and 1940's. The markets have changed a great deal. It is time to have a thorough going—restructuring that rationalizes all this and closes the regulatory gaps.

Mr. SNOW. I think regulators need more transparency on the risks and the leverage in the financial system. I think some regulators should be given responsibility for assessing broad systemic risks and the ability to step in where they see the risk management function being abused, too much leverage being created in some aspect of some businesses' behavior, as you now have with the GSEs, to step in and stop it. That's what we lack today, I think.

Chairman WAXMAN. Thank you.

Mr. MICA. Mr. Chairman, I have my unanimous consent.

Chairman WAXMAN. The gentleman will have to hold until after we finish with the other Members.

Mr. MICA. I have to ask after each timely——

Chairman WAXMAN. No. Why don't you wait until all the Members have had a chance to ask questions and then——

Mr. MICA. I just want to put this one page in from the Wall Street Journal that mentions you and me and today's hearing.

Chairman WAXMAN. You have one page and that's it?

Mr. MICA. Yes, sir.

Chairman WAXMAN. Without objection, your one page will be made part of the record.

And the Chair will only comment that the statement that everybody has responsibility means nobody has responsibility. It's like saying a criminal acted without personal responsibility because the society caused all the problems that led that person to act that way. That's the way I hear it.

And let me also point out the Republicans controlled the Congress for 12 years. It's only the last 2 years the Democrats have been in power and we have had a Republican administration for 8 years, and I can see why you don't want to hold any party responsible but I just think that fact ought to be out there.

Mr. DAVIS OF VIRGINIA. Mr. Chairman, as long as we're doing facts, the Commodities Futures Modernization Act was signed by President Clinton by—Democrats, by the way, controlled the Senate for the first 2 years of the Bush administration. Let's not get into partisanship. Why don't we focus—I'm responding to what the chairman is saying. I have tried to stay away from that today. I think we need to focus on the issues. That's what the public is interested in. They are tired of this partisan carping back and forth.

Chairman WAXMAN. We will stop the harping and go to Mr. Tierney for his questions.

Mr. TIERNEY. Thank you, Mr. Chairman.

Dr. Greenspan, I don't think all of it was relative to forecasting on that, and I want to go back over a little bit about the irresponsible subprime lending, which I think many or most experts have indicated they think that is the root cause of this crisis. I think when I looked at your testimony you said subprime mortgage organizations were undeniably the original source of the crisis, so I assume that you agree.

Mr. GREENSPAN. I do.

Mr. TIERNEY. And Mr. Cox has said this. He said the current credit crisis began with the deterioration of mortgage orientation standards. And Mr. Snow cited lax lending practices as one of the causes of the financial crisis.

So when Mr. Waxman was discussing that with you, Dr. Greenspan, in response to the question of why you hadn't used the regulatory authority that Congress gave you in 1994 to rein in the irresponsible subprime lending, you said I took an oath that I am here to uphold the law of the land, the will of the Congress, not my own predilections. But you had a clear directive to act. I went back and checked. The law of the land as of 1994, the Homeownership Equity Protection Act, Title 15, United States Code, Chapter 41, subchapter 1, part b, section 1639, subsection 11(2) and all that, it says this. It says that the Board, meaning your board, by regulation or order, shall, not may, but shall prohibit acts or practices in connection with refinancing of mortgage loans that the Board finds to be associated with abusive lending practices or that are otherwise not in the interests of the borrower.

Now, you had a nice conversation where you said, well, Mr. Gramlich came in, he came into the conversation where he requested that you send bank examiners out on this. You didn't do that. But then you said to Mr. Waxman that you spoke of sending them up to the committee thinking they would come back and that you would act, and then you also said you voted for regulations.

But unfortunately, the regulations on which you voted in 2001, they dealt only with high cost mortgages. That leaves like 99 percent of subprime mortgages totally off the table. You didn't deal with deceptive tease rates, you didn't deal with balloon payment loans, you didn't deal with prepayment for homeowners who wanted to refinance before their rate goes up.

So I guess the question again to you is, you had Mr. Gramlich's cautions, you had the Treasury Department and the Housing and Urban Development office all asking you to use the authority that Congress gave you as a mandate, not a wish, but a mandate. So can you still say I guess that you thought that you were carrying out the law of the land and the will of Congress as opposed to having your own ideology sort of influence, not having strong enough regulation that you didn't bring to the Board and you didn't press for stronger regulation of the unsavory subprime loans?

Mr. GREENSPAN. Well, let's take the issue of unfair and deceptive practices, which is a fundamental concept to the whole predatory lending issue.

The staff of the Federal Reserve, the best in the business as far as I am concerned, looks at that statement and then says how do they determine as a regulatory group what is unfair and deceptive? And the problem that they were concluding and therefore were raising with the staff of the Congress was the issue of maybe 10 percent or so are self-evidently unfair and deceptive, but the vast majority would require a jury trial or other means to deal with it and that rulemaking—can I finish my sentence?

Mr. TIERNEY. The debate was over. The law passed. The debate between your office and Congress was over. In 1994, the Congress passed a law telling your board and you to actually do something about it and it wasn't done. I guess the evidence of that is—we have that situation, and I don't want to—I share with Mr. Davis the desire not to get political about this, but Mr. Mica and others sort of went off on this GSE thing here.

1994 I guess was a Democratic Congress instructed you to do that. It wasn't done. 1995 to 2006, the Republicans are in. They don't pressure to do it. Nothing got done in that respect. But the core part of this problem is the irresponsible subprime lending.

Then in 2007, when Democrats take control, a bipartisan group in the House passes by a significant margin a directive to you. They basically write your regulation for you and tell you, by that time you are gone, but tell the Board what it should do in terms of dealing with subprime mortgages. It passes by a huge bipartisan vote in the House, 291 to 127, but it doesn't go anywhere in the

Senate because the Bush administration opposes it and kills it and then they don't deal with it then.

In 2005, back when the Republicans were still in charge, Mr. Oxley made an effort to have a bipartisan group do something about subprimes because the Fed Board wasn't doing it, and in his own language the White House gave him what he said was the one finger salute on that. It wouldn't deal with it. But it still passed the House by 331–90, so you had a bipartisan group in the House that wanted to deal with it.

So I think that if we are going to talk about what happened here, there was at some point somebody who didn't want to regulate, but a group at least in the House of Representatives that did.

I understand my time is up. Thank you.

Chairman WAXMAN. The gentleman's time has expired.

Mr. Bilbray.

Mr. BILBRAY. Thank you, Mr. Chairman.

Gentleman, I appreciate you pointed out that even though it may look small, the iceberg that we call the toxic twins, Freddie and Fannie Mae, had a much more substantial impact than appearances may first appear. So that scuttling of the "good ship economy" can be traced back to an incident that can be related though those toxic twins, that iceberg, Freddie and Fannie.

But even with that damage done and the severe damage done to the economy by that small little low profile thing called the iceberg, Freddie and Fannie, there was other things that could have helped to mitigate this impact. I guess the quality control, the safety inspections, to make sure that the good ship was able to take this kind of hit doesn't appear to have been there to the level we want.

Mr. Cox, I realize that the SEC has just recently been granted the authority to regulate the credit rating agencies, the ones who are supposed to be inspecting the craft and telling us that it is safe to use. In your testimony, in the testimony we heard yesterday, it was clear that the credit rating agencies are not significantly regulated and that there were major abuses of the independent raters.

Considering the level of Federal regulations to these independent, so-called independent assessments, and how important that is, do you think that you have significant authority now to regulate them? Do you think there is enough transparency for not only regulators, but also investors, to know exactly what they are buying and do you have the ability to regulate them appropriately now, or do you need more regulation and more authority to be able to create more transparency?

Mr. COX. We do have the authority that we need in this area. One of the first things that I did when I became chairman is work with the Congress and urge the passage of this legislation. There was a move afoot in the industry to develop a voluntary code of conduct as a way to stop the legislation, and I put the SEC strongly on record in support with the chairmen of the authorizing committees in both the House and in the Senate.

That legislation was signed in my second year as chairman. We immediately went to work using the authority to register the credit rating agencies with us, and in fact beat the deadline in the statute by a month to put out the first rules under the statute. We inspected the big three in this industry and produced this report, which was the basis for much of the questioning yesterday.

We looked through 2 million e-mails, some of which we provided to this committee, to discover what was going on in this industry, and then to propose even more thoroughgoing new rules that will govern many of the problems that we have seen here. Without even waiting for the notice and comment period and the implementation of the rules to take effect, we have worked with the industry to put those reforms into place, and as I think you saw yesterday, this is a much chastened industry because of what has gone on and the impact on the markets and investors.

Mr. BILBRAY. Now you were talking about one of the problems with regulation is not just how much we have, but where it is and the ability to respond. You squeeze off one part of the private sector with regulation here and they tend to find another place where all at once it starts blossoming, blooming and growing out of control. Much with the swaps were a good example.

Do you think now we have the flexibility for regulators to be able to move laterally over to respond to these kind of bubbles as they are created by our regulation being at one location or another, or do you need more flexibility to be able to respond to those? Gentleman? Either one.

Mr. COX. I don't think the current regulatory system works when it comes to integration and cooperation and sharing of information. The SEC, even before we had the avalanche of problems in 2008 in the industries that we regulated and that the Federal Reserve regulates, began work with the Fed on a memorandum of understanding to share information, because it was, as someone alluded to here earlier, too much like the blind man and the elephant. Everyone had a good view of their part of the problem, but by law they were focused only on that part and not on the total picture.

So in addition to having the regulatory gaps filled, which is of vital importance, there also has to be a much more seamless integration.

Mr. BILBRAY. So a lot of parallel to what we saw on 9/11 where the Intel people were not sharing information and no one group had all the information, we are running into the same thing here. There has been a proposal by Mr. Issa to have a bipartisan commission, like the 9/11 Commission, not only to look at what has happened in the past and do a report within that 1 year, but also stay in force for 5 years to avoid this.

Gentleman, do you have any comment about us approaching this with that general bipartisan view so we avoid the bickering that you have seen up here today?

Chairman WAXMAN. The gentleman's time has expired, but we would like to hear answers to the question.

Mr. GREENSPAN. I don't have any response to that.

Mr. COX. I think it is vitally important, as this hearing is doing today, as your other hearings have done, and as you have proposed and Congressman Issa has proposed, to understand it is very complex how all of these things have happened around the world. History is going to tell us eventually a lot more than we know even today.

It is also important to do the other piece of what you have described, and that is to confront it in an empirical way. That is what "bipartisan" in this context I think means. We have to make sure that we are after the facts and that we are willing to infer the tough lessons from those facts.

Finally, I would say, make sure that you have a forward-looking approach. If all that we do is look backward and say "that is who shot John," and we don't protect the economy, investors, our kids and grandkids whose debt is getting run up right now, then that will be a new failure on top of all that is happening.

Chairman WAXMAN. Mr. Snow.

Mr. SNOW. I have nothing to add.

Chairman WAXMAN. Thank you. The gentleman's time has expired.

Mr. Yarmuth.

Mr. YARMUTH. Thank you, Mr. Chairman.

With all apologies to my New England colleagues here, I feel like I am looking out there at three Bill Buckners, the first baseman for the Red Sox who let the ball go through his legs and cost his team the championship. All of you let the ball go through your legs. You didn't want to let the ball go through your legs, you didn't try to let the ball go through your legs, but it got through. And it is important that we do try to find out why it got through, whether it took a bad bounce, or whether there was something fundamentally wrong with the way you and others played the ball.

Some of these things I understand were unforeseeable. There is no question about that. But some of them were very foreseeable. And I want to refer to the credit rating agencies, because we knew beginning at least in 2001 when Enron was given a superior rating 4 days before it collapsed, and we knew it in subsequent events. In 2002, the SEC published its own report which found serious problems—I am sorry, 2003. But before that in 2002 the Lieberman committee in the Senate issued a report on these problems. And the SEC was actually moving it seemed like with good intentions and with intelligence to create some authority to regulate the credit rating agencies. And in 2005 they issued a proposed rule that never was acted on.

Mr. Cox, why was that not acted on?

Mr. COX. Well, the SEC cannot create for itself authority over credit rating agencies. The proposed rule was a designation of NRSROs, but it was not legislative authority to regulate what until the fall of last year was an unregulated industry. Legislation was needed to do that.

As a Member of Congress, I strongly supported that legislation going back even before Enron, because I saw what happened in Orange County with the largest municipal bankruptcy in American history. There, just as with Enron, up until the event itself, the debt was rated top grade, AAA. These problems have been recurrent.

What was absolutely necessary and what I took on full tilt when I became chairman, was getting authority to make that a regulated industry, not an unregulated industry, and we have been using our authority to great effect since we have gotten it.

Mr. YARMUTH. I appreciate that, and I agree that the steps you are taking are commendable and I think they make sense. But your predecessor, William Donaldson at the SEC, he wrote a letter to Congress in 2003 and said he did have ample authority to regulate credit rating authorities because he could decertify them if he found that they weren't doing the job properly.

So you did have authority, maybe not specific legislative authority, but you had authority to use the certification process, didn't you?

Mr. COX. The certification process was the basis—remember, in that period there were essentially three main rating agencies and they were already there. So rubber stamping them as "certified" was rather circular and tautological. What was under development, as I mentioned earlier, was a program of voluntary compliance, a code of conduct. This was in fact being developed on an international basis.

Even though I am currently the chairman of the Tech Committee of the International Organization of Security Commissions and I have a deep and abiding respect for the work of IOSCO, I saw immediately that a voluntary code of conduct was going to be as nothing against what this industry needed, which was actual regulation. And I am very, very pleased that the Congress gave the SEC that authority, which it never had before.

Make no mistake, credit rating agencies did not have a regulator, were not regulated, and all that they were going to get was volunteer. Volunteer regulation does not work. We have seen it over and over again.

Mr. YARMUTH. I would agree with that. I still don't understand the fact—I don't understand your point that you couldn't decertify these agencies. You say basically the certification was a rubber stamp. What if you took the rubber stamp away?

Mr. COX. Well, the rule concerning the designation of NRSROs was essentially limited to that. You know, you have to credit the agency for trying to move into that space. But what happened in 2005 is that we finally got legislation moving, and that clearly made more sense than trying to do something without any authority.

Mr. YARMUTH. So that is why you dropped the rulemaking process? That is why you stopped that?

Mr. COX. Yes. The focus was on getting the legislation passed, which actually happened very, very quickly. And, as I said, we beat the deadline in the statute for putting out rules. We moved very, very quickly.

Mr. YARMUTH. My time has expired. Thank you.

Chairman WAXMAN. Thank you are, Mr. Yarmuth.

Mr. Platts.

Mr. PLATTS. Thank you, Mr. Chairman. I appreciate you and the ranking member's efforts on investigating this crisis facing our country and appreciate all three of our witnesses.

There has been a lot of discussion, Fannie Mae and Freddie Mac and the lack of sufficient regulatory authority and how that has played into helping to create this crisis. I would like to address a similar issue about regulatory authority, but how maybe over-aggressive regulatory efforts helped create it, and specifically get your input on the Community Reinvestment Act.

Mr. Cox, you shared in your testimony that if honest lending practices had continued and we hadn't gotten to where there was almost no lending practices being used for these no-down-payment, no documentation loans, that played a huge role in where we are today.

Back home, I have had numerous banking officials, bank board members, address with me the Community Reinvestment Act, that in essence they are being forced by the bank regulators to engage in making loans, to have a specific or certain part of their portfolio, to risky applicants, and they are in essence being forced by the regulators to make loans that they would not otherwise make and that they know are at great risk of default.

So I would be interested in each of your opinions on that role in this crisis, big or small, and is it something we should be looking at, reforming the way the Community Reinvestment Act is being enforced and implemented by the regulators?

Mr. GREENSPAN. Well, you know, it is instructive to go back to the early stages of the subprime market, which has essentially emerged out of the CRA.

The evidence now suggests, but only in retrospect, that this market evolved in a manner which if there were no securitization, it would have been a much smaller problem and indeed very unlikely to have taken on the dimensions that it did.

It wasn't until the securitization became a significant factor, which doesn't occur until 2005, that you have this huge increase in demand for subprime loans, because remember that without securitization there would not have been a single subprime mortgage held outside of the United States; that it is the opening up of this market which created a huge demand from abroad for subprime mortgages as embodied in mortgage-backed securities.

Now, we didn't know that the deterioration in the standards was occurring until 2005, because you look now at the outstanding subprime mortgages and it is very obvious that those that were made in 2004 and earlier have not turned out to be an incredibly difficult issue. In other words, the real toxic mortgages occur with the huge increase in securitization and largely the demand from abroad and to whatever extent Fannie and Freddie were involved, from them as well.

So, it strikes me that if you go back and ask yourself how in the early years anybody could realistically make a judgment as to what was ultimately going to happen to subprime, I think you are asking more than anybody is capable of judging. And we have this extraordinarily complex global economy which, as everybody now realizes, is very difficult to forecast in any considerable detail.

Mr. Chairman, I know I agree with you in the fact that there were a lot of people who raised issues about problems emerging. But there were always a lot of people raising issues, and half the time they are wrong. And the question is, what do you do?

I mean, you point out quite correctly that the Federal Reserve had as good an economic organization as exists, and I would say in the world. If all those extraordinarily capable people were unable to foresee the development of this critical problem, which undoubtedly was the cause of the world problem with respect to mortgage backed securities, I think we have to ask ourselves, why is that? And the answer is that we are not smart enough as people. We just cannot see events that far in advance. And unless we can, it is very difficult to look back and say why didn't we catch something?

I think it is a very, very difficult problem with respect to supervision and regulation. We cannot expect perfection in any area where forecasting is required, and I think we have to do our best, but not expect infallibility or omniscience.

Mr. PLATTS. Can Mr. Cox and Mr. Snow answer the question?

Chairman WAXMAN. Yes. If Mr. Cox and Mr. Snow, if you wish to respond to the question outstanding?

Mr. COX. I am sorry, Congressman Platts, do you want to restate the question?

Mr. PLATTS. Specifically on CRA and going forward. And, Dr. Greenspan, I am not asking if we could have predicted it. In going forward, should we be looking at reforms to the Community Reinvestment Act? What my local bankers are saying, they feel very pressured by regulators to make loans they know are not good loans and risky loans and likely to be defaulted or have been defaulted in the past.

Mr. COX. Well, I would just point out the obvious which is that the SEC does not regulate lending or credit or mortgages. But on the more general point of whether or not legislation needs to be carefully drafted and carefully conceived so that it does not create risk in the system, I have abundant agreement, and as the investors' advocate, obviously when that kind of legislation or those kind of regulatory policies lead to the creation of new risk that otherwise wouldn't exist, investors are indeed very ill-served.

Mr. PLATTS. Thank you.

Mr. SNOW. Congressman, I actually think it is a much broader phenomena, and in the risk of being maybe a little controversial here, you know, we have had a policy in the United States to promote homeownership for a long time. That is a good thing. Administrations of both stripes and Congresses of both stripes have continued to push for policies that would encourage homeownership. We see that very much in the Tax Code. We saw that with GSEs. We saw it in a number of ways.

I think the larger problem here, frankly, is that we have probably somewhat overdone that without reference to the consequences that commitment to housing has created for the country as a whole. I think we have to rethink that balance, how do we promote housing appropriately while at the same time encouraging savings rates and prudent borrowing practices. And I could go on and on.

Thank you very much.

Chairman WAXMAN. The gentleman's time has expired.

Mr. Davis, you seek recognition for 1 minute?

Mr. DAVIS OF VIRGINIA. One minute, yes.

Dr. Greenspan, you made an interesting comment. The Federal Reserve has probably the best economic organization in the world, and yet you couldn't reach any agreement on seeing this coming and predicting it.

Let me ask this question to all three of you, because as I have gone through the testimony, it looks like the regulatory regimes, it wasn't a question of deregulation, re-regulation, overregulation. The regulatory regimes that were set up appear to be too fragmented, too stove-piped, too non-communicative, so that no one could see the problems arising in total, everybody saw a piece of that, until it was too late. Is that a fair statement?

Mr. GREENSPAN. I am not sure, Congressman. I think that we all had as much information as probably was available. So I am not clear by any means that if you combine the levels of ignorance, that you somehow enhance insight.

I mean, for example, as I just was mentioning, we now know that the subprime mortgages that were originated in 2004 and earlier are not our problem. These are data that are available only now. We didn't know that at the time. And I am not sure that merely conglomerating everybody's insights—and as I said, I have dealt with many different organizations, and if the Federal Reserve at the level of technical capability is not capable of confronting this type of problem, I think it is telling us something about the nature of the problem which itself is incapable of being handled in the way we all would like.

Mr. DAVIS OF VIRGINIA. Mr. Cox.

Mr. COX. I think I am going to answer the question from a slightly different angle so as not to disagree any more than I have to with the answer that Dr. Greenspan has just given. I think it stands on its four corners and there is a logic to it, but I see more in your question.

In the last few months in the caldron of these crises, events have been moving on not just a day-to-day basis, but an hour-to-hour basis. The coordination of information and the demands that has placed on regulators are very high. So when you are looking at the safety and soundness of banks, as the Fed does, when you are looking at what is going on inside a broker-dealer, as the SEC does, you are concerned with now the fact that things can change in a matter of hours. Everything that was there this morning could be gone by the evening.

You need to know what the liquidity issues are, what the funding position is for a firm, and when the Fed has some of those firms and the SEC has other of those firms, we don't get the same clear picture of what is going on in the market in real time that I think we need.

So it is fine these statistics are all published and everyone has access to them and we can all understand it eventually, but you have to do this in real time. The President's working group was formed to deal with crises like this. It has been an ongoing meeting of the President's working group for several months now. We have all been working 20 hours a day, 7 days a week since March. So we just need all the tools we can get to coordinate better.

Chairman WAXMAN. Thank you, Mr. Cox.

Mr. SNOW. I agree with you, Congressman Davis. I will be clear. I think we have too many stovepipes in the financial market regulatory system, with the left hand not knowing what the right hand knows. And I agree with Chairman Greenspan about the complexity of regulation. I used to be a regulator of an agency, Mr. Chairman, you know well, NTSA, and I have an appreciation of the burdens and complexities of regulation.

But it does seem to me that we have regulators, I think the chairman said, Chairman Cox mentioned this earlier, regulating under different jurisdictions and with different bodies of law the same thing. Equivalent things ought to be regulated on an equivalent basis.

We also have the turf battles. This was clear just last week in an article in the Washington Post, Mr. Chairman, on the subject of the swaps market and who would regulate the swaps market. We had the three agencies, according to this article, in serious conflict about who should have the jurisdiction.

Now, I think it is time to overhaul the regulatory system.

Chairman WAXMAN. Thank you very much.

Ms. Norton, but as I understand it, Mr. Yarmuth had a unanimous consent request?

Mr. YARMUTH. I ask unanimous consent that it be placed in the record the report of the Senate Committee on Government Affairs from October 8, 2002, which relates to the committee's request that the SEC implement rules to regulate the credit rating agencies. Mr. Cox said that they moved in an expeditious way. He may have, but the SEC was asked to do that in 2002.

Chairman WAXMAN. Without objection, the document will be made part of the record.

Ms. Norton.

Ms. NORTON. This is a question for all three of you. I will be using language from Dr. Greenspan, but it is for all of you. I agree that all of us are often not smart enough. I don't agree that because of the stovepipe quality of regulation, there was no way in which this could have been seen. My question really goes to remedy, and particularly to remedy as events unfold.

Dr. Greenspan, you have said that regulation by its nature is ineffective because it cannot actually predict problems, and you have indicated the percentage of predictability, and I think that is pretty good, too. I am interested in what happens as events occur and nothing happens.

For example, 14 years ago, in 1994, GAO published a 2-year study, 200 pages, exhaustive study, entitled "Financial Derivatives: Actions Needed to Protect the Financial System."

I am interested in the financial system. We have seen the collapse of the financial system. We are coming back for a lame duck session at the end of a President's term because we think we are seeing perhaps the collapse of the economy itself. Now, I am really into remedy at this point.

The GAO, I want to quote it. "Derivatives are rapidly expanding"—this is 1994—"and increasingly affected by the globalization of commerce and financial markets. The sudden failure or abrupt withdrawal from trading of any of these large dealers could liquify the problems in the markets and could also pose risk to others, including the financial system as a whole. The Federal Government would be likely to intervene to keep the financial system functioning. In cases of severe financial stress, intervention could result in a financial bailout paid for by the taxpayers."

That is the only remedy we have now, huge intervention into the market system of the kind none of us would have desired.

The GAO, of course, wasn't alone in warning. Representative Markey had a hearing. Representative Oxley, a Republican from Ohio, asked the question then about bailout, the only remedy we now have, how realistic is the threat of a taxpayer bailout? And you, Dr. Greenspan, said "negligible." Those are your words. "Short of a virtually inconceivable situation, one cannot envisage where taxpayer funds would show up."

Four years, of course, ago we saw the collapse of Long-Term Capital Management and Enron. Now AIG, $140 billion worth of essentially bailout.

Now, I am going to ask you in light of the fact that these are new instruments that people say none of us understand because people who are outside of your and my sphere made them up, could you regulate now? At one point along this timeframe should some form of regulation have taken place? Could you regulate now? Do you understand enough of what happened to regulate now? And I would appreciate your insight into what form you think regulation should begin to take. What should we do now that we are faced with bailouts as the only remedy that the Federal Government has?

Mr. GREENSPAN. First of all, on derivatives, remember in 1994 and indeed pretty much throughout maybe 2004, even 2005, the major part of derivatives were interest rate and foreign exchange derivatives, and they are still functioning rather well. In other words, the problem that has emerged——

Ms. NORTON. Well, the GAO talked about it , they did this in 1994.

Mr. GREENSPAN. I understand that. I think they were mistaken. In other words, that was one of the forecasts that didn't go right. In other words, the types of things they were raising——

Ms. NORTON. What did go right is they said you could see a bailout and the collapse of our financial system. That was predicted. That happened.

Mr. GREENSPAN. Remember, the point I am trying to make is the only areas where we are running into some problems, which are curable, frankly, by resolving certain structural problems which the Federal Reserve Bank of New York is working on, is——

Ms. NORTON. How would you advise this committee, this Congress, to begin to do the appropriate, intelligent regulation or remedy seeking, whatever you call it?

Mr. Snow, you seem to wish to answer that question as well.

Mr. SNOW. I think there are a number of things that can be done and should be done. The securitization market is a good market. It shouldn't be disestablished in any way. But it seems to me, Congresswoman Norton, it would work an awful lot better if the original loan, the people who make the loans initially——

Ms. NORTON. What about them?

Mr. SNOW. Kept some skin in the game. You know, we used to have something that functioned real well in this country called Bank Credit Committees where the question would be asked can the borrower repay the loan? How will the borrower repay the loan? What is the collateral the borrower has for the loan? That is good banking practices.

One of the unintended consequences I think of the securitization market is that function isn't being carried on nearly as effectively as it once was.

So a suggestion for you would be when somebody originates a loan and then sends it off to the securities market, keep a percentage of that loan.

Something else that seems to me should be done in the name of transparency and openness to get our markets working better: When investment banks and banks are selling these products into the market and also hedging those projects by going on the other side, there ought to be transparency. They ought to be telling the marketplace, yeah, we are selling you these things, but we are also hedging them. That would provide useful information to the would be buyers of those issuers.

So I have a lot of suggestions for you I can give you for the record.

Ms. NORTON. Mr. Cox didn't get a chance to answer.

Chairman WAXMAN. Do you have something you want to add to this, Mr. Cox, briefly?

Mr. COX. First of all, I strongly believe with former Secretary Snow that the movement from the originate to hold model to the originate to securitize model contributed to the breakdown in market discipline, and as he very straightforwardly put it, if you don't have skin in the game, you are just passing off the risk to someone else and then you are inclined to take more risk. And that built risk into the system we have seen has been dangerous.

Second, I think it is very important for us to build future ways to understand complex securities from the investor's standpoint. Right now, analysts are unable to track with complex structured securities the underlying assets and the risk in them. There is no tracking right now, for example, on a loan-by-loan basis of whether the loan amount is more or less the property value, whether the loan is current. With data tagging, this could be accumulated and the securities valued by analysts so that investors would understand and the market would be able to price the risk of these structured securities.

Ms. NORTON. Mr. Chairman, can I put in the record the document from which I quoted from the GAO in 1994, Financial Derivatives: Action Needed to Protect the Financial System?

Chairman WAXMAN. Without objection, that document will be made in put in the record.

Ms. WATSON. Mr. Chairman, matter of personal privilege, please. I notice there is a banner up down on the other side, and I remember being asked to take a banner down that I had.

What is your procedure for banners that are put up by members?

Mr. ISSA. The gentleman has left.

Ms. WATSON. I would like the chairman to respond.

Mr. ISSA. The gentleman has left.

Ms. WATSON. No, I still would like the chairman to respond. Can everyone do that from time to time? Can any Member?

Chairman WAXMAN. If you will a yield to me, I wasn't aware of it. I don't know that we have standard. I hear the point you are making, and the banner has been taken down.

It is now the Chair's opportunity to recognize Mr. Cooper. And I consider that a great opportunity, so I do recognize Mr. Cooper.

Mr. COOPER. Thank you, Mr. Chairman.

As important as it is to learn from the mistakes of the past, I think people are even more concerned about trying to prevent or avoid crises in the future.

The crisis I am worried about could be even bigger than the subprime mortgage and financial crisis we are facing today. The crisis I am worried about is probably best exemplified by this official U.S. Treasury document that comes out every year, but very few Americans, very few Members of Congress have ever seen or heard about this document.

It is called the Financial Report of the U.S. Government. It is available for free on the Treasury or GAO Web site. And yet it seems to be a deep, dark secret in Washington, despite the fact that this is the only official U.S. Government document that actually uses real accounting, accrual accounting, to describe our problem, and the only one that contains audited numbers. All the rest of the budget documents we use around here don't meet those standards.

Well, why is this document such a deep, dark secret? And it is not classified. It is hidden in the public domain. Perhaps if we did classify it, some spy would try to steal it and then it would get more publicity. But why is this document so hidden? Because it contains such bad news.

Now, this document goes out under the signature of the Secretary of the Treasury. This particular one was signed by former Secretary Snow. The deficit that all the politicians talked about that year was $316 billion. The deficit contained in this document was $760 billion, over twice as large. And the debt is also much worse, because that year the debt was, the official statutory debt was something like $8 trillion. Here the fiscal gap is $46 trillion.

So, my question for each of the panelists is this: Secretary Snow, your predecessor lost his job in part because he cared so much about budget deficits. On your watch, did you do anything to publicize this report, to make sure that everybody in America knew the real story about the real numbers for America?

Mr. SNOW. Thank you for that, calling attention to that report. You asked me what I did. One thing I did was to send it to you, as I recall, to call your attention to it back then in 2005 or 2006.

It is a serious subject, it is a deeply serious subject, because the systemic risk associated with the unfunded liabilities, and that is what that report deals with, primarily the unfunded liabilities. The promises we have made to the future that we have not provided for would swamp any problem we have ever seen financially, handily.

Mr. COOPER. Mr. Secretary, my time is so limited, only four Members of Congress get this officially. More Members of Congress were briefed on the ultra-secret NSA wiretapping than on this document. You were kind enough to write me a letter after you left office saying how important it is to get this information out, but there is no evidence of any press conference or any public statement that I could find that you made while you were Secretary of the Treasury to get the word out.

Mr. Cox, Chairman Cox, you are well aware that every public company in America has to meet certain strict disclosure standards. They have to use real accounting. Well, the Federal Government has exempted itself for many years from these standards. And wasn't it the first plank in the Contract with America to stop these Federal Government exemptions from the laws that apply to regular Americans?

So here we are in the situation where the Federal Government is the only large entity in America, for profit or nonprofit, government or nongovernment, that has successfully exempted itself from real accounting standards. Have you done anything in your tenure at the SEC to highlight the real numbers for America?

Mr. COX. Indeed, just on the point that you made about the Contract with America, specifically that was about making sure that Congress didn't exempt itself from the rules that apply to everybody also.

But I just so strongly agree with you that for the entire time that I served here in Congress, I mailed that report in the form of an annual report of the U.S. Government to my constituents every year. And I also made it available to every Member of Congress so that they could do the same with their constituents.

Now, obviously because the SEC does not have authority to oversee books of the Federal Government, this is a Treasury report, so it is not the SEC's province. But as a Member of Congress, every single year I sent that out to my constituents instead of the promotional mailings that people get from their Senators and Representatives. People very much want to see that. I couldn't agree with you more.

Mr. COOPER. Well, if you are so informed about these numbers, what is the current fiscal gap for the United States of America?

Mr. COX. It is changing very rapidly.

Mr. COOPER. Give me a ballpark number.

Mr. COX. I just met with Director Nussle and talked to him about what would be the impact——

Mr. COOPER. Ballpark is fine. Give me a number.

Mr. COX. The scoring of the $700 billion that the Congress just approved will have such a material impact on this that the ballpark is rather enlarged.

Mr. COOPER. So you don't know. The last report said $54 trillion.

Chairman Greenspan, you were the longest serving chairman of the Federal Reserve in our history. You are a well-known financial expert. What did you do in your tenure to help Americans and help Congress understand the real numbers for America?

Mr. GREENSPAN. Congressman, I took a version of that, which is essentially the—you are talking about the accrual system, and that then gets reflected in the cash system in the forecasting structure.

What I have argued for for quite a significant period of time is that we have underfunded for Medicare, which is a very significant part of the numbers that you are concerned about, by half. In other words, in order to actually honor all of the promises that are being made to the next generation, the Baby Boom Generation who are retiring, we would have to either cut benefits by 50 percent, raise taxes to a point which probably cannot fundamentally be sustained, and therefore we are looking at as the underlying meaning of these types of reports, is we essentially promised to the American people far more than we can deliver.

And I am very fearful that unless and until we solve this problem, before everyone retires, the large numbers of people who will not be able to get what they are fundamentally promised still have time to make adjustments in their retirements. But if we wait until the hammer falls on us with the inexorable grind of the numbers, I think we are doing a very great disservice to the American people.

Chairman WAXMAN. The gentleman's time has expired.

Mr. Issa.

Mr. ISSA. Thank you, Mr. Chairman. For the gentleman from Tennessee and perhaps for the Chair, it would be interesting under GAAP accounting on the balance sheet what we would do with the House-Senate and other buildings here in Washington. Would they be on at set-side or liability side?

Chairman Greenspan, thank you for your many years of service. Today people seem to want to think that you were somehow a partisan for the Bush administration. I am never sure which Bush administration they are talking about here when they somehow think your many years of great service should be clouded by your inability along with the rest of us to properly predict this crisis.

My questions today are mostly going to be limited to the future. First of all, as Mr. Bilbray said a little while ago, I am calling for and have a draft bill which is being circulated with all the Members here today, saying that this, and I think this is evidenced here today, is not something Congress will deal well with. There are too many interests, such as Freddie and Fannie, such as all the other parts of this moving target, that I think we need to rise above Congress in suggestions for how much we regulate and for how much transparency we have.

I would hope that sort of each of you would comment on whether or not you support taking it out of the hands both of the next administration and of Congress, at least in part, in order to do the after-action, as we did with 9/11.

What I would like to specifically ask you though on, and this is also for Chairman Cox, there are a number of modeling systems that are at your disposal today and more you are looking at. Chairman Cox, I believe the XBLR system is one you are familiar with that is being developed.

But should the Congress bring to bear additional resources for each of you and for other agencies so that your predictive modeling and your doomsday scenarios, and specifically for you, Chairman Greenspan, the doomsday scenario we now live with undoubtedly could have been modeled but wasn't predictively modeled by any of the agencies of government and delivered to Congress.

Should we be in fact investing in that kind of modeling? In other words, micro-modeling of everybody's product and derivative products, but macromodeling of if in fact there is a hiccup of 6 percent in the California market for homes and it ripples throughout the United States, then what could or would happen? If that modeling is available today, please tell me. Otherwise tell me, do you think we should be investing in that?

Mr. GREENSPAN. It is not available. Indeed, Congressman, earlier this year I raised the question about modeling procedures for the economy, and the econometric work that is being done has essentially been restricted to taking the whole history and assuming that it is homogenous and therefore you can get some insight.

What is very evident to me, and I think increasingly others, is that the way the economy functions in the period of expansion is really quite different from what happens on the way down. And I should think that we will find that we could model the euphoria stage, as I like to put it, and the fear stage, and they are really quite different, and I think we would find that we learn a great deal about specifically the fear stage, because we do have numbers of episodes in the past.

Our major problem is that we don't have a third model which tells us which of those two are about to happen. And the reason essentially is that a financial crisis must of necessity be unanticipated, because if it is anticipated, it will be arbitraged away, and if a financial crisis by definition is a discontinuity in asset prices, then it means from 1 day to the next people were surprised. Something fundamentally different happened.

I think that, and I have argued this, and I am not saying whether the government resources are relevant to this, I think the academic community could do it surely as well. And what we do have to understand is that our view of the way an economy functions is not properly modeled by what we now have.

Just let me say quickly, the Federal Reserve has an as sophisticated a modeling structure and capable people as any organization I am aware of. It did not forecast what is happening.

Mr. ISSA. I see. As a pilot, by the way, I know that a landing is not just a takeoff in reverse.

Mr. GREENSPAN. That is a very good analogy, I think.

Mr. ISSA. Mr. Cox.

Mr. COX. Well, you alluded to XBRL, and I will just point out that is not a modeling system, but it could contribute very much to the construction used for models. The SEC is focused on moving us from the bare bones disclosure that we have right now, which is just paper data, and tagging each element of the elements of a financial statement so that computers can do work on behalf of people that the people don't even have to mine. It will deliver results to them.

It will permit you instead of looking at the financial statements of one company or financial reports about one security, to instantly do comparative analysis. It will vastly improve as a result risk analysis in the market and by regulators, and we are very focused on it for that reason.

With respect to modeling all of the risk in the system, I suppose at some point you run up against the problem of trying to create such a level of exactitude that you rebuild the whole world in all of its complexity. That is probably an aspiration that we ought not to have. Therefore, we have to recognize that computer modeling is going to always have its weaknesses, and we have certainly seen that in the last year. We have seen it in a lot of the risk models that people relied on. We saw it in Long-Term Capital Management. We have seen it many times over. A lot of those things required more human input.

Chairman WAXMAN. Do you have any comment on that before we move on?

Mr. SNOW. Just very briefly.

Chairman WAXMAN. Is your mic on? If you forget to look to turn on your mic, you might forget to look at your model.

Mr. SNOW. I share the basic thrust of your question here, which is can't we do better? Can't we find ways to do better? It seems to me, and this is retrospective, the question is leverage in the system. When loans and debt gets to be some fraction of GDP, it probably ought to send off some signals, because GDP represents the earning power, the debt represents the obligations.

Congressman Cooper talked to us about future obligations that vastly—that rise at a very significant rate relevant to the GDP of the United States. That sort of thing in rough and ready terms we should be able to model and have signals go off.

But no model I think could ever be really anywhere close to perfection at figuring out where the market is going to go. The problem right now in the financial markets is the banks and financial institutions hold all this paper. The market has said that paper is a lot riskier than you the banks thought it was. So the market has driven down the value of that paper. And as long as the housing problems continue, it continues to drive down the value of the paper. Nobody really knows where the bottom is, and only the market will have the capacity to figure that out.

I don't think you can really model anywhere near with perfection, as has been said, but you always ought to look at the assumptions, the assumptions finely on point. The assumptions in the models of many of our banking institutions that housing prices would keep rising and rising and rising probably should have been seen as a mistake.

Chairman WAXMAN. Thank you, Mr. Issa. Your time has expired. Mr. Van Hollen.

Mr. VAN HOLLEN. Thank you, Mr. Chairman. Thank all of you gentleman for your testimony. I think these hearings are important to try and figure out what went wrong and to hold individuals and institutions accountable, and, most importantly to try and figure out how we can learn from the mistakes that were made.

Mr. Cox, I had some questions for you with respect to the capital requirements and leverage rules in place for investment banks. I am sure you have seen the quote that you made on March 11, 2008, where you said, "We have a good deal of comfort about the capital cushions at these firms," referring to investment banks, "at the moment." Three days later, as you know, Bear Stearns was drained of most of its cash. They had to enter into this quick marriage with J.P. Morgan Chase, along with about $29 billion of taxpayer dollars infused as part of the deal.

With that in mind, I want to ask you about the rule changes, the leverage rule changes that were made by the SEC in 2004 where you loosened the leverage requirements, allowing these banks to borrow big, big amounts of dollars and to take even bigger, bigger risks with those dollars.

From where you sit now, do you believe that decision in 2004 was a mistake?

Mr. COX. I repealed the program. We did away with the program because based on experience, the program had two flaws. The first was really baked into the statutory scheme. The SEC did not have the statutory authority to do most of what it was doing on a mandatory basis.

Second, the metrics.

Mr. VAN HOLLEN. If I could, I am asking a slightly different question. There were two pieces to that deal, as I understand it, right? One was changing the net capital rule to allow more borrowing. And as part of that it was supposed to be balanced by more SEC oversight. Let me just ask you on first part, did you think it was wise?

You weren't there at the time. Was it wise of the SEC to change the capital requirement rules and allow much more leverage, was that wise?

Mr. COX. Well, you are correct that I was not there at the time, and so I have to ascribe to the Commission, which voted unanimously to do this in 2004, the best motives. It was very clear that at that time——

Mr. VAN HOLLEN. I am just asking you based on what you know today. Was that a mistake or not?

Mr. COX. Yes. I have said that the program was fundamentally flawed. We know this in hindsight because we saw that, as you mentioned, for example, Bear Stearns met the capital requirements, met the liquidity requirements in the program.

It used the internationally accepted Basel standards that other banks have relied upon. And, yet, those metrics did not help us in the week of March 10th when the liquidity of Bear Stearns in the space of 2 days went from $12 billion to $2 billion.

Mr. VAN HOLLEN. Now, I understand and agree with you that a voluntary program is not—doesn't give you the kind of leverage that you want in terms of oversight. But it was the only oversight that was part of that deal.

In other words, I think, based on what you just said, I think it was a mistake to loosen the capital requirements and allow all of this borrowing. But what was agreed at the time was that the SEC would take on greater oversight responsibilities. It was a voluntary program.

And, in light of that, I just wanted to read to you from the New York Times, the October 3rd article from this month that says, "The supervisory program under Mr. Cox was a low priority. The office had not completed a single inspection since its was reshuffled by Mr. Cox more than a year and a half ago."

They go on to say, despite the fact it had the weaknesses you talk about, former officials, as well the Inspector General's report—that was issued in connection with Bear Stearns—"I have suggested that a major reason for its failure was Mr. Cox's use of it." And they quote Mr. Goldschmidt, one of the former SEC Commissioners saying, "In retrospect, the tragedy is that the 2004 rulemaking gave us the ability to get information that would have been critical to sensible monitoring, and, yet, the SEC didn't oversee well enough." That was a quote from a former SEC Commissioner, who said that given the fact that those were the tools you did have at your disposal, you just didn't use them adequately to protect investors.

I would like you to respond to that.

Mr. COX. Well, I have had occasion to talk to Commissioner Goldschmidt, and I think I understand his views more fully than are represented there about the program, because while he voted to create it, and while he understood the problems with the voluntary program and so on, he also recognizes what really is needed right now.

I also want to correct something that has been said several times that is a factual matter that everybody needs to understand, and that is that the 2004 rule change—again, I was not at the Commission in 2004 when this change occurred, but it's just a fact about it that it did not loosen leverage requirements on investment bank holding companies. That's not at all what happened, because, prior to 2004, there were no requirements of any kind that the SEC placed on investment bank holding companies. They had no regulation.

As I pointed out several times today, by statute they have no regulator. And up until 2004, when this voluntary program was created, there was absolutely nothing.

So what was created in 2004 was at least more than existed before. As we have seen, it was not nearly enough, and I think it used the wrong metrics. I think that has been amply illustrated.

In terms of reshuffling the program or dismantling it or what, I think that must refer to some other program, because the Consolidated Supervised Entities Program, during my chairmanship, was increased in terms of its staffing by over 30 percent. We focused more resources on this, recognizing its importance.

Mr. TIERNEY [presiding]. Thank you very much. Thank you, Mr. Van Hollen.

Mr. Hodes, you are recognized for 5 minutes.

Mr. HODES. Thank you, Mr. Chairman.

Dr. Greenspan, during your tenure at the Fed, we went from irrational exuberance to an unregulated Wild West of subprime lending, Wall Street gone wild, and here we are.

You said in your excellent book that you had a libertarian opposition to most regulation. Now, you said that on page 373. By the time we got to the epilogue, you seem to have changed that view somewhat. And, today, we talked about infallibility, the inability to predict risk, because we were infallible human beings.

And also, in your epilogue, you said, "Modern political reality requires elected officials to respond to virtually every economic aberration with a government program."

Well, we are now in an unprecedented economic crisis. We have just passed a bailout, which I opposed. You supported an unprecedented ideological upside-down turn of events in terms of the massive nature of that government intervention in the free markets, following, apparently, the Lincoln philosophy, the purpose of government is to do what the free markets cannot or will not do so well for themselves.

Yet the fundamental problem, a mortgage foreclosure crisis, is still raging in this country all over the country. Those subprimes, which you talked about, are still being foreclosed on. It slopped over into the AAAs and the prime mortgages. We have seen record job losses, and it strikes me that until we deal with the mortgage foreclosure crisis we are not going to really get a handle on things.

Now, back in December, you said that you favored spending government money to assist Americans struggling to make mortgage payments without fundamentally changing market structure. You said, I don't know if it would work, but it would certainly help people. It would help their incomes. It would help their personal state without affecting the structure of the way markets are behaving and the way the adjustment process is going on.

With all that as background, what do you think we need to do now to get to the root, the cause of the mortgage foreclosure crisis? And do you agree that we need to do that, not just deal with the institutional help we provided, but deal with that crisis in order to solidify things?

Is the button pressed?

Mr. GREENSPAN. Sorry about that.

The foreclosure crises is basically the result of the decline in prices of homes, because clearly it impacts on the amount of equity that is in the homes. And, obviously, as prices fall, generally we are seeing an ever increasing number of American households whose mortgages exceed the value of their homes. That will stop only as prices stabilize, and they will.

But prior to that, we still have a rise in foreclosures, and we will, and it strikes me that anything that can be done to confront that issue is valuable not only to the homeowner, obviously, but also to the lender, because nobody gains from foreclosure.

I recall, before we had all of the securitization and the like, when, for example, most of the loans were made by savings and loans, when the borrower got into trouble, the holder of the mortgage recognized that if foreclosure occurred that he would lose as well. And they got together and essentially resolved what a new mortgage would look like.

So anything that can be done in the area of bringing the people together, which is far more difficult—and I think as Secretary Snow was saying—we have servicers who are too far removed from the borrower. And we have to find ways in which we can cut through that issue to resolve it.

But there is nothing like a stabilization of home prices to resolve this issue. Until that happens we have more difficulties. We are clearly in a position where, as I mentioned in my prepared remarks, we have several months to go at least. And as I said earlier, as you point out, that ultimately what you don't want to do is restructure the market because, for example, if you alter the mortgage contract, it's going to cost future borrowers much higher interest rates.

And my view is that if we just give transfer payments to people who are in difficulty, that would be a way to carry over the difficulty of transition during this period when prices are still declining.

So I would say that it's a short-term problem, it's not a long-term problem. Indeed, there are numbers of scenarios which are basically saying that if the rate of mortgage foreclosures slows down, even though it's still increasing, what happens is that the number of homeowners who fall into foreclosure start to decline. We are not there yet, but we are getting close.

Mr. TIERNEY. Thank you very much.

Mr. Murphy, you are recognized for 5 minutes.

Mr. MURPHY. Thank you very much.

Mr. Chairman, I want to ask one retrospective question and one prospective question, because my constituents certainly are interested in how we got to this situation we are in, but I think most of our constituents are much more interested in how we move forward from here.

I want to come back to this issue, Mr. Cox, of the CSE program. Understanding that you have terminated the program due to certain systemic failures, inability to do the job that it set out to do, the report from the Inspector General's office specific to the oversight that was done on Bear Stearns is troubling not for the systemic failures, but for the practical failures that occurred in your office's efforts to try to figure out what was happening at Bear Stearns.

The Inspector General says that the SEC ignored numerous potential red flags, that it allowed Bear Stearns to do some of the audits themselves, rather than being done by the SEC, that the SEC didn't perform reviews in a timely fashion.

And I certainly understand your problem in that even with that information, the SEC doesn't have all the tools necessary to make the corrective changes that you might want to make, but at the very least the Inspector General notes that the lack of information that the SEC got through its work, specifically with Bear Stearns, had the result of "depriving investors of material information that they could have used to make well-informed investment decisions."

Building on Representative Van Hollen's questions, what do you make of the Inspector General's specific findings on the lack of oversight at Bear Stearns? Did you know about those red flags, and how troubling is it to you, those specific findings as to that one company?

Mr. COX. Well, with the exception of the last one that you referred to, with respect to the annual review of the 10-Ks, as you will note from the footnotes to those particular items in the report, they occurred before I became chairman.

This was a new program. It was put in place in 2004. It was meant, as I mentioned a moment ago, to provide a window into what was going on at the holding company level.

I think it's important, that first, you asked what I think of the Inspector General's recommendations and report. We have either already implemented or are implementing all of the recommendations. I would think that having such a report——

Mr. MURPHY. But do you think there's a specific failure—forget putting aside the problems of the program itself. Was there a specific problem with respect to the oversight that you could have done with respect to Bear Stearns that would have given information to at least outside investors that would have been useful?

Mr. COX. I think the things that you are describing, they fall into two categories. They were sort of procedural and paperwork issues that need to be corrected, and those are, you know, operational and probably not ultimately material.

Then there are those things that go to whether or not the risk assessment function is being properly performed. There the fundamental question was, could the SEC have better foreseen the mortgage meltdown that other regulators didn't see, and could we have, you know, used different metrics, different scenarios, for stressing the portfolios, for taking a look at what was going on inside the firm?

I wish that we had been able to predict the mortgage market meltdown. But, you know, failing that, I don't think that the program itself would have had a different outcome. Unless you could go in as a regulator and actually regulate the investment bank holding company, all that was being done then was reviewing, according to the program metrics, and the SEC rather aggressively managed against those metrics. So the Inspector General found at all times all of the CSE firms were well above the capital requirements and the liquidity requirements of the program.

Mr. MURPHY. Before my time expires, let me then go to a little bit broader question.

Understanding that our inability to manage risk and leverage to allow some of these firms like Bear Stearns to get so large that they became a part of this new category called "too big to fail"—this is a question for the panel—what do we do, going forward, to address this issue of firms that are too big to fail? And how do I answer my constituents' concerns who say, aren't we just now setting a precedent, which allows these major financial firms in the future to make these same types of risks that they made that got themselves into this position, because we have now set up a precedent that we are going to come in rescue them? How do we address that issue?

Mr. GREENSPAN. I think that is a very important question.

If, indeed, there are firms in this country which are too big to fail, it necessarily means that investors will give them moneys at lower interest rates, because they are perceived to be guaranteed by the Federal Government. The result of that is they have a competitive advantage over smaller firms, and that creates huge distortions in the system.

So the question is, is it feasible to eliminate too big to fail? That's a, you know, once you have gone down this road, everyone is not going to believe you. But, remember, we used to argue strenuously that Fannie and Freddie were not backed by the full faith and credit of the U.S. Government because that's what the law said. The markets didn't believe that.

Mr. MURPHY. What would we do if we wanted to eliminate too big to fail, if we wanted to? What would be the first steps we would take?

Mr. GREENSPAN. Well, I think the first thing you would have to say, as a minimum, you would have to eliminate these—the larger institutions' subsidy effectively, and one way to do that is to either raise capital charges or to raise fees, but you cannot allow it to go on without very serious consequences.

At the end of the day, there has to be something which penalizes those firms which move above the level where they become too big to fail, and that raises very, very large questions.

Chairman WAXMAN [presiding]. Thank you very much, Mr. Murphy.

Mr. Sarbanes.

Mr. SARBANES. Thank you. Thank you to the panel. Thank you, Mr. Chairman.

We have been talking a lot about this metaphor, the blind man and the elephant. I don't really buy that, because I think what—I certainly don't buy it as an explanation for what happened. I think it's being used as kind of an excuse to pass the buck and sort of say, well, nobody could see the whole picture, so we were each compromised in our ability to take action that would have mattered and made a difference, but the hearing testimony today just confirms to me that in each part of the world that you each had a clear perspective on, you had tools that you could have used, which if you had used them, might have averted the situation, or certainly lessened its impact.

So we keep putting it off when we didn't have a model that worked. We had to develop new models, and they couldn't be developed as quickly as needed and so forth.

Dr. Greenspan, you talk about how, I think you said, we are not smart enough as people to predict where these things are going and so forth. Well, I mean, that may be true when it comes to understanding the full extent of the securitization of these subprime mortgages, how things would kind of spin from there, but certainly we are smart enough as people to have put basic underwriting standards in place or to have preserved basic underwriting standards. I mean, that doesn't take a lot of smarts, really, and we certainly are that smart, but you didn't do that when people were coming to you that you respect and were saying, we have to take some steps here to make sure that these subprime mortgages are being judged accurately in terms of their danger.

So, I mean, you have responded a few times to that, but respond again to me, because I don't understand that. I think that if you had taken some action with tools that you had available to you, that it would have acted to push back against the securitization demand or appetite that you have described. You sort of said, well, what happened was you had this huge appetite from the securitizers to package these things up and market them around the world to get better yields, and that's what kicked in in 2005 and 2006 and 2007, and that just kind of overwhelmed the system.

But if in 2003, 2004 and 2005, and during those periods when you were being asked to exercise more aggressively these tools of oversight with respect to the lending standards, if that had been done, that would have acted as a kind of firewall against this pressure that was coming from the securitizers, and it might have made a difference.

So, if you could speak to that, I would appreciate it.

Mr. GREENSPAN. Well, remember, we did not know the size of the subprime market probably until late 2005.

In short, we had no data that was worthwhile in the public sector. We had, for example, HMDA data on mortgage holders that you are familiar with, but we had no indication that the subprime market had soared to the level that it did until very late in 2005. In retrospect, we now know with the data we have that subprime mortgages constituted about 7 percent of total originations for mortgages in the United States. By 2005, it had gotten up to 20 percent, and we didn't know that at the time.

Mr. SARBANES. Well, I appreciate that. My time is going to run. Let me just followup on that quickly, because certainly you are not suggesting that it's only when a problem gets to be of a certain—in other words, if you see the fact that even in a handful of circumstances, basic traditional principles of honest underwriting and lending standards are being compromised, it shouldn't be that the fact that the size of that problem, volume of it, it hasn't reached a certain threshold that satisfies you that you don't need to take action. You ought to be taking action just based on what's happening here, which if it had happened, would have begun a process of oversight and vigilance that might have prevented this thing, when it got to a certain size, from having a particular impact.

Now, I am about to run out of time. Let me just close with this observation, Mr. Chairman, if you will indulge me for a second.

What concerns me, and I have read some of your writings, is you have conceded that there was a flaw in your ideology earlier today with respect to the situation of bad actors, right? But what you haven't conceded is I think a flaw in the ideology that suggests that the market will always punish the bad actors, or at least not allow for the fact that if you put a driver in a car and they drive recklessly, and maybe they have a car crash, it's going to punish them and maybe they will learn their lesson.

But in the meantime, a lot of innocent bystanders can get run over. I think that's what happened. There's a lot of the American people out there who feel like innocent bystanders, and they have been hurt.

Thank you.

Chairman WAXMAN. Thank you, Mr. Sarbanes.

Mr. SNOW. Mr. Chairman, can I just——

Chairman WAXMAN. Yes.

Mr. SNOW. Since Congressman Sarbanes mentioned Treasury in his opening comments, suggesting we, too, were not on the watch, let me just go back to a point I have tried to make over and over again, Congressman. That is we were on the watch. When we saw a large systemic risk, we called it to the attention of the Congress.

We couldn't have been clearer. I could not have been clearer about the risk posed by the GSEs. I called it to the attention of Congress in a number of testimonies. We didn't duck our responsibilities. We assumed them, and we put a lot of effort—I am glad to see that it eventually resulted in Congress enacting the strong regulator legislation. It would have been better if it could have acted sooner.

Chairman WAXMAN. Ms. Watson.

Ms. WATSON. Thank you so much. I would like to thank the three gentlemen for their ability to withstand this current barrage of questions and your responses.

Mr. Cox, I want to start with you. I would like the other two gentlemen to respond, too.

Since the beginning of the economic crisis, you have come up with a number of suggestions in order to properly oversee America's financial markets.

Now, if you, with all clarity, can respond to this, and I would like the other two gentlemen to follow, do you believe in regulating the financial markets, and what role do you think the Federal Government should play in the U.S. economy in light of our current economic crisis?

Mr. COX. Thank you, Congresswoman. First, the answer is yes, and, strongly, I believe in regulation of financial markets. That is why I serve as the chairman of the Securities and Exchange Commission.

Embedded within the description of regulation of financial markets are two things, regulation and markets, and both are good, and both are important. Congressman Sarbanes just a moment ago analogized to driving and the rules of the road. It's vitally important for markets that there be rules of the road.

It would be very, very difficult to get people in America to part with their money, to have investors be confident that they could put money into the system with rules. So I support——

Ms. WATSON. Congressman Cox, who should be involved in formulating those rules?

Mr. COX. Pardon me?

Ms. WATSON. Who should be involved in formulating those rules?

Mr. COX. Well, clearly the Congress, first and foremost, needs to describe the architecture and rulemaking, as has been devised by the Congress as a means of addressing things at a level of granularity that legislation can't reach. I think that's a sound system.

With respect to the second part of your question, the role of the government in the economy, that's the market's part. I think it's vitally important that we never fail to appreciate how powerful a means of wisdom markets can be in allocating scarce resources in a nation of 300 million people and a world of 6 billion people. Markets are going to give us the wisdom of crowds, the markets are going to make decisions that a central government can't. We have seen the failure of central planning before but not both. You have to have regulation and markets.

Ms. WATSON. Let me just, because our time is going to run out, what additional authority would you, as Secretary need, or whoever follows you need, to do the job smartly?

Mr. COX. First and foremost, close the regulatory gaps that I have described with respect to investment bank holding companies, with respect to municipal securities, with respect to credit default swaps, harmonize the regulation of economically competitive products that currently are regulated by the CFTC and the SEC.

If we fill those regulatory gaps, then I think the SEC will be able to do a far better job than what it already does.

Ms. WATSON. All right. And would you then put in writing to the committee those specific items that you just pointed out?

Mr. COX. I would be very pleased to do that.

Ms. WATSON. Thank you. Let me go to Mr. Snow.

Chairman WAXMAN. Microphone.

Mr. SNOW. I keep forgetting it. I agree with the comments and associate myself with the comments of Chairman Cox. It's not a matter of no regulation or some regulation. We know we have to regulate financial markets. It's the matter of getting, I think as the chairman said, smart regulation, targeted, effective regulation.

On the economy, I think the economy is in tough shape. I think it's going down a bad, bad path. And I think that the stimulus package that's being talked about, a targeted, well-shaped, well-formed stimulus package would make good sense at this time.

Ms. WATSON. Mr. Greenspan, please.

Mr. GREENSPAN. We have to recognize that this is almost surely a once-in-a-century phenomenon. In that regard, to realize that the types of regulation that would prevent this from happening in the future are so onerous as to basically suppress the growth rate in the economy, and I think the standards of living of the American people, this is the really major tradeoff problem that governments have in the sense that we do know, on the basis of history, that free markets grow far faster, create greater wealth, than, say, centrally planned economies.

Ms. WATSON. We know that, and I am sure you are very experienced in explaining that. But who should then formulate the regulations? Where would that lie?

Mr. GREENSPAN. I think it has to lie with the Congress.

Ms. WATSON. All right, OK.

I have one question, I am going to run out of time, may I just ask, and they can respond?

Chairman WAXMAN. Sure.

Ms. WATSON. We have a personal problem in California and Los Angeles, Mr. Cox, you might be aware of it. It's with the Los Angeles County Metropolitan Transit Authority, MTA. The Southlands commuter rail agency sold most of its train cars and locomotives in four lease-back deals, three of which involved AIG.

Metrolink and the MTA have to look for another firm to replace AIG, which provided $1 billion in loans to finance the lease-back transaction. This is a daunting task, considering the Nation's current economic status. Outside of the financial services industry, do you gentlemen foresee a wide variety of bankruptcies that involve small businesses and other corporations as a result of this financial crisis?

And thank you for allowing me to finish my questions.

Chairman WAXMAN. If you could answer very, very briefly. In fact you can say, yes, no or maybe.

Mr. SNOW. Unfortunately, yes.

Mr. GREENSPAN. I second that statement.

Mr. COX. I have no reason to disagree with what has been said thus far.

Chairman WAXMAN. Well, we are sorry to hear your answers, but we appreciate that you gave us an answer.

Ms. McCollum.

Ms. MCCOLLUM. Thank you, Mr. Chairman.

A free market isn't the same thing as an unregulated market. The private sector and the government play two different but very essential roles in our economy, and there's a healthy tension between the private and the public interest, and that's the balance you were referring to, Mr. Snow.

But when financial regulators decide to let the private markets run free, the public interest is left defenseless to the greed of Wall Street.

Mr. Snow, this morning you talked about the importance of regulation, and you gave examples of regulatory matters you wish Congress had acted on. But that seems to be a change of heart from when you were Treasury Secretary.

I would like to show you a photograph taken in 2003 while you were in charge of the Treasury Department. The picture includes some of Treasury's top officials, including the Director of the Office of Thrift Supervision, James Gilleran; the Comptroller of the Currency, John Hawke. The picture also includes representatives of the banking industry.

Now, this photo was taken at a press conference to announce a new initiative to limit regulations on banks. There they are, standing happily, destroying a tall stack of Federal rules.

I think it's telling that they are not using a scissor to cut up the regulations, they are not even using an Enron paper shredder. They are using a chain saw. So there's not much nuance there, Mr. Snow.

The photo obviously is intended to send a clear, unmistakable message to the market and to the public.

Mr. Snow, in your opinion, what message is this photograph conveying about regulation in the Treasury Department when you were the head of it, and how do you interpret this photo?

Mr. SNOW. Sorry, Congresswoman, I don't see myself in that photo. Maybe I am in there, maybe my eyesight has failed me.

Ms. MCCOLLUM. Mr. Snow, I did not say you were in the photo. What I did say is you were head of the Treasury, and these are people who are very highly placed Treasury officials.

Mr. SNOW. Congresswoman, I have no knowledge of what that photo is about or what those smiling people are celebrating.

Ms. MCCOLLUM. Well, Mr. Snow, at the time you were in charge of the Treasury Department you were unaware of this massive deregulation, cutting up of the banking industry?

Mr. SNOW. Yes, I am unaware of any massive deregulation, cutting the banking industry.

Ms. MCCOLLUM. Well, Mr. Snow, taking a chain saw to the banking regulations was just the beginning. Two months after this press conference, the Office of Comptroller of the Currency issued a rule that prevented States from banning predatory lending.

Your Treasury Department didn't act to prevent this crisis. In fact, your Department blocked, your Department blocked the States from protecting their citizens. Is that correct, yes or no?

Mr. SNOW. I think that's false.

Ms. MCCOLLUM. So your Department did absolutely no lobbying to stop States from being able to regulate predatory lending?

Mr. SNOW. I don't think the Treasury Department lobbied on that matter. This was an action, as I recall it, taken by the OCC, and under laws established by the Congress, the OCC on regulatory matters is, enforcement matters, is entirely independent of the Treasury Department.

Ms. MCCOLLUM. Mr. Snow, do you think that a law should have been put in place that would have allowed States who wanted to protect their citizens from predatory lending? Do you think that law should have been allowed to move forward for States to have control over that?

Mr. SNOW. Well, I think an awful lot depends on the circumstances and particulars of the law in question.

Ms. MCCOLLUM. Well, I am a former State representative, yes or no. I mean, it's pretty clear to me, States rights or not.

Mr. SNOW. Well, I would have to see the law. I am not going to give a blanket answer to something unless I know what the proposal is.

Ms. MCCOLLUM. Thank you.

Well, Chairman Cox, I have to agree with your statement at CQ Weekly this month. You said the last 6 months has made it abundantly clear that voluntary regulation does not work. I have heard Dr. Greenspan refer to the fact that what he thought the market would regulate to protect its investors it did not regulate. I am paraphrasing from your earlier statement.

One of the lessons from this financial crisis is that over the long term voluntary regulation is really no regulation at all. We saw that at Lehman Brothers, AIG, and the credit rating agencies that testified yesterday. Unregulated markets and voluntary regulation, was a failed experiment. It's an ideological approach to government that is erasing hard-earned retirement and savings of millions of Americans, including my constituents.

If we need an ideology, if we need a philosophy to govern, as Mr. Greenspan suggested, I would suggest we give pragmatism a try, we give common sense a try.

Thank you, Mr. Chairman.

Chairman WAXMAN. Thank you, Ms. McCollum. We have two Members who have not asked questions, Mr. Shays and Mr. Lynch, and I think that will close out the hearing.

Mr. Shays.

Mr. SHAYS. Thank you, Mr. Chairman. Thank you for holding these hearings. They have really been amazing, and I have learned a lot, and I have met the enemy, and it's all of us.

I do want to say that I think Ms. McCollum's questions were misinterpreting what was happening, where banks were being told that they needed to lend to people who didn't have the income and had bad credit, and we were forcing banks to move in that direction.

I am struck by the fact that we have Freedom of Information for the executive branch, but we don't have it for us, thank God, huh?

But the Freedom of Information, when we had the hearing on the regulators, excuse me, those who appraised the value of companies and transactions, one of them said we just lost a huge Mitsu RMBS deal to Moody's due to a huge difference in the required credit support.

Then they said I think the only way to compete is to have a paradigm shift in thinking, especially with the interest rate risks; because they were rating them higher, they had to have a greater set-aside.

Another memo we had was we don't have sufficient staff, with the appropriate expertise, to research and establish criteria to engage in dialog with our clients and to be responsive. There were all these instruments, and we think the rating agencies didn't understand them.

This is the one that really gets me. They said rating agencies continue to create an even bigger monster, the CDO market. Let's hope we are all wealthy and retired by the time this house of cards falters. I mean, that's the kind of testimony we get, or the kind of testimony where we learn that after we bail out AIG, just days afterwards, they went to a swanky St. Regis resort in Monarch Beach for a week of wining and dining of top salespeople.

As it happens, congressional investigators release that they paid more than $440,000 for the event, including $200,000 for rooms, $150,000 for meals, $23,000 in spa charges. This is after the $85 billion bailout.

But what I want to do is have you comment on this. We had a savings and loan bust in the 1980's, and then we had the commercial banks in the late 1980's and early 1990's. Then we had the dot-com bubble bust, and now we have this subprime meltdown.

My sense is, first off, somewhere between there was Enron and Sarbanes-Oxley, and a bill I voted for. Was Sarbanes-Oxley intended to prevent any of what we have seen here, and, if so, did it?

I am not looking for a long answer. I will start with you, Mr. Greenspan.

Mr. GREENSPAN. Well, it did one thing that I thought was important; namely, to put the responsibility for the accounting system on the—make it responsible for the chief executive officer, because, as we have all learned in recent years——

Mr. SHAYS. OK, that's the first one. Any other benefit?

Mr. GREENSPAN. I am hard pressed to find any of them.

Mr. SHAYS. When we passed Sarbanes-Oxley, we learned that the Fannie Mae and Freddie Mac, these huge giants, were not under it. They weren't under it because they are not under the 1933 act and they are not under the 1934 act. That's the SEC. They were not you, Mr. Cox, were they?

Mr. COX. No. They had their own regulator, OFHEO.

Mr. SHAYS. They weren't under the regulator. They weren't under the SEC. We forced them, by introducing legislation in 2002 and 2003 to put them under both. They voluntarily, kind of arrogantly, voluntarily agreed to be under the 1934 act. That just made us understand their macro numbers. The 1933 act would have been all these different instruments. Why in the world is not Fannie Mae and Freddie Mac under the 1933 act?

Mr. COX. There is no good reason for that.

Mr. SHAYS. Thank you.

Mr. COX. I have consistently urged, and I think we missed a big opportunity in the emergency economic——

Mr. SHAYS. And the reason why it's not happening is Congress doesn't want to put them under it, and that's the challenge that we have.

We also, Mr. Snow, you advocated that they be, have a stronger regulator. We have finally done it, but you went after it day in and day out. Mr. Cox, you did as well. Mr. Greenspan, you advocated that they have a better regulator.

So, my understanding is that the housing market, the drop, the subprime, that has us into this meltdown.

Now, the criticism of you, Mr. Greenspan, and I would love to hear your comment, is that when we had the dot-com crash, you felt we needed easy money to get out, and then you kept easy money after we were out of it. And some of my constituents said that led to dumb lending and dumb borrowing.

They said it was not just dumb lending to individuals buying homes, people buying homes they couldn't afford, but it was the big financial houses, Lehman, Bear Stearns, Morgan Stanley, Merrill Lynch, Goldman Sachs, all making these big deals with huge leveraging, getting people to buy businesses that they, frankly, were having extraordinary debt.

I am just wondering with hindsight if you would have maybe pushed the rates up a little higher a little sooner?

Mr. GREENSPAN. It's very evident, from all of the data, that what we began to confront in the last 10 years is a major change in the global structure of the world, basically the result of huge increases in markets developed in China and elsewhere.

Without getting into the details, this created a major decline in real long-term interest rates globally. It started to fall in early 2000, and it shows up by the year 2006 where, for the first time in history we had not only inflation rates, but long-term interest rates in single digits around the world.

What that meant was for any central bank which tried to raise interest rates for mortgages, or anything with maturities more than, say, 5 or 6 years, and found itself running into trouble—we, for example, every time we raised rates in the post-World War II period, and what we would raise, of course, is the short-term rate, long-term rates would go up as well.

In 2004, however, when we started to embark upon a major increase in rates, we found that long-term rates did not move at all, that we had lost control of the markets in the longer end of the market, as we like to say. That is true of the European Central Bank, the Bank of England, all central banks are being driven to the point where for longer-term issues they basically are confronted with this global situation.

Mr. DAVIS OF VIRGINIA. Mr. Chairman, I would ask to yield 1 additional minute to Mr. Shays.

Chairman WAXMAN. I recognize Mr. Shays for 1 additional minute.

Mr. SHAYS. Mr. Cox, I would like you to have the opportunity to respond to criticism that said in 2004 the SEC allowed Lehman Brothers, Bear Stearns, Morgan brothers, Merrill Lynch, Goldman Sachs, to leverage at 30–1, in some cases even higher, from their practice of doing 12–1 or 15–1. That has been a severe criticism against you. I would love to hear your answer.

Mr. COX. Well, first, that 2004 rule change occurred while I was a Member of Congress. But what the SEC did in 2004 was not to lift leverage requirements on investment bank holding companies or to repeal a 12–1 leverage rule. First, there was no 12–1 leverage rule; and, second, there was no rule whatsoever for investment bank holding companies.

The SEC never purported to regulate them, had no statutory authority to do so. So, until 2004, there were simply no rules at all.

It happened that post those rules, leverage increased, but it did not increase because of the rules. And the rules at least gave an opportunity to see at the holding company level what was going on and to manage better than the SEC otherwise could have.

Nonetheless, as I have pointed out several times, that was a fundamentally flawed system of voluntary regulation with metrics that did not work any better in the investment banks than they did for WaMu or for IndyMac or for commercial banks in this country and around the world that were using the Basel standards.

Mr. SHAYS. Thank you.

Chairman WAXMAN. Thank you, Mr. Shays.

Mr. Lynch.

Mr. LYNCH. Mr. Chairman, in the interest of time, I would ask unanimous consent that I submit for the record, this is a speech, actually an article by Harvey Pitt, former SEC chairman, in Compliance Week from June 24, 2008. And also there's another article, actually a piece here, a report by Mark Jickling for Congress, entitled Averting Financial Crisis, dated October 8, 2008.

Chairman WAXMAN. Without objection.

[The information referred to follows:]

COMPLIANCE WEEK
The leading resource on corporate compliance and governance for U.S. public companies.

Regulation That Achieves What We Need Today

By Harvey L. Pitt, *Compliance Week Columnist* — June 24, 2008

Editor's note: Harvey Pitt recently provided a keynote address at Compliance Week's annual conference at the Mayflower Hotel in Washington, D.C., June 4-5. Below is an abridged version of the text of the speech.

I was asked to discuss the regulatory pendulums and what its recent trajectory means for public company executives. I must start by noting a small conceptual problem with this topic. Talking about a "trajectory" implies there's mathematical precision in what's been roiling our markets for the last year and a half and in what's likely to transpire from here on out. While life would be easier, albeit less interesting, if it were mathematically determinable, the reality is it isn't. So, the best I can do is describe financial market regulation's recent past and offer you some predictions about where we may be headed.

Many espouse the concept that some firms are too big to fail. I don't subscribe to that, and I don't believe the Fed embraced it in connection with Bear Stearns' meltdown. Make no mistake about it, Bear Stearns failed. When you're forced to sell substantial assets once valued in the tens of billions of dollars for an original price of $260 million, you've failed, and failed big time. But, the Fed was, in my view, right to worry not about Bear's "bigness" but about its interrelationship with major counterparties that could have brought our entire financial markets to a screeching halt had Bear gone belly-up. Those events, and the Fed's decision to open its discount window to investment banking firms for at least six months, form the backdrop for our discussion.

Where We've Been

Our regulatory regime failed because it's predicated on the assumption that what an enterprise is called, or what it was born as, determines who regulates it. It's also limited by the fact that Congress and regulatory agencies have one very significant characteristic in common—neither likes to give up jurisdiction once obtained. If you think it's hard to extract regulatory jurisdiction from the SEC and give it to the CFTC, or vice-versa, just try telling the Senate Agriculture Committee it should cede its jurisdiction over the CFTC to the Senate Banking Committee!

Unlike anything else, financial services regulation got a boost from the Great Depression, which saw passage of the Glass-Steagall Act, the Securities Act of 1933, and the

Securities Exchange Act of 1934, as well as creation of the FDIC and SEC. Three decades later came the CFTC. The result of the patchwork quilt of alphabet soup agencies leaves us with an embarrassment of regulators: today, the U.S. boasts having at least 51 insurance regulators, 57 for commercial banks, and 53 for investment banks, not counting commodities, credit unions, and allied regulators.

We're blessed—or cursed—with federal regulatory bodies, self-regulatory bodies, multiple-state regulatory bodies, local regulatory bodies, and global regulatory bodies, each struggling to define its role and justify its existence, often creating duplicative or conflicting regulations. This compartmentalized regulatory system mirrored the contours of the financial services landscape. Each new regulatory initiative with its related agency and volumes of regulations is aimed at particular market players that once had exclusive rights to market-specific products. Market participants were regulated based on birth, not substance!

This balkanized regulatory regime was ill suited to control waves of new financial products and services beginning in the 1970s, with the advent of money market mutual funds, and cresting with the exotic and complex synthetic financial instruments implicated in the rise and recent meltdown of the sub-prime market. Passage of Gramm-Leach-Bliley swept away any vestiges of viability in legacy regulatory systems. While GLB repealed Glass-Steagall and removed artificial barriers between commercial and investment banking, it deliberately left in place the existing patchwork of federal and state regulatory agencies and regimes. The political fallout from trying to modernize the regulatory structure was viewed as too much to tackle in the immediate wake of the historic deconstruction of barriers to commerce.

Where We Are?

And yet, today's financial world is, well, worlds apart from the one in which the U.S. regulatory system developed. It's a world where financial products are fungible, financial services are ubiquitous, transactions are electronic, and the effects of financial activities are global. It's a world in which our regulatory system remains redundant, overlapping, and discontinuous such that, in the final analysis, it stifles innovation, discourages informed and prudent risk taking, promotes inefficiency, encourages regulatory arbitrage, and ultimately, incentivizes domestic firms and capital to go offshore, and foreign firms and capital to avoid U.S. markets.

As the recent meltdown of the sub-prime market and Bear Stearns' collapse indicate, it leaves us a regulatory and legal system in which, at best, each regulator understands and addresses the discrete area it regulates, without fully understanding the surrounding landscape or the relationship of one area to the other. At worst, regulators don't fully understand what they regulate, causing some areas to receive attention from multiple regulators while others escape any regulatory consideration.

How Do We Get Someplace Else?

What we need is "smart" and, of course, effective, regulation. To make regulation both smart and effective, we have to start from some fundamental principles: first, capital is the lifeblood of innovation. It's also finite. Thus, an effective financial market regulatory system permits unimpeded movement of capital to its most effective uses. This means minimizing both the number of regulators and the amount of regulation. Second, financial markets are increasingly global, and the U.S. is no longer their focal point. U.S. and foreign investors can invest in either U.S. or foreign companies, so there's international competition for every investment dollar of every investor.

Third, competitors for investment dollars must compete under similar ground rules. If not, some will gain unfair advantages. And, if there are significant disparities in regulation across markets, competitors subject to higher standards may try to evade them, either by not complying or by moving to less-regulated markets. Fourth, on a related note, global markets, governed by global regulators, require global accommodations. Put another way, within the constraints of disparate cultures, local regulatory regimes should be comparable to—and compatible with—those in place internationally.

Where Should We Be Headed?

In any reevaluation and restructuring of our regulatory scheme, we must limit the burdens of regulation while providing necessary tools to avoid undermining its effectiveness. Treasury's "Blueprint for a Modernized Financial Regulatory Structure" is a useful framework for considering regulatory overhaul, but it is only the beginning of analysis, not its conclusion.

Most fundamentally, on a macro level, the right move is one toward a principles-based and prudential regulatory system and away from prescriptive approaches. Not only must regulation become more principles-based and less prescriptive, it also must be rationalized to address, consistently, the entire universe of companies, activities, products, and services that constitute the modern global financial services industry. This includes areas traditionally regulated by the SEC and its international counterparts, as well as commercial banking, commodities, and insurance. Such an overarching federal regulatory system would decrease, if not eliminate, the burdens of duplicative, overlapping regulation.

Financial market regulatory agencies should be constructed and operated as regulators with enforcement powers, not enforcement agencies that happen to regulate. The fundamental goal of regulation should be defining appropriate standards and facilitating compliance with them. Enforcement is a critical element of any regulatory system. When people fail to observe fiduciary duties, for example, they should be clobbered! But if regulation is achieved largely and primarily through enforcement actions, the system has failed. Usually, by the time enforcement actions are brought, wrongful conduct has occurred, investors have been fleeced, and ill-gotten gains have been dissipated. As a practical matter, regulation is most effective if it induces compliance in the first instance, before violations occur.

A way to achieve better compliance is if all competitors are subject to comparable regulatory standards when they engage in comparable conduct, and there's a single regulator to whom the regulated can talk before taking action that will ultimately be detrimental to investors as well as our capital markets. Those subject to regulation should be encouraged to ask questions and vet proposed products, services, and activities in advance of implementation, rather than being left to guess at the legality of their plans and being prosecuted if they guess incorrectly.

New regulations should be approached differently as well. Any proposed new rule should, as a matter of course, be subject to disciplined consideration of the costs its new mandates impose. When regulators put pen to paper, they should bear in mind that it's always cheaper for government to propound new rules than it is for the subjects of new rules to comply; market participants are partners in the regulatory process, and neither its enemies nor its intended victims.

A steady flow of relevant information about markets and market participants is the lubricant that permits markets to function efficiently. If useful data are available, market participants can, and assuming economic rationality will, make appropriate decisions without needing regulatory intervention. The sub-prime crisis illustrates the consequences of insufficient market data. Prior to the summer of 2007, market participants relied on the ratings agencies to classify securities. The failure of the ratings agencies to perform this classification properly has created the largest private placement market in financial history. As a consequence, formerly liquid balance sheets have now become illiquid. Even today, market participants lack a central clearing house for information on underlying collateral performance and access to models that can process information into cash flows. Creating a system for production of this type of information on an ongoing basis will elevate market efficiency.

Finally, rules and regulations presumptively should be provisional. Some reasonable period after promulgation, agencies should be required to undertake reconsideration of the rule to assess what compliance actually costs, how effective it's been, and whether it's violated the "law of unintended consequences." Even after such reconsideration and a finding that a rule is not "more trouble than it is worth," it should be subject to a sunset provision to force regulators to revisit the rule's continued efficacy.

What's a Compliance Officer to Do?

Significant change is coming to the regulatory landscape, sooner or later. No matter when it happens, or what form it takes, managements and boards must take responsibility for the fates of their companies. A number of lessons from the recent failings of our regulatory system will, I expect, continue to stand companies in good stead, no matter what the contours of the regulatory landscape.

1. **Transparency is Critical.** Decisions aren't any better than the information on which they're based. Lack of information and analysis poses other dire consequences: investor decision making is impaired if critical facts are lacking; companies can't disclose what they don't know, and disseminating incomplete information begets financial exposure. Companies should secure the best possible information and analytical tools, both for risk-management purposes and for ensuring appropriate disclosure.

2. **Risk Management Can't Be Left to Chance.** A management paradigm in which risk managers veto plans that unbalance risks and rewards serves to keep a company on the straight and narrow. Some investment banks escaped the sub-prime debacle because they integrated risk management into their business processes and gave risk managers a decision-making voice. In contrast, others relentlessly pursued short-term profits, excluding risk managers and their cautionary messages.

3. **Avoid the Sara Pitt Syndrome.** My mother was a self-medicating health fanatic. It took years to have her see a doctor about stomach pain. After she went, I called to get her take on the visit. She said, "You know, Harvey, I was never sick a day in my life until I went to see that doctor!" Many boards are like my mother was—if no one tells them they have cancer, they think they don't have it! But, life doesn't work that way. Bad things happen to good companies, and rarely come from nowhere. Lists of potential horribles should be kept, checked, analyzed, and updated, with contingency planning for each.

4. **Haste Makes Waste.** Firms with significant sub-prime exposure made quick decisions in the aftermath of a market meltdown. Some initially supported affiliated hedge funds, but later reversed course and let them fail. In the legal profession, that's called piercing your own corporate veil. The consequences of these hasty decisions will be thrashed out in courts for years.

5. **Unstable Foundations Make for Short-Lived Institutions.** Players in mortgage-related industries remade themselves and built strategic plans expecting returns from sub-prime profits to continue indefinitely. Their futures were built on unsupportable mathematics and models, leaving them with personnel and infrastructure not suited to new economic reality and sub-prime assets for which there's no market. This, in turn, has led to layoffs and business unit closures.

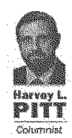
6. **The Buck Stops Here.** In the sub-prime crisis, some firms fired CEOs and other high-ranking executives. Ultimate responsibility, though, lies with boards, which hire CEOs, and boards must accept that responsibility. This is true both in choosing senior managers and in ensuring an appropriate infrastructure of checks and balances to curtail irrational exuberance.

7. **You Only Get One Bite at the Apple.** Some firms irrevocably harmed

themselves by multiple write-downs. If you've made a mistake, you've only got one chance to say you're sorry and correct it. It's not a time for a succession of "oh-by-the-ways." It's the board's responsibility to prevent that from happening.

I realize that operating effectively in a new and changing business environment has become extremely complicated, and even daunting. But, no matter how difficult your situation or dangerous the environment, with thoughtfulness, creativity, fortitude, patience, and exacting care, you can solve any problem and surmount any obstacle. In a challenging environment, tough standards, exacting procedures, and rigorous policies will be rewarded. You can count on it.

ABOUT THE AUTHOR



Compliance Week columnist Harvey Pitt is a former chairman of the Securities Exchange Commission and founder of Kalorama Partners.

As the 26th chairman of the SEC, Pitt led Commission adoption of dozens of rules responding to corporate and accounting crises, created an SEC "real time enforcement" program, and responded to market disruptions from the Sept. 11 terrorist attack.

Before becoming SEC chairman, Pitt was senior corporate partner at Fried, Frank, Harris, Shriver & Jacobson, an international law firm, for nearly 25 years.

He served previously with the SEC from 1968-1978, including three years as Commission General Counsel.

In 2003, Pitt founded Kalorama Partners with former SEC Chief Accountant Robert K. Herdman.

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Mr. LYNCH. Thank you, Mr. Chairman. I too want to thank the panelists for their willingness to come forward and help this committee with its work. This Congress and the next Congress will be charged with the responsibility of trying to reconfigure our regulatory framework to deal with the problems that now have become evident.

While each of you have said during today's testimony that there's probably not one cause of this, I think there is one way to describe the current problem we have now, which is valuation risk, and the inability of market participants to really, you know, value products and to ascertain where they stand and where some of their counterparties stand.

Accurate information for the markets is really its life's blood. If we don't have that, we will never gain back the trust that we need in these markets.

We had a couple of glaring examples. We had a financial report by Bear Stearns on the way down, just as they were about to be forced into a sale, where in their report they said, I had a quote here, they were talking about their balance sheet, and they said we currently have $19 billion in complex derivatives on our books, the value of which is not readily observable.

The instruments they had are just too complex, and the market had basically gone away for those instruments.

As well, you had E. Stanley O'Neill, the CEO of Merrill, came out in early October 2007, said we had losses of $4 billion. Came out a week later, said we have losses of $7 billion. Came out 3 weeks later and said we have losses of $11 billion.

Clearly, you know, these folks had no idea of what was really going on, and it's a function of the complexity of some of these instruments.

I think the complexity amplified some of the problems that we had.

Dr. Greenspan, I was—and this happens in a number of ways. It's not only the complexity of the instruments, but also some of them are off book, off the balance sheets, so we don't know about them.

As you mentioned before, these credit default swaps are completely unregulated, so we don't get to see those. But the lack of transparency is what I am getting and I was a little surprised, Dr. Greenspan, at your comments earlier today, although you may have started to clarify them a little bit, that there's nothing wrong or that most of the derivatives are working properly, because the complexity of some of those—now, if you are talking about the standard, very common derivatives that are used in interest rate calculation and the early payments of mortgages, prepayment penalties, that type thing, those are very common. But we also have some very complex derivatives that are really gumming up the system, and it has caused distrust between lenders, because one party doesn't want to lend to the other because of the opaqueness or the opacity, I guess, of what their derivatives are and some of their holdings.

So is what you are saying that most of these derivatives are working, is that an implication that we shouldn't do something in terms of regulatory action with respect to some of these complex derivatives, is that what you are saying?

Mr. GREENSPAN. Well, I think you are going to find, Congressman, that many of those complex derivatives are gone, never to be seen again.

Mr. LYNCH. Well, I wish I could—I wish I could believe that, but we have short memories around here, and as soon as the urgency and this crisis is over, folks, you know, there's good money being made on those and so there's an incentive there to push them out into the market. So I wish I could believe you that these things won't come back, but I want to make sure.

Because it will be to the Congress' detriment, as well as to the financial industry, if these things do come back or if we have another failure like we are having right now.

Mr. GREENSPAN. Well, I certainly have no objection to regulating those instruments. I mean, structured investment vehicles, for example, my puzzlement is who is buying those things? And if you are going to tell me that there are a lot of instruments out there which make no sense, I agree with you.

Mr. LYNCH. Interestingly enough, 72 percent of them were held by hedge funds, the smartest people in the room, we are told.

Mr. GREENSPAN. That is what I find most disturbing. We are not dealing with people who are dumb. We are dealing with, by far, the most sophisticated, thoughtful people about the way markets work who created the major problems.

Mr. LYNCH. Mr. Chairman, could I give the other two witnesses a crack at that?

Chairman WAXMAN. Yes, certainly, if they wish to engage.

Mr. LYNCH. Please.

Mr. COX. First, an observation about what we can do in real time—an observation about what we can do in real time to address some of the problems that you have just described. With respect to credit default swaps, the creation of a central counterparty and exchange trading for these can start to bring them into the sunlight. Beyond that, if we had regulation of them, so we can have a disclosure, that will help.

Beyond that, a more general point, the financial system that's administered by Wall Street institutions exists for a purpose. It exists to raise money for productive enterprise. It supports a lot of jobs, it's what the real economy needs to operate on. It should not be an end in itself. It should not become a baroque cathedral of complexity that pays itself richly in the short run while exposing all the rest of us to extraordinary risk that can threaten the Nation itself.

I think we need to understand that complexity in and of itself can frustrate investors' understanding of what is in the market, can make it difficult for markets to work. An all-out war on complexity is absolutely important. It's needed in accounting. We have been doing it with the Financial Accounting Standards Board to make sure that we simplify GAAP, but all the complexity and the instruments and the disclosures where we have been working to simplify it so investors can understand it, and the lack of transparency in the markets, all of that, I think you are absolutely right, conspires to let risk grow in the darkness.

Mr. LYNCH. Thank you.

Chairman WAXMAN. Mr. Snow.

Mr. SNOW. I will just say I thought your statement, Congressman, was a very coherent and lucid description of the problem in the banking system today. It's gummed up, I think that was your word, with all of this paper that is hard to get price discovery on. They can't find out what the darn stuff is worth because it's so opaque, and the banks don't trust each other's balance sheets.

You can put liquidity in, as is being done by the Fed and Treasury, and you can put capital in which is being done through the TARP program you approved, but unless you clear up this complexity, unless people trust each other's balance sheets and the paper on the balance sheets, they are pretty darn disinclined. It's called risk aversion. You are really risk averse with your counterparty.

I think as long as this continues, until we get the price discovery, overcome the risk aversion, we are going to have the frozen credit markets, which is why I have been arguing we take a page from the book of the Brits, who have not only done liquidity and done capital, but they have put in place guarantees, interbank lending guarantees so the banks will start lending to each other, and do it for some period of time.

But we have to unfreeze this frozen mass of bad paper in the system and get it disgorged, get it out of the system. But in the interim while the disgorging and price discovery goes on, it would seem to me it would make sense for us to move toward interbank guarantees so that banks will start lending again and overcome the risk aversion that they see in all their counterparts.

Mr. LYNCH. Thank you. Thank you, Mr. Chairman.

Chairman WAXMAN. The gentleman's time has expired. When I talked to Dr. Greenspan about coming to testify, he told me that hearing could last 4 hours. You were absolutely on the mark. This hearing has lasted 4 hours.

It has been a very helpful 4-hour period for us to have the three of you here to give us your views on these issues of where we have been and where we can go and what reforms we ought to look to for the future. I want to thank you on behalf of the committee for your generosity of your time and your willingness to answer our questions for such a lengthy period of time.

We stand adjourned in terms of the hearing. Those who are here for the hearing certainly could leave. I thank you for that.

We are adjourned for the hearing.

[Whereupon, at 1:55 p.m., the committee was adjourned.]

[The prepared statements of Hon. Edolphus Towns and Hon. Bill Sali follow:]

ONE HUNDRED TENTH CONGRESS

Congress of the United States

House of Representatives

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Statement of Rep. Edolphus "Ed" Towns

Committee on Oversight and Government Reform Full Committee Hearing Entitled "Financial Crisis and the Role of the Federal Regulators."

Thursday, October 23, 2008 at 10:00 a.m. in Room 2154 of the Rayburn House Office Building

I want to thank the Chairman and Ranking Member for holding this hearing to review the role of federal regulators in the current financial crisis.

The United States financial system is extremely complex. There are several distinct entities at the federal level which have been charged with regulating all of its different pieces. Those regulators were not able to prevent the current financial crisis that the federal government is now attempting to resolve at an enormous expense. I am concerned with the fact that those regulators could not identify ways to prevent or correct problems which lead to our current situation early enough to do something about it at a lesser cost to American taxpayers.

We need to make sure that regulatory bodies have the tools, resources, and direction to detect problems in our economy at an earlier stage. They need to be able to find out about problems and sound the alarm immediately to let us know when activities are going on in the financial markets that could threaten the stability of our entire economy.

Although I do want to make sure federal authorities are able to take a closer look at the marketplace so we can detect issues sooner, I also want to make sure that we do not overreact. The extraordinary complexity of both our financial system and our system of regulation demands that we make only small careful adjustments to those systems to ensure that our solutions don't accidently cause more trouble than the underlying problems.

I urge my colleagues to carefully consider what we learn at today's hearing to figure out ways to better monitor the financial marketplace. I also strongly urge my colleagues to use caution when tailoring what we learn today into any kind of legislative or regulatory action so that we don't end up producing any inadvertent negative effects in our already struggling economy.

Thank you Mr. Chairman.

# # #

Statement of U.S. Rep. Bill Sali (R-ID)
House Committee on Oversight and Government Reform
Hearing on "The Financial Crisis and the Role of Federal Regulators"
October 23, 2008

Mr. Chairman and Ranking Member Davis,

Once again, thank you for holding this important hearing on the current financial crisis and the role of federal regulators in it.

During the recent debate on the proposed "bailout" package, the input from my fellow Idahoans was loud, clear and resounding. My constituents told me that while action was likely needed to address problems in our financial sector, it should not be in the form of an enormous bailout for Wall Street and people who made poor investment decisions at the expense of hardworking taxpayers, who have to go it alone with the benefits – or hardships - - of their own financial decisions.

Although the Senate version included a number of improvements to the bill, including several tax credits that I strongly support, the core of the bailout remained the same: the use of $700 billion of taxpayer money to purchase "troubled assets." Because of its patent unfairness, and its apparent lack of a mechanism to quickly deal with unlocking frozen credit in our banks, I opposed not only the first but also the second bailout package.

A recitation of our financial ills would be redundant. We all know the serious needs our country faces. But let me emphasize two things I believe are particularly relevant.

First, the Bush Administration made efforts in its early years to remedy this problem. For example, as the *New York Times* noted on September 11, 2003, and I quote:

> The Bush administration today recommended the most significant regulatory overhaul in the housing finance industry since the savings and loan crisis a decade ago. Under the plan, disclosed at a Congressional hearing today, a new agency would be created within the Treasury Department to assume supervision of Fannie Mae and Freddie Mac, the government-sponsored companies that are the two largest players in the mortgage lending industry.

Whether or not this specific plan was advisable, it is but one example of calls for enhanced oversight of Fannie and Freddie over the years.

Of course, there is plenty of blame to spread around. Partisan blame-games, whether from the Democrat side of the aisle or my own won't fix anything. But I find it troubling that at a time when millions of Americans are wrestling with how to pay their most important bills, we hold court, as it were, up here on Capitol Hill pointing fingers. We owe our fellow Americans better than that.

However, I doubt I am the only one who finds it curious that the Democrat controlled House failed to hold even one hearing on one of the most critical pieces of financial legislation in our lifetime, yet now insists on holding these hearings after the House adjourned and just weeks before elections. The American people must wait another month – after the election — for the greatly anticipated hearing on Fannie Mae and Freddie Mac. Given what we know about the state of the economy and unheeded warnings about these reckless Government Sponsored Enterprises (GSE's) over the years, such a hearing warrants a far higher priority and is past due. That is the hearing we should be having today.

Second, what I hope to learn from our panel today is this: Who knew what, and when? When did the problems become apparent, and what did you do as a federal official in response? I am hopeful former Chairman Greenspan, former Secretary of the Treasury John Snow and Chairman Cox will be forthright. I also hope to hear what the distinguished witnesses before us knew about and what actions they took to shore-up the sagging financial systems whose near-collapse is now costing Americans hundreds of billions of dollars in loses or even more.

As we all know, the American economy is complex and inter-connected. As we proceed in working through these issues, including those with Fannie Mae and Freddie Mac, we also need to explore the role that low, prolonged interest rates served in contributing to the housing bubble, which is a prime factor in today's economic issues.

Holding people accountable is a legitimate role for Congress. We must hold one another accountable, Mr. Chairman, as much as we do people in the agencies and Cabinet Departments and financial houses and lending institutions. Let's be honest and talk straight. Truth can be harsh, at times, but without the antiseptic of honesty the infection of failure will become all the more rampant. The hope of the future of our children and grand children rests with us who serve today. We must not fail them by substituting partisan gain for pursuit of truth.

Finally, it is my hope that these hearings will inspire meaningful policy proposals. Any framing of this discussion in binary concepts of regulation versus deregulation ignores not only the inherent complexity of the American economy but risks compromising the principles of limited government and free enterprise that have given us unparalleled prosperity and made our economy the envy of the world in the first place.

Regulation should be designed to prevent abuse of power, of public funds and of political influence. It should not constrict the free flow of capital, the creativity of our private institutions and the citizens who work for them nor the ability of the private market to sort through financial and economic difficulties in a rational and efficient fashion. Washington can play a role, but only a supporting one. The main actors on the stage of this matter have to be the private entities and employees. The key is for Congress to recognize and stay in that supporting role and not try to become the lead actor. As George Will recently wrote, "Government is important in establishing the legal framework for markets to function (yet the) most competent political class allows markets to work wonders that government cannot replicate." We would do well to heed Mr. Will's good counsel.

Thank you, Mr. Chairman.