“Where Were the Watchdogs:
The Financial Crisis and the Breakdown of Financial Governance”
Homeland Security and Governmental Affairs Committee
Chairman Joseph Lieberman
January 21, 2009

Good afternoon and welcome to our hearing today. As our nation begins work under our new President to recover from the worst financial crisis since the Great Depression, we must also ask how and why it happened. Is the existing U.S. financial regulatory system adequately equipped to protect consumers, investors, and our economy?

A new report by the Government Accountability Office that is the focus of today’s hearing lays out a very persuasive case that the answer to that big question is no.

Over time, as the financial services sector has grown and moved in new directions, Congress has usually responded in a piecemeal fashion, grafting new regulatory agencies on top of one another.

As a result, responsibilities for overseeing the financial services industry are today shared by over 200 different regulatory agencies at the Federal and state level, not to mention numerous self-regulatory organizations, such as the stock exchanges.

GAO's report concludes that our current regulatory structure is outdated and unable to meet today's challenges and highlights several key changes in financial markets that have exposed significant gaps and limitations in our ability to protect the public interest.

Some of GAO's observations are familiar to members of this Committee. We have heard about the careless lending practices that led to the current sub-prime mortgage crisis, the increasing number of over-leveraged financial institutions that need to be bailed out by the government, the failures of credit-reporting agencies to provide credible ratings for increasingly complex financial products, and the inability of regulators to uncover, or in some way respond to the world's largest-ever Ponzi scheme.

It gives this Committee no satisfaction to note that some of these shortcomings were highlighted over six years ago in our investigation by the full Committee and the Permanent Subcommittee on Investigations following the collapse of Enron. Unfortunately these were just the tip of a regulatory iceberg. Then, we noted the inadequacies of the credit rating agencies and the failures of regulators to notice the red flags that warned of massive financial fraud.

Rather than contributing to the stability of financial markets, our fractured regulatory system encourages financial institutions to play regulators off against one another. New and complex financial products are created that bypass antiquated regulatory regimes. In certain derivatives markets, regulation is absent altogether. All in all, these problems surely contributed to the build-up of systemic risks and the eventual breakdown in credit and financial markets last year that has put millions of people out of work, destroyed so much of the savings and home values of the American people and broken our economic confidence in the future.

We have called this hearing today to take a government-wide look at our existing structure of regulation of financial services. We have asked today's witnesses, Gene Dodaro, Acting Comptroller of GAO, Professor Howell Jackson of Harvard Law School and Professor Steven Davidoff of the University of Connecticut School of Law to tell us if the current regulatory system fails to adequately protect consumers, preserve the integrity of our markets, and protect the safety and soundness of important financial institutions.

Given the scope of the crisis we face today on top of the crises that we have gone through over recent years, including the Savings and Loan scandals, the dot-com bubble, and the Enron accounting mess, now is the time to think not just about regulatory reform, but about regulatory reorganization.

Personally, I have not yet concluded whether the way to fix our current regulatory structure will lie in establishing one super-regulatory agency, like that seen in other developed countries, or whether it will be wiser to simply improve the abilities of the regulators we currently have, or whether the answer is somewhere in between.

However, what I do know is that there are serious deficiencies in our current patchwork regulatory system, and before Congress can fix them wisely – and in a way that won't just respond to the last economic crisis but will respond to the next one – I think we must step back and carefully scrutinize how the pieces would best fit together. That is what I hope our Committee is best suited do.

President Obama has declared that reforming the current financial regulatory structure will be one of his top priorities. I welcome this. Any legislation in this regard will come out of the Senate Banking Committee. However, I believe that this Committee's unique authority concerning governmental organization and oversight, as well as the special investigative power of our Permanent Subcommittee on Investigations, requires us to get involved in this urgent review and will enable us to help the Senate reach the right conclusions about how we restructure our system of financial governance to prevent future financial crises that cause terrible economic pain.

Now, how will we do this, you ask? We can do this with a series of hearings and investigations, express our conclusions in a report, and offer amendments later in the year. This is a matter of importance and urgency to the country, and I do believe we have something to contribute. Thank you.

Senator Collins?