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House of Representatives

COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM

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Opening Statement of Rep. Henry A. Waxman
Chairman, Committee on Oversight and Government Reform
Hedge Funds and the Financial Markets
November 13, 2008

Today we are holding the Committee's fifth hearing on the financial crisis. Our focus today is the hedge fund industry.

Our four previous hearings have looked at failure. Our first two hearings examined the collapse of Lehman Brothers and AIG. We learned that these companies took on massive risk. When the bottom fell out, senior management walked away with millions of dollars, while shareholders and taxpayers lost billions.

Our third hearing focused on the role of the credit ratings agencies. At that hearing, we learned about the colossal failures of these gatekeepers of the financial market. As one internal document said: "we sold our soul to the devil for revenue."

At our fourth hearing, we examined the role of financial regulators. Former Federal Reserve Chairman Alan Greenspan told us that he had identified a flaw in the deregulatory ideology he championed.

Today's hearing has a different focus. The five hedge fund managers who will testify today have had unimaginable success in the financial markets. Although there is variation in how much they made individually, on average our witnesses made over $1 billion last year.

There are two reasons we have invited these hedge fund managers to testify. First, these are some of the most successful and knowledgeable investors in our financial markets. They each have valuable perspectives to share about what has gone wrong and what steps we need to take to restore our financial system.

Second, their testimony — and the testimony of the independent experts on our first panel — will help the Committee to examine three important questions: What role have hedge funds played in our current financial crisis? Do hedge funds pose a systemic risk to our financial system? And what level of government oversight and regulation is appropriate?

Currently, hedge funds are virtually unregulated. They are not required to report information on their holdings, their leverage, or their strategies. Regulators aren't even certain how many hedge funds exist or how much money they control.

We do know, however, that hedge funds are growing rapidly and becoming increasingly important players in the financial markets. Over the last decade, their holdings reportedly have increased over five-fold to more than $2 trillion.

We also know that some hedge funds are highly leveraged. They invest in assets that are illiquid and difficult to price and sell rapidly.

And we know from our hearings into the Lehman and AIG collapses, combining these factors can cause financial institutions to blow up. As we will hear today, some experts worry that the failure of large hedge funds could pose significant systemic risks to our financial system.

We also know that hedge funds can receive special tax breaks. The five witnesses we will hear from today earned on average over $1 billion last year. Yet the tax law allows them to treat the vast majority of their earnings as capital gains. That means that at least some portions of their earnings could be taxed at rates as low as 15%. That's a lower tax rate than many school teachers, firefighters, or plumbers pay.

In our prior hearings, we have focused on what went wrong in the past. Today's hearing lets us ask what could go wrong in the future so we can prevent damage before it occurs. Both types of hearings are essential. We need to understand both what happened and what could happen to solve the immense economic problems we are facing.

I want to thank all of our witnesses for appearing here today. Several of the witnesses readjusted their schedules to testify today. They all responded to our request for documents. I appreciate their cooperation and look forward to their testimony.